ANTITRUST LAW AND TRADE REGULATION

CASES AND MATERIALS

SEVENTH EDITION

2023-24 SUPPLEMENT

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Chapter 1.5: The Future of Antitrust Law?

[insert at the end of the discussion, on page 59]

When we wrote the text in 2017, we noted that "the basic framing of antitrust law seems open to question in a way that has not happened seriously since the triumph of economic analysis in antitrust law." [p. 56]. Several factors prompted that comment, including the growth of the dominant internet-based platforms such as Google, Apple, Meta (then known as Facebook), and Amazon, the troublesome growth in income distribution, and a renewed interest in combatting exclusionary practices. We wondered whether there would be a push to deemphasize economics in antitrust analysis and a renewed effort, not seen since the 1950s, to protect small businesses.

Six years later, it is fair to say that the trend we highlighted has become turbocharged. Lawsuits and investigations are currently pending around the world against the tech platforms, and the 2020 election of Joe Biden as President accelerated those trends. On July 9, 2021, President Biden issued an executive order promoting competition in order to preserve "America's role as the world's leading economy.".[1] Congress has had before it a number of bills are pending in the U.S. Congress that, if passed, would make the most extensive changes to antitrust law since the passage of the Clayton Act and the Federal Trade Commission Act in 1914.

There has been an outpouring of literature re-examining the classic Chicago School model of antitrust. Some, notably Jonathan B. Baker, THE ANTITRUST PARADIGM: RESTORING A COMPETITIVE ECONOMY (2019), accept the premise that antitrust law should be based on sound economic analysis but argue that current antitrust doctrine has failed to adapt in light of new economic learning over the past few decades. That economic learning includes empirical studies that suggest that market power and industrial concentration have been increasing in recent years. These critics suggest incremental changes to antitrust doctrine, such as reallocating the burden of proof in some merger matters.

Other critics, notably Tim Wu, THE CURSE OF BIGNESS: ANTITRUST IN THE NEW GILDED AGE (2018), go further and advocate broadening antitrust law to take account of other objectives such as equality of economic and political power, in addition to economic analysis. These critics propose more far-reaching changes to antitrust

[1] The order is available at https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/executive-order-on-promoting-competition-in-the-american-economy/.

doctrine, such as breaking up, or restricting vertical integration by, certain large firms with apparently enduring market power without regard to whether they have engaged in the kind of conduct that would be deemed anticompetitive under current law.

Studies of digital markets in particular by government agencies and others have expressed a shared concern as to whether the traditional tools of antitrust are up to the task of regulating the digital economy. These include a March 2019 report in the United Kingdom on Unlocking digital competition; an April 2019 report sponsored by the European Commission on competition policy for the digital era; a July 2019 report by the Stigler Center at Chicago Booth at The University of Chicago; and another July report from the Australian Competition & Consumer Commission as part of its digital platforms inquiry. Although these reports differ in many ways, all express concern about the timelines frequently associated with antitrust cases against tech firms and whether it would better to regulate these firms outside of antitrust with tools more typically associated with public-utilities regulation.

The common thread here is that antitrust is, if anything, even more important to the modern world than it was for the "old economy" of the 20th century, that laissez-faire practices yield anticompetitive outcomes without the antitrust police on the beat, and that antitrust law needs to be reinvigorated. Whether and how this activity will affect antitrust law remains to be seen. It is likely that their debate will give rise to new legal challenges with which the courts will have to wrestle, and there have been several proposals for new legislation to revise or supplement the antitrust laws. In all events, antitrust law is back in the headlines and on politicians' minds, making possible the first serious discussion of competition policy in a Presidential campaign in a very long time.

Chapter 3: Collaboration Among Competitors

[insert before the discussion of B. Joint Ventures, on page 278]

The Supreme Court last considered the rules of the NCAA in 1984 in *National Collegiate Athletic Association v. Board of Regents of the University of Oklahoma*, 468 U.S. 85 (1984). In that case, the University of Oklahoma and the University of Georgia challenged restrictions imposed by the NCAA on how frequently schools could have their college football games televised. (There was a world in which Notre Dame wasn't on every weekend.) In a 7-2 decision, the Court ruled that the NCAA restrictions violated Section 1 of the

Sherman Act. As you read the next case, have in mind the changes that have occurred in college sports and the broader society.

National Collegiate Athletic Ass'n v. Alston

United States Supreme Court, 2021.
594 U.S. ___, 141 S. Ct. 2141.

Justice GORSUCH, delivered the opinion of the Court. In the Sherman Act, Congress tasked courts with enforcing a policy of competition on the belief that market forces "yield the best allocation" of the Nation's resources. *National Collegiate Athletic Assn. v. Board of Regents of Univ. of Okla.*, 468 U.S. 85, 104, n. 27 (1984). The plaintiffs before us brought this lawsuit alleging that the National Collegiate Athletic Association (NCAA) and certain of its member institutions violated this policy by agreeing to restrict the compensation colleges and universities may offer the student-athletes who play for their teams. After amassing a vast record and conducting an exhaustive trial, the district court issued a 50-page opinion that cut both ways. The court refused to disturb the NCAA's rules limiting undergraduate athletic scholarships and other compensation related to athletic performance. At the same time, the court struck down NCAA rules limiting the education-related benefits schools may offer student-athletes—such as rules that prohibit schools from offering graduate or vocational school scholarships. Before us, the student-athletes do not challenge the district court's judgment. But the NCAA does. In essence, it seeks immunity from the normal operation of the antitrust laws and argues, in any event, that the district court should have approved all of its existing restraints. We took this case to consider those objections.

I.

A.

* * * [In 1929], the Carnegie Foundation produced a report on college athletics that found them still "sodden with the commercial and the material and the vested interests that these forces have created." H. Savage, The Carnegie Foundation for the Advancement of Teaching, American College Athletics Bull. 23, p. 310 (1929). Schools across the country sought to leverage sports to bring in revenue, attract attention, boost enrollment, and raise money from alumni. The University of California's athletic revenue was over $480,000, while Harvard's football revenue alone came in at $429,000. Id., at 87. College football was "not a student's game"; it was an "organized commercial enterprise" featuring athletes with "years of training,"

"professional coaches," and competitions that were "highly profitable." Id., at viii.

The commercialism extended to the market for student-athletes. Seeking the best players, many schools actively participated in a system "under which boys are offered pecuniary and other inducements to enter a particular college." Id., at xiv-xv. One coach estimated that a rival team "spent over $200,000 a year on players." A. Zimbalist, Unpaid Professionals 9 (1999). In 1939, freshmen at the University of Pittsburgh went on strike because upperclassmen were reportedly earning more money. Crabb, The Amateurism Myth: A Case for a New Tradition, 28 Stan. L. & Pol'y Rev. 181, 190 (2017). In the 1940s, Hugh McElhenny, a halfback at the University of Washington, "became known as the first college player 'ever to take a cut in salary to play pro football.'" Zimbalist 22-23. He reportedly said: "'[A] wealthy guy puts big bucks under my pillow every time I score a touchdown. Hell, I can't afford to graduate.'" Id., at 211, n. 17. In 1946, a commentator offered this view: "[W]hen it comes to chicanery, double-dealing, and general undercover work behind the scenes, big-time college football is in a class by itself." Woodward, Is College Football on the Level?, Sport, Nov. 1946, Vol. 1, No. 3, p. 35.

In 1948, the NCAA sought to do more than admonish. It adopted the "Sanity Code." Colleges Adopt the 'Sanity Code' To Govern Sports, N. Y. Times, Jan. 11, 1948, p. 1, col. 1. The code reiterated the NCAA's opposition to "promised pay in any form." Hearings before the Subcommittee on Oversight and Investigations of the House Committee on Interstate and Foreign Commerce, 95th Congress, 2d Sess., pt. 2, p. 1094 (1978). But for the first time the code also authorized colleges and universities to pay athletes' tuition. Ibid. And it created a new enforcement mechanism—providing for the "suspension or expulsion" of "proven offenders." Colleges Adopt 'Sanity Code,' N. Y. Times, p. 1, col. 1. To some, these changes sought to substitute a consistent, above-board compensation system for the varying under-the-table schemes that had long proliferated. To others, the code marked "the beginning of the NCAA behaving as an effective cartel," by enabling its member schools to set and enforce "rules that limit the price they have to pay for their inputs (mainly the 'student-athletes')." Zimbalist 10.

The rules regarding student-athlete compensation have evolved ever since. In 1956, the NCAA expanded the scope of allowable payments to include room, board, books, fees, and "cash for incidental expenses such as laundry." In re *National Collegiate Athletic Assn. Athletic Grant-in-Aid Cap Antitrust Litig.*, 375 F. Supp. 3d 1058, 1063

(ND Cal. 2019) (hereinafter D.Ct.Op.). In 1974, the NCAA began permitting paid professionals in one sport to compete on an amateur basis in another. In 2014, the NCAA "announced it would allow athletic conferences to authorize their member schools to increase scholarships up to the full cost of attendance." *O'Bannon v. National Collegiate Athletic Assn.*, 802 F.3d 1049, 1054-1055 (CA9 2015). The 80 member schools of the "Power Five" athletic conferences—the conferences with the highest revenue in Division I—promptly voted to raise their scholarship limits to an amount that is generally several thousand dollars higher than previous limits. *D.Ct.Op.*, at 1064.

In recent years, changes have continued. The NCAA has created the "Student Assistance Fund" and the "Academic Enhancement Fund" to "assist student-athletes in meeting financial needs," "improve their welfare or academic support," or "recognize academic achievement." Id., at 1072. These funds have supplied money to student-athletes for "postgraduate scholarships" and "school supplies," as well as "benefits that are not related to education," such as "loss-of-value insurance premiums," "travel expenses," "clothing," and "magazine subscriptions." Id., at 1072, n. 15. In 2018, the NCAA made more than $84 million available through the Student Activities Fund and more than $48 million available through the Academic Enhancement Fund. Id., at 1072. Assistance may be provided in cash or in kind, and there is no limit to the amount any particular student-athlete may receive. Id., at 1073. Since 2015, disbursements to individual students have sometimes been tens of thousands of dollars above the full cost of attendance. Ibid.

The NCAA has also allowed payments "'incidental to athletics participation,'" including awards for "participation or achievement in athletics" (like "qualifying for a bowl game") and certain "payments from outside entities" (such as for "performance in the Olympics"). Id., at 1064, 1071, 1074. The NCAA permits its member schools to award up to (but no more than) two annual "Senior Scholar Awards" of $10,000 for students to attend graduate school after their athletic eligibility expires. Id., at 1074. Finally, the NCAA allows schools to fund travel for student-athletes' family members to attend "certain events." Id., at 1069. * * *

The NCAA's current broadcast contract for the March Madness basketball tournament is worth $1.1 billion annually. See id., at 1077, n. 20. Its television deal for the FBS conference's College Football Playoff is worth approximately $470 million per year. See id., at 1063; Bachman, ESPN Strikes Deal for College Football Playoff, Wall Street Journal, Nov. 21, 2012. Beyond these sums, the Division I conferences

earn substantial revenue from regular-season games. For example, the Southeastern Conference (SEC) "made more than $409 million in revenues from television contracts alone in 2017, with its total conference revenues exceeding $650 million that year." *D.Ct.Op.*, at 1063. All these amounts have "increased consistently over the years." Ibid.

Those who run this enterprise profit in a different way than the student-athletes whose activities they oversee. The president of the NCAA earns nearly $4 million per year. Commissioners of the top conferences take home between $2 to $5 million. College athletic directors average more than $1 million annually. And annual salaries for top Division I college football coaches approach $11 million, with some of their assistants making more than $2.5 million.

B.

The plaintiffs are current and former student-athletes in men's Division I FBS football and men's and women's Division I basketball. They filed a class action against the NCAA and 11 Division I conferences (for simplicity's sake, we refer to the defendants collectively as the NCAA). The student-athletes challenged the "current, interconnected set of NCAA rules that limit the compensation they may receive in exchange for their athletic services." *D.Ct.Op.*, at 1062, 1065, n. 5. Specifically, they alleged that the NCAA's rules violate §1 of the Sherman Act, which prohibits "contract[s], combination[s], or conspirac[ies] in restraint of trade or commerce." 15 U.S.C. §1.

After pretrial proceedings stretching years, the district court conducted a 10-day bench trial. It heard experts and lay witnesses from both sides, and received volumes of evidence and briefing, all before issuing an exhaustive decision. * * * In applying the rule of reason, the district court began by observing that the NCAA enjoys "near complete dominance of, and exercise[s] monopsony power in, the relevant market"—which it defined as the market for "athletic services in men's and women's Division I basketball and FBS football, wherein each class member participates in his or her sport-specific market." *D.Ct.Op.*, at 1097. The "most talented athletes are concentrated" in the "markets for Division I basketball and FBS football." Id., at 1067. There are no "viable substitutes," as the "NCAA's Division I essentially is the relevant market for elite college football and basketball." Id., at 1067, 1070. In short, the NCAA and its member schools have the "power to restrain student-athlete compensation in any way and at any time they wish, without any meaningful risk of diminishing their market dominance." Id., at 1070.

The district court then proceeded to find that the NCAA's compensation limits "produce significant anticompetitive effects in the relevant market." Id., at 1067. Though member schools compete fiercely in recruiting student-athletes, the NCAA uses its monopsony power to "cap artificially the compensation offered to recruits." Id., at 1097. In a market without the challenged restraints, the district court found, "competition among schools would increase in terms of the compensation they would offer to recruits, and student-athlete compensation would be higher as a result." Id., at 1068. "Student-athletes would receive offers that would more closely match the value of their athletic services." Ibid. And notably, the court observed, the NCAA "did not meaningfully dispute" any of this evidence. Id., at 1067; see also Tr. of Oral Arg. 31 ("[T]here's no dispute that the—the no-pay-for-play rule imposes a significant restraint on a relevant antitrust market").

The district court next considered the NCAA's procompetitive justifications for its restraints. The NCAA suggested that its restrictions help increase output in college sports and maintain a competitive balance among teams. But the district court rejected those justifications, *D.Ct.Op.*, at 1070, n. 12, and the NCAA does not pursue them here. The NCAA's only remaining defense was that its rules preserve amateurism, which in turn widens consumer choice by providing a unique product—amateur college sports as distinct from professional sports. Admittedly, this asserted benefit accrues to consumers in the NCAA's seller-side consumer market rather than to student-athletes whose compensation the NCAA fixes in its buyer-side labor market. But, the NCAA argued, the district court needed to assess its restraints in the labor market in light of their procompetitive benefits in the consumer market—and the district court agreed to do so. Id., at 1098.

Turning to that task, the court observed that the NCAA's conception of amateurism has changed steadily over the years. The court noted that the NCAA "nowhere define[s] the nature of the amateurism they claim consumers insist upon." *D.Ct.Op.*, at 1070. And, given all this, the court struggled to ascertain for itself "any coherent definition" of the term, id., at 1074, noting the testimony of a former SEC commissioner that he's "'never been clear on . . . what is really meant by amateurism.'" Id., at 1070-1071.

Nor did the district court find much evidence to support the NCAA's contention that its compensation restrictions play a role in consumer demand. As the court put it, the evidence failed "to establish that the challenged compensation rules, in and of themselves, have

any direct connection to consumer demand." Id., at 1070. * * * At the same time, however, the district court did find that one particular aspect of the NCAA's compensation limits "may have some effect in preserving consumer demand." Id., at 1082. Specifically, the court found that rules aimed at ensuring "student-athletes do not receive unlimited payments unrelated to education" could play some role in product differentiation with professional sports and thus help sustain consumer demand for college athletics. Id., at 1083.

The court next required the student-athletes to show that "substantially less restrictive alternative rules" existed that "would achieve the same procompetitive effect as the challenged set of rules." Id., at 1104. The district court emphasized that the NCAA must have "ample latitude" to run its enterprise and that courts "may not use antitrust laws to make marginal adjustments to broadly reasonable market restraints." Ibid. (internal quotation marks omitted). In light of these standards, the court found the student-athletes had met their burden in some respects but not others. The court rejected the student-athletes' challenge to NCAA rules that limit athletic scholarships to the full cost of attendance and that restrict compensation and benefits unrelated to education. These may be price-fixing agreements, but the court found them to be reasonable in light of the possibility that "professional-level cash payments. . . could blur the distinction between college sports and professional sports and thereby negatively affect consumer demand." Ibid.

The court reached a different conclusion for caps on education-related benefits—such as rules that limit scholarships for graduate or vocational school, payments for academic tutoring, or paid posteligibility internships. Id., at 1088. On no account, the court found, could such education-related benefits be "confused with a professional athlete's salary." Id., at 1083. If anything, they "emphasize that the recipients are students." Ibid. Enjoining the NCAA's restrictions on these forms of compensation alone, the court concluded, would be substantially less restrictive than the NCAA's current rules and yet fully capable of preserving consumer demand for college sports. Id., at 1088.

The court then entered an injunction reflecting its findings and conclusions. Nothing in the order precluded the NCAA from continuing to fix compensation and benefits unrelated to education; limits on athletic scholarships, for example, remained untouched. The court enjoined the NCAA only from limiting education-related compensation or benefits that conferences and schools may provide to student-athletes playing Division I football and basketball. App. to Pet. for

Cert. in No. 20-512, p. 167a, ¶1. The court's injunction further specified that the NCAA could continue to limit cash awards for academic achievement—but only so long as those limits are no lower than the cash awards allowed for athletic achievement (currently $5,980 annually). The court added that the NCAA and its members were free to propose a definition of compensation or benefits "'related to education.'" App. to Pet. for Cert. in No. 20-512, at 168a, ¶4. And the court explained that the NCAA was free to regulate how conferences and schools provide education-related compensation and benefits. Ibid. The court further emphasized that its injunction applied only to the NCAA and multi-conference agreements—thus allowing individual conferences (and the schools that constitute them) to impose tighter restrictions if they wish. Id., at 169a, ¶6. The district court's injunction issued in March 2019, and took effect in August 2020.

Both sides appealed. The student-athletes said the district court did not go far enough; it should have enjoined all of the NCAA's challenged compensation limits, including those "untethered to education," like its restrictions on the size of athletic scholarships and cash awards. *In re National Collegiate Athletic Assn. Athletic Grant-in-Aid Cap Antitrust Litig.*, 958 F.3d 1239, 1263 (CA9 2020). The NCAA, meanwhile, argued that the district court went too far by weakening its restraints on education-related compensation and benefits. In the end, the court of appeals affirmed in full, explaining its view that "the district court struck the right balance in crafting a remedy that both prevents anticompetitive harm to Student-Athletes while serving the procompetitive purpose of preserving the popularity of college sports." Ibid.

C.

Unsatisfied with this result, the NCAA asks us to reverse to the extent the lower courts sided with the student-athletes. For their part, the student-athletes do not renew their across-the-board challenge to the NCAA's compensation restrictions. Accordingly, we do not pass on the rules that remain in place or the district court's judgment upholding them. Our review is confined to those restrictions now enjoined.

Before us, as through much of the litigation below, some of the issues most frequently debated in antitrust litigation are uncontested. The parties do not challenge the district court's definition of the relevant market. They do not contest that the NCAA enjoys monopoly (or, as it's called on the buyer side, monopsony) control in that labor market—such that it is capable of depressing wages below competitive levels and restricting the quantity of student-athlete labor. Nor does

the NCAA dispute that its member schools compete fiercely for student-athletes but remain subject to NCAA-issued-and-enforced limits on what compensation they can offer. Put simply, this suit involves admitted horizontal price fixing in a market where the defendants exercise monopoly control.

Other significant matters are taken as given here too. No one disputes that the NCAA's restrictions in fact decrease the compensation that student-athletes receive compared to what a competitive market would yield. No one questions either that decreases in compensation also depress participation by student-athletes in the relevant labor market—so that price and quantity are both suppressed. Nor does the NCAA suggest that, to prevail, the plaintiff student-athletes must show that its restraints harm competition in the seller-side (or consumer facing) market as well as in its buyer-side (or labor) market.

Meanwhile, the student-athletes do not question that the NCAA may permissibly seek to justify its restraints in the labor market by pointing to procompetitive effects they produce in the consumer market. Some amici argue that "competition in input markets is incommensurable with competition in output markets," and that a court should not "trade off" sacrificing a legally cognizable interest in competition in one market to better promote competition in a different one; review should instead be limited to the particular market in which antitrust plaintiffs have asserted their injury. Brief for American Antitrust Institute as Amicus Curiae 3, 11-12. But the parties before us do not pursue this line.

II.

A.

With all these matters taken as given, we express no views on them. Instead, we focus only on the objections the NCAA does raise. Principally, it suggests that the lower courts erred by subjecting its compensation restrictions to a rule of reason analysis. In the NCAA's view, the courts should have given its restrictions at most an "abbreviated deferential review," Brief for Petitioner in No. 20-512, p. 14, or a "'quick look,'" Brief for Petitioners in No. 20-520, p. 18, before approving them. * * *

The NCAA accepts that its members collectively enjoy monopsony power in the market for student-athlete services, such that its restraints can (and in fact do) harm competition. See *D.Ct.Op.*, at 1067. Unlike customers who would look elsewhere when a small van company raises its prices above market levels, the district court found (and the NCAA does not here contest) that student-athletes have

nowhere else to sell their labor. Even if the NCAA is a joint venture, then, it is hardly of the sort that would warrant quick-look approval for all its myriad rules and restrictions.

Nor does the NCAA's status as a particular type of venture categorically exempt its restraints from ordinary rule of reason review. We do not doubt that some degree of coordination between competitors within sports leagues can be procompetitive. Without some agreement among rivals—on things like how many players may be on the field or the time allotted for play—the very competitions that consumers value would not be possible. See *Board of Regents*, 468 U.S., at 101 (quoting R. Bork, The Antitrust Paradox 278 (1978)). Accordingly, even a sports league with market power might see some agreements among its members win antitrust approval in the "'twinkling of an eye.'" *American Needle*, 560 U.S., at 203.

But this insight does not always apply. That some restraints are necessary to create or maintain a league sport does not mean all "aspects of elaborate interleague cooperation are." Id., at 199, n. 7. While a quick look will often be enough to approve the restraints "necessary to produce a game," ibid., a fuller review may be appropriate for others.

The NCAA's rules fixing wages for student-athletes fall on the far side of this line. Nobody questions that Division I basketball and FBS football can proceed (and have proceeded) without the education-related compensation restrictions the district court enjoined; the games go on. Instead, the parties dispute whether and to what extent those restrictions in the NCAA's labor market yield benefits in its consumer market that can be attained using substantially less restrictive means. That dispute presents complex questions requiring more than a blink to answer.

B.

Even if background antitrust principles counsel in favor of the rule of reason, the NCAA replies that a particular precedent ties our hands. The NCAA directs our attention to *Board of Regents*, where this Court considered the league's rules restricting the ability of its member schools to televise football games. 468 U.S., at 94. * * * Given the sensitivity of antitrust analysis to market realities—and how much has changed in this market—we think it would be particularly unwise to treat an aside in *Board of Regents* as more than that. * * *

C.

The NCAA submits that a rule of reason analysis is inappropriate for still another reason—because the NCAA and its

member schools are not "commercial enterprises" and instead oversee intercollegiate athletics "as an integral part of the undergraduate experience." The NCAA represents that it seeks to "maintain amateurism in college sports as part of serving [the] societally important non-commercial objective" of "higher education." Id., at 3.

Here again, however, there may be less of a dispute than meets the eye. The NCAA does not contest that its restraints affect interstate trade and commerce and are thus subject to the Sherman Act. * * * Nor, on the other side of the equation, does anyone contest that the status of the NCAA's members as schools and the status of student-athletes as students may be relevant in assessing consumer demand as part of a rule of reason review.

With this much agreed it is unclear exactly what the NCAA seeks. To the extent it means to propose a sort of judicially ordained immunity from the terms of the Sherman Act for its restraints of trade—that we should overlook its restrictions because they happen to fall at the intersection of higher education, sports, and money—we cannot agree. * * *

III.

A.

While the NCAA devotes most of its energy to resisting the rule of reason in its usual form, the league lodges some objections to the district court's application of it as well. When describing the rule of reason, this Court has sometimes spoken of "a three-step, burden-shifting framework" as a means for "'distinguish[ing] between restraints with anticompetitive effect that are harmful to the consumer and restraints stimulating competition that are in the consumer's best interest.'" *American Express Co.,* 585 U. S., at ___ (slip op., at 9). As we have described it, "the plaintiff has the initial burden to prove that the challenged restraint has a substantial anticompetitive effect." Ibid. Should the plaintiff carry that burden, the burden then "shifts to the defendant to show a procompetitive rationale for the restraint." Ibid. If the defendant can make that showing, "the burden shifts back to the plaintiff to demonstrate that the procompetitive efficiencies could be reasonably achieved through less anticompetitive means." Id., at ___-___ (slip op., at 9-10). * * *

In the proceedings below, the district court followed circuit precedent to apply a multistep framework closely akin to *American Express's*. As its first step, the district court required the student-athletes to show that "the challenged restraints produce significant anticompetitive effects in the relevant market." *D.Ct.Op.*, at 1067. This was no slight burden. According to one amicus, courts have disposed

of nearly all rule of reason cases in the last 45 years on the ground that the plaintiff failed to show a substantial anticompetitive effect. Brief for 65 Professors of Law, Business, Economics, and Sports Management as Amici Curiae 21, n. 9 ("Since 1977, courts decided 90% (809 of 897) on this ground"). This suit proved different. As we have seen, based on a voluminous record, the district court held that the student-athletes had shown the NCAA enjoys the power to set wages in the market for student-athletes' labor—and that the NCAA has exercised that power in ways that have produced significant anticompetitive effects. See *D.Ct.Op.*, at 1067. Perhaps even more notably, the NCAA "did not meaningfully dispute" this conclusion. Ibid.

Unlike so many cases, then, the district court proceeded to the second step, asking whether the NCAA could muster a procompetitive rationale for its restraints. Id., at 1070. This is where the NCAA claims error first crept in. On its account, the district court examined the challenged rules at different levels of generality. At the first step of its inquiry, the court asked whether the NCAA's entire package of compensation restrictions has substantial anticompetitive effects collectively. Yet, at the second step, the NCAA says the district court required it to show that each of its distinct rules limiting student-athlete compensation has procompetitive benefits individually. The NCAA says this mismatch had the result of effectively—and erroneously—requiring it to prove that each rule is the least restrictive means of achieving the procompetitive purpose of differentiating college sports and preserving demand for them.

We agree with the NCAA's premise that antitrust law does not require businesses to use anything like the least restrictive means of achieving legitimate business purposes. * * * Even worse, "[r]ules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve." Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 234 (CA1 1983) (BREYER, J.). After all, even "[u]nder the best of circumstances," applying the antitrust laws "'can be difficult'"—and mistaken condemnations of legitimate business arrangements "'are especially costly, because they chill the very'" procompetitive conduct "'the antitrust laws are designed to protect.'" Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 414 (2004). * * *

While we agree with the NCAA's legal premise, we cannot say the same for its factual one. Yes, at the first step of its inquiry, the district court held that the student-athletes had met their burden of

showing the NCAA's restraints collectively bear an anticompetitive effect. And, given that, yes, at step two the NCAA had to show only that those same rules collectively yield a procompetitive benefit. The trouble for the NCAA, though, is not the level of generality. It is the fact that the district court found unpersuasive much of its proffered evidence. See *D.Ct.Op.*, at 1070-1076, 1080-1083. Recall that the court found the NCAA failed "to establish that the challenged compensation rules . . . have any direct connection to consumer demand." Id., at 1070.

* * *[W]e see nothing about the district court's analysis that offends the legal principles the NCAA invokes. The court's judgment ultimately turned on the key question at the third step: whether the student-athletes could prove that "substantially less restrictive alternative rules" existed to achieve the same procompetitive benefits the NCAA had proven at the second step. Ibid. Of course, deficiencies in the NCAA's proof of procompetitive benefits at the second step influenced the analysis at the third. But that is only because, however framed and at whichever step, anticompetitive restraints of trade may wind up flunking the rule of reason to the extent the evidence shows that substantially less restrictive means exist to achieve any proven procompetitive benefits.

Simply put, the district court nowhere—expressly or effectively—required the NCAA to show that its rules constituted the least restrictive means of preserving consumer demand. Rather, it was only after finding the NCAA's restraints "'patently and inexplicably stricter than is necessary'" to achieve the procompetitive benefits the league had demonstrated that the district court proceeded to declare a violation of the Sherman Act. *D.Ct.Op.*, at 1104. That demanding standard hardly presages a future filled with judicial micromanagement of legitimate business decisions.

B.

In a related critique, the NCAA contends the district court "impermissibly redefined" its "product" by rejecting its views about what amateurism requires and replacing them with its preferred conception. Brief for Petitioner in No. 20-512, at 35-36.

This argument, however, misapprehends the way a defendant's procompetitive business justification relates to the antitrust laws. Firms deserve substantial latitude to fashion agreements that serve legitimate business interests—agreements that may include efforts aimed at introducing a new product into the marketplace. But none of that means a party can relabel a restraint as a product feature and declare it "immune from §1 scrutiny." *American Needle*, 560 U.S., at 199, n. 7. * * *

The NCAA's argument not only misapprehends the inquiry, it would require us to overturn the district court's factual findings. While the NCAA asks us to defer to its conception of amateurism, the district court found that the NCAA had not adopted any consistent definition. Instead, the court found, the NCAA's rules and restrictions on compensation have shifted markedly over time. The court found, too, that the NCAA adopted these restrictions without any reference to "considerations of consumer demand," id., at 1100, and that some were "not necessary to preserve consumer demand," id., at 1075, 1080, 1104. None of this is product redesign; it is a straightforward application of the rule of reason.

C.

Finally, the NCAA attacks as "indefensible" the lower courts' holding that substantially less restrictive alternatives exist capable of delivering the same procompetitive benefits as its current rules. Brief for Petitioner in No. 20-512, at 46. The NCAA claims, too, that the district court's injunction threatens to "micromanage" its business. Id., at 50.

Once more, we broadly agree with the legal principles the NCAA invokes. As we have discussed, antitrust courts must give wide berth to business judgments before finding liability. Similar considerations apply when it comes to the remedy. Judges must be sensitive to the possibility that the "continuing supervision of a highly detailed decree" could wind up impairing rather than enhancing competition. *Trinko*, 540 U.S., at 415. Costs associated with ensuring compliance with judicial decrees may exceed efficiencies gained; the decrees themselves may unintentionally suppress procompetitive innovation and even facilitate collusion. Judges must be wary, too, of the temptation to specify "the proper price, quantity, and other terms of dealing"—cognizant that they are neither economic nor industry experts. *Trinko*, 540 U.S., at 408. Judges must be open to reconsideration and modification of decrees in light of changing market realities, for "what we see may vary over time." *California Dental*, 526 U.S., at 781. And throughout courts must have a healthy respect for the practical limits of judicial administration: "An antitrust court is unlikely to be an effective day-to-day enforcer" of a detailed decree, able to keep pace with changing market dynamics alongside a busy docket. *Trinko*, 540 U.S., at 415. Nor should any court "'impose a duty . . . that it cannot explain or adequately and reasonably supervise.'" Ibid. In short, judges make for poor "central planners" and should never aspire to the role. Id., at 408.

Once again, though, we think the district court honored these principles. The court enjoined only restraints on education-related benefits—such as those limiting scholarships for graduate school, payments for tutoring, and the like. The court did so, moreover, only after finding that relaxing these restrictions would not blur the distinction between college and professional sports and thus impair demand—and only after finding that this course represented a significantly (not marginally) less restrictive means of achieving the same procompetitive benefits as the NCAA's current rules.

Even with respect to education-related benefits, the district court extended the NCAA considerable leeway. As we have seen, the court provided that the NCAA could develop its own definition of benefits that relate to education and seek modification of the court's injunction to reflect that definition. The court explained that the NCAA and its members could agree on rules regulating how conferences and schools go about providing these education-related benefits. The court said that the NCAA and its members could continue fixing education-related cash awards, too—so long as those "limits are never lower than the limit" on awards for athletic performance. *D.Ct.Op.*, at 1104. And the court emphasized that its injunction applies only to the NCAA and multiconference agreements; individual conferences remain free to reimpose every single enjoined restraint tomorrow—or more restrictive ones still.

In the end, it turns out that the NCAA's complaints really boil down to three principal objections.

First, the NCAA worries about the district court's inclusion of paid posteligibility internships among the education-related benefits it approved. The NCAA fears that schools will use internships as a way of circumventing limits on payments that student-athletes may receive for athletic performance. * * * The court refused to enjoin NCAA rules prohibiting its members from providing compensation or benefits unrelated to legitimate educational activities—thus leaving the league room to police phony internships. As we've observed, the district court also allowed the NCAA to propose (and enforce) rules defining what benefits do and do not relate to education. Accordingly, the NCAA may seek whatever limits on paid internships it thinks appropriate. And, again, the court stressed that individual conferences may restrict internships however they wish. All these features underscore the modesty of the current decree.

Second, the NCAA attacks the district court's ruling that it may fix the aggregate limit on awards schools may give for "academic or graduation" achievement no lower than its aggregate limit on

parallel athletic awards (currently $5,980 per year). *D.Ct.Op.*, at 1104. This, the NCAA asserts, "is the very definition of a professional salary." Brief for Petitioner in No. 20-512, at 48. The NCAA also represents that "[m]ost" of its currently permissible athletic awards are "for genuine individual or team achievement" and that "[m]ost . . . are received by only a few student-athletes each year." Ibid. Meanwhile, the NCAA says, the district court's decree would allow a school to pay players thousands of dollars each year for minimal achievements like maintaining a passing GPA.

The basis for this critique is unclear. The NCAA does not believe that the athletic awards it presently allows are tantamount to a professional salary. And this portion of the injunction sprang directly from the district court's finding that the cap on athletic participation awards "is an amount that has been shown not to decrease consumer demand." *D.Ct.Op.*, at 1088. Indeed, there was no evidence before the district court suggesting that corresponding academic awards would impair consumer interest in any way. Again, too, the district court's injunction affords the NCAA leeway. It leaves the NCAA free to reduce its athletic awards. And it does not ordain what criteria schools must use for their academic and graduation awards. So, once more, if the NCAA believes certain criteria are needed to ensure that academic awards are legitimately related to education, it is presently free to propose such rules—and individual conferences may adopt even stricter ones.

Third, the NCAA contends that allowing schools to provide in-kind educational benefits will pose a problem. This relief focuses on allowing schools to offer scholarships for "graduate degrees" or "vocational school" and to pay for things like "computers" and "tutoring." App. to Pet. for Cert. in No. 20-512, at 167a-168a, ¶2. But the NCAA fears schools might exploit this authority to give student-athletes "'luxury cars'" "to get to class" and "other unnecessary or inordinately valuable items" only "nominally" related to education. Brief for Petitioner in No. 20-512, at 48-49.

Again, however, this over-reads the injunction in ways we have seen and need not belabor. Under the current decree, the NCAA is free to forbid in-kind benefits unrelated to a student's actual education; nothing stops it from enforcing a "no Lamborghini" rule. And, again, the district court invited the NCAA to specify and later enforce rules delineating which benefits it considers legitimately related to education. To the extent the NCAA believes meaningful ambiguity really exists about the scope of its authority—regarding internships, academic awards, in-kind benefits, or anything else—it has been free

to seek clarification from the district court since the court issued its injunction three years ago. The NCAA remains free to do so today. To date, the NCAA has sought clarification only once—about the precise amount at which it can cap academic awards—and the question was quickly resolved. Before conjuring hypothetical concerns in this Court, we believe it best for the NCAA to present any practically important question it has in district court first.

When it comes to fashioning an antitrust remedy, we acknowledge that caution is key. Judges must resist the temptation to require that enterprises employ the least restrictive means of achieving their legitimate business objectives. Judges must be mindful, too, of their limitations—as generalists, as lawyers, and as outsiders trying to understand intricate business relationships. Judges must remain aware that markets are often more effective than the heavy hand of judicial power when it comes to enhancing consumer welfare. And judges must be open to clarifying and reconsidering their decrees in light of changing market realities. Courts reviewing complex business arrangements should, in other words, be wary about invitations to "set sail on a sea of doubt." *United States v. Addyston Pipe & Steel Co.*, 85 F.271, 284 (CA6 1898) (Taft, J.). But we do not believe the district court fell prey to that temptation. Its judgment does not float on a sea of doubt but stands on firm ground—an exhaustive factual record, a thoughtful legal analysis consistent with established antitrust principles, and a healthy dose of judicial humility.

* * *

The judgment is Affirmed.

Justice KAVANAUGH, concurring: * * * I join the Court's excellent opinion in full. But this case involves only a narrow subset of the NCAA's compensation rules—namely, the rules restricting the education-related benefits that student athletes may receive, such as post-eligibility scholarships at graduate or vocational schools. The rest of the NCAA's compensation rules are not at issue here and therefore remain on the books. Those remaining compensation rules generally restrict student athletes from receiving compensation or benefits from their colleges for playing sports. And those rules have also historically restricted student athletes from receiving money from endorsement deals and the like.

I add this concurring opinion to underscore that the NCAA's remaining compensation rules also raise serious questions under the antitrust laws. Three points warrant emphasis.

First, the Court does not address the legality of the NCAA's remaining compensation rules. * * * Second, although the Court does

not weigh in on the ultimate legality of the NCAA's remaining compensation rules, the Court's decision establishes how any such rules should be analyzed going forward. After today's decision, the NCAA's remaining compensation rules should receive ordinary "rule of reason" scrutiny under the antitrust laws. * * * Third, there are serious questions whether the NCAA's remaining compensation rules can pass muster under ordinary rule of reason scrutiny. Under the rule of reason, the NCAA must supply a legally valid procompetitive justification for its remaining compensation rules. As I see it, however, the NCAA may lack such a justification.

The NCAA acknowledges that it controls the market for college athletes. The NCAA concedes that its compensation rules set the price of student athlete labor at a below-market rate. And the NCAA recognizes that student athletes currently have no meaningful ability to negotiate with the NCAA over the compensation rules.

The NCAA nonetheless asserts that its compensation rules are procompetitive because those rules help define the product of college sports. Specifically, the NCAA says that colleges may decline to pay student athletes because the defining feature of college sports, according to the NCAA, is that the student athletes are not paid.

In my view, that argument is circular and unpersuasive. The NCAA couches its arguments for not paying student athletes in innocuous labels. But the labels cannot disguise the reality: The NCAA's business model would be flatly illegal in almost any other industry in America. All of the restaurants in a region cannot come together to cut cooks' wages on the theory that "customers prefer" to eat food from low-paid cooks. Law firms cannot conspire to cabin lawyers' salaries in the name of providing legal services out of a "love of the law." Hospitals cannot agree to cap nurses' income in order to create a "purer" form of helping the sick. News organizations cannot join forces to curtail pay to reporters to preserve a "tradition" of public-minded journalism. Movie studios cannot collude to slash benefits to camera crews to kindle a "spirit of amateurism" in Hollywood.

Price-fixing labor is price-fixing labor. And price-fixing labor is ordinarily a textbook antitrust problem because it extinguishes the free market in which individuals can otherwise obtain fair compensation for their work. See, e.g., *Texaco Inc. v. Dagher*, 547 U.S. 1, 5 (2006). Businesses like the NCAA cannot avoid the consequences of price-fixing labor by incorporating price-fixed labor into the definition of the product. Or to put it in more doctrinal terms, a monopsony cannot launder its price-fixing of labor by calling it product definition.

The bottom line is that the NCAA and its member colleges are suppressing the pay of student athletes who collectively generate billions of dollars in revenues for colleges every year. Those enormous sums of money flow to seemingly everyone except the student athletes. College presidents, athletic directors, coaches, conference commissioners, and NCAA executives take in six- and seven-figure salaries. Colleges build lavish new facilities. But the student athletes who generate the revenues, many of whom are African American and from lower-income backgrounds, end up with little or nothing. See Brief for African American Antitrust Lawyers as Amici Curiae 13-17.

Everyone agrees that the NCAA can require student athletes to be enrolled students in good standing. But the NCAA's business model of using unpaid student athletes to generate billions of dollars in revenue for the colleges raises serious questions under the antitrust laws. In particular, it is highly questionable whether the NCAA and its member colleges can justify not paying student athletes a fair share of the revenues on the circular theory that the defining characteristic of college sports is that the colleges do not pay student athletes. And if that asserted justification is unavailing, it is not clear how the NCAA can legally defend its remaining compensation rules.

If it turns out that some or all of the NCAA's remaining compensation rules violate the antitrust laws, some difficult policy and practical questions would undoubtedly ensue. Among them: How would paying greater compensation to student athletes affect non-revenue-raising sports? Could student athletes in some sports but not others receive compensation? How would any compensation regime comply with Title IX? If paying student athletes requires something like a salary cap in some sports in order to preserve competitive balance, how would that cap be administered? And given that there are now about 180,000 Division I student athletes, what is a financially sustainable way of fairly compensating some or all of those student athletes?

Of course, those difficult questions could be resolved in ways other than litigation. Legislation would be one option. Or colleges and student athletes could potentially engage in collective bargaining (or seek some other negotiated agreement) to provide student athletes a fairer share of the revenues that they generate for their colleges, akin to how professional football and basketball players have negotiated for a share of league revenues. Cf. *Brown v. Pro Football, Inc.*, 518 U.S. 231, 235-237 (1996); *Wood v. National Basketball Assn.*, 809 F. 2d 954, 958-963 (CA2 1987) (R. Winter, J.). Regardless of how those issues ultimately would be resolved, however, the NCAA's current

compensation regime raises serious questions under the antitrust laws.

To be sure, the NCAA and its member colleges maintain important traditions that have become part of the fabric of America—game days in Tuscaloosa and South Bend; the packed gyms in Storrs and Durham; the women's and men's lacrosse championships on Memorial Day weekend; track and field meets in Eugene; the spring softball and baseball World Series in Oklahoma City and Omaha; the list goes on. But those traditions alone cannot justify the NCAA's decision to build a massive money-raising enterprise on the backs of student athletes who are not fairly compensated. Nowhere else in America can businesses get away with agreeing not to pay their workers a fair market rate on the theory that their product is defined by not paying their workers a fair market rate. And under ordinary principles of antitrust law, it is not evident why college sports should be any different. The NCAA is not above the law.

NOTES AND QUESTIONS

1. *The Framing of the Case.* Litigants frame their cases, and courts then decide the cases presented to them by the litigants. That of course is generally true, but that point is especially important when litigants anticipate that change in the challenged conduct may need to come incrementally if it is to come at all. And of course, the court system is just one possible place of redress, and court decisions and the outcomes that they generate may in turn shape the actions that Congress and state legislatures take. And the positions that litigants take may evolve as a case works its way through various appeals. Note here the distinction between compensation and benefits related to education and those that are not related to education. The student-athletes had challenged both sets of restrictions in the lower courts but had limited their challenge in the Supreme Court to only the restrictions on education-related benefits. Justice Kavanaugh's concurrence emphasizes that point as well as he sets out a potential roadmap for future litigation after *Alston*.

2. *The role of consumer demand.* One of the central issues in the 1984 *Board of Regents* case and in *Alston* is the role of amateurism in college sports. The district court's factual findings on this were detailed and nuanced. The district court rejected the contention that the NCAA's restrictions on education-related benefits played a role in sustaining demand for college sports. The court noted that interest in the college sports in issue in the case—Division I FBS football and Division I men's and women's basketball—had grown even as

additional funds related to education flowed to the student-athletes participating in those sports. The district court did find that rules blocking unlimited payments to these athletes might serve to keep these college sports in a separate market from their professional counterparts.

3. *Per se illegality v. quick look v. the rule of reason*. Note the fact that the NCAA thought that the case could be resolved in its favor under an abbreviated quick-look analysis. There is a way in which that should seem remarkable to you. A natural characterization of the NCAA here is that it was operating as a buyer-side cartel limiting the price at which it was buying labor, and you might think that would be per se illegal. As a general matter, we don't let cartels defend their behavior by saying that there are good reasons for their otherwise forbidden behavior. What explains the posture that the NCAA was taking in the case? How would you frame the depth of the analysis that the Court seems to contemplate after *Alston,* especially given the idea that the Court appears to believe that the NCAA should have latitude in running its operations?

4. *Immunity*? Note that the NCAA argued that its restrictions should be immune from antitrust inquiry because of the "non-commercial objective" of higher education. The Supreme Court understandably and appropriately dispensed with that quickly, again, consistent with the idea that we don't allow market participants to assert that they are in some sense "good" and therefore should be given a subsidy by allowing them to violate otherwise applicable antitrust laws. But many other jurisdictions are now addressing themselves to two of the most salient social problems of our age—environmental sustainability and extreme and growing inequality of wealth and income—and they are considering whether and how to use competition law as one tool. Are these issues off the table for U.S. antitrust? Is that a good or bad thing?

5. *Cross-market effects*? A frequent criticism of the Supreme Court's 2018 decision in *American Express* is that it forces plaintiffs to do more than just show price increases in a particular market (in that case, increases in the fees that Amex was charging to merchants): "Evidence of a price increase in one side of a two-sided transaction platform cannot by itself demonstrate an anticompetitive exercise of market power." However one wants to characterize the institutional arrangement in *Alston*, there clearly is no transaction platform of the sort at stake in *American Express*. But the doctrinal spillover from *American Express* means that parties are sensitive to the litigation posture of multiple markets presented in a single case. Here the

relevant markets are (1) the consumers of the relevant sports and (2) the schools as buyers in the labor side of the market, where the student-athletes are the suppliers. Be sure to focus on the positions the parties took on these cross-market issues in the case and how that framed how the Supreme Court addressed these issues.

6. *Building back better*? One university—call it Ivy U.—announces that it believes in amateur sports and that, going forward, it will provide to its student-athletes no more than cost of education and other awards like those available to non-athletes. Any problem so far? Suppose that it takes the next step and says that it will only compete against schools with similar views. OK? Suppose a group of those schools take the next step and form an organization to set the rules for the conduct of that product in competition with one another. They will make no effort to coerce other schools to offer the same arrangements. Is that all fine? Or would you say that this should be characterized as "horizontal price fixing in a market where the defendants exercise monopoly control?" If you think it's ok, how is it different from what defendants did in *Alston*?

7. *NIL*. Prodded by state legislation and possible looming federal legislation, in July 2021, new NCAA interim rules on names, images and likenesses (NIL) have gone into effect. The response has been dramatic with a number of prominent college athletes likely to earn more than $1 million over the next year. How, if at all, should the NIL issue play into the path forward on high-end college athletics?

Chapter 5.3.A.1: Customer Foreclosure

In re: EPIPEN ANTITRUST LITIGATION.

United States Court of Appeals, Tenth Circuit, 2022.
44 F.4th 959.

[insert on page 482, before 2. Input Foreclosure]

BALDOCK, Circuit Judge.

"Competition is a tough weed, not a delicate flower." — George Stigler

Despite the extraordinary length of this opinion, this appeal presents a simple question. Can a plaintiff present a triable issue of monopolization without offering any evidence of actual or threatened consumer harm? We conclude such a plaintiff cannot.

I.

Plaintiff Sanofi-Aventis U.S., LLC ("Sanofi") sued Defendants Mylan, Inc. and Mylan Specialty, LP (collectively "Mylan") under Section 2 of the Sherman Antitrust Act. 15 U.S.C. § 2. Sanofi, one of the world's largest pharmaceutical companies, alleges Mylan, the distributor of EpiPen, monopolized the epinephrine auto-injector market effectively and illegally foreclosing Auvi-Q—Sanofi's innovative epinephrine auto-injector—from the market. The parties cross-moved for summary judgment. The district court, holding no triable issue of exclusionary conduct, granted Mylan's motion for summary judgment. Exercising jurisdiction under 28 U.S.C. § 1291, we affirm

A.

The following facts are either uncontroverted, or, where genuinely controverted, are viewed in the light most favorable to Sanofi, the party opposing the grant of summary judgment to Mylan. . . . Sanofi's allegations of monopolization center around industry-specific practices in the prescription drug market. We must, therefore, begin with an indispensable, albeit technical, overview of the prescription drug market.

"Before a patient can go to the pharmacy (or mailbox) to pick up their prescription, the medicine must make its way from the pharmaceutical manufacturer to the pharmacy." Pharm. Research & Mfrs. of Am., Follow the Dollar 3 (2017). The distribution chain starts with the manufacturer who sells to a wholesaler for the wholesale acquisition cost ("list price"). Wholesalers then sell to the pharmacy, who dispense the product to the patient with a doctor's prescription.

While prescription drug distribution is conventional, the payments are not. . . .The cost of prescription drugs is shared between the patient and a patient's health plan, so the amount a patient pays depends on the existence and extent of the patient's insurance. An uninsured patient pays the price set by the pharmacy. An insured patient pays—depending on the insurance policy's terms—a co-payment (a fixed dollar amount), a co-insurance payment (a percentage of the drug's price), or the full price. If the insured is paying a co-payment or co-insurance, the health plan covers the balance.

At this point, the drug has been purchased, but the amount paid to the pharmacy does not typically represent the drug's actual price. Health plans can effectively reduce the price of a drug by negotiating rebates with drug manufacturers. A rebate is a partial refund on the purchase price of an item. Even though the health plan

must circle back post-purchase to collect the rebate, we can say the rebate is, in effect, a price discount. The cost savings from rebates are substantial. One report found "health plans received manufacturer rebates of $23 billion [in 2016], which is 12% of point-of-purchase spending." Charles Roehrig, Altarum, The Impact of Prescription Drug Rebates on Health Plans and Consumers 7 (2018). These rebate agreements are at the heart of the present dispute.

To understand why drug manufacturers offer rebates, we must explain the role of health plans. . . . Health plans control patients' access to prescription drugs by utilizing formularies. A formulary is a list of drugs covered by the health plan and is usually structured as "open" or "closed." An "open" formulary generally covers many, or sometimes all, drugs, whether they are listed on the formulary or not. A "closed" formulary only covers drugs listed on the formulary. Health plans are not required to cover all available prescription drugs. Some formularies cover a wide range of drugs to treat the same condition, while others are more restrictive. Choice comes at a cost. . . . When a formulary covers more drugs, it increases the health plan's costs which, in turn, raises the patient's premiums.

Some health plans develop and manage their own formularies, but most retain Pharmacy Benefit Managers ("PBMs") to do so on their behalf. PBMs are effectively purchasing cooperatives. . . . The PBM industry is "highly consolidated," with three PBMs processing about 70% of all prescription drug claims. . . .

To reduce health plan costs, PBMs control access to the formularies using what are called utilization management ("UM") techniques. By utilizing UM techniques, PBMs can nudge patients towards cost-effective products and negotiate better pricing from drug manufacturers. A PBM may only employ UM techniques after its pharmacy and therapeutics committee—a group of medical experts evaluating prescription drugs' efficacy, safety, and availability—determines two or more products are therapeutically equivalent (that is they have the same clinical effect and safety profile). A drug class that is subject to UM techniques is called a "managed class." Four commonly used UM techniques are relevant to this appeal:

Formulary Tiering. Formularies often use at least three tiers corresponding to different co-payments. The lower the tier, the lower the patient's co-payment. Generics are usually placed on the lowest tier (Tier 1), while branded drugs occupy the higher tiers (Tier 2 and Tier 3). When a PBM wants to cover multiple branded drugs, the PBM might place its preferred products on the lower tier (Tier 2), and less preferred products on the higher tier (Tier 3).

Step Edits. With a step edit, the PBM requires the patient to try a cheaper drug first and treatment failure before covering a more expensive drug.

Prior Authorizations. A PBM can require, before it will cover a specific drug, a formal request from the patient's physician asserting the patient meets certain criteria developed by the PBM.

Formulary Exclusion. Finally, PBMs may exclude drugs from the formulary. When a PBM excludes a drug from coverage, the patient can seek a medical necessity exemption or pay out of pocket for the product.

By using UM techniques, PBMs create some degree of price competition among sellers of therapeutically equivalent products. Drug manufacturers offer rebates and price protection for better formulary placement and to disadvantage rival products. Rebates are partial refunds that are calculated as some percentage of the list price. Price protection is an agreement to refund some, if not all, of the drug's increased price above some specified level. Implementing UM techniques for therapeutically equivalent drugs is how PBMs lower prescription drug costs. . . .

The way you get low prices in the pharmaceutical industry is by the ability to exclude drugs. What do I mean by that? You identify a few therapeutic substitutes and you essentially hold an auction. I am happy to buy any one of these drugs. Whoever gives me the best price is the one I am going to buy from, and everybody else gets none of my business. When you can do that, you force price competition.

PBMs commonly solicit multiple rebate offers from manufacturers, including different rebate offers for different levels of formulary placement. For convenience, these bids are usually submitted in the form of "bid grids." A bid grid is a table with several cells, each of which represents a different level of formulary control and rebate percentage. Drug manufacturers offer higher rebates conditioned on the drug's exclusive or preferred (lower tier) status on the formulary. The manufacturer might also offer a higher rebate if the PBM agrees to subject competing products to additional restrictions like a step edit or prior authorization.

After a PBM and manufacturer agree on price concessions, the PBM enters an agreement with the manufacturer . . . . The rebate agreement does not require the PBM or health plan to make specific formulary decisions. Instead, only if and when a coverage option is selected by a PBM's client (the health plan) is the manufacturer obligated to provide the agreed-upon level of price concessions. This preserves flexibility for a PBM's client to, for example, receive the

rebate for covering a drug that is otherwise excluded on the PBM's national formulary. PBMs may sign rebate agreements with multiple manufacturers for drugs in the same therapeutic class. Sanofi alleges, through the use of these rebate agreements, Mylan illegally monopolized the market for epinephrine auto-injectors.

B.

Millions of Americans suffer from anaphylaxis, a life-threatening allergic reaction caused by exposure to allergens such as foods, insect stings, pets, latex, or medications. The reaction occurs within seconds or minutes of exposure. Anaphylaxis causes a person's blood pressure to drop and restricts their airways, blocking breathing. If anaphylaxis is not treated immediately, it can be fatal. Epinephrine is the first-line treatment for anaphylaxis. An epinephrine auto-injector is a medical device used to inject a fixed dose of epinephrine through a spring-activated needle. Physicians prescribe epinephrine auto-injectors to patients at risk for anaphylaxis. Patients who suffer from anaphylaxis should always carry an epinephrine auto-injector. . . .

In 2007, defendant Mylan obtained the exclusive right to market, distribute, and sell EpiPen and EpiPen Jr. Auto-Injectors (collectively "EpiPen") in the United States. Introduced in the 1980s, EpiPen was the first epinephrine auto-injector available on the market. . . . After acquiring the rights to distribute EpiPen, Mylan invested substantially in marketing the product. Between 2007 and 2012, EpiPen accounted for at least 90% of epinephrine auto-injector prescriptions in the United States. Other than a few fringe competitors, EpiPen was the epinephrine auto-injector market.

That all changed in 2013 when plaintiff Sanofi launched a new epinephrine auto-injector called Auvi-Q. Auvi-Q treats anaphylaxis with the same active ingredient (epinephrine) and same delivery mechanism (auto-injector) as EpiPen. Auvi-Q differs from EpiPen in that it is smaller (the thickness of a smart phone and size of a credit card), has a rectangular shape, has a needle that retracts (as opposed to one covered before and after injection), and plays audio instructions. No clinical studies show Auvi-Q is safer or more effective treating anaphylaxis, but market research suggested Auvi-Q would, nevertheless, be heavily favored among patients. . . .

From the outset, Mylan knew Auvi-Q was a potentially disruptive product. Auvi-Q offered patients a solution to one of EpiPen's most significant problems: its size and shape. This would make Auvi-Q a particularly attractive option for certain patient populations who do not carry bags or purses. Mylan recognized that

"physician research evaluating Auvi-Q and EpiPen perception/messaging had indicated strong interest in the new device." Mylan understood the research to show that "many physicians believed more patients would be willing to carry an Auvi-Q auto-injector," and some had "expressed strong interest and intent to prescribe Auvi-Q for a percentage of new and repeat patients."

When it came time to launch, Sanofi decided to market Auvi-Q as a premium alternative to EpiPen. Sanofi's strategy was to seek a mix of Tier 2 and Tier 3 access for Auvi-Q—but "not Tier 2 at all cost." At the time, this marketing strategy may have made sense. Before 2012, no formulary excluded a non-EpiPen epinephrine auto-injector. But around the time of Auvi-Q's launch, patients and health plans became increasingly cost conscious. Where previously patients wanted choice, they were now accepting tighter formularies for lower premiums. PBMs adapted by increasingly using UM techniques to lower drug prices and decrease health plan costs. . . .

Mylan developed a strategy for responding to Auvi-Q's launch that included strengthening EpiPen's formulary positions by adding, for example, "exclusivity language in 2012 contract renewals," causing "PBMs to be heavily impacted if they work against Mylan," or encouraging PBMs "to require prior authorization" for Auvi-Q. Before Auvi-Q's launch, Mylan was offering single digit rebates (roughly 3%-10%) conditioned on equivalent access to the formulary as other epinephrine auto-injectors. After Auvi-Q's introduction, Mylan's rebate offers increased significantly: EpiPen's average rebate grew from 17% in 2014 to 36% in 2015. Mylan was also no longer satisfied with co-equal access; Mylan demanded exclusive or preferred formulary placement. And Mylan's higher rebates now required some PBMs to place restrictions on competing products (like step edits or prior authorizations).

Sanofi's initial marketing strategy was unsuccessful. At launch, Sanofi adopted contracting guidelines for Auvi-Q that authorized "pretty small" rebates, in the range of 3%-10% for Tier 2 with no price protection and no rebate strategy for Tier 3 coverage. PBMs rejected these offers as "inadequate," "not competitive," and even "laughable," telling Sanofi these rebates "couldn't match the Mylan offer." Sanofi learned that Mylan was making offers conditioned on exclusivity that PBMs "couldn't refuse". . . .

Sanofi also miscalculated how much PBMs would value Auvi-Q's unique attributes. Several PBMs believed Auvi-Q delivered a treatment that was similar to or interchangeable with EpiPen. Departing from their previous practice of not excluding epinephrine

auto-injectors, some PBMs decided to cover just one epinephrine auto-injector product. Auvi-Q's introduction was seen by many PBMs as an opportunity to manage the epinephrine auto-injector class and push for more competitive pricing.

Even though the clear answer to Sanofi's problem was offering better prices, Sanofi was concerned that offering aggressive rebates during its first year of launch would "set off a whole cascade of price discounts" which would be "nearly impossible to withdraw." Sanofi's former CEO testified that, by September 2013, the company was not yet ready to authorize discounting to match Mylan's offers. He explained why: The first objective is really to establish the value proposition of a product with your customer, and pricing moves are very difficult to reverse in the future. . . .

In the months leading up to Auvi-Q's launch, Mylan implemented various price increases for EpiPen. In 2012—the year before Sanofi's launch—Mylan raised EpiPen's price three times. And during the period of Sanofi's distribution of Auvi-Q (2013 through 2015), EpiPen's net price, on average, increased. In 2016, Mylan submitted a "U.S. EpiPen Profitability Analysis" to Congress as a supplement to its congressional testimony. The analysis shows that EpiPen's sales increased from 4.5 million pens and $200 million in gross sales in 2009 to 8.3 million pens and $912 million in gross sales in 2015. . . .

C.

Most of Sanofi's specific allegations of monopolization center around Mylan's rebate agreements and EpiPen's formulary coverage from 2013 to 2015. Every year or two, PBMs solicit bids from drug manufacturers for formulary coverage. As described in more detail below, four PBMs—ESI, Aetna, OptumRx/UnitedHealthcare, and MedImpact—excluded or restricted Auvi-Q from coverage in 2014. But in 2015, two of the four—ESI and Aetna—removed those restrictions. Three PBMs—CVS, Prime, and Cigna—never restricted or excluded Auvi-Q, covering it on Tier 2 or Tier 3 without restriction. * * *

2015 Formulary Coverage

After discovering PBMs were more interested in Mylan's exclusive rebate offers than paying a premium for Auvi-Q, Sanofi "changed its contracting strategy" and "made deeper offers" to PBMs to gain formulary access. Sanofi's former CEO, Chris Viehbacher, testified at his deposition that, after seeing the "very aggressive approach on pricing to try to exclude Auvi-Q," "it became clear to Sanofi that there was no choice but to try to gain an access to the

marketplace by significantly discounting." Thus, in early 2014 Viehbacher proposed "making an offer that kicks Mylan off a formulary. If Mylan knows we can be aggressive it may help." Sanofi's change in "contracting strategy" had an "impact on its profitability" but it helped Sanofi to "resecure the ESI business starting in 2015" and secured a "tier two parity agreement for 2015" with Aetna. "So those deeper offers started to pull Sanofi's access back." * * *

Sanofi's increased price competition also impacted Mylan. PBMs approached Mylan with requests for deeper discounts using Sanofi's competition in the epinephrine auto-injector market as leverage. . . . In response, Mylan offered better price protection. Sanofi began seeing Auvi-Q's market share increase in 2015.

D.

Despite Auvi-Q's frequent exclusion, several PBMs testified that they could have excluded EpiPen in favor of Auvi-Q because they could shift product use from EpiPen to Auvi-Q. This testimony is confirmed by the record. On at least two occasions, patients shifted to Auvi-Q after EpiPen was excluded. . . .

II.

In 2017, Sanofi sued Mylan under Section 2 of the Sherman Act alleging monopolization. 15 U.S.C. §§ 2, 15. After discovery, the parties cross-moved for summary judgment on the two elements of Sanofi's claim: "(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *United States v. Grinnell Corp.,* 384 U.S. 563, 570-71 (1966). Sanofi moved on the first element, Mylan on the second. In a learned order, the district court granted Mylan's motion and denied Sanofi's motion as moot. * * *

IV.

The offense of monopolization "has two elements: (1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *Grinnell,* 384 U.S. at 570-71. The issue of monopoly power—the power to "raise prices substantially above a competitive level without losing so much business that the gambit becomes unprofitable"—is not in play here. The district court held there was no triable issue of exclusionary conduct, meaning, for purposes of summary judgment, it was unnecessary to reach the issue

of monopoly power. Thus, the sole issue on appeal is whether the district court properly granted summary judgment on the exclusionary conduct element.

A.

* * * "Whether any particular act of a monopolist is exclusionary, rather than merely a form of vigorous competition, can be difficult to discern." Competitive and exclusionary conduct look alike and "the means of illicit exclusion, like the means of legitimate competition, are myriad." *United States v. Microsoft Corp.,* 253 F.3d 34, 58 (D.C. Cir. 2001) (en banc). The courts, with time and a gathering body of experience, have been able to "adapt this general inquiry to particular circumstances, developing considerably more specific rules for common forms of alleged misconduct"—like tying, predatory pricing, or exclusive dealing. *Novell Inc. v. Microsoft Corp.,* 731 F.3d 1064, 1072 (10th Cir. 2013).

Real-world monopolists may engage in allegedly exclusionary conduct which does not fit within a single paradigm, instead exhibiting characteristics of several common forms of alleged misconduct. In these situations, the courts disaggregate the exclusionary conduct into its component parts before applying the relevant law. The Supreme Court, for example, separated a price-squeeze claim into a duty-to-deal and predatory-pricing claim. *Pac. Bell Tel. Co. v. linkLine Commc'ns, Inc.,* 555 U.S. 438, 449-52, 457 (2009). . . . In granting summary judgment to Mylan on Sanofi's monopolization claim, the district court disaggregated Mylan's allegedly exclusionary conduct into several common forms of alleged misconduct and, after applying the relevant law, concluded that—considered separately or together—the facts presented no triable issue of exclusionary conduct.

The district court's methodology was flawed, so says Sanofi, because it took "a balkanized view of the evidence that badly missed the forest for the trees". . . . Mylan's allegedly exclusionary conduct can be split up into three categories: (1) Mylan's use of exclusive rebate agreements; (2) the leveraging of EpiPen's entrenched demand to deny Sanofi a meaningful opportunity to compete for the non-entrenched demand; and (3) other conduct working in concert to lock Sanofi out of the market, including Mylan's EpiPen4Schools program and the misclassification of EpiPen as a generic drug for Medicaid purposes. We take each in turn and conclude that, considered separately or together, the district court properly held the summary judgment facts present no triable issue of exclusionary conduct.

B.

Sanofi alleges Mylan's rebate agreements were anticompetitive exclusive dealing contracts. "An exclusive dealing arrangement is an agreement in which a buyer agrees to purchase certain goods or services only from a particular seller for a certain period of time

"Despite some initial confusion, today exclusive dealing contracts are not disfavored by the antitrust laws." *E. Food Servs., Inc. v. Pontifical Catholic Univ. Serv. Ass'n*, 357 F.3d 1, 8 (1st Cir. 2004). Courts repeatedly explain that exclusive dealing agreements are often entered into for entirely procompetitive reasons and pose very little threat to competition even when utilized by a monopolist. See, e.g., *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 333 (1961). For example, exclusive deals might ensure a buyer with a predictable source of inputs from an otherwise volatile supply market; enable buyers to group repeat purchases into a single contract to reduce the cost of using the market; or prevent distributors from free riding on a manufacturer's promotional investments. . . .

1.

To analyze the legality of exclusive dealing contracts, we apply the rule of reason. * * * To delineate between permissive and prohibited exclusionary contracts, we need some guiding principle—some standard that allows us to quickly and easily resolve whether exclusive contracts harm competition. In our Circuit, this is the consumer welfare standard. . . . The emphasis of antitrust policy has wisely shifted from "protection of competition as a process of rivalry to the protection of competition as a means of promoting economic efficiency." *Olympia Equip. Leasing Co. v. W. Union Tel. Co.,* 797 F.2d 370, 375 (7th Cir. 1986) (Posner, J.) . . . . Under the consumer welfare standard, we still seek to "protect[] the process of competition," but we do it "with the interests of consumers, not competitors, in mind." As the Supreme Court explains, the goal is to "distinguish[] between restraints with anticompetitive effect that are harmful to the consumer and restraints stimulating competition that are in the consumer's best interest." *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.,* 551 U.S. 877, 886 (2007). Consequentially, with the adoption of the consumer welfare standard, antitrust became indifferent to the preservation of inefficient competitors. * * *

Some amici curiae urge us to either supplant or supplement our consumer welfare standard with a consumer choice framework. Because of the industry at issue, we must necessarily reject this invitation. In urging us to reverse the district court, these amici argue the district court erred by failing to consider the patients' deprivation

of choice arising from Mylan's exclusive rebate agreements. At the outset, it is hard to say patients were ever deprived of choice. Even when a patient's health plan excluded Auvi-Q, the patient could seek a medical necessity exemption or otherwise pay out of pocket for the device. But even if the inability to choose between multiple *covered* products was considered a deprivation of choice, it would subvert the health insurance industry to adopt a consumer choice framework. * * * Adopting a consumer choice framework would frustrate, for example, the patient who sought out a health plan with a tighter formulary and lower premiums, because the health plan would be obligated to cover both EpiPen and Auvi-Q when covering EpiPen alone would be cheaper. The proper balance between health plan premiums and formulary coverage is better struck through the workings of the private market than the judiciary. * * *

2.

In the exclusive dealing context, we can broadly state that an exclusive dealing contract is anticompetitive under the consumer welfare standard if it harms consumers by excluding rivals. In a case like this where buyers instigated exclusivity to obtain lower prices, the rival plaintiff must prove two things to show the exclusive dealing agreements are anticompetitive. First, the rival plaintiff must show that the agreements are likely to foreclose it from doing business in the relevant market. To determine whether the challenged exclusive agreements are likely to foreclose a competitor from the market, courts generally look at (among other things) the duration, ease of terminability, and percentage of the market foreclosed by the contracts.

Second, the rival plaintiff must show that, once foreclosed, the defendant could reduce output or increase prices and those consumer harms would outweigh any consumer benefit received from the period of lower prices. The monopolist's successful elimination of a rival alone is an insufficient condition to prove harm to competition.* * *

3.

Because Mylan's exclusive rebate agreements brought about lower prices for epinephrine auto-injectors than if Mylan and Sanofi used preferred or co-preferred rebate agreements, Sanofi must prove that (1) Mylan's exclusive rebate agreements were likely to foreclose Auvi-Q from the epinephrine auto-injector market, and (2) after Auvi-Q's foreclosure, Mylan could reduce output or increase prices above the competitive level, and the reduced output or increased prices would produce anticompetitive effects outweighing the procompetitive benefits from the period of lower prices. Sanofi fails to present a triable

issue that Mylan's rebate agreements were likely to foreclose it from doing business in the epinephrine auto-injector market. We, therefore, affirm the district court's judgment on that element alone.

. . . . At the height of its allegedly anticompetitive behavior, Mylan only foreclosed Auvi-Q from 31% of the U.S. population. That means Auvi-Q was still covered and available for nearly 70% of the U.S. population. And remember, patients whose health plans excluded or restricted Auvi-Q could still pay out of pocket for the device if they so desired. But percentage of market foreclosure is only half the inquiry. . . . Mylan's exclusive rebate agreements did not impair Sanofi's opportunity to compete for several reasons.

First, Mylan's exclusive rebate agreements were short and easily terminable. It is axiomatic that short, easily terminable exclusive agreements are of little antitrust concern; a competitor can simply wait for the contracts to expire or make alluring offers to initiate termination. . . . Furthermore, the summary judgment record establishes that PBMs invoked these termination provisions and renegotiated rebate agreements annually and, sometimes, even more frequently. Mylan's exclusive rebate agreements made the epinephrine auto-injector market hard to enter midyear but did not "stifle competition over the longer run." *Paddock Publ'ns, Inc. v. Chi. Tribune Co.*, 103 F.3d 42, 45 (7th Cir. 1996) (Easterbrook, J.).

Second, exclusive rebate agreements were a normal competitive tool in the epinephrine auto-injector market to stimulate price competition. The undisputed summary judgment facts show that PBMs often instigated exclusivity to stimulate price competition, with Sanofi bidding for and entering into exclusive rebate agreements for Auvi-Q. The widespread use of exclusive rebate agreements in the epinephrine auto-injector market—and the pharmaceutical drug market more broadly—does not suggest Mylan acted anticompetitively. Rather, this demonstrates the market was functioning properly.

Third, in the absence of any coercion, we are left with the firm and singular conclusion that Sanofi "need only offer a better product or a better deal" to reverse, and possibly wield, exclusivity. . . .Sanofi changed its contracting strategy and made deeper offers to reverse exclusivity. The shift in strategy was a resounding success. . . .

Sanofi challenges our de novo conclusion that it only had to offer a better price to reverse or wield exclusivity, but its arguments suffer from a serious evidentiary deficiency. . . . While we agree with Sanofi that it offered *higher rebates* (30% for exclusivity versus

Mylan's 23%), the record belies Sanofi's claim that it offered *better prices*. . . .

The record supports only one conclusion: when Sanofi beat Mylan's prices it succeeded. For instance, Sanofi reversed Auvi-Q's exclusion on ESI's national formulary and successfully excluded EpiPen on ESI's High Performance formulary; Sanofi secured exclusive formulary positioning for Auvi-Q on Aetna's value formularies and co-preferred positioning on Aetna's premier formularies; and Sanofi obtained Auvi-Q's co-preferred formulary placement on CVS's Preferred Drug List and exclusive formulary positioning on CVS's Value Based Formulary and Advanced Control Formulary. PBMs were not afraid of excluding popular, high-market share products if another product offered better exclusive pricing. . . .

4.

Sanofi makes several objections to our de novo conclusion that no triable issue of exclusionary conduct exists in this case. First, Sanofi alleges Mylan foreclosed it from more than half the market because of spillover foreclosure. Second, Sanofi argues we should not weigh its use of exclusive contracts against it. Third, Sanofi contends Mylan's offers were coercive. Finally, Sanofi maintains its desperate attempts to regain epinephrine auto-injector market access by granting incremental rebates on a different drug (Lantus) exemplifies foreclosure. None of these arguments undermine our conclusion.

a.

Sanofi begins by challenging our de novo conclusion that, at most, Auvi-Q was foreclosed from 31% of the market. According to Sanofi, EpiPen's "spillover foreclosure" blocked Auvi-Q from more than half the market. Spillover foreclosure is the idea that doctors act on imperfect information and fail to prescribe Auvi-Q even when it is better for the patient and covered by the patient's insurance. Basically, doctors want to prescribe covered drugs to their patients, but patients are covered by many different health plans and each health plan covers different products, so doctors—instead of researching each patient's coverage before prescribing a product— tend to default to the product that they know is most widely covered in the region. . . .

Spillover foreclosure is predicated on a breakdown of rational behavior. . . . In our perfect world, we would expect the doctor to prescribe the drug that produces the highest utility (a function of the expected benefits and risks of the drug) per patient dollar (a function of formulary coverage). . . . In economic terms, we would call this doctor "rational." With the rational doctor, the highest foreclosure percentage

Sanofi could claim is 31%—the percentage of the U.S. population for which Auvi-Q was either not covered or restricted.

According to Sanofi, this is not what happens in the real world. Doctors cannot possibly retain an encyclopedic knowledge of prescription drug coverages for thousands of health plans, . . . So doctors default to the drug they know is most widely covered by health plans. This, of course, is a stark departure from the rational doctor. This imperfect doctor could be said to exhibit "irrational" behavior. . . . This irrational behavior is what Sanofi calls "spillover foreclosure." Combining spillover foreclosure and contractual foreclosure, Sanofi estimates Mylan foreclosed Auvi-Q from over half the market.

We refuse to recognize Sanofi's theory of spillover foreclosure for three reasons. First, Sanofi's theory of spillover foreclosure depends on crediting market participants' irrationality as a means of measuring market foreclosure. This squarely contradicts the Supreme Court's guidance in *Tampa Electric* where foreclosure was measured only by contractual foreclosure—that is, the percentage of the market covered by the contested contracts.

Second, any spillover foreclosure is subject to neutralization by vigorous competition. The clear problem with Sanofi's theory is spillover foreclosure is not actual foreclosure—it does not prevent customers from accessing Auvi-Q. . . . should we consider spillover foreclosure because Mylan ran an advertising campaign to amplify spillover foreclosure? No. Quite simply, any harm from Mylan's advertising campaign or spillover foreclosure was "readily susceptible to neutralization or other offset by rivals". . . .

Finally, any recognition of spillover foreclosure intolerably raises the risk of false condemnation under the antitrust laws and disincentivizes procompetitive behavior. Our rule, prohibiting the use of spillover foreclosure to bolster market foreclosure, is under-inclusive in the sense it might err "by permitting a deleterious practice," rather than err by "condemning a beneficial practice." But our rule is correct because limiting the risk of false condemnation is a central tenet of modern antitrust jurisprudence.

We also agree with the district court and reject Sanofi's spillover foreclosure for factual reasons. To begin with, Sanofi fails to adequately quantify spillover foreclosure into any foreclosure percentage. . . .

b.

Sanofi contends we should not weigh its use of exclusive rebate offers against it when deciding whether Mylan engaged in any

exclusionary conduct. . . . The use of exclusive contracts by a defendant's rivals is relevant for two reasons. First, such use illuminates the "particular structure and circumstance of the industry at issue," *Verizon Commc'ns Inc. v Law Offices of Curtis V. Trinko, LLP*, 540 U,S. 398, 411 (2004), and reveals whether competition was effectively waged for the contract. . . . Sanofi's use of exclusive rebate agreements confirms what is otherwise abundantly clear in the record: PBMs used exclusivity to encourage price competition.

Second, and somewhat related, the competitors' use of exclusive contracts might suggest that customers are instigating exclusivity—a circumstance that sometimes eases any anticompetitive concern arising from a monopolist's use of exclusive dealing contracts. . . . When the party instigating exclusive dealing is the end user, we are not particularly concerned about the anticompetitive effects of the arrangement. . . . Because end users must eventually reenter the market once the exclusive deal expires, they have every incentive to ensure alternative suppliers remain in the market.. . .

c.

Sanofi also attacks our de novo conclusion that Mylan's exclusive rebate agreements were not exclusionary by arguing Mylan coerced PBMs into exclusivity. Coercion—although unnecessary to establish a successful exclusive dealing case—will often be present in successful exclusive dealing cases because the presence of coercion in such cases casts doubt on the assumption that the exclusive deals are naturally procompetitive. Exclusive deals tend to create efficiencies far more often than they inflict consumer harm because a buyer will generally only agree to exclusivity if the seller offers something to the buyer that is worth more than the cost of giving up alternative sources of supply. We can therefore generally presume exclusive deals are procompetitive. But this assumption is thrown out the window when record evidence suggests coercion by the monopolist. United States v. *Dentsply Int'l, Inc.,* 399 F.3d 181 (3rd Cir. 2005), is a good example.

In *Dentsply,* the United States brought an antitrust suit against Dentsply—the dominant artificial tooth manufacturer—for implementing a clause in its distribution contracts which prohibited distributors from adding further tooth lines to their product offerings. The United States presented testimony that distributors were dissatisfied with the exclusive-dealing clause, but "none of them have given up the popular Dentsply teeth to take on a competitive line." The distributor's testimony suggested Dentsply was willfully maintaining its monopoly power by imposing an "all-or-nothing" choice on distributors. Partly because of this testimony, the Third Circuit

reversed the district court's judgment in favor of Dentsply and ordered the district court to grant the Government's injunctive relief. . . .

Sanofi fails to marshal sufficient evidence suggesting that Mylan engaged in any coercion. Sanofi, instead of presenting evidence like *Dentsply,* develops its own novel theory of "coercion in the relevant sense." According to Sanofi, PBMs who refused Mylan's exclusive rebate agreements "would face the penalty of EpiPen's ever-rising list price multiplied by Mylan's dominant share, without the safeguard of price protection, and barely offset by a small EpiPen access rebate." But if that was the "practical reality" of the market, why is there no PBM testimony to that effect? We cannot infer coercion from abstract theories. Unlike *Dentsply,* no PBM testified that they felt compelled to enter into exclusive agreements with Mylan despite unfavorable terms. * * *

Sanofi has another theory of coercion but fails to substantiate it with any evidence. Sanofi alleges exclusivity was partially triggered by Mylan's price escalation. According to Sanofi, PBMs aggressively manage a therapeutic class where there is high list price escalation. Mylan supposedly took advantage of this by raising EpiPen's list price to trigger tighter formulary controls and then bid for exclusivity. By doing so, according to Sanofi, Mylan was able to coerce PBMs, who would have otherwise preferred co-equal access, into exclusive rebate agreements. But this theory is doomed because Sanofi fails to marshal any evidence to support it. Contrary to Sanofi's assertions, exclusivity was not forced upon PBMs; exclusivity was wielded by PBMs to push for more competitive pricing. . . .

d.

Sanofi also challenges our de novo conclusion that because Sanofi reversed exclusivity and regained 80% market access it was not substantially foreclosed. According to Sanofi, just because it "was 'able to enter and grow despite' Mylan's scheme does not end the analysis". . . . We assume Sanofi's proposition is correct that a monopolist can be liable under § 2 even when its rival was "able to enter and grow." But we cannot infer substantial foreclosure simply because Sanofi had to offer lower prices through a portfolio bid to compete with Mylan. . . . Under our consumer welfare standard, this argument is a clear non-starter. The Lantus payments may prove "harm to one or more *competitors,*" but they do nothing to satisfy Sanofi's burden to prove "harm to the competitive *process* and thereby harm [to] consumers". . . .

C.

Sanofi's next argument is Mylan leveraged its entrenched share to monopolize the epinephrine auto-injector market. Entrenched share (a.k.a. non-contestable demand) is "the portion of the market that—even in the face of entry of an alternative— will not switch away from the incumbent's product, at least in the shorter term." Non-entrenched share (a.k.a. contestable demand) is, by reason of deduction, that portion of the market that will switch away from an incumbent's product in the short term. According to Dr. Scott Morton, EpiPen, as the incumbent epinephrine auto-injector, had a "committed customer base that would not easily switch away from the EpiPen."

To quickly summarize its argument, Sanofi contends that a monopolist—with an entrenched share—commits monopolization when it offers loyalty discounts to compete for the market's non-entrenched share. Loyalty discounts (a.k.a. all-unit or cliff discounts) "are a particular form of non-linear pricing in which the unit price of a good declines when the buyer's purchases meet a buyer-specific minimum threshold requirement."

Litigants and scholars have only recently begun to raise antitrust concerns about volume-based loyalty discounts. Sanofi alleges the entrenched monopolist's use of loyalty discounts—conditioned on sales exceeding entrenched demand—is anticompetitive because the loyalty discounts effectively foreclose competition for the non-entrenched demand. To reach a jury on this issue, Sanofi must show that Mylan's alleged leveraging of entrenched demand raises a factual issue that is "material."

We look to the substantive law to decide whether an issue of fact is material for purposes of summary judgment. Sanofi describes a phenomenon where an entrenched firm might be able to offer hard-to-match discounts to the non-entrenched share by offering loyalty discounts conditioned on sales exceeding the entrenched demand.[21] But Sanofi does not provide us any legal standard by which to evaluate

[21] . . . . The entrenched monopolist's use of loyalty discounts *might* make it harder for a rival to compete for the non-entrenched portion of the market, but we cannot immediately discern any reduction in consumer welfare from this situation because the loyalty discounts lower aggregate prices. "By adopting exclusivity, a [PBM] can be thought of as acting as the bargaining agent for all its loyal consumers, so they are made better off as a group. If, alternatively, the [PBM covered] both brands and left it up to ex post competition between manufacturers to determine prices, consumers would have indulged their individual brand preferences and driven up prices for everyone." Sanofi's briefing fails to answer the *material* question—whether Mylan's use of loyalty rebates hurt or threatened to hurt consumers—and instead answers an *immaterial* one—whether Mylan's use of loyalty rebates hurt or threatened to hurt a competitor.

Mylan's alleged leveraging of entrenched share, making it impossible for us to determine whether there is a material issue of fact. We could overlook this oversight if Sanofi's theory inherently lends itself to only one legal standard—but it does not. At least four legal standards exist by which to evaluate Mylan's alleged leveraging of entrenched demand. First, the entrenched monopolist's use of loyalty rebates could be a per se violation of § 2 because it may foreclose the non-entrenched portion "of the market to a potential competitor." *LePage's Inc. v. 3M,* 324 F.3d 141, 155 (3d Cir. 2003) (en banc).[22] Second, the entrenched monopolist's use of loyalty rebates may be anticompetitive when, after applying the full amount of the loyalty rebates to the non-entrenched portion of the market, the resulting price is below the monopolist's cost. *Cascade Health Sols. v. PeaceHealth,* 515 F.3d 883, 906 (9th Cir. 2008). This is the discount-attribution test.[23] Third, applying Dr. Scott Morton's Effective Entrant Burden ("EEB") test. the entrenched monopolist's use of loyalty discounts would be anticompetitive when the extent of entrenched share and the magnitude of discounts makes it too hard for a rival to compete for the non-entrenched share.[25] Fourth, the entrenched monopolist's use of loyalty rebates is lawful "as long as the prices being charged are not predatory"—that is price is not below cost. *linkLine,* 555 U.S. at 455. One group of amici curiae—which includes Nobel laureate Vernon L. Smith and several serious legal and economic scholars— persuasively argues that this fourth legal standard, often called the price-cost test, should apply to Sanofi's theory.

Sanofi does not explicitly mention *any* of these legal standards in its briefing. And in the absence of an appropriate legal standard, we cannot decide whether this issue is material. After all, for at least one of these legal standards (the price-cost test), the existence and leveraging of entrenched share is wholly immaterial to the issue of liability. We decline Sanofi's invitation to send this "issue of fact" to the jury without the opportunity to first adjudge whether the existence and leveraging of entrenched share is material. * * *

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[22] The entrenched monopolist's use of loyalty discounts may be procompetitive or competitively neutral, which necessarily means a per se rule is inappropriate.

[23] We worry about the administrability of this test. To determine prospectively whether its loyalty rebates would offend the discount-attribution test, the entrenched firm must calculate the entrenched share before applying the aggregate discounts to the non-entrenched share. But entrenched share based upon consumer preference is impossible to calculate with any objective precision.

[25] The EEB test suffers the same administrability problems as the discount-attribution test—it relies upon the extent of entrenched share which is difficult to objectively derive.

V.

When antitrust and the health insurance industry meet, a *nearly* impenetrable fog descends upon what might otherwise be a manageable case. What occurred in this case is no different than the competition which occurs at thousands of retail stores across the country—ranging from supermarket behemoths to family-owned mercantiles. These stores bring about lower prices for their customers by engaging in the exact same practices Sanofi complains of—and, astoundingly, the stores often discover and utilize these practices without exploiting any special economic expertise. For example, a mercantile might enter discussions with several bakeries to decide whose bread will occupy its shelves. During these negotiations, the mercantile can solicit lower wholesale prices by promising a bakery preferred positioning at the front of the aisle where sales are higher. And every so often, when a bakery offers low enough wholesale prices, the mercantile might exclusively stock that bakery's bread. Despite being unable to choose between multiple brands of bread, the mercantile's customers are unlikely to complain. They are, after all, compensated in the form of lower retail prices. By deciding to stock only one bakery's bread, the mercantile does not eliminate competition in the bread market—instead competition takes on a different, more powerful form, but one that is harder to intuitively understand.

The same thing happened in the epinephrine auto-injector market: instead of competing *on* the formulary, Mylan and Sanofi competed *for* the formulary. Mylan's legitimate competition *for* the formulary must not now expose it to liability. "The successful competitor, having been urged to compete, must not be turned upon when he wins." *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 430 (2d Cir. 1945) (L. Hand, J.). Without any evidence of harm *to* competition—as opposed to harm *from* competition—Sanofi cannot present this case to a jury. Considered separately or together, Sanofi's arguments do not raise a triable issue of exclusionary conduct. For the reasons stated herein, we AFFIRM the district court's judgment.

NOTES AND QUESTIONS

1. *Simple or hard?* At the end of the opinion, the Tenth Circuit backs away from the institutional complexity of the drug prescription market to suggest that the case is ultimately quite familiar once, as the court puts it, the fog is penetrated. Does that seem like a fair characterization of the case? Much of that turns on the court's conclusion that the epinephrine injection market is characterized by competition for the market? What determines whether a market is a

market in which firms compete in the market or one in which firms compete for the market?

2. *Focusing on consumer choice*. The court rejected supplementing the consumer welfare standard with what it termed a "consumer choice framework." The core idea here is that exclusive contracts hurt consumers as they are denied the opportunity to choose between the competing drugs. That choice has instead been made by their health insurance company. The court doesn't see the consumer as having really been deprived of a choice here as the consumer could "otherwise pay out of pocket" for the preferred version of the drug. Does that analysis seem removed from the reality of most consumer's experience of prescription drugs? Does assessing that require knowledge of how competitive the health insurance market is? How does that question figure into the court's analysis?

3. *Who wants exclusivity?* Does it matter whether the buyer or the seller instigates the exclusive arrangement? In one version of this, the seller offers exclusivity for a lower price. One characterization of that is that the seller is paying through lower prices to block a competitor's access to customers. What is the social utility of that practice? An alternative characterization is that, very much as the court suggests at the end of the opinion, the various tiering deals in the case are just like General Mills buying preferred placement for Cheerios at a grocery store. General Mills doesn't have its own grocery store so it wants to strike a deal to ensure that the ultimate consumer sees its product in the best possible way. Kellogg's can compete with General Mills as each works with grocers to reach consumers. Suppose that exclusivity is something offered by the seller to the buyer? Does that say something about whether the practice is pro- or anti-competitive?

4. *Economic rationality*. Sanofi argued that foreclosure effect of Mylan's exclusive agreements extended beyond the sales of the exclusive PBMs because, instead of studying the multitude of alternative medical products available, physicians "default to the drug they know is most widely covered by health plans." The court rejected this argument in part on the ground that it assumed physicians behave "irrational[ly]." Later in its opinion, the court explained that, if the customer requests a lower price in exchange for exclusivity, the exclusivity is unlikely to harm competition because customers "have every incentive to ensure alternative suppliers remain in the market." Is the court correct in asserting that antitrust law does and should assume that economic actors behave rationally, even if they often do not behave rationally? Is it irrational to use default rules instead of spending more time to do research about drugs? Is it irrational to take

extra money for exclusivity in the short run even though a pattern of exclusive agreements might reduce competition in the long run? (As to the last question, see pages 500-501 in the main text.) Can the antitrust laws sensibly take into account the emerging field of behavioral economics, which studies the ways in which decisions of individuals and institutions differ from those assumed by economic theory?

5. *Loyalty rebates (again).* Loyalty rebates make a late appearance in the opinion. We won't review those issues here, but you undoubtedly saw a few old friends, we hope, in *LePage's* and *PeaceHealth*, along with some new contenders. As the court notes, this continues to evolve and presumably will do so until the Supreme Court jumps in to, perhaps, clarify the situation.

6. *A thumb on the scale?* The court reveals its caution about antitrust cases in explaining that "limiting the risk of false condemnation is a central tenet of modern antitrust jurisprudence." That position, however, is contestable as some scholars suggest the focus on avoiding "false positives" while increasing the risk of "false negatives" is misguided. *See, e.g.,* Jonathan Baker, The Antitrust Paradigm (2019). Should antitrust courts assume, as other scholars argue, that false positives (antitrust judgments that are overly aggressive) are a bigger concern than false negatives (a failure to act when courts should do so)? *See* Frank Easterbrook, The Limits of Antitrust, 63 Texas L. Rev. 1 (1984).

Chapter 6.1.B.4: Note on Hart-Scott-Rodino Pre-Merger Notification

[insert at the end of p. 645, before 5. The State of Merger Activity and Enforcement]

On August 3, 2021, Holly Vedova, the Acting Director of the Burean of Competition, announced on the FTC's website that the FTC was changing how it approached the pre-merger notification regime under the Hart-Scott-Rodino Act.[2] The statement noted the rise in merger filings and the FTC's limited resources to process the notifications. Because the FTC would therefore in some cases not be able to conduct full investigations of mergers in a timely manner, the FTC would notify the parties that they would be permitted close the transactions "at their own risk." The form letter provides in pertinent part as follows:

[2] The statements is available at https://www.ftc.gov/news-events/blogs/competition-matters/2021/08/adjusting-merger-review-deal-surge-merger-filings.

"Please be advised that if the parties consummate this transaction before the Commission has completed its investigation, they would do so at their own risk. Any inaction by the Commission before the expiration of the waiting period should not be construed as a determination regarding the lawfulness of the transaction. Indeed, no such determination could be made unless and until the Commission completes its investigation. The parties cannot stop the investigation or avoid an enforcement action by consummating. To the contrary, and in keeping with its commitment to aggressive enforcement, the Commission may challenge transactions— before or after their consummation—that threaten to reduce competition and harm consumers, workers, and honest businesses.

"Accordingly, even if the parties consummate the above-referenced transaction, the Commission may still take further action as the public interest may require, which may include any and all available legal actions and seeking any and all appropriate remedies."

Critics of the new policy have expressed concern that it will undermine the objectives of the Hart-Scott-Rodino Act to prevent anticompetitive mergers, instead of requiring disruptive and ineffective remedies after deals are consummated, and to give businesses and their customers, suppliers and employees valuable certainty about the lawfulness of the transactions. Critics are also concerned that the resulting uncertainty will deter procompetitive mergers.

Chapter 6.2. The Merger Guidelines

[the following on page 692 of the main text after subparagraph c. on that page]

On July 19, 2023, the Federal Trade Commission and the Department of Justice announced new draft merger guidelines. Those guidelines present a unified approach to all mergers and, if adopted, would replace the 2010 horizontal merger guidelines. The new 2020 vertical merger guidelines were dropped by the FTC in 2021, so the 2023 draft guidelines will offer full new guidance on how the agencies will approach mergers. We set forth the guidelines in full and then turn to notes and questions on those after that.

Merger Guidelines

U.S. Department of Justice and the Federal Trade Commission

I. Overview

These Merger Guidelines explain how the Department of Justice and the Federal Trade Commission (the "Agencies") identify potentially illegal mergers. They are designed to help the public, business community, practitioners, and courts understand the factors and frameworks the Agencies consider when investigating mergers.

The Agencies enforce the federal antitrust laws, specifically Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2; Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45; and Sections 3, 7, and 8 of the Clayton Act[1], 15 U.S.C. §§ 14, 18, 19. Congress has charged the Agencies with administering these statutes as part of a national policy to promote open and fair competition, including by preventing mergers and acquisitions that would violate these laws.

Section 7 of the Clayton Act is the antitrust law that most directly addresses mergers and acquisitions.[2] Section 7 prohibits mergers and acquisitions where "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."[3] Section 7 is a preventative statute that reflects the "mandate of Congress that tendencies toward concentration

[1] As amended under the Celler-Kefauver Antimerger Act of 1950, Public Law 81-899, 64 Stat. 1125, and the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a.
[2] Mergers may also violate, *inter alia*, Sections 1 and 2 of the Sherman Act or Section 5 of the FTC Act.
[3] 15 U.S.C. § 18.

in industry are to be curbed in their incipiency."[4]

The Clayton Act requires the Agencies to assess the risk to competition from mergers. As the Supreme Court has explained, "Section 7 itself creates a relatively expansive definition of antitrust liability: To show that a merger is unlawful, a plaintiff need only prove that its effect '*may be* substantially to lessen competition.'"[5] This is because "[t]he grand design of…Section 7, as to stock acquisitions [and] the acquisition of assets, was to arrest incipient threats to competition which the [more broadly applicable] Sherman Act did not ordinarily reach."[6] Accordingly, in analyzing a proposed merger, the Agencies do not seek to predict the future or the precise effects of a merger with certainty. Rather, the Agencies assess the risk that the merger may lessen competition substantially or tend to create a monopoly based on the totality of the evidence available at the time of the investigation.

Across the economy, competition plays out in many ways and on a variety of dimensions. In recognition of this fact, "Congress indicated plainly that a merger had to be functionally viewed, in the context of its particular industry."[7] The Agencies therefore begin their merger analysis with the question: how does competition present itself in this market and might this merger risk lessening that competition substantially now or in the future?

The Agencies apply the following Guidelines to help answer this question. In some cases, "it is possible…to simplify the test of illegality" by focusing on discrete facts that, when present, suggest a merger is "so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects."[8]

Guidelines 1-8 identify several frameworks that the Agencies use to assess the risk that a merger's effect may be substantially to lessen competition or to tend to create a monopoly. Guidelines 9-12 explain issues that often arise when the Agencies apply those frameworks in several common settings. Guideline 13 explains how the Agencies consider mergers and acquisitions that raise competitive concerns not addressed by the other Guidelines.

These Guidelines are not mutually exclusive, as a single transaction can have multiple effects or trigger concern in multiple ways. To promote efficient review, for any given transaction the Agencies may limit their analysis to any one Guideline or subset of Guidelines that most readily demonstrates the risks to competition from the transaction.

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[4] *Brown Shoe Co. v. United States*, 370 U.S. 294, 346 (1962) ("*Brown Shoe*").
[5] *California v. Am. Stores Co.*, 495 U.S. 271, 284 (1990) (quoting 15 U.S.C. § 18 with emphasis) (citing *Brown Shoe*, 370 U.S. at 323).
[6] *United States v. Penn-Olin Chemical Co.*, 378 U.S. 158, 170-71 (1964).
[7] *United States v. Gen. Dynamics Corp.*, 415 U.S. 486, 498 (1974) (quoting *Brown Shoe*, 370 U.S. at 321-22) ("*Gen. Dynamics*").
[8] *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 362-63 (1963) (*Phila. Nat'l Bank*).

Guideline 1: Mergers Should Not Significantly Increase Concentration in Highly Concentrated Markets.[9] Concentration refers to the number and relative size of rivals competing to offer a product or service to a group of customers. The Agencies examine whether a merger between competitors would significantly increase concentration and result in a highly concentrated market. If so, the Agencies presume that a merger may substantially lessen competition based on market structure alone.

Guideline 2: Mergers Should Not Eliminate Substantial Competition between Firms.[10] The Agencies examine whether competition between the merging parties is substantial, since their merger will necessarily eliminate competition between them.

Guideline 3: Mergers Should Not Increase the Risk of Coordination.[11] The Agencies examine whether a merger increases the risk of anticompetitive coordination. A market that is highly concentrated or has seen prior anticompetitive coordination is inherently vulnerable and the Agencies will presume that the merger may substantially lessen competition. In a market that is not yet highly concentrated, the Agencies investigate whether facts suggest a greater risk of coordination than market structure alone would suggest.

Guideline 4: Mergers Should Not Eliminate a Potential Entrant in a Concentrated Market.[12] The Agencies examine whether, in a concentrated market, a merger would (a) eliminate a potential entrant or (b) eliminate current competitive pressure from a perceived potential entrant.

Guideline 5: Mergers Should Not Substantially Lessen Competition by Creating a Firm That Controls Products or Services That Its Rivals May Use to Compete.[13] When a merger involves products or services rivals use to compete, the Agencies examine whether the merged firm can control access to those products or services to substantially lessen competition and whether they have the incentive to do so.

Guideline 6: Vertical Mergers Should Not Create Market Structures That Foreclose Competition.[14] The Agencies examine how a merger would restructure a vertical supply or distribution chain. At or near a 50% share, market structure alone indicates the merger may substantially lessen competition. Below that level, the Agencies examine whether the merger would create a "clog on competition…which deprives rivals of a fair opportunity to compete."[15]

Guideline 7: Mergers Should Not Entrench or Extend a Dominant Position.[16] The Agencies examine whether one of the merging firms already has a dominant position that the merger may reinforce. They also examine whether the merger may extend that dominant position to substantially lessen competition or tend to create a monopoly in another market.

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[9] *See, e.g., Phila. Nat'l Bank*, 374 U.S. at 363, *modified by Gen. Dynamics*, 415 U.S. at 498 (see Section IV).
[10] *See, e.g., ProMedica Health System, Inc. v. FTC*, 749 F.3d 559, 568-70 (6th Cir. 2014), *cert. denied*, 575 U.S. 996 (2015).
[11] *See, e.g., Hospital Corp. of America v. FTC*, 807 F.2d 1381, 1387-89 (7th Cir. 1986) (Posner, J.).
[12] *See, e.g., United States v. Marine Bancorp.*, 418 U.S. 602, 623-26 (1974).
[13] *See United States v. AT&T*, 916 F.3d 1029, 1035-36 (D.C. Cir. 2019).
[14] *See, e.g., Ford Motor Co. v. United States*, 405 U.S. 562 (1972).
[15] *Brown Shoe*, 370 U.S. at 324.
[16] *See, e.g., FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577-78 (1967).

Guideline 8: Mergers Should Not Further a Trend Toward Concentration.[17] If a merger occurs during a trend toward concentration, the Agencies examine whether further consolidation may substantially lessen competition or tend to create a monopoly.

Guideline 9: When a Merger is Part of a Series of Multiple Acquisitions, the Agencies May Examine the Whole Series.[18] If an individual transaction is part of a firm's pattern or strategy of multiple acquisitions, the Agencies consider the cumulative effect of the pattern or strategy.

Guideline 10: When a Merger Involves a Multi-Sided Platform, the Agencies Examine Competition Between Platforms, on a Platform, or to Displace a Platform. Multi-sided platforms have characteristics that can exacerbate or accelerate competition problems. The Agencies consider the distinctive characteristics of multi-sided platforms carefully when applying the other Guidelines.

Guideline 11: When a Merger Involves Competing Buyers, the Agencies Examine Whether It May Substantially Lessen Competition for Workers or Other Sellers.[19] Section 7 protects competition among buyers and prohibits mergers that may substantially lessen competition in any relevant market. The Agencies therefore apply these Guidelines to assess whether a merger between buyers, including employers, may substantially lessen competition or tend to create a monopoly.

Guideline 12: When an Acquisition Involves Partial Ownership or Minority Interests, the Agencies Examine Its Impact on Competition.[20] Acquisitions of partial control or common ownership may in some situations substantially lessen competition.

Guideline 13: Mergers Should Not Otherwise Substantially Lessen Competition or Tend to Create a Monopoly. The Guidelines are not exhaustive of the ways that a merger may substantially lessen competition or tend to create a monopoly.

* * *

These Guidelines consolidate, revise, and replace the various versions of Merger Guidelines issued by the Agencies since the Department of Justice's first Merger Guidelines in 1968. This revision builds on the learning and experience reflected in those prior Guidelines and successive revisions. These Guidelines reflect the collected experience of the Agencies over many years of merger review in a changing economy.

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[17] *See, e.g., Gen. Dynamics*, 415 U.S. at 497-98; *United States v. Pabst Brewing Co.*, 384 U.S. 546, 552–53 (1966).
[18] *See* H.R. Rep. No. 1191, 81st Cong., 2d Sess. 12-13 (1950).
[19] *See, e.g.*, *Mandeville Island Farms v. Am. Crystal Sugar Co.*, 334 U.S. 219, 235 (1948).
[20] *See, e.g.*, *Denver & Rio Grande v. United States*, 387 U.S. 485, 504 (1967).

To make their content both accessible to new readers and useful for experts, these Guidelines are organized at varying levels of detail:

- The Overview outlines the guidelines in summary form to help the public and market participants identify potential concerns and understand the Agencies' approach.
- Section II discusses the application of these Guidelines in further detail.
- Section III identifies some of the tools the Agencies use to define relevant markets; and
- Section IV explains how the Agencies approach several common types of rebuttal evidence.[21]

Several appendices follow these Guidelines. The Appendices describe evidentiary and analytical tools the Agencies often use.

- Appendix 1 discusses sources of evidence commonly relied on by the Agencies.
- Appendix 2 describes tools sometimes used to evaluate competition among firms.
- Appendix 3 discusses additional details regarding the process for defining relevant markets.
- Appendix 4 explains how the Agencies typically calculate market shares and concentration metrics.

These Guidelines create no independent rights or obligations and do not limit the discretion of the Agencies or their staff in any way. Although the Guidelines identify the factors and frameworks the Agencies consider when investigating mergers, the Agencies' enforcement decisions will necessarily continue to require prosecutorial discretion and judgment. Because the specific standards set forth in these Guidelines must be applied to a broad range of factual circumstances, the Agencies will apply them reasonably and flexibly to the specific facts and circumstances of each merger.

Similarly, the factors contemplated in these Guidelines neither dictate nor exhaust the range of evidence that the Agencies may introduce in merger litigation. Instead, they set forth various methods of analysis that may be applicable depending on the availability and/or reliability of information related to a given market or transaction. Given the variety of markets, market participants, and acquisitions that the Agencies encounter, merger analysis does not consist of uniform application of a single methodology. The Agencies assess any relevant and meaningful evidence to evaluate whether the effect of a merger may be substantially to lessen competition or to tend to create a monopoly. Merger review is ultimately a fact-specific exercise. The Agencies follow the facts in analyzing mergers, as they do in other areas of law enforcement.

These Guidelines include citations to binding legal precedent. Citations to court decisions in these Guidelines do not necessarily suggest that the Agencies would analyze the facts in those cases identically today. While the Agencies adapt their analytical tools to new learning, legal

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[21] These Guidelines pertain only to the consideration of whether a merger or acquisition is illegal. The consideration of remedies appropriate for otherwise illegal mergers and acquisitions is beyond its scope. The Agencies review proposals to revise a merger in order to alleviate competitive concerns consistent with applicable law regarding remedies.

holdings reflecting the Supreme Court's interpretation of a statute apply unless subsequently modified. These Guidelines therefore cite binding propositions of law to explain core principles that the Agencies apply in a manner consistent with modern analytical tools and market realities.

II. Applying the Merger Guidelines

1. Mergers Should Not Significantly Increase Concentration in Highly Concentrated Markets.

In highly concentrated markets, a merger that eliminates even a relatively small competitor creates undue risk that the merger may substantially lessen competition. As a result, even a relatively small increase in concentration in a relevant market can provide a basis to presume that a merger is likely to substantially lessen competition. The Supreme Court has held that "[a] merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects."[22] In the Agencies' experience, this type of structural presumption provides a highly administrable and useful tool for identifying mergers that may substantially lessen competition.

"Concentration" reflects the number and relative size of firms competing to offer a product[23] or service to a group of customers.[24] Concentration is "high" when the market only has a few significant competitors. An analysis of concentration begins with calculating pre-merger market shares within a relevant market (see Section III and Appendix 4), then proceeds to assess whether the merger would lead to or increase undue concentration in that market.[25]

The Agencies generally measure concentration levels using the Herfindahl-Hirschman Index ("HHI"). The HHI is defined as the sum of the squares of the market shares; it is small when there are many small firms and grows larger as the market becomes more concentrated, reaching 10,000 in a market with a single firm. Markets with post-merger HHI greater than 1,800 are highly concentrated.[26] A merger causes undue concentration and triggers a structural presumption that the merger may substantially lessen competition or tend to create a monopoly when it would result in a highly concentrated market and produce an increase in the HHI of more

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[22] *Phila. Nat'l Bank*, 374 U.S. at 363 (1963).

[23] These Guidelines use the term "products" to encompass anything that is traded between firms and their suppliers, customers, or business partners, including physical goods, services, or access to assets. Products can be as narrow as an individual brand, a specific version of a product, or a product that includes specific ancillary services such as the right to return it without cause, or delivery to the customer's location.

[24] In the context of buyers, concentration reflects the number and relative size of firms competing to purchase a product or service.

[25] Typically, a merger eliminates a competitor by bringing two market participants under common control. Similar concerns arise if the merger threatens to cause the exit of a current market participant, such as a leveraged buyout that puts the target firm at significant risk of failure.

[26] For illustration, the HHI for a market of five equal firms is 2,000 ($5 \times 20^2 = 2{,}000$), and for six equal firms is 1,667 ($6 \times 16.67^2 = 1667$). Markets with HHI between 1,000 and 1,800 are referred to as "concentrated markets."

than 100 points.[27] The Agencies also may examine the market share of the merged firm: a merger that significantly increases concentration and creates a firm with a share over thirty percent presents an impermissible threat of undue concentration regardless of the overall level of market concentration.[28]

Indicator	Threshold for Structural Presumption
Post-merger HHI	Market HHI greater than 1,800 AND Change in HHI greater than 100
Merged Firm's Market Share	Share greater than 30% AND Change in HHI greater than 100

Higher concentration levels suggest even greater risk that the merger may substantially lessen competition.[29]

2. Mergers Should Not Eliminate Substantial Competition Between Firms.

A merger eliminates competition between the merging firms by bringing them under joint control. If evidence demonstrates substantial competition between the merging parties prior to the merger, the Agencies can determine that the merger may substantially lessen competition.[30]

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[27] The change in HHI from a merger of firms with shares a and b is equal to $2ab$. For example, in a merger between a firm with 20% market share and a firm with 5% market share, the change in HHI is 2 x 20 x 5 = 200.

[28] *Phila. Nat'l Bank*, 374 U.S. at 364-65 ("Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat.").

[29] The first merger guidelines to reference an HHI threshold were the merger guidelines issued in 1982, which used the 1,800 HHI threshold for a highly concentrated market, and 100 HHI for a significant increase. Each subsequent iteration until 2010 maintained those thresholds. *See* Fed. Trade Comm'n & U.S. Dep't of Justice Horizontal Merger Guidelines (1992), § 1.51; Fed. Trade Comm'n & U.S. Dep't of Justice Horizontal Merger Guidelines (1997), § 1.51; U.S. Dep't of Justice Merger Guidelines (1982), § 3(A). During this time, courts routinely cited to the guidelines and these HHI thresholds in decisions. *See, e.g., Chicago Bridge & Iron Co. N.V. v. FTC.*, 534 F.3d 410, 431 (5th Cir. 2008); *FTC. v. H.J. Heinz Co.*, 246 F.3d 708, 716 (D.C. Cir. 2001); *FTC. v. Univ. Health, Inc.*, 938 F.2d 1206, 1211 (11th Cir. 1991); *FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1503 (D.C. Cir. 1986) (relying on Department of Justice's 1984 merger guidelines); *United States v. Baker Hughes Inc.*, 908 F.2d 981, 983 (D.C. Cir. 1990) (referencing the Department of Justice's 1984 guidelines). In practice, the Agencies tended to challenge mergers that greatly exceeded these thresholds to focus their limited resources on the most problematic transactions. The more permissive thresholds included in the 2010 Horizontal Merger Guidelines reflected that agency practice, rather than a judgment of the appropriate thresholds for competitive concern or the requirements of the law. The Agencies consider a threshold of a post-merger 1,800 HHI and an increase in HHI of 100 to better reflect both the law and the risks of competitive harm and have therefore returned to those thresholds here.

[30] 15 U.S.C. § 18. *See also United States v. First Nat'l Bank & Trust Co. of Lexington*, 376 U.S. 665, 669-70 (1964) ("it [is] clear that the elimination of significant competition between [merging parties] constitutes an unreasonable restraint of trade in violation of § 1 of the Sherman Act…. It [can be] enough that the two…compete[ ]. That their

Focusing on the competition between the merging parties can reveal that a merger between competitors may substantially lessen competition even where market shares are difficult to measure or where market shares understate the competitive significance of the merging parties to one another.

Competition often involves firms trying to win business by offering lower prices, new or better products and services, more attractive features, higher wages, improved benefits, or better terms relating to various additional dimensions of competition. The more the merging parties have shaped one another's behavior, or have affected one another's sales, profits, valuation, or other drivers of behavior, the more significant the competition between them.

The Agencies examine a variety of indicators to identify substantial competition. For example:

Strategic Deliberations or Decisions. The Agencies may analyze the extent of competition between the merging firms by examining evidence relating to strategic deliberations or decisions in the regular course of business. For example, in some markets, the firms may monitor each other's pricing, marketing campaigns, facility locations, improvements, products, capacity, output, and/or innovation plans. This can provide evidence of competition between the merging firms, especially when they react by taking steps to preserve or enhance the competitiveness or profitability of their own products or services.

Prior Merger, Entry, and Exit Events. The Agencies may look to historical events to assess the presence and substantiality of direct competition between the merging firms. For example, the Agencies may examine the impact of recent relevant mergers, entry, expansion, or exit events.

Customer Substitution. Customers' willingness to switch between different firms' products is an important part of the competitive process. Firms are closer competitors the more that customers are willing to switch between their products. The Agencies use a variety of tools, detailed in Appendix 2, to assess customer substitution.

Impact of Competitive Actions on Rivals. Competitive actions by one firm can increase its sales at the expense of its rivals. The Agencies may gauge the extent of competition between the merging firms by considering the impact that competitive actions by one of the merging firms has on the other merging firm. The impact of a firm's competitive actions on a rival is generally greater when customers consider their products to be closer substitutes, so that a firm's competitive actions result in greater lost sales for the rival, and when the profitability of the rival's lost sales is greater.

Impact of Eliminating Competition Between the Firms. In some instances, evidence may be available to assess the impact of competition from one firm on the other's actions, such

competition [is] not insubstantial and that the combination [would] put an end to it."); *ProMedica Health System, Inc. v. FTC*, 749 F.3d 559, 568-70 (6th Cir. 2014), *cert. denied*, 575 U.S. 996 (2015). The effect on competition of the elimination of competition between the merging firms, without considering the risk of coordination among the remaining firms, is sometimes referred to as "horizontal unilateral effects."

as firm choices about price, quality, wages, or another dimension of competition. Appendix 2 describes a variety of approaches to measuring such impacts.

Additional Evidence, Tools, and Metrics. The Agencies may use additional evidence, tools, and metrics to assess the loss of competition between the firms. Depending on the realities of the market, different evidence, tools, or metrics may be appropriate. Appendix 2 provides examples and detail on several tools and settings.

3. Mergers Should Not Increase the Risk of Coordination.

The Agencies determine that a merger may substantially lessen competition when it meaningfully increases the risk of coordination among the remaining firms in a relevant market or makes existing coordination more stable or effective.[31] Firms can coordinate across any or all dimensions of competition, such as price, product features, customers, wages, benefits, or geography. Coordination among rivals lessens competition whether it occurs explicitly—through collusive agreements between competitors not to compete or to compete less—or tacitly, through observation and response to rivals. Because tacit coordination may be difficult to address under Section 1 of the Sherman Act, vigorous enforcement of Section 7 of the Clayton Act to prevent market structures conducive to such coordination is especially critical.

To assess the extent to which a merger may increase the likelihood, stability, or effectiveness of coordination, the Agencies often consider three primary factors and several secondary factors. The Agencies may consider additional factors depending on the market.

A. Primary Factors

The Agencies presume that post-merger market conditions are susceptible to coordinated interaction if any of the three primary factors are present.

Highly Concentrated Market. By reducing the number of firms in a market, a merger increases the risk of coordination. The fewer the number of competitively meaningful rivals prior to the merger, the greater the likelihood that merging two competitors will facilitate coordination. Markets that are highly concentrated after a merger that significantly increases concentration (see Guideline 1) are presumptively susceptible to coordination. If merging parties claim that a highly concentrated market is not susceptible to coordination, the Agencies will assess this evidence using the framework described in Section IV.4. Where a market is not highly concentrated, the Agencies may still consider other risk factors.

Prior Actual or Attempted Attempts to Coordinate. Evidence that firms representing a substantial share in the relevant market appear to have previously engaged in express or tacit coordination to lessen competition is highly informative as to the market's susceptibility to coordination. Evidence of failed attempts at coordination in the relevant market suggest that successful coordination was not so difficult as to deter attempts, and a merger reducing the number of rivals may tend to make success more likely.

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[31] *See Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.,* 509 U.S. 209, 229-30 (1993) ("In the § 7 context, it has long been settled that excessive concentration, and the oligopolistic price coordination it portends, may be the injury to competition the Act prohibits.").

Elimination of a Maverick. A maverick is a firm with a disruptive presence in a market. The presence of a maverick only reduces the risk of coordination so long as the maverick retains the disruptive incentives that drive its behavior. A merger that eliminates a maverick or significantly changes its incentives increases the susceptibility to coordination.[32]

B. Secondary Factors

The Agencies also examine whether secondary factors demonstrate that a merger may meaningfully increase the risk of coordination, even absent the primary risk factors. Not all secondary factors must be present for a market to be susceptible to coordination.

Market Concentration. Even in markets that are not highly concentrated, coordination becomes more likely as concentration increases. The more concentrated a market with an HHI above 1,000, the more likely the Agencies are to conclude that the market structure suggests susceptibility to coordination.

Market Transparency. A market is more susceptible to coordination if a firm's behavior can be promptly and easily observed by its rivals. Rivals' behavior is more easily observed when the terms offered to customers are readily discernible and relatively transparent (that is, known to rivals). Transparency can refer to the ability to observe prices, terms, the identities of the firms serving particular customers, or any other competitive actions of other firms. Information sharing arrangements among market participants, such as public exchange of information through announcements or private exchanges through trade associations or publications, increase market transparency. Regular monitoring of one another's prices or customers can indicate that the terms offered to customers are relatively transparent. Use of algorithms or artificial intelligence to track or predict competitor prices or actions likewise increases the transparency of the market.

Competitive Responses. A market is more susceptible to coordination if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by likely responses of those rivals. This is more likely to be the case the stronger and faster the responses from its rivals because such responses reduce the benefits of competing more aggressively. Some factors that increase the likelihood of strong or rapid responses by rivals include: (1) the market has few significant competitors, (2) products in the relevant market are relatively homogeneous, (3) customers find it relatively easy to switch between suppliers, (4) suppliers use algorithmic pricing, or (5) suppliers use meeting-competition clauses.

Aligned Incentives. Removing a firm that has different incentives from most others in a market can increase the risk of coordination. For example, a firm with a small market share may have less incentive to coordinate because it has more potential to gain from winning new business than do other firms. The same issue can arise when a merger more closely aligns one or both merging firms' incentives with the other firms in the market.

Profitability or Other Advantages of Coordination for Rivals. The Agencies regard coordinated interaction as more likely to occur when participants in the market stand to gain more from successful coordination. Coordination generally is more profitable or otherwise

[32] *United States v. Alcoa*, 377 U.S. 271, 280-81 (1964).

advantageous for the coordinating firms the less often customers substitute outside the market when firms offer worse terms.

4. Mergers Should Not Eliminate a Potential Entrant in a Concentrated Market.

Mergers can substantially lessen competition by eliminating a potential entrant. For instance, a merger can eliminate the possibility that entry or expansion by one or both firms would have resulted in new or increased competition in the market in the future. A merger can also eliminate current competitive pressure exerted on other market participants by the mere perception that one of the firms might enter. Both of these risks can be present simultaneously.

A merger that eliminates a potential entrant into a concentrated market can substantially lessen competition or tend to create a monopoly.[33] The more concentrated the market, the greater the magnitude of harm to competition from any lost potential entry and the greater the tendency to create a monopoly. Accordingly, for mergers involving one or more potential entrants, the higher the market concentration, the lower the probability of entry that gives rise to concern.

A. Actual Potential Competition: Eliminating Reasonably Probable Future Entry

The antitrust laws reflect a preference for internal growth over acquisition.[34] In contrast to internal growth, merging a current and a potential market participant eliminates the possibility that the potential entrant would have entered on its own.[35]

To determine whether an acquisition that eliminates a potential entrant into a concentrated market may substantially lessen competition,[36] the Agencies examine (1) whether one or both of the merging firms had a reasonable probability of entering the relevant market other than through an anticompetitive merger, and (2) whether such entry offered "a substantial likelihood of ultimately producing deconcentration of [the] market or other significant procompetitive effects."[37]

Reasonable Probability of Alternative Entry. The Agencies' starting point for assessment of a reasonable probability of entry is objective evidence regarding the firm's available feasible means of entry, including its capabilities and incentives. Relevant objective evidence can include, for example, evidence that the firm has sufficient size and resources to enter; evidence of any advantages that would make the firm well-situated to enter; evidence that

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[33] *United States v. Marine Bancorp.*, 418 U.S. 602, 630 (1974). A concentrated market is one with an HHI greater than 1,000 (See Guideline 1).
[34] *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 559 n.13 (1973) (Marshall, J., concurring) ("[S]urely one premise of an antimerger statute such as § 7 is that corporate growth by internal expansion is socially preferable to growth by acquisition." (quoting *Phila. Nat'l Bank*, 374 U.S. at 370)).
[35] *See, e.g.*, *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 560–61 (1973) (Marshall, J., concurring).
[36] Harm from the elimination of a potential entrant can occur in markets that do not yet consist of commercial products, even if the market concentration of the future market cannot be measured using traditional means. Where there are few equivalent potential entrants including one or both of the merging firms, that indicates that the future market, once commercialized, will be concentrated. The Agencies will consider other potential entrants' capabilities and incentives in comparison to the merging potential entrant to assess equivalence.
[37] *United States v. Marine Bancorp.*, 418 U.S. 602, 633 (1974).

the firm has successfully expanded into other markets in the past or already participates in adjacent or related markets; evidence that the firm has an incentive to enter; or evidence that industry participants recognize the company as a potential entrant.[38] This analysis is not limited to whether the company could enter with its pre-merger production facilities, but also considers overall capability, which can include the ability to expand or add to its capabilities on its own or in collaboration with someone other than the acquisition target.

Subjective evidence that the company considered entering absent the merger can also indicate a reasonable probability that the company would have entered without the merger.[39] Subjective evidence that the company considered organic entry as an alternative to merging generally suggests that, absent the merger, entry would be reasonably probable.

Likelihood of Deconcentration or Other Significant Procompetitive Effects. New entry can yield a variety of procompetitive effects, including market deconcentration, increased output or investment, higher wages or improved working conditions, greater innovation, higher quality, and lower prices.[40] If the merging firm had a reasonable probability of entering the concentrated relevant market, the Agencies will usually presume that the resulting deconcentration and other benefits that would have resulted from its entry would be competitively significant, unless there is substantial direct evidence that the competitive effect would be *de minimis*.[41] To supplement the presumption that new entry yields procompetitive effects, the Agencies will consider projections of the potential entrant's competitive significance, such as market share, its business strategy, the anticipated response of competitors, or customer preferences or interest.

A merger of two potential entrants can also result in a substantial lessening of competition. The merger need not involve a firm that has a commercialized product in the market or an existing presence in the same geographic market. The Agencies analyze similarly mergers between two potential entrants and those involving a current market participant and a potential entrant.

B. Perceived Potential Competition: Lessening of Current Competitive Pressure

A perceived potential entrant can stimulate competition among incumbents. That pressure can prompt current market participants to make investments, expand output, raise wages, increase product quality, lower product prices, or take other procompetitive actions. The acquisition of a firm that is perceived by market participants as a potential entrant can substantially lessen competition by eliminating or relieving competitive pressure.[42]

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[38] As to all of these types of evidence, see *Marine Bancorp.*, 418 U.S. at 636–37; *Yamaha Motor Co. v. FTC*, 657 F.2d 971, 978 (8th Cir. 1981).

[39] *Yamaha Motor Co.*, 657 F.2d at 978.

[40] *Brown Shoe Co.*, 370 U.S. at 345 n.72 ("Internal expansion is . . . more likely to provide increased investment . . . more jobs and greater output.").

[41] For example, where state banking laws prohibit alternative *de novo* entry and dictate that alternative entry via toehold acquisition "would be frozen at the level of its initial acquisition," the Agencies would not presume such alternative entry would yield deconcentration as a significant procompetitive effect. *Marine Bancorp., Inc.*, 418 U.S. 602, 633-39 (1974).

[42] This elimination of present competitive pressure is sometimes known as an anticompetitive "edge effect" or a loss of "perceived potential competition." *E.g., Marine Bancorp.*, 418 U.S. at 639.

To assess whether the acquisition of a perceived potential entrant may substantially lessen competition, the Agencies consider whether a current market participant could reasonably consider one of the merging companies to be a potential entrant and whether that potential entrant has a likely influence on existing competition.

Market Participant Could Reasonably Consider a Firm to Be a Potential Entrant. The starting point for this analysis is evidence regarding the company's capability of entering or applying competitive pressure.[43] Objective evidence is highly probative and includes evidence of feasible means of entry or communications by the company indicating plans to expand or reallocate resources in a way that could increase competition in the relevant market. Objective evidence can be sufficient to find that the firm is a potential entrant; it need not be accompanied by any subjective evidence of current market participants' internal perceptions or direct evidence of strategic reactions to the potential entrant. If such evidence is available, it can weigh in favor of finding that a current market participant could reasonably consider the firm to be a potential entrant.

Likely Influence on Existing Rivals. Objective evidence establishing that a current market participant could reasonably consider one of the merging firms to be a potential entrant can also establish that the firm has a likely influence on existing market participants.[44] Subjective evidence indicating that current market participants, including for example customers, suppliers, or distributors, internally perceive the merging firm to be a potential entrant can also establish a likely influence. Direct evidence that the firm's presence or behavior has affected or is affecting current market participants' strategic decisions can also establish a likely influence.[45] Circumstantial evidence that the firm's presence or behavior had a direct effect on the competitive reactions of firms in the market may also show likely influence.[46]

The existence of a perceived potential entrant does not override or counteract harm from mergers between companies that already participate in the relevant market. The impact of perceived potential entrants is secondary to the competition provided by current market participants. Accordingly, when evaluating a merger of current competitors, the Agencies will assess whether firms are likely to enter the market to replace the lost competition using the standards discussed in Section IV.2. Concentrated markets often lack robust competition, and so the loss of even a secondary source of competition, like perceived potential entrants, may substantially lessen competition.

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[43] *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 533–36 (1973) (identifying "specific question" as "whether, given [the acquirer's] financial capabilities and conditions in the market, it would be reasonable to consider it a potential entrant into that market").
[44] *Falstaff Brewing Corp.*, 410 U.S. at 534.
[45] *FTC v. Procter & Gamble*, 386 U.S. 568, 581 (1967) (relying on objective evidence that "barriers to entry . . . were not significant" for the acquirer, that the number of potential entrants was "not so large that the elimination of one would be insignificant," and that "the acquiring firm was the most likely entrant," in addition to direct evidence of current edge effects on existing competitors' behavior).
[46] For instance, a market participant may have expressed concerns that certain competitive actions would hurt its ability to compete against the potential entrant.

5. Mergers Should Not Substantially Lessen Competition by Creating a Firm That Controls Products or Services That Its Rivals May Use to Compete.

The Agencies evaluate whether a merger may substantially lessen competition by giving a firm control over access to a product, service, or customers that its rivals use to compete. Control of rivals' access to these tools of competition can enable the merged firm to weaken its rivals and, in so doing, lessen competition or tend to create a monopoly.

This concern applies to any transaction involving access to products, services, or customers rivals use to compete, whether or not they involve traditional vertical supply and distributor relationships. The Agencies' analysis focuses on the risk that the merged firm would have the ability and incentive to make it harder for rivals to compete and thereby harm competition.[47]

The relevant market for this analysis can be the market in which the merged firm competes with its rivals, while the product, service, or customer that rivals use to compete in that market is termed the "related product" or "related service." Many types of related products or services can implicate this concern, such as: (1) related products rivals may use, now or in the future, as inputs; (2) related products that provide distribution services for rivals or otherwise influence consumer purchase decisions, or the firm's own purchases of intermediate products; (3) related products that provide the merged firm access to competitively sensitive information about its rivals; or (4) related products that are complementary to, and therefore increase the value of, rivals' products. Even if the related product or service is not currently being used by rivals, it might be competitively significant because, for example, its availability enables rivals to obtain better terms from other providers in negotiations.

A. The Ability and Incentive to Weaken or Exclude Rivals

A merger involving products, services, or customers that rivals use to compete may substantially lessen competition when it results in a firm with both the ability and incentive to make it harder for its rivals to compete in the relevant market, or to eliminate them or deter the entry of new firms into the relevant market. Because the merged firm may have the ability to control access to the related product in many different ways, the Agencies do not seek to specify the precise actions the merged firm would take to weaken rivals.

(1) Ability

The Agencies assess the merged firm's ability to make it harder for its rivals to compete by examining (1) the extent to which the firm can limit or degrade its rivals' access to a related product, service, or customers, and (2) the extent to which the related product, service, or customers affects those rivals' competitiveness.

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[47] The inquiry in Guideline 6 into vertical market structures is distinct from this ability and incentive analysis.

Ability to Limit Access. The Agencies assess whether the merged firm may be able to limit or degrade rivals' access to the related product or service by looking at the availability of substitutes. In particular, the merged firm might be able to deny rivals access altogether or might be able to worsen the terms on which rivals can access the related product or service. For example, the merged firm might raise price, reduce quality, provide less reliable access, or delay access to product improvements or information relevant to making efficient use of the product.

Competitive Significance of Limiting Rivals' Access. The Agencies consider the potential impact on competition from limiting or degrading rivals' access to the related product or service. This inquiry focuses on whether doing so would make it harder for rivals to compete or raise barriers to entry by new firms and expansion by existing firms. For example, it would be harder for rivals to compete if raising rivals' costs as a result of the merger led rivals to charge higher prices, made their products less attractive to customers, or meant those products were less readily available to customers. The merged firm's ability to exclude or weaken rivals is greater, the worse are rivals' alternative options to the merged firm's related product or service.

(2) Incentive

The Agencies assess whether the merged firm may have an incentive to worsen the terms on which rivals can access the related product and thereby benefit from substantially lessened competition. This incentive discourages the merged firm from providing those rivals with access to the related product or service. Evidence regarding the merged firm's incentives can include evidence about the structure, history, and probable future of the market.

Competition with Rivals That Use the Related Product or Service. The merged firm's incentives to worsen terms for the related product depend on the extent to which it competes with rivals that use the related product. The merged firm may benefit from higher sales or prices in the relevant market if they worsen terms for rivals. This benefit can make it profitable to worsen the terms offered to rivals for the related product and thereby substantially lessen competition, even though it would not have been profitable for the firm that controlled the related product prior to the merger.

The Agencies may assess the extent of competition with rivals using analogous methods to the ones used to assess the extent of competition between the merging firms (see Guideline 2 and Appendix 2). For example, the Agencies may consider evidence about the impact on the merged firm of competitive actions by rivals that use the related product.

Prior Transactions or Prior Actions. If firms used prior acquisitions or engaged in prior actions to limit rivals' access to the related product, or other products its rivals use to compete, that suggests that the merged firm has an incentive to lessen competition in the relevant market. However, lack of past action does not necessarily indicate a lack of incentive in the present transaction.

Internal Documents. Business planning and merger analysis documents prepared by the merging firms might identify instances where the firms themselves believe they have incentives

to raise rivals' costs. Such documents, where available, are highly probative of an incentive to raise rivals' costs. The lack of such documents, however, is less informative.

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If the merged firm has the ability and incentive to make it harder for its rivals to compete in the relevant market, there are many ways it could act on those incentives. The merging parties may put forward evidence that there are no plausible ways in which they could profitably worsen the terms for the related product and thereby make it harder for rivals to compete, or that the merged firm will be more competitive as a result of the merger. When evaluating whether this rebuttal evidence is sufficient to conclude that no substantial lessening of competition is threatened by the merger, the Agencies will give little weight to claims that are not supported by an objective analysis, including, for example, speculative claims about reputational harms. Moreover, the Agencies are unlikely to credit claims or commitments to protect or otherwise avoid harming their rivals that do not align with the firm's incentives.[48] The Agencies' assessment will be consistent with the principle that firms act to maximize their overall profits and valuation rather than the profits of any particular business unit.[49] A merger may substantially lessen competition or tend to create a monopoly regardless of the claimed intent of the merging companies or their executives.[50] (See Section IV.)

B. Mergers Involving Access to Rivals' Competitively Sensitive Information

If rivals would continue to access or purchase a related product controlled by the merged firm post-merger, the merger may substantially lessen competition if the merger would grant the firm access to rivals' competitively sensitive information. This situation could arise in many settings, including, for example, if the merged firm learns about rivals' sales volumes or projections from supplying an input or a complementary product; if it learns about promotion plans and anticipated product improvements or innovations from its role as a distributor; or if it learns about entry plans from discussions with potential rivals about compatibility with a complementary product it controls. A merger that gives the merged firm access to competitively sensitive information could undermine rivals' ability or incentive to compete aggressively or could facilitate coordination.

Undermining Competition. The merged firm might use access to a rival's competitively sensitive information to undermine competition from the rival. For example, the merged firm's ability to preempt, appropriate, or otherwise undermine the rival's procompetitive actions can discourage the rival from fully pursuing competitive opportunities. As a result, rivals might see less value in taking procompetitive actions when a competitor has access to its competitively

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[48] *See FTC v. H.J. Heinz Co.*, 246 F.3d 708, 721 (D.C. Cir. 2001).

[49] *Copperweld Corp. v. Indep. Tube Corp.*, 467 U.S. 752, 770–72 (1984); *United States v. AT&T, Inc.*, 916 F.3d 1029, 1043 (D.C. Cir. 2019).

[50] *United States v. E. I. du Pont de Nemours & Co.*, 353 U.S. 586, 607 (1957); *see also Miss. River Corp. v. FTC*, 454 F.2d 1083, 1089 (8th Cir. 1972) ("Honest intentions, business purposes and economic benefits are not a defense to violations of an antimerger law.").

sensitive information. Relatedly, rivals might refrain from doing business with the merged firm rather than risk that the merged firm would use their competitively sensitive business information to undercut them. Those rivals might become less-effective competitors if they must rely on less preferred trading partners or accept less favorable trading terms because their outside options have worsened or are more limited.

Facilitating Coordination. A merger that provides access to rivals' competitively sensitive information might facilitate coordinated interaction among firms in the relevant market by allowing the merged firm to observe its rivals' competitive strategies faster and more confidently. (See Guideline 3.)

6. Vertical Mergers Should Not Create Market Structures That Foreclose Competition.

A merger is "vertical" when the merging firms operate different levels of the same supply or distribution chain. Vertical integration occurs when the product or service supplied by the "upstream" firm (e.g., an input supplier) will be used by the "downstream" firm (e.g., a manufacturer of a finished product). "The primary vice of a vertical merger…is that, by foreclosing the competitors of either party from a segment of the market otherwise open to them, the arrangement may act as a clog on competition, which deprives rivals of a fair opportunity to compete."[51] The Agencies therefore sometimes undertake a structural analysis of a supply chain as a means of assessing whether a vertical merger may substantially lessen competition.[52]

A. Market Share Analysis

The risk of harm to competition is greater when unintegrated rivals have fewer substitutes for the related product. The Agencies may define a "related market" around the related product (see Guideline 5), using methodologies described in Section III. The "foreclosure share" is the share of the related market that is controlled by the merged firm, such that it could foreclose rival's access to the related product on competitive terms. If the foreclosure share is above 50 percent, that factor alone is a sufficient basis to conclude that the effect of the merger may be to substantially lessen competition, subject to any rebuttal evidence (see Section IV).[53]

B. Plus Factors Analysis

Below a foreclosure share of 50 percent, the Agencies consider a range of plus factors, in addition to the foreclosure share, to determine whether a vertical merger is reasonably likely to

[51] *Brown Shoe*, 380 U.S. at 323-24 (cleaned up). *See Fruehauf Corp. v. FTC*, 603 F.2d 345, 352 (2d Cir. 1979); *U.S. Steel Corp. v. FTC*, 426 F.2d 592, 599 (6th Cir. 1970); *United States v. Am. Cyanamid Co.*, 719 F.2d 558, 567 (2d Cir. 1983).

[52] In addition to this structural analysis, many vertical mergers can also be analyzed under the ability and incentive analysis in Guideline 5. Either can be a sufficient basis to warrant concern.

[53] *Brown Shoe*, 370 U.S. at 328 ("If the share of the market foreclosed is so large that it approaches monopoly proportions, the Clayton Act will, of course, have been violated . . ."); *Fruehauf Corp.*, 603 F.2d 345, 352, n.9 (2d Cir. 1979) ("[N]o such Per se rule has been adopted, except where the share of the market foreclosed reaches monopoly proportions," and the roughly 50% foreclosure share in *United States v. EI du Pont de Nemours & Co.*, 353 U.S. 586 (1957) "left no doubt that the vertical tie conferred market power.").

restrict options along the supply chain, depriving rivals of a fair opportunity to compete. The following is not an exhaustive list of all sources of potentially relevant evidence.

Trend Toward Vertical Integration. The Agencies will generally consider evidence about the degree of integration between firms in the relevant and related markets and whether there is a trend toward further vertical integration. The acceleration of a trend toward vertical integration may be shown through, for example: a pattern of vertical integration following mergers by one or both of the merging companies; or evidence that a merger was motivated by a desire to secure supply or distribution in response to similar transactions among other companies.[54]

Nature and Purpose of the Merger. When the nature and purpose of the merger is to foreclose rivals, including by raising their costs, that suggests the merged firm is likely to foreclose rivals.[55]

The Relevant Market is Already Concentrated. The risk to competition from restricted supply chains is greater when the relevant market is already concentrated or when the merged firm already has a dominant position in that market (see Guideline 7).

The Merger Increases Barriers to Entry. A vertical merger can raise barriers to entry by limiting independent sources of supply so that a new entrant would need to invest not only in entering the relevant market, but also in the related market, sometimes referred to as two-stage entry.[56]

7. Mergers Should Not Entrench or Extend a Dominant Position.

In a market that is already concentrated, merger enforcement should seek to preserve the possibility of eventual deconcentration.[57] Accordingly, the Agencies evaluate whether a merger involving an "already dominant[] firm may substantially reduce the competitive structure of the industry."[58] The Agencies also evaluate whether the merger may extend that dominant position into new markets, thereby substantially lessening competition in those markets.[59] The effect of entrenching or extending an already dominant position "may be substantially to lessen competition" or it "may be…to tend to create a monopoly" in violation of Section 7 of the

[54] *United States Steel Corp. v. FTC*, 426 F.2d 592 (6th Cir. 1970).
[55] *See Ford Motor Co.*, 405 U.S. at 571.
[56] *Marquette Cement Manufacturing, Co.*, 75 FTC 32, 44 (1969) ("The increased capital costs and the greater risks that entry at both levels would entail substantially increased barriers to entry in this market . . .").
[57] *Phila. Nat'l Bank*, 374 U.S. at 365 n.42 (1963) ("[I]f concentration is already great, the importance of … preserving the possibility of eventual deconcentration is correspondingly great.").
[58] *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577-578 (1967); *see, e.g., Allis-Chalmers Mfg. Co. v. White Consol. Indus*., *Inc.*, 414 F.2d 506, 518 (3d Cir. 1969) ("The potential entrenchment of … market power… may be anticompetitive and violative of § 7."); *Fruehauf Corp. v. FTC*, 603 F.2d 345, 353 (2d Cir. 1979) (the "entrenchment of a large supplier or purchaser" can be an "essential" showing of a Section 7 violation); *United States v. FCC*, 652 F.2d 72, 102 (D.C. Cir. 1980) (under "entrenchment theory" a merger may violate Section 7 when it would allow the firm to "dominate the relevant market and to drive out actual or potential competitors"); *Stanley Works v. FTC*, 469 F.2d 498, 505 (2d Cir. 1972) (affirming order blocking a merger under Section 7 that would "entrench" an "already dominant position").
[59] *Ford Motor Co. v. United States*, 405 U.S. 562, 571 (1972) (condemning acquisition by dominant firm to obtain a foothold in another market when coupled with incentive to create and maintain barriers to entry into that market).

Clayton Act.[60] "Th[is] entrenchment doctrine properly blocks artificial competitive advantages … but not simple improvements in efficiency."[61]

These concerns can arise in mergers that are neither strictly horizontal nor vertical, so the Agencies seek to identify any connection suggesting the merger may entrench or extend the dominant position.

To evaluate this concern, the Agencies consider whether (a) one of the merged firms already has a dominant position, and (b) the merger may entrench or extend that position. The Agencies assess the magnitude of the lessening of competition that may arise from entrenching a dominant position based on the degree of dominance already held and the extent to which it would be entrenched by a merger. The greater the dominance already held, the lower the degree of entrenchment that gives rise to a substantial lessening of competition. When one merging firm has or is approaching monopoly power, any acquisition that may tend to preserve its dominant position may tend to create a monopoly in violation of Section 7.

To identify whether one of the merging firms already has a dominant position,[62] the agencies look to whether (i) there is direct evidence that one or both merging firms has the power to raise price, reduce quality, or otherwise impose or obtain terms that they could not obtain but-for that dominance, or (ii) one of the merging firms possesses at least 30 percent market share.

If this inquiry reveals that at least one of the merging firms already has a dominant position, the Agencies then examine whether the merger would either entrench that position or extend it into additional markets.

Entrenching a Dominant Position. The Agencies examine whether the merger may entrench the dominant position through any mechanism consistent with market realities that lessens the competitive threats the merged firm faces. For example:

A. *Increasing Entry Barriers Generally.* Entry barriers protect an incumbent firm from competition by making it more difficult for firms to enter the market or for existing firms to expand. Entry barriers can include, for example, the time, money, and expertise needed to develop a competing product; the risk that such entry would fail to recover the required investment; the costs to customers of switching providers;

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[60] A merger that entrenches or extends a firm's dominant position may also violate Section 1 or Section 2 of the Sherman Act. *See, e.g.*, *United States v. Grinnell Corp.*, 384 U.S. 563 (1966) (acquisitions among the types of conduct that may violate the Sherman Act). The various provisions of the Sherman, Clayton, and FTC acts each have separate standards, and one may be violated when the others are not.

[61] *See Emhart Corp. v. USM Corp*., 527 F.2d 177, 182 (1st Cir. 1975).

[62] Cases use various terms to describe a firm with an already powerful position in a market. *See, e.g.*, *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 575 (1967) ("dominant position"); *id.* at 571 ("leading manufacturer"); *United States v. Aluminum Co. of Am*., 377 U.S. 271, 278 (1964) ("leading producer"); *Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 414 F.2d 506, 524 (3d Cir. 1969) ("leading firm"); *Fruehauf Corp. v. FTC*, 603 F.2d 345, 353 (2d Cir. 1979) ("large supplier"); *United States v. FCC*, 652 F.2d 72, 103 (D.C. Cir. 1980) ("dominant firms"); *id.* ("leading . . . firm"); *Stanley Works v. FTC*, 469 F.2d 498, 505 (2d Cir. 1972) ("dominant position"); *Mo. Portland Cement Co. v. Cargill, Inc.*, 498 F.2d 851, 866 (2d Cir. 1974) ("dominant firm"). Concern with entrenching or extending a powerful position, however, does not depend on the precise term, and arises whether the firm has market power or monopoly power. These Guidelines therefore use the term "dominant position" to refer to the position of those firms for which antitrust law is concerned about extending or entrenching power through a merger.

existing regulatory barriers; the control over necessary inputs by a current market participant; scale economies; network effects; entrenched preferences for established brands; or control of patents. A merger that increases barriers to entry, including by requiring rivals to incur additional entry costs, can entrench a dominant position.[63] Several specific entry barriers are discussed below in B-D.

B. *Increasing Switching Costs.* The costs associated with changing suppliers (often referred to as switching costs) are an important barrier to entry that can entrench a dominant position. A merger may increase switching costs if it makes it more difficult for customers to switch away from the dominant firm's product or service, such as by enabling the bundling of multiple products or services together. A merger may also increase switching costs if it gives the dominant firm control of something customers use to switch providers, such as a data transfer service.

C. *Interfering With Use of Competitive Alternatives.* A dominant position may be threatened by a service that customers use to work with multiple providers of similar or overlapping bundles of products and services. If an already dominant firm acquires a firm that provides a service that supports the use of multiple providers, it may have an incentive to degrade the utility or availability of that service, or to modify the service to steer customers to its own products, entrenching its dominant position.

D. *Depriving Rivals of Scale Economies or Network Effects.* Scale economies and network effects can serve as a barrier to entry. Depriving rivals of access to scale economies and network effects can therefore entrench a dominant position. If an already dominant firm acquires by merger additional scale or customers such that they are not available to would-be rivals, the merger can limit the ability of rivals to improve their own products and compete more effectively.

E. *Eliminating a nascent competitive threat.* A nascent threat to a dominant firm is a firm that could grow into a significant rival, facilitate other rivals' growth, or otherwise lead to a reduction in dominance. In assessing a merger that eliminates a nascent threat, the Agencies examine the merger's tendency to create a monopoly under Section 7 of the Clayton Act.

In addition to these examples, the Agencies will assess whether the merger entrenches a dominant position in any other way based on the market realities specific to the merger.

At times, high entry barriers can become temporarily less effective in protecting a firm's dominance. For example, technological transitions can render existing entry barriers less relevant, and a dominant firm might seek to acquire firms to help it reinforce or recreate those entry barriers so that its dominance endures past the technological transition. Further, technological transitions can create temporary opportunities for entrants to differentiate based on their alignment with new technologies. A dominant firm might seek to acquire firms that might

[63] *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 578 (1967) (a merger "may substantially reduce the competitive structure of the industry by raising entry barriers and by dissuading the smaller firms from aggressively competing").

otherwise gain sufficient customers to overcome entry barriers. The Agencies take particular care to preserve opportunities for deconcentration during technological shifts.

Separate from and in addition to its Section 7 analysis, the Agencies will consider whether the merger violates Section 2 of the Sherman Act. For example, under Section 2 of the Sherman Act, a firm that may challenge a monopolist may be characterized as a "nascent threat" even if the impending threat is uncertain and may take several years to materialize.[64] The Agencies assess whether the merger is reasonably capable of contributing significantly to the preservation of monopoly power in violation of Section 2, which turns on whether the acquired firm is a nascent competitive threat.[65]

Extending a Dominant Position into a Related Market. The Agencies also examine the risk that a merger could enable the merged firm to extend a dominant position from one market into a related market, thereby substantially lessening competition in the related market. For example, the merger might lead the merged firm to leverage its position by tying, bundling, conditioning, or otherwise linking sales of two products, excluding rival firms and ultimately substantially lessening competition in the related market.[66] The Agencies will not attempt to assess whether such tying, bundling, conditioning, or other linkage of the two products would itself violate any law, but instead will assess whether such conduct, if it were to occur, may tend to extend the firm's dominant position.

8. Mergers Should Not Further a Trend Toward Concentration.

The effect of a merger may be substantially to lessen competition or to tend to create a monopoly if it contributes to a trend toward concentration. The Clayton Act "was designed to arrest mergers 'at a time when the trend to a lessening of competition in a line of commerce is still in its incipiency.'"[67] The Supreme Court has therefore "adopt[ed] an approach to a determination of a 'substantial' lessening of competition [that] allow[s] the Government to rest its case on a showing of even small increases of market share or market concentration in those industries or markets where concentration is already great or has been recently increasing."[68] Guideline 1 explains how the Agencies consider mergers in, or resulting in, highly concentrated markets. If concentration "has been recently increasing," the Agencies examine whether the merger would further that trend toward concentration.

The Agencies look for two factors that together indicate a merger would further a trend toward concentration sufficiently that it may substantially lessen competition.

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[64] *United States v. Microsoft Corp.*, 253 F.3d 34, 79 (D.C. Cir. 2001) (en banc) (per curiam) ("[I]t would be inimical to the purpose of the Sherman Act to allow monopolists free reign to squash nascent, albeit unproven, competitors at will[.]")
[65] *See id.* at 79.
[66] *Ford Motor Co. v. United States*, 405 U.S. 562, 571 (1972) (condemning an acquisition by a dominant firm with the incentive to create and maintain barriers to entry into target's market).
[67] *United States v. Marine Bancorp.*, 417 U.S. 602, 622 (1974) (*quoting Brown Shoe*, 370 U.S. at 317).
[68] *Gen. Dynamics*, 415 U.S. at 497-98 nn. 7-8 (1974) (*citing United States v. Continental Can Co.*, 378 U.S. 441, 458 (1974); *United States v. Pabst Brewing Co.*, 384 U.S. 546, 550-552 (1966) and explaining that evidence of trend toward concentration "would…have sufficed to support a finding of undue concentration in the absence of other considerations.").

First, the Agencies consider whether the merger would occur in a market or industry sector where there is a significant tendency toward concentration. That trend may be toward horizontal concentration, or it may be a "trend toward vertical integration" that would ultimately result in the "foreclosure of independent manufacturers from markets otherwise open to them."[69] (See Guideline 6). That trend can be established by market structure, for example as a steadily increasing HHI exceeds 1,000 and rises toward 1,800. Or it can be reflected in other market characteristics, such as the exit of significant players or other factors driving concentration.[70]

Second, the Agencies examine whether the merger would increase the existing level of concentration or the pace of that trend. That may be established by a significant increase in concentration, such as a change in HHI greater than 200, or it may be established by other facts showing the merger would increase the pace of concentration.

9. When a Merger is Part of a Series of Multiple Acquisitions, the Agencies May Examine the Whole Series.

A firm that engages in an anticompetitive pattern or strategy of multiple small acquisitions in the same or related business lines may violate Section 7, even if no single acquisition on its own would risk substantially lessening competition or tending to create a monopoly.[71] In these situations, the Agencies may evaluate the series of acquisitions as part of an industry trend (Guideline 8) or evaluate the overall pattern or strategy of serial acquisitions by the acquiring firm under Guidelines 1-7.

In expanding antitrust law beyond the Sherman Act through passage of the Clayton Act, Congress intended "to permit intervention in a cumulative process when the effect of an acquisition may be a significant reduction in the vigor of competition, even though this effect may not be so far-reaching as to amount to a combination in restraint of trade, create a monopoly, or constitute an attempt to monopolize."[72] As the Supreme Court has recognized, a cumulative series of mergers can "convert an industry from one of intense competition among many enterprises to one in which three or four large [companies] produce the entire supply."[73] Accordingly, the Agencies will consider individual acquisitions in light of the cumulative effect of related patterns or business strategies.

The Agencies may examine a pattern or strategy of growth through acquisition by examining both the firm's history and current or future strategic incentives. Historical evidence focuses on the actual acquisition practices (consummated or not) of the firm, both in the markets at issue and in other markets, to reveal any overall strategic approach to serial acquisitions. Evidence of the firm's current incentives includes documents and testimony reflecting its plans

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[69] *Brown Shoe*, 370 U.S. at 332.
[70] *See United States v. Pabst Brewing Co.*, 384 U.S. 546, 550-552 (1966).
[71] Such strategies may also violate Section 2 of the Sherman Act and Section 5 of the FTC Act. Fed. Trade Comm'n, *Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act* at 12-14 nn.73, 82 (Nov. 10, 2022) (noting that "a series of acquisitions that tend to bring about the harm that the antitrust laws were designed to prevent . . . " have been subject to liability under Section 5).
[72] H.R. Rep. No. 1191, 81st Cong., 2d Sess. 12-13 (1950).
[73] *See Brown Shoe*, 370 U.S. at 334 (1962) (citing S.Rep. No. 1775, 81st Cong., 2d Sess. 5, U.S. Code Cong. and Adm. News 1950, p. 4297.61; H.R.Rep. No. 1191, 81st Cong., 1st Sess. 8).

and strategic incentives both for the individual acquisition and for its position in the industry more broadly. Where one or both of the merging parties has engaged in a pattern or strategy of pursuing consolidation through acquisition, the Agencies will examine the impact of the cumulative strategy under any of the other Guidelines to determine if that strategy may substantially lessen competition or tend to create a monopoly.

10. When a Merger Involves a Multi-Sided Platform, the Agencies Examine Competition Between Platforms, on a Platform, or to Displace a Platform.

Platforms provide different products or services to two or more different groups or "sides" who may benefit from each other's participation. Mergers involving platforms can give rise to competitive problems, even when a firm merging with the platform has a relationship to the platform that is not strictly horizontal or vertical. When evaluating a merger involving a platform, the Agencies apply Guidelines 1-8 while accounting for market realities associated with platform competition. Specifically, the Agencies consider competition *between* platforms, competition *on* a platform, and competition to *displace* the platform.

Multi-sided platforms generally have several attributes in common, though they can also vary in important ways. Some of these attributes include:

A. Platforms have multiple sides. On each side of a platform, platform participants provide or use distinct products and services.[74] Participants can provide or use different types of products or services on each side.

B. A platform operator provides the core services that enable the platform to connect participant groups across multiple sides. The platform operator controls other participants' access to the platform and can influence how interactions among platform participants play out.

C. Platform participants comprise each side of a platform. Their participation might be as simple as using the platform to find other participants, or as involved as building platform services that enable participants to connect in new ways and allow new participants to join the platform.

D. Network effects occur when platform participants contribute to the value of the platform for other participants and the operator. The value for groups of participants on one side may depend on the number of participants either on the same side (direct network effects) or on the other side(s) (indirect network effects).[75] Network effects can create a tendency toward concentration in platform industries. Indirect network effects can be asymmetric and heterogeneous; for example, one side of the market or segment of participants may place relatively greater value on the other side(s).

[74] For example, on 1990s operating-system platforms for personal computer (PC) software, software developers were on one side, PC manufacturers on another, and software purchasers on another.
[75] For example, 1990s PC manufacturers, software developers, and consumers all contributed to the value of the operating system platform for one another.

E. A conflict of interest may arise when a platform operator is also a platform participant. The conflict of interest stems from the operator's interest in operating the platform as a forum for competition and its interest in winning competition on it.

Consistent with the Clayton Act's protection of competition "in any line of commerce," the Agencies will seek to prohibit a merger that harms competition within a relevant market for any product or service offered on a platform to any group of participants—i.e., around one side of the platform (see Section III, Market Definition).[76]

The Agencies protect competition *between* platforms by preventing the acquisition or exclusion of other platform operators that may substantially lessen competition or tend to create a monopoly. This scenario can arise from various types of mergers:

A. Mergers involving two platform operators eliminate the competition between them. In a market with a dominant platform, entry or growth by smaller competing platforms can be particularly challenging because of network effects. A common strategy for smaller platforms is to specialize, providing distinctive features. Thus, dominant platforms can lessen competition and entrench their position by systematically acquiring platforms while they are in their infancy. The Agencies seek to stop these trends in their incipiency.

B. A platform operator may acquire a platform participant, which can entrench the operator's position by depriving rivals of participants and, in turn, depriving them of network effects. For example, acquiring a major seller on a platform may make it harder for rival platforms to recruit buyers. The long-run benefits to a platform operator of denying network effects to rival platforms create a powerful incentive to withhold or degrade those rivals' access to platform participants that the operator acquires. The more powerful the platform operator, the greater the threat to competition presented by mergers that may weaken rival operators or increase barriers to entry and expansion.

C. Acquisitions of firms that provide services that facilitate participation on multiple platforms can deprive rivals of platform participants. Many services can facilitate such participation, such as tools that help shoppers compare prices across platforms, applications that help sellers manage listings on multiple platforms, or software that helps users switch among platforms.

D. Mergers that involve firms that provide other important inputs to platform services can enable the platform operator to deny rivals the benefits of those inputs. For example,

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[76] In the limited scenario of a "special type of two-sided platform known as a 'transaction' platform," under the Sherman Act, *Ohio v. Am. Express*, 138 S. Ct. 2274, 2280 (2018), a relevant market encompassing both sides of a two-sided platform may be warranted. *Id.* Simultaneous transaction platforms have the "key feature…that they cannot make a sale to one side of the platform without simultaneously making a sale to the other." *Id.* Because "they cannot sell transaction services to [either user group] individually…transaction platforms are better understood as supplying only one product—transactions." *Id.* at 2286. This characteristic is not present for many types of two-sided or multi-sided platforms; in addition, many platforms offer simultaneous transactions as well as other products and services, and further they may bundle these products with access to transact on the platform or offer quantity discounts. Even for simultaneous transaction platforms, non-price evidence such as a change in market structure (see Guideline 1) or a loss of competition between the merging firms (see Guideline 2) can still indicate that a merger may substantially lessen competition in a line of commerce for purposes of the Clayton Act.

acquiring data that helps facilitate matching, sorting, or prediction services may enable the platform to weaken rival platforms by denying them that data.

The Agencies protect competition *on* a platform in any markets that interact with the platform. When a merger involves a platform operator and platform participants, the Agencies carefully examine whether the merger would create conflicts of interest that would harm competition. A platform operator that is also a platform participant has a conflict of interest from the incentive to give its own products and services an advantage against other competitors participating on the platform, harming competition in the product market for that product or service. This problem is exacerbated when discrimination in favor of a product or service would reduce access to distribution for rivals in the participants' market and deprive rivals of network effects in the platform market, both extending and entrenching a dominant position.

The Agencies protect competition to *displace* the platform or any of its services. For example, new technologies or services may create an important opportunity for firms to replace one or more services the incumbent platform operator provides, shifting some participants to partially or fully meet their needs in different ways or through different channels. Similarly, a non-platform service can lessen dependence on the platform by providing an alternative to one or more functions provided by the platform operators. When platform owners are dominant, the Agencies seek to prevent even relatively small accretions of power from inhibiting the prospects for displacing the platform or for decreasing dependency on the platform.

11. When a Merger Involves Competing Buyers, the Agencies Examine Whether It May Substantially Lessen Competition for Workers or Other Sellers.

A merger between competing buyers may harm sellers just as a merger between competing sellers may harm buyers.[77] The same—or analogous—tools used to assess the effects of a merger of sellers can be used to analyze the effects of a merger of buyers, including employers as buyers of labor. A merger of competing buyers can substantially lessen competition by eliminating the competition between the merging buyers or by increasing coordination among the remaining buyers. It can likewise lead to undue concentration among buyers, accelerate a trend towards undue concentration, or entrench or extend the position of a dominant buyer. Competition among buyers can have a variety of beneficial effects analogous to competition among sellers. For example, buyers may compete by expanding supply networks, through transparent and predictable contracting, procurement, and payment practices, or by investing in technology that reduces frictions for suppliers. In contrast, a reduction in competition among buyers can lead to artificially suppressed input prices or purchase volume, which in turn reduces incentives for suppliers to invest in capacity or innovation. The level of concentration at which competition concerns arise may be lower in buyer markets than in seller markets, given the unique features of certain buyer markets.

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[77] *See, e.g.*, *Mandeville Island Farms, Inc. v. Am. Crystal Sugar Co.*, 334 U.S. 219, 235-36 (1948) (in the Sherman Act context noting that "[t]he statute does not confine its protection to consumers, or to purchasers, or to competitors, or to sellers.… The Act is comprehensive in its terms and coverage, protecting all who are made victims of the forbidden practices by whomever they may be perpetrated.").

Labor markets are important buyer markets. The same general concerns as in other markets apply to labor markets where employers are the buyers of labor and workers are the sellers. The Agencies will consider whether workers face a risk that the merger may substantially lessen competition for their labor.[78] Where a merger between employers may substantially lessen competition for workers, that reduction in labor market competition may lower wages or slow wage growth, worsen benefits or working conditions, or result in other degradations of workplace quality. When assessing the degree to which the merging firms compete for labor, any one or more of these effects may demonstrate that substantial competition exists between the merging firms.

Labor markets frequently have characteristics that can exacerbate the competitive effects of a merger between competing employers. For example, labor markets often exhibit high switching costs and search frictions due to the process of finding, applying, interviewing for, and acclimating to, a new job. Switching costs can also arise from investments specific to a type of job or a particular geographic location. Moreover, the individual needs of workers may limit the geographical and work scope of the jobs that are competitive substitutes.

In addition, finding a job requires the worker and the employer to agree to the match. Even within a given salary and skill range, employers often have specific demands for the experience, skills, availability, and other attributes they desire in their employees. At the same time, workers may seek not only a paycheck but also work that they value in a workplace that matches their own preferences, as different workers may value the same aspects of a job differently. This matching process often narrows the range of rivals competing for any given employee.

In light of their characteristics, labor markets are often relatively narrow.

The features of labor markets may in some cases put firms in dominant positions. To assess this dominance in labor markets (see Guideline 7), the Agencies often examine the merging firms' power to cut or freeze wages, exercise increased leverage in negotiations with workers, or generally degrade benefits and working conditions without prompting workers to quit.

If the merger may substantially lessen competition or tend to create a monopoly in upstream markets, that loss of competition is not offset by purported benefits in a separate downstream product market. Because the Clayton Act prohibits mergers that may substantially lessen competition or tend to create a monopoly in *any* line of commerce and in *any* section of the country, a merger's harm to competition among buyers is not saved by benefits to competition among sellers.[79] That is, a merger can substantially lessen competition in one or

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[78] *See, e.g., NCAA v. Alston*, 141 S. Ct. 2141 (2021) (applying the Sherman Act to protect workers from an employer-side agreement to limit compensation).

[79] *Brown Shoe*, 370 U.S. at 325 ("Because § 7 of the Clayton Act prohibits any merger which may substantially lessen competition 'in *any* line of commerce' (emphasis supplied), it is necessary to examine the effects of a merger in each such economically significant submarket to determine if there is a reasonable probability that the merger will substantially lessen competition. If such a probability is found to exist, the merger is proscribed.").

more buyer markets, seller markets, or both, and the Clayton Act protects competition in any one of them.

Just as they do when analyzing competition in the markets for products and services, the Agencies will analyze labor market competition on a case-by-case basis.

12. When an Acquisition Involves Partial Ownership or Minority Interests, the Agencies Examine Its Impact on Competition.

In many acquisitions, two companies come under common control. In some situations, however, the acquisition of less-than-full control may still influence decision-making at the target firm or another firm in ways that may substantially lessen competition. Acquisitions of partial ownership or other minority interests may give the investor rights in the target firm, such as rights to appoint board members, observe board meetings, veto the firm's ability to raise capital, or impact operational decisions, or access to competitively sensitive information. The Agencies have concerns with both cross-ownership, which refers to holding a non-controlling interest in a competitor, as well as common ownership, which occurs when individual investors hold non-controlling interests in firms that have a competitive relationship that could be affected by those joint holdings.

Partial acquisitions that do not result in control may nevertheless present significant competitive concerns. The acquisition of a minority position may permit influence of the target firm, implicate strategic decisions of the acquirer with respect to its investment in other firms, or change incentives so as to otherwise dampen competition. The post-acquisition relationship between the parties and the independent incentives of the parties outside the acquisition may be important in determining whether the partial acquisition may substantially lessen competition. Such partial acquisitions are subject to the same legal standard as any other acquisition.[80]

While the Agencies will consider any way in which a partial acquisition may affect competition, they generally focus on three principal effects:

First, a partial acquisition can lessen competition by giving the partial owner the ability to influence the competitive conduct of the target firm.[81] For example, a voting interest in the target firm or specific governance rights, such as the right to appoint members to the board of directors, influence capital budgets, determine investment return thresholds, or select particular managers, can create such influence. Additionally, a nonvoting interest may, in some instances, provide opportunities to prevent, delay, or discourage important competitive initiatives, or otherwise impact competitive decision making. Such influence can lessen competition because the partial owner could use its influence to induce the target firm to compete less aggressively or to coordinate its conduct with that of the acquiring firm.

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[80] *See United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 592 (1957) ("[A]ny acquisition by one corporation of all or any part of the stock of another corporation, competitor or not, is within the reach of [Section 7 of the Clayton Act] whenever the reasonable likelihood appears that the acquisition will result in a restraint of commerce or in the creation of a monopoly of any line of commerce.").

[81] *See United States v. Dairy Farmers of Am., Inc.*, 426 F.3d 850, 860–61 (6th Cir. 2005).

Second, a partial acquisition can lessen competition by reducing the incentive of the acquiring firm to compete.[82] Acquiring a minority position in a rival might blunt the incentive of the partial owner to compete aggressively because it may profit through dividend or other revenue share even when it loses business to the rival. For example, the partial owner may decide not to develop a new product feature to win market share from the firm in which it has acquired an interest, because doing so will reduce the value of its investment in its rival. This reduction in the incentive of the acquiring firm to compete arises even when it cannot directly influence the conduct or decision making of the target firm.

Third, a partial acquisition can lessen competition by giving the acquiring firm access to non-public, competitively sensitive information from the target firm. Even absent any ability to influence the conduct of the target firm, access to competitively sensitive information can substantially lessen competition through other mechanisms. For example, it can enhance the ability of the target and the partial owner to coordinate their behavior and make other accommodating responses faster and more targeted. The risk of coordinated effects is greater if the transaction also facilitates the flow of competitively sensitive information from the investor to the target firm. Even if coordination does not occur, the partial owner may use that information to preempt or appropriate a rival's competitive business strategies for its own benefit. If rivals know their efforts to win trading partners can be immediately appropriated, they may see less value in taking competitive actions in the first place, resulting in a lessening of competition.

13. Mergers Should Not Otherwise Substantially Lessen Competition or Tend to Create a Monopoly.

The analyses above address common scenarios that the Agencies use to assess the risk that a merger may substantially lessen competition or tend to create a monopoly. However, they are not exhaustive. The Agencies have in the past encountered mergers that lessen competition through mechanisms not covered above. For example:

A. A merger that would enable firms to avoid a regulatory constraint because that constraint was applicable to only one of the merging firms;

B. A merger that would enable firms to exploit a unique procurement process that favors the bids of a particular competitor who would be acquired in the merger; or

C. In a concentrated market, a merger that would dampen the acquired firm's incentive or ability to compete due to the structure of the acquisition or the acquirer.

As these scenarios and these Guidelines indicate, a wide range of evidence can show that a merger may lessen competition or tend to create a monopoly. Whatever the sources of evidence, the Agencies look to the facts and the law in each case.

[82] *See Denver & Rio Grande v. United States*, 387 U.S. 485, 504 (1967) (identifying Section 7 concerns with 20% investment).

III. Market Definition

The Clayton Act protects competition "in any line of commerce in any section of the country."[83] The Agencies identify the "area of effective competition" in which competition may be lessened "with reference to a product market (the 'line of commerce') and a geographic market (the 'section of the country.')."[84] The Agencies refer to the process of identifying market(s) protected by the Clayton Act as a "market definition" exercise and the markets so defined as "relevant antitrust markets." Market definition can also allow the Agencies to identify market participants and measure market shares and market concentration.

A relevant antitrust market is an area of effective competition, comprising both product (or service) and geographic elements. The outer boundaries of a relevant product market are determined by the "reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it."[85] Within a broad relevant market, however, effective competition often occurs in numerous narrower relevant markets.[86] Market definition ensures that antitrust markets are sufficiently broad, but it does not lead to a single relevant market. Section 7 of the Clayton Act prohibits any merger which may substantially lessen competition "in any line of commerce" and in "any section of the country" and the Agencies protect competition by challenging a merger that may lessen competition in any one or more relevant markets.

Market participants often encounter a range of possible substitutes for the products of the merging firms. However, a relevant market "cannot meaningfully encompass that infinite range" of substitutes.[87] There may be effective competition among a narrow group of products, and the loss of that competition may be harmful, making the narrow group a relevant market, even if competitive constraints from significant substitutes are outside the group. The loss of both the competition between the narrow group of products and the significant substitutes outside that group may be even more harmful, but that does not prevent the narrow group from being a market in its own right.

Relevant markets need not have "precise 'metes and bounds.'"[88] Some substitutes may be closer, and others more distant, and defining a market necessarily requires including some substitutes and excluding others. Defining a relevant market sometimes requires a line drawing exercise around product features, such as size, quality, distances, customer segment, or prices. There can be many places to draw that line and properly define a relevant market. The Agencies recognize that such scenarios are common, and indeed "fuzziness would seem inherent in any

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[83] 15 U.S.C. § 18.
[84] *Brown Shoe*, 370 U.S. at 324.
[85] *Brown Shoe*, 370 U.S. at 325.
[86] *Id*. ("[W]ithin [a] broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes"). Multiple overlapping markets can be appropriately defined relevant markets. For example, a merger to monopoly for food worldwide would lessen competition in well-defined relevant markets for, among others, food, baked goods, cookies, low-fat cookies, and premium low-fat chocolate chip cookies. Illegality in any of these in any city or town comprising a relevant geographic market would suffice to prohibit the merger.
[87] *United States v. Cont'l Can Co.*, 378 U.S. 441, 449 (1964).
[88] *United States v. Gen. Dynamics Corp.* 415 U.S. 486, 521 (1974).

attempt to delineate the relevant…market."[89] Market participants may use the term "market" colloquially to refer to a broader or different set of products than those that would be needed to constitute a valid antitrust market.

The Agencies rely on several tools to demonstrate that a market is a relevant antitrust market. For example, the Agencies may rely on any one or more of the following to demonstrate the validity of a candidate relevant antitrust market.

A. Direct evidence of substantial competition between the merging parties can demonstrate that a relevant market exists in which the merger may substantially lessen competition and can be sufficient to identify the line of commerce and section of the country affected by a merger, even if the precise metes and bounds of the market are not specified. (See Guideline 2).

B. Direct evidence of the exercise of market power can demonstrate a relevant market in which that power exists. This evidence can be valuable when assessing the risk that a dominant position may be entrenched, maintained, or extended, since the same evidence identifies market power and the rough contours of the relevant market.

C. A relevant market can be identified from evidence on observed market characteristics ("practical indicia"), such as "industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors."[90] Various practical indicia may identify a relevant market in different settings.

D. Another "common method employed by courts and the [Agencies]…is the hypothetical monopolist test."[91] This test examines whether a proposed market is too narrow by asking whether a hypothetical monopolist over this market could profitably worsen terms significantly, for example, by raising price. An analogous hypothetical monopsonist test applies when considering the impact of a merger on competition among buyers. Appendix 3 describes this test in more detail.

The Agencies use these tools to define relevant markets because they each leverage commercial realities to identify an area of effective competition.

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[89] *Phila. Nat'l Bank*, 374 U.S. at 360 n.37.

[90] *Brown Shoe*, 370 U.S. at 325, *quoted in United States v. U.S. Sugar Corp.*, No. 22-2806, slip op. at 11, 13-14 (3d Cir. July 13, 2023) (affirming district court's application of *Brown Shoe* practical indicia to evaluate relevant product market that included, based on the unique facts of the industry, those distributors who "could counteract monopolistic restrictions by releasing their own supplies.").

[91] *FTC v. Penn State Hershey Med. Center*, 838 F.3d 327 (3d Cir. 2016). While these guidelines focus on applying the hypothetical monopolist test in analyzing mergers, the test can be adapted for similar purposes in cases involving alleged monopolization or other conduct. *See, e.g.*, *McWane, Inc. v. FTC*, 783 F.3d 814, 829-30 (11th Cir. 2015).

IV. Rebuttal Evidence Showing that No Substantial Lessening of Competition is Threatened by the Merger.

The Agencies may assess whether a merger may substantially lessen competition or tend to create a monopoly based on a fact-specific analysis under any one or more of the Guidelines discussed above.[92] Supreme Court precedent also examines whether "other pertinent factors" presented by the merging parties nonetheless "mandate[] a conclusion that no substantial lessening of competition [is] threatened by the acquisition."[93]

Several types of rebuttal and defense evidence are subject to legal tests established by the courts. The Agencies apply those tests consistent with prevailing law, as described below.

1. Failing Firms

When merging parties suggest the weak or weakening financial position of one of the merging parties will prevent a lessening of competition, the Agencies examine that evidence under the "failing firm" defense established by the Supreme Court. This defense applies when the assets to be acquired would imminently cease playing a competitive role in the market even absent the merger.

As set forth by the Supreme Court, the failing firm defense has three requirements:

A. "[T]he evidence show[s] that the [failing firm] face[s] the grave probability of a business failure."[94] The Agencies typically look for evidence in support of this element that the allegedly failing firm would be unable to meet its financial obligations in the near future. Declining sales and/or net losses, standing alone, are insufficient to show this requirement.

B. "The prospects of reorganization of [the failing firm are] dim or nonexistent."[95] The Agencies typically look for evidence suggesting that the failing firm would be unable to reorganize successfully under Chapter 11 of the Bankruptcy Act, taking into account that "companies reorganized through receivership, or through [the Bankruptcy Act] often emerge[] as strong competitive companies."[96] Evidence of the firm's actual attempts to resolve its debt with creditors is important.

C. "[T]he company that acquires the failing [firm] or brings it under dominion is the only available purchaser."[97] The Agencies typically look for evidence that a company

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[92] *See United States v. AT&T, Inc.*, 916 F.3d 1029, 1032 (D.C. Cir. 2019) (either "short cut" market-concentration presumption or "fact-specific showing" sufficient to establish prima facie case of Section 7 violation).
[93] *See Gen. Dynamics*, 415 U.S. 486, 498 (1974); *United States v. Baker Hughes*, 908 F.2d 981, 990 (D.C. Cir. 1990) (quoting *General Dynamics* and describing its holding as permitting rebuttal based on a "finding that 'no substantial lessening of competition occurred or was threatened by the acquisition'").
[94] *Citizen Publ'g Co. v. United States*, 394 U.S. 131, 138 (1969).
[95] *Citizen Publ'g*, 394 U.S. at 138.
[96] *Id*.
[97] *Id.* at 136-39 (1969) (quoting *Int'l Shoe Co. v. FTC*, 280 U.S. 291, 302 (1930)).

has made unsuccessful good-faith efforts to elicit reasonable alternative offers that pose a less severe danger to competition than does the proposed merger.[98]

Although merging parties sometimes argue that a poor or weakening position should serve as a defense even when it does not meet these elements, the Supreme Court has "confine[d] the failing company doctrine to its present narrow scope."[99] The Agencies evaluate evidence of a failing firm consistent with this prevailing law.[100]

2. Entry and Repositioning

Merging parties sometimes raise a rebuttal claiming that a reduction in competition resulting from the merger would induce entry into the relevant market, preventing the merger from substantially lessening competition in the first place. This claim posits that a merger may, by substantially lessening competition, make the market more profitable for the merged firm and any remaining competitors, and that this increased profitability may induce new entry. To evaluate this rebuttal evidence, the Agencies assess whether entry induced by the merger would be "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern."[101]

A. ***Timeliness.*** To show that no substantial lessening of competition is threatened by a merger, entry must be rapid enough to replace lost competition before any effect from the loss of competition due to the merger may occur. Entry in most industries takes a significant amount of time and is therefore insufficient to counteract any substantial lessening of competition that is threatened by a merger. Moreover, the entry must be durable: an entrant that does not plan to sustain its investment or that may exit the market would not ensure long-term preservation of competition.

B. ***Likelihood.*** Entry induced by lost competition must be so likely that no substantial lessening of competition is threatened by the merger. Firms make entry decisions based on the market conditions they expect once they participate in the market. If the new entry is sufficient to counteract the merger's effect on competition, the Agencies analyze why the merger would induce entry that was not planned in pre-merger competitive conditions.

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[98] Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Parties must solicit reasonable alternative offers before claiming that the business is failing. Liquidation value is the highest value the assets could command outside the market. If a reasonable alternative offer was rejected, the parties cannot claim that the business is failing.

[99] *Citizen Publ'g Co. v. United States*, 394 U.S. at 139.

[100] The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill; and (2) the owner of the failing division has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its assets in the relevant market and pose a less severe danger to competition than does the proposed acquisition. Because firms can allocate costs, revenues, and intra-company transactions among their subsidiaries and divisions, the Agencies require evidence that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.

[101] *FTC v. Sanford Health*, 926 F.3d 959, 965 (8th Cir. 2019).

The Agencies also assess whether the merger may increase entry barriers. For example, the merging firms may have a greater ability to discourage or block new entry when combined than they would have as separate firms. Mergers may enable or incentivize unilateral or coordinated exclusionary strategies that make entry more difficult. Entry can be particularly challenging when a firm must enter at multiple levels of the market at sufficient scale to compete effectively.

C. ***Sufficiency.*** Even where timely and likely, the prospect of entry may not effectively prevent a merger from threatening a substantial lessening of competition. Entry may be insufficient due to a wide variety of constraints that limit an entrant's effectiveness as a competitor. Entry must at least replicate the scale, strength, and durability of one of the merging parties to be considered sufficient. The Agencies typically do not credit entry that depends on lessening competition in other markets.

As part of their analysis, the Agencies will consider the economic realities at play. For example, lack of successful entry in the past will likely suggest that entry may be slow or difficult. Recent examples of entry, whether successful or unsuccessful, provide the starting point for identifying the elements of practical entry barriers and the features of the industry that facilitate or interfere with entry.

3. Procompetitive Efficiencies

The Supreme Court has held that "possible economies [from a merger] cannot be used as a defense to illegality."[102] Competition usually spurs firms to achieve efficiencies internally, and Congress and the courts have indicated their preference for internal efficiencies and organic growth. Firms also often work together using contracts short of a merger to combine complementary assets without the full anticompetitive consequences of a merger.

Merging parties sometimes raise a rebuttal argument that, notwithstanding other evidence that competition may be lessened, evidence of procompetitive efficiencies shows that no substantial lessening of competition is in fact threatened by the merger. When assessing this argument, the Agencies will not credit vague or speculative claims, nor will they credit benefits outside the relevant market.[103] Rather, the Agencies examine whether the evidence[104] presented by the merging parties shows each of the following:

A. ***Merger Specificity***. The merger will produce substantial competitive benefits that could not be achieved without the merger under review.[105] Alternative ways of achieving the claimed benefits are considered in making this determination.

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[102] *Phila. Nat'l Bank*, 374 U.S. at 371; *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 580 (1967) ("Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition.").

[103] *Miss. River Corp. v. FTC*, 454 F.2d 1083, 1089 (8th Cir. 1972) ("[T]he anticompetitive effects of an acquisition in one market cannot be justified by procompetitive effects in another market. Honest intentions, business purposes and economic benefits are not a defense to violations of an antimerger law.").

[104] In general, evidence related to efficiencies developed prior to the merger challenge is much more probative than evidence developed during the Agencies' investigation or litigation.

[105] If inter-firm collaborations are achievable by contract, they are not merger specific. The Agencies will credit the merger specificity of efficiencies only in the presence of identified barriers to achieving them by contract.

Alternative arrangements could include organic growth of one of the merging firms, contracts between them, mergers with others, or a partial merger involving only those assets that give rise to the procompetitive efficiencies.

B. ***Verifiability.*** These benefits are verifiable, and have been verified, using reliable methodology and evidence not dependent on the subjective predictions of the merging parties or their agents. Procompetitive efficiencies are often speculative and difficult to verify and quantify, and efficiencies projected by the merging firms often are not realized. If reliable methodology for verifying efficiencies does not exist or is otherwise not presented by the merging parties, the Agencies are unable to credit those efficiencies.

C. ***Pass Through to Prevent a Reduction in Competition.*** To the extent efficiencies merely benefit the merging firms, they are not cognizable. The merging parties must show that, within a short period of time, the benefits will improve competition in the relevant market or prevent the threat that it may be lessened.

D. ***Procompetitive.*** Any benefits claimed by the merging parties are cognizable only if they do not result from the anticompetitive worsening of terms for the merged firm's trading partners.[106] Similarly, efficiencies are not cognizable if they will accelerate a trend toward concentration (see Guideline 8) or vertical integration (see Guideline 6).

Procompetitive efficiencies that satisfy each of these criteria are called cognizable efficiencies. To overcome evidence that a merger may substantially lessen competition, cognizable efficiencies must be of sufficient magnitude and likelihood that no substantial lessening of competition is threatened by the merger in any relevant market. Cognizable efficiencies that would not prevent the creation of a monopoly cannot justify a merger that may tend to create a monopoly.

4. Structural Barriers to Coordination Unique to the Industry

When market structure evidence suggests that a merger may substantially lessen competition through coordination (Guidelines 1 and 3), the merging parties sometimes argue that anticompetitive coordination is nonetheless impossible due to structural market barriers to coordinating. The Agencies consider whether structural market barriers to coordination are "so much greater in the [relevant] industry than in other industries that they rebut the normal presumption" of coordinated effects.[107] In the Agencies' experience, structural conditions that prevent coordination are exceedingly rare in the modern economy. The greater the level of concentration in the relevant market, the greater must be the structural barriers to coordination in order to show that no substantial lessening of competition is threatened.

[106] The Agencies will not credit efficiencies if they reflect or require a decrease in competition in a separate market. For example, if input costs are expected to decrease, the cost savings will not be treated as an efficiency if they reflect an increase in monopsony power.

[107] *See FTC v. H.J. Heinz, Co.*, 246 F.3d 708, 725 (D.C. Cir. 2001).

Appendix 1: Sources of Evidence

This appendix describes the most common sources of evidence the Agencies draw on in a merger investigation. The evidence the Agencies will rely upon to evaluate whether a merger *may* substantially lessen competition or tend to create a monopoly is weighed based on its probative value. In assessing the available evidence, the Agencies consider documents, testimony, available data, and analysis of those data, including credible econometric analysis and economic modeling.

Merging Parties. The Agencies often obtain substantial information from the merging parties, including documents, testimony, and data. Across all of these categories, evidence created in the normal course of business is more probative than evidence created after the company began anticipating a merger review. Similarly, the Agencies give less weight to predictions by the parties or their employees, whether in the ordinary course of business or in anticipation of litigation, offered to allay competition concerns. Where the testimony of outcome-interested merging party employees contradicts ordinary course business records, the Agencies typically give greater weight to the business records.

Evidence that the merging parties intend or expect the merger to lessen competition, such as plans to coordinate with other firms, raise prices, reduce output or capacity, reduce product quality or variety, lower wages, cut benefits, exit a market, cancel plans to enter a market without a merger, withdraw products or delay their introduction, or curtail research and development efforts after the merger, can be highly informative in evaluating the effects of a merger on competition. The Agencies give little weight, however, to the lack of such evidence or the expressed contrary intent of the merging parties.

Customers, Workers, Industry Participants, and Observers. Customers can provide a variety of information to the Agencies, ranging from information about their own purchasing behavior and choices to their views about the effects of the merger itself. The Agencies consider the relationship between customers and the merging parties in weighing customer evidence. The ongoing business relationship between a customer and a merging party may discourage the customer from providing evidence inconsistent with the interests of the merging parties.

Workers and representatives from labor organizations can provide information regarding, among other things, wages, non-wage compensation, working conditions, the individualized needs of workers in the market in question, the frictions involved in changing jobs, and the industry in which they work.

Similarly, other suppliers, indirect customers, distributors, consultants, and industry analysts can also provide information helpful to a merger inquiry. As with other interested parties, the Agencies give less weight to evidence created in anticipation of a merger investigation and more weight to evidence developed in the ordinary course of business.

Market Effects in Consummated Mergers. Evidence of observed post-merger price increases or worsened terms is given substantial weight. A consummated merger, however, may substantially lessen competition even if such effects have not yet been observed, perhaps because the merged firm may be aware of the possibility of post-merger antitrust review and is therefore moderating its conduct. Consequently, in evaluating consummated mergers, the Agencies also consider the same types of evidence when evaluating proposed mergers.

Econometric Analysis and Economic Modeling. Econometric analysis of data and other types of economic modeling can be informative in evaluating the potential effects of a merger on competition. The Agencies typically give more weight to analysis using high quality data and adhering to rigorous standards. But the Agencies also take into account that in some cases, the availability or quality of data or reliable modeling techniques might limit the availability and relevance of econometric modeling. When data is available, the Agencies recognize that the goal of economic modeling is not to create a perfect representation of reality, but rather to inform an assessment of the likely change in firm incentives resulting from a merger.

Transaction Terms. The financial terms of the transaction may also be informative regarding a merger's impact on competition. For example, a purchase price that exceeds the acquired firm's stand-alone market value can sometimes indicate that the acquiring firm is paying a premium because it expects to be able to benefit from reduced competition.

Appendix 2. Evaluating Competition Between Firms

This appendix discusses evidence and tools the Agencies look to when assessing competition between firms. The evidence and tools in this section can be relevant to a variety of settings, for example: to assess competition between rival firms (Guideline 2); the incentive to reduce or withhold access to a product rivals use to compete (Guideline 5); or for market definition (Section III of these Guidelines), for example when carrying out the Hypothetical Monopolist Test (Appendix 3.A).

For clarity, the discussion in this appendix often focuses on competition between two suppliers of substitute products that set prices. Analogous analytic tools may also be relevant in more general settings, for example when considering: competition between more than two suppliers; competition among buyers or employers to procure inputs and labor; competition that derives from customer willingness to buy in different locations; and competition that takes place in dimensions other than price or when terms are determined through, for example, negotiations or auctions.

Guideline 2 describes how different types of evidence can be used in assessing the potential harm to competition from a merger; some portions of Guideline 2 that are relevant in other settings are repeated below.

A. Generally Applicable Considerations

The Agencies may consider one or more of the following types of evidence, tools, and metrics when assessing the degree of competition among firms:

Strategic Deliberations or Decisions. The Agencies may analyze the extent of competition between the merging firms by examining evidence of their strategic deliberations or decisions in the regular course of business, as well as information considered during the process of deciding whether to merge. For example, in some markets, the firms may monitor each other's pricing, marketing campaigns, facility locations, improvements, products, capacity, output, input costs, and/or innovation plans. This can provide evidence of competition between the merging firms, especially when they react by taking steps to preserve or enhance the competitiveness or profitability of their own products or services.

Prior Merger, Entry, and Exit Events. The Agencies may look to historical events to assess the presence and substantiality of direct competition between the merging firms. For example, the Agencies may examine the impact of recent relevant mergers, entry, expansion, or exit events.

Customer Substitution. Customers' willingness to switch between different firms' products is an important part of the competitive process. Firms are closer competitors the more that customers are willing to switch between their products.

Evidence commonly analyzed to show the extent of substitution among firms' products includes: how customers have shifted purchases in the past in response to relative changes in

price or other terms and conditions; documentary and testimonial evidence such as win/loss reports, evidence from discount approval processes, switching data, customer surveys, as well as information from suppliers of complementary products and distributors; objective information about product characteristics; and market realities affecting the ability of customers to switch.

Impact of Competitive Actions on Rivals. Competitive actions, such as lowering prices or increasing output, by one firm can increase its sales at the expense of its rivals. The Agencies may gauge the extent of competition among firms by considering the impact that competitive actions by one firm have on the others. The impact of a firm's competitive actions on a rival generally depends on how many sales a rival would lose as a result of the competitive actions, as well as the profitability of those lost sales. The Agencies may use margins to measure the profitability of the sale a rival would have made.[1]

Impact of Eliminating Competition Between the Firms. In some instances, evidence may be available to assess the impact of competition from one or more firms on the other firms' actions, such as firm choices about price, quality, wages, or another dimension of competition. This can be gauged by comparing the two firms' actions when they compete and make strategic choices independently, against the actions the firms might choose if they acted jointly. Actual or predicted changes in these results of competition, when available, can indicate the degree of competition between the firms.

To make this type of comparison, the Agencies sometimes rely on economic models. Often, such models consider the firms' incentives to change their actions in one or more selected dimensions, such as price, in a hypothetical, simplified scenario. For example, a model might focus on the firms' short-run incentives to change price, while abstracting from a variety of additional competitive forces and dimensions of competition, such as the potential for firms to reposition their products or for the merging firms to coordinate with other firms. Such a model may incorporate data and evidence in order to produce quantitative estimates of the impact of a loss of competition on firm incentives and corresponding choices. For example, the model may yield a range of estimates of the effect of a merger on short-run prices or output. This type of exercise is sometimes referred to by economists as "merger simulation" despite the fact that the hypothetical setting considers only selected aspects of the loss of competition from a merger. The Agencies use such models to give an indication of the scale and importance of competition, not to precisely predict outcomes.

B. Considerations When Terms Are Set by Firms

The Agencies may use various types of evidence and metrics to assess the strength of competition between firms that offer the same terms to many different customers. Firms might offer different terms to different groups of customers.

[1]The margin on incremental units is the difference between incremental revenue (often equal to price) and incremental cost on those units. The Agencies may use accounting data to measure incremental costs, but do not necessarily rely on accounting margins recorded by firms in the ordinary course of business because such margins often do not align with the concept of incremental cost that is relevant in economic analysis of a merger.

Competition in this setting can lead firms to set lower prices or offer more attractive terms when they act independently than they would in a setting where that competition was eliminated by a merger. When considering the impact of competition on the incentives to set price, to the extent price increases on one firm's products would lead customers to switch to products from the other firm, their merger will enable the merged firm to profit by unilaterally raising the price of one or both products above the pre-merger level. Some of the sales lost because of the price increase will be diverted to the products of the other firm, and capturing the value of these diverted sales can make the price increase profitable even though it would not have been profitable prior to the merger.

A measure of customer substitution between firms in this setting is the diversion ratio. The diversion ratio from one product to another is a metric of how customers likely would substitute between them. The diversion ratio is the fraction of unit sales lost by the first product due to a change in terms, such as an increase in its price that would be diverted to the second product. The higher the diversion ratio between two products made by different firms, the stronger the competition between them.

A high diversion ratio between the products owned by the merging firms can indicate strong competition between them even if the diversion ratio to a non-merging firm is higher. The diversion ratio from one of the products of one firm to a group of products made by other firms, defined analogously, is sometimes referred to as the aggregate diversion ratio or the recapture rate.

A measure of the impact on rivals of competitive actions is the value of diverted sales from a price increase. The value of sales diverted from one firm to a second firm, when the first firm raises its price on one of its products, is equal to the number of units that would be diverted from the first firm to the second, multiplied by the difference between the second firm's price and the incremental cost of the diverted sales. To interpret the magnitude of the value of diverted sales, the Agencies may use as a basis of comparison either the incremental cost to the second firm of making the diverted sales, or the revenues lost by the first firm as a result of the price increase. The ratio of the value of diverted sales to the revenues lost by the first firm can be an indicator of the upward pricing pressure that would result from the loss of competition between the two firms. Analogous concepts can be applied to analyze the impact on rivals of worsening terms other than price.

C. Considerations When Terms Are Set Through Bargaining or Auctions

In some industries, buyers and sellers negotiate prices and other terms of trade. In bargaining, buyers commonly negotiate with more than one seller, and may play competing sellers off against one another. In other industries, sellers might sell their products, or buyers might procure inputs, using an auction. Negotiations may involve aspects of an auction as well as aspects of one-on-one negotiation. Competition among sellers can significantly enhance the ability of a buyer to obtain a result more favorable to it, and less favorable to the sellers, compared to a situation where the elimination of competition through a merger prevents buyers from playing those sellers off against each other in negotiations.

Sellers may compete even when a customer does not directly play their offers against each other. The attractiveness of alternative options influences the importance of reaching an agreement to the negotiating parties and thus the terms of the agreement. A party that has many attractive alternative trading partners places less importance on reaching agreement with any one particular trading partner than a party with few attractive alternatives. As alternatives for one party are eliminated (such as through a merger), the counterparty gains additional bargaining leverage reflecting that loss of competition. A merger between sellers may lessen competition even if the merged firm handles negotiations for the merging firms' products separately.

Thus, qualitative or quantitative evidence about the leverage provided to buyers by competing suppliers may be used to assess the extent of competition among firms in this setting. Analogous evidence may be used when analyzing a setting where terms are set using auctions, for example, procurement auctions where suppliers bid to serve a buyer. If, for some categories of procurements, suppliers are often among the most attractive to the buyer, competition among them is likely to be strong.

Firms sometimes keep records of the progress and outcome of individual sales efforts, and the Agencies may use this data to generate measures of the extent to which customers would likely substitute between the two firms. Examples of such measures might include a diversion ratio based on the rate at which customers would buy from one firm if the other one was not available, or the frequency with which the two firms bid on contracts with the same customer.

D. Considerations When Firms Determine Capacity and Output

In some markets, the choice of how much to produce (output decisions) or how much productive capacity to maintain (capacity decisions) are key strategic variables. When a firm decreases output, it may lose sales to rivals, but also drive up prices. Because a merged firm will account for the impact of higher prices across all of the merged firms' sales, it may have an incentive to decrease output as a result of the merger. The loss of competition through a merger of two firms may lead the merged firm to leave capacity idle, refrain from building or obtaining capacity that would have been obtained absent the merger, lay off or stop hiring workers, or eliminate pre-existing production capabilities. A firm may also divert the use of capacity away from one relevant market and into another market so as to raise the price in the former market. The analysis of the extent to which firms compete may differ depending on how a merger between them might create incentives to suppress output.

Competition between merging firms is greater when (1) the merging firms' market shares are relatively high; (2) the merging firms' products are relatively undifferentiated from each other; (3) the market elasticity of demand is relatively low; (4) the margin on the suppressed output is relatively low; and (5) the supply responses of non-merging rivals are relatively small. Qualitative or quantitative evidence may be used to evaluate and weigh each of these factors.

In some cases, competition between firms—including one firm with a substantial share of the sales in the market and another with significant excess capacity to serve that market—can prevent an output suppression strategy from being profitable. This can occur even if the firm with the excess capacity has a relatively small share of sales, as long as that firm's ability to expand, and thus keep prices from rising, makes an output suppression strategy unprofitable for the firm with the larger market share.

Output or capacity reductions also may affect the market's resilience in the face of future shocks to supply or demand, and the Agencies will consider this loss of resilience in assessing whether the merger may substantially lessen competition or tend to create a monopoly.

E. Considerations for Innovation and Product Variety Competition

Firms can compete for customers by offering varied and innovative products and features, which could range from minor improvements to the introduction of a new product category. Features can include new or different product attributes, services offered along with a product, or higher-quality services standing alone. Customers value the variety of products or services that competition generates, including having a variety of locations at which they can shop.

Offering the best mix of products and features is a critically important dimension of competition that may be harmed as a result of the elimination of competition between the merging parties.

When a firm introduces a new product or improves a product's features, some of the sales it gains may be at the expense of its rivals, including rivals that are competing to develop similar products and features. As a result, competition between firms may lead them to make greater efforts to offer a variety of products and features than would be the case if the firms were jointly owned, for example, if they merged. The merged firm may have a reduced incentive to continue or initiate development of new products that would have competed with the other merging party, but post-merger would "cannibalize" what would be its own sales.[2] A service provider may have a reduced incentive to continue valuable upgrades offered by the acquired firm. The merged firm may have a reduced incentive to engage in disruptive innovation that would threaten the business of one of the merging firms. Or it may have the incentive to change its product mix, such as by ceasing to offer one of the merging firms' products.

The incentives to compete aggressively on innovation and product variety depend on the capabilities of the firms and on customer reactions to the new offerings. Development of new features depends on having the appropriate expertise and resources. Where firms are two of a small number of companies with specialized employees, development facilities, intellectual property, or research projects in a particular area, competition between them will have a greater impact on their incentives to innovate.

Innovation may be directed at outcomes beyond product features; for example, innovation may be directed at reducing costs or adopting new technology for the distribution of products.

[2] Sales "cannibalization" refers to a situation where customers of a firm substitute away from one of the firm's products and to another product offered by the same firm.

Appendix 3: Details of Market Definition

Section III of these Guidelines describes several approaches that can be used to define markets. In this appendix, we further discuss several details of market definition. Appendix 3.A describes one of the approaches, the Hypothetical Monopolist Test, in greater detail. Appendix 3.B addresses issues that may arise when defining antitrust markets in a number of specific scenarios.

A. The Hypothetical Monopolist Test

This Section describes the Hypothetical Monopolist Test, which is a method by which the Agencies often define antitrust markets. As outlined in Section III of these Guidelines, a relevant antitrust market is an area of effective competition. The Hypothetical Monopolist/Monopsonist Test ("HMT") evaluates whether a group of products is sufficiently broad to constitute a relevant antitrust market. To do so, the HMT asks whether eliminating the competition among the group of products by combining them under the control of a hypothetical monopolist likely would lead to a worsening of terms for customers. The Agencies generally focus their assessment on the constraints from competition, rather than on constraints from regulation, entry, or other market changes. The Agencies are concerned with the impact on economic incentives and assume the hypothetical monopolist would seek to maximize profits.

When evaluating a merger of sellers, the HMT asks whether a hypothetical profit-maximizing firm, not prevented by regulation from worsening terms, that was the only present and future seller of a group of products ("hypothetical monopolist") likely would undertake at least a small but significant and non-transitory increase in price ("SSNIP") or other worsening of terms ("SSNIPT") for at least one product in the group.[3] For the purpose of analyzing this issue, the terms of sale of products outside the candidate market are held constant. Analogously, when considering a merger of buyers, the Agencies ask the equivalent question for a hypothetical monopsonist. This Appendix often focuses on merging sellers to simplify exposition.

1. Implementing the Hypothetical Monopolist Test

The SSNIPT. A SSNIPT may entail worsening terms along any dimension of competition, including price (SSNIP), but also other terms (broadly defined) such as quality, service, capacity investment, choice of product variety or features, or innovative effort.

Input and Labor Markets. When the competition at issue involves firms buying inputs or employing labor, the HMT considers whether the hypothetical monopsonist would undertake at

[3] If the pricing incentives of the firms supplying the products in the group differ substantially from those of the hypothetical monopolist, for reasons other than the latter's control over a larger group of substitutes, the Agencies may instead employ the concept of a hypothetical profit-maximizing cartel comprised of the firms (with all their products) that sell the products in the candidate market. This approach is most likely to be appropriate if the merging firms sell products outside the candidate market that significantly affect their pricing incentives for products in the candidate market. This could occur, for example, if the candidate market is one for durable equipment and the firms selling that equipment derive substantial net revenues from selling spare parts and service for that equipment. Analogous considerations apply when considering a SSNIPT for terms other than price.

least a SSNIPT, such as a decrease in the offered price or a worsening of the terms of trade offered to suppliers, or a decrease in the wage offered to workers or a worsening of their working conditions or benefits.

The Geographic Dimension of the Market. The hypothetical monopolist test is generally applied to a group of products together with a geographic region to determine a relevant market, though for ease of exposition the two dimensions are discussed separately, with geographic market definition discussed in Appendix 3.B.2.

Negotiations or Auctions. For clarity, the HMT is stated in terms of a hypothetical monopolist *undertaking* a SSNIPT. This includes the hypothetical monopolist imposing a price increase, but it also applies to cases where terms are the result of a negotiation or an auction.

Benchmark for the SSNIPT. The HMT asks whether the hypothetical monopolist likely would worsen terms relative to those that likely would prevail absent the proposed merger. In some cases, the Agencies will use as a benchmark different outcomes than those prevailing prior to the merger. For example, if outcomes are likely to change absent the merger, e.g., because of innovation, entry, exit, or exogenous trends, the Agencies may use anticipated future outcomes as the benchmark. Or if suppliers in the market are coordinating prior to the merger, the Agencies may use a benchmark that reflects conditions that would arise if coordination were to break down. When evaluating whether a merging firm is dominant (Guideline 7), the Agencies may use terms that likely would prevail in a more competitive market as a benchmark.[4]

Magnitude of the SSNIPT. What constitutes a “small but significant” worsening of terms depends upon the nature of the industry and the merging firms’ positions in it, the ways that firms compete, and the dimension of competition at issue. When considering price, the Agencies will often use a SSNIP of five percent of the price charged by firms for the products or services to which the merging firms contribute value. The Agencies, however, may consider a different term or a price increase that is larger or smaller than five percent.[5]

The Agencies may base a SSNIP on explicit or implicit prices for the firms’ specific contribution to the value of the product sold, or an upper bound on the firms’ specific contribution, where these can be identified with reasonable clarity. For example, the Agencies may derive an implicit price for the service of transporting oil over a pipeline as the difference between the price the pipeline firm paid for oil at one end and the price it sold the oil for at the other and base the SSNIP on this implicit price.

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[4] In the entrenchment context, if the inquiry is being conducted after market or monopoly power has already been exercised, using prevailing prices can lead to defining markets too broadly and thus inferring that dominance does not exist when, in fact, it does. The problem with using prevailing prices to define the market when a firm is already dominant is known as the “Cellophane Fallacy.”

[5] The five percent price increase is not a threshold of competitive harm from the merger. Because the five percent SSNIP is a minimum expected effect of a hypothetical monopolist of an *entire* market, the actual predicted effect of a merger within that market may be significantly lower than five percent. A merger within a well-defined market that causes undue concentration can be illegal even if the predicted price increase is well below the SSNIP of five percent.

2. Evidence and Tools for Carrying Out the Hypothetical Monopolist Test

Appendix 2 describes some of the qualitative and quantitative evidence and tools the Agencies can use to assess the extent of competition between two firms. The Agencies can use similar evidence and analogous tools to apply the HMT, in particular to assess whether competition among a set of firms likely leads to better terms than a hypothetical monopolist would undertake.

The Agencies sometimes interpret the qualitative and quantitative evidence using an economic model of the profitability to the hypothetical monopolist of undertaking at least a SSNIP on one or more products in the candidate market; the Agencies may adapt these tools to apply to other forms of SSNIPTs.

One approach utilizes the concept of a "recapture rate" (the percentage of sales lost by one product in the candidate market, when its price alone rises, that is recaptured by other products in the candidate market). A price increase is profitable when the recapture rate is high enough that the incremental profits from the increased price plus the incremental profits from the recaptured sales going to other products in the candidate market exceed the profits lost when sales are diverted outside the candidate market. It is possible that a price increase is profitable even if a majority of sales are diverted outside the candidate market, for example if the profits on the lost sales are relatively low or the profits on the recaptured sales are relatively high.

Sometimes evidence is presented in the form of "critical loss analysis," which can be used to assess whether imposing at least a SSNIP on one or more products in a candidate market would raise or lower the hypothetical monopolist's profits. Critical loss analysis compares the magnitude of the two offsetting effects resulting from the price increase. The "critical loss" is defined as the number of lost unit sales that would leave profits unchanged. The "predicted loss" is defined as the number of unit sales that the hypothetical monopolist is predicted to lose due to the price increase. The price increase raises the hypothetical monopolist's profits if the predicted loss is less than the critical loss. Smaller or larger price increases may be even more profitable or more likely to be implemented by the hypothetical monopolist.

The Agencies require that estimates of the predicted loss be consistent with other evidence, including the pre-merger margins of products in the candidate market used to calculate the critical loss. Unless the firms are engaging in coordinated interaction, high pre-merger margins normally indicate that each firm's product individually faces demand that is not highly sensitive to price. Higher pre-merger margins thus indicate a smaller predicted loss as well as a smaller critical loss. The higher the pre-merger margin, the smaller the recapture rate[6] necessary for the candidate market to satisfy the hypothetical monopolist test. Similar considerations inform other analyses of the profitability of a price increase.

B. Market Definition in Certain Specific Settings

This Appendix provides details on market definition in several specific common settings. In much of this section, concepts are presented for the scenario where the merger involves

[6] The recapture rate is sometimes referred to as the aggregate diversion ratio, defined in Appendix 2.B.

sellers. In some cases, clarifications are provided as to how the concepts apply to merging buyers; in general, the concepts apply in an analogous way.

1. Targeted Trading Partners

If the merged firm could profitably target a subset of customers for changes in prices or other terms, the Agencies may identify relevant markets defined around those targeted customers. The Agencies may do so even if firms are not currently targeting specific customer groups but could do so after the merger.

For targeting to be feasible, two conditions typically must be met. First, the suppliers engaging in targeting must be able to set different terms for targeted customers than other customers. This may involve identification of individual customers to which different terms are offered or offering different terms to different types of customers based on observable characteristics.[7] Markets for targeted customers need not have precise metes and bounds. In particular, defining a relevant market for targeted customers sometimes requires a line-drawing exercise on observable characteristics. There can be many places to draw that line and properly define a relevant market. Second, the targeted customers must not be likely to defeat a targeted worsening of terms by arbitrage (e.g., by purchasing indirectly from or through other customers). Arbitrage may be difficult if it would void warranties or make service more difficult or costly for customers, and it is inherently impossible for many services. Arbitrage on a modest scale may be possible but sufficiently costly or limited, for example due to transaction costs or search costs, that it would not deter or defeat a discriminatory pricing strategy.

If prices are negotiated or otherwise set individually, for example through a procurement auction, there may be relevant markets that are as narrow as an individual customer. Nonetheless, for analytic convenience, the Agencies may define cluster markets for groups of targeted customers for whom the conditions of competition are reasonably similar. (See Appendix 3.B.4 for further discussion of cluster markets.)

Analogous considerations arise for a merger involving one or more buyers or employers. In this case, the analysis considers whether buyers target suppliers, for example by paying targeted suppliers or workers less, or by degrading the terms of supply contracts for targeted suppliers. Arbitrage would involve a targeted supplier selling to the buyer indirectly, through a different supplier who could obtain more favorable terms from the buyer.

If the HMT is applied in a setting where targeting of customers is feasible, it requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the targeted group would undertake at least a SSNIPT on some, though not necessarily all, customers in that group. The products sold to those customers form a relevant market if the hypothetical monopolist likely would undertake at least a SSNIPT despite the potential for customers to substitute away from the product or to take advantage of arbitrage.

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[7] In some cases, firms offer one or more versions of products or services defined by their characteristics (where brand might be a characteristic). When customers can select among these products and terms do not vary by customer, the Agencies will typically define markets based on products rather than the targeted customers. In such cases, relevant antitrust markets may include only some of the differentiated products, for example products with only "basic" features, or products with "premium features." The tools described in Appendix 2 can be used to assess competition among differentiated products.

In this exercise, the terms of sale for products sold to all customers outside the region are held constant.

2. Geographic Markets

A relevant antitrust market is an area of effective competition, comprising both product (or service) and geographic elements. A market's geography depends on the limits that distance puts on some customers' willingness or ability to substitute to some products, or some suppliers' willingness or ability to serve some customers. Factors that may limit the geographic scope of the market include transportation costs (relative to the price of the good), language, regulation, tariff and non-tariff trade barriers, custom and familiarity, reputation, and local service availability.

a) Geographic Markets Based on the Locations of Suppliers

The Agencies sometimes define geographic markets as regions encompassing a group of supplier locations. When they do, the geographic market's scope is determined by customers' willingness to switch between suppliers. Geographic markets of this type often apply when customers receive goods or services at suppliers' facilities, for example when customers buy in-person from retail stores. A single firm may offer the same product in a number of locations, both within a single geographic market or across geographic markets; customers' willingness to substitute between products may depend on the location of the supplier. When calculating market shares, sales made from supplier locations in the geographic market are included, regardless of whether the customer making the purchase travelled from outside the boundaries of the geographic market (see Appendix 4 for more detail about calculating market shares).

If the HMT is used to evaluate the geographic scope of the market, it requires that a hypothetical profit-maximizing firm that was the only present or future supplier of the relevant product(s) at supplier locations in the region likely would undertake at least a SSNIPT in at least one location. In this exercise, the terms of sale for products sold to all customers at facilities outside the region are typically held constant.[8]

b) Geographic Markets Based on Targeting of Customers by Location

When targeting based on customer location is feasible (see Appendix 3.B.1), the Agencies may define geographic markets as a region encompassing a group of customers.[9] For example, geographic markets may sometimes be defined this way when suppliers deliver their products or services to customers' locations, or tailor terms of trade based on customers' locations. Competitors in the market are firms that sell to customers that are located in the specified region. Some suppliers may be located outside the boundaries of the geographic market, but their sales to customers located within the market are included when calculating market shares (see Appendix 4 for more detail about calculating market shares).

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[8] In some circumstances, as when the merging parties operate in multiple geographies, if applying the HMT, the Agencies may apply a "Hypothetical Cartel" framework for market definition, following the approach outlined in Appendix 3A n.3.

[9] For customers operating in multiple locations, only those customer locations within the targeted region are included in the market.

If prices are negotiated individually with customers that may be targeted, geographic markets may be as narrow as individual customers. Nonetheless, the Agencies often define a market for a cluster of customers located within a region if the conditions of competition are reasonably similar for these customers. (See Appendix 3.B.4 for further discussion of cluster markets.)

A firm's attempt to target customers in a particular area with worsened terms can sometimes be undermined if some customers in the region substitute by travelling outside it to purchase the product. Arbitrage by customers on a modest scale may be possible but sufficiently costly or limited that it would not deter or defeat a targeting strategy.[10]

If the HMT is used to evaluate market definition when customers may be targeted by location, it requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the region likely would undertake at least a SSNIPT on some, though not necessarily all, customers in that region. The products sold in that region form a relevant market if the hypothetical monopolist would undertake at least a SSNIPT despite the potential for customers to substitute away from the product or to locations outside the region. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.[11]

3. Supplier Responses

Market definition focuses solely on demand substitution factors, that is, on customers' ability and willingness to substitute away from one product or location to another in response to a price increase or other worsening of terms. Supplier responses may be considered in the analysis of competition between firms (Guideline 2 and Appendix 2), entry and repositioning (Section IV), and in calculating market shares and concentration (Appendix 4).

4. Cluster Markets

A relevant antitrust market is generally a group of products that are substitutes for each other. However, when the competitive conditions for multiple antitrust markets are reasonably similar, it may be appropriate to aggregate the products in these markets into a "cluster market" for analytic convenience, even though not all products in the cluster are substitutes for each other. For example, competing hospitals may each provide a wide range of acute health care services. Acute care for one health issue is not a substitute for acute care for a different health issue. Nevertheless, the Agencies may aggregate them into a cluster market for acute care services if the conditions of competition are reasonably similar across the services in the cluster.

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[10] Arbitrage by suppliers is a type of supplier response and is thus not considered in market definition; see Appendix 3.B.3.

[11] In some circumstances, as when the merging parties operate in multiple geographies, the Agencies may apply a "Hypothetical Cartel" framework for market definition, as described in Appendix Footnote 2.

The Agencies need not separately analyze market definition for each product included in the cluster market, and market shares will typically be calculated for the cluster market as a whole.

Analogously, the Agencies sometimes define a market as a cluster of targeted customers (see Appendix 3.B.1) or a cluster of customers located in a region (see Appendix 3.B.2(b)).

5. Bundled Product Markets

Firms may sell a combination of products as a bundle or a "package deal," rather than offering products "*a la carte*," that is, separately as standalone products. Different bundles offered by the same or different firms might package together different combinations of component products and therefore be differentiated according to the composition of the bundle. If the components of a bundled product are also available separately, the bundle may be offered at a price that represents a discount relative to the sum of the *a la carte* product prices.

The Agencies take a flexible approach based on the specific circumstances to determine whether a candidate market that includes one or more bundled products, standalone products, or both is a relevant antitrust market. In some cases, a relevant market may consist of only bundled products. A market composed of only bundled products might be a relevant antitrust market even if there is significant competition from the unbundled products. In other cases, a relevant market may include both bundled products and some unbundled component products.

Even in cases where firms commonly sell combinations of products or services as a bundle or a "package deal," relevant antitrust markets do not necessarily include product bundles. In some cases, a relevant market may be analyzed as a cluster market, as discussed in Appendix 3.B.4.

6. One-Stop Shops in Markets

In some settings, the Agencies may consider a candidate market that includes one or more "one-stop shops," where customers can select a combination of products to purchase from a single seller, either in a single purchase instance or in a sequence of purchases. Products are commonly sold at a one-stop shop when customers value the convenience, which might arise because of transaction costs or search costs, savings of time, transportation costs, or familiarity with the store or web site.

A multi-product retailer such as a grocery store or online retailer is an example of a one-stop shop. Customers can select a particular basket of groceries from a range of available goods and different customers may select different baskets. Some customers may make multiple stops at specialty shops (e.g., butcher, baker, green grocer), or they may do the bulk of their shopping at a one-stop shop (the grocery store), but also shop at specialty shops for particular product categories.

There are several ways in which markets may be defined in one-stop shop settings, depending on market realities, and the Agencies may further define more than one antitrust market for a particular merger. For example, a relevant market may consist of only one-stop shops, even if there is significant competition from specialty shops; or it may include both one-stop shops and specialty shops. When a product category is sold by both one-stop shops and

specialty suppliers (such as a type of produce sold in grocery stores and produce stands), the Agencies may define antitrust markets for the product category sold by a particular type of supplier, or it may include multiple types of suppliers.

7. Market Definition When There is Harm to Innovation

When considering harm to competition in innovation, market definition may follow the same approaches that are used to analyze other dimensions of competition. In the case where a merger may substantially lessen competition by decreasing incentives for innovation, the Agencies may define relevant antitrust markets around the products that would result from that innovation, even if they do not yet exist. In some cases, the Agencies may analyze different relevant markets when considering innovation than when considering other dimensions of competition.

8. Market Definition for Input Markets and Labor Markets

The same market definition tools and principles discussed above can be used for input markets and labor markets, where labor is a particular type of input. In input markets, firms compete with each other to attract suppliers, including workers. Therefore, input suppliers are analogous to customers in the discussions above about market definition. In defining relevant markets, the Agencies focus on the alternatives available to input suppliers. An antitrust input market consists of a group of products (goods or services) and a geographic area defined by the location of the purchasers or input suppliers. Just as buyers of a product may consider products to be differentiated according to the brand or the identity of the seller, suppliers of a product or service may consider different buyers to be differentiated. For example, if the suppliers are contractors, they may have distinct preferences about who they provide services to, due to different working conditions, location, reliability of buyers in terms of paying invoices on time, or the propensity of the buyer to make unexpected changes to specifications.

The HMT considers whether a hypothetical monopsonist likely would undertake a SSNIPT, such as a reduction in price paid for inputs, or imposing less favorable terms on suppliers. See Appendix 2.C for more discussion about competition in settings where terms are set through auctions and negotiations, as is common for input markets.

When defining a market for labor the Agencies will consider the alternative job opportunities available to workers who supply a relevant type of labor service, where worker choice among jobs or between geographic areas is the analog of consumer choices among products and regions when defining a product market. The Agencies may consider workers' willingness to switch in response to changes to wages or other aspects of working conditions, such as changes to benefits or other non-wage compensation, or adoption of less flexible scheduling. Depending on the occupation, alternative job opportunities might include the same occupation with alternative employers, or alternative occupations. Geographic market definition may involve considering workers' willingness or ability to commute, including the availability of public transportation. The product and geographic market definition may involve assessing whether workers may be targeted for less favorable wages or other terms of employment according to factors such as education, experience, certifications, or work locations. The Agencies may define cluster markets for different jobs when firms employ workers in a variety of jobs characterized by similar competitive conditions (see Appendix 3.B.4).

Appendix 4: Calculating Market Shares and Concentration

This appendix further describes how the agencies calculate market shares and concentration metrics.

A. Market Participants

All firms that currently supply products (or consume products, when buyers merge) in a relevant market are considered participants in that market. Vertically integrated firms are also included to the extent that their inclusion accurately reflects their competitive significance. Firms not currently supplying products in the relevant market, but that have committed to entering the market in the near future, are also considered market participants.

Firms that are not currently active in a relevant market, but that very likely would rapidly enter with direct competitive impact in the event of a small but significant change in competitive conditions, without incurring significant sunk costs, are also considered market participants. These firms are termed “rapid entrants.” Sunk costs are entry or exit costs that cannot be recovered outside a relevant market. Entry that would take place more slowly in response to a change in competitive conditions, or that requires firms to incur significant sunk costs, is considered in Section IV.2 of the Guidelines.

Firms that are active in the relevant product market but not in the relevant geographic market may be rapid entrants. Other things equal, such firms are most likely to be rapid entrants if they are already active in geographies that are close to the geographic market. Factors such as transportation costs are important; or for services or digital goods, other factors may be important, such as language or regulation.

In markets for relatively homogeneous goods where a supplier’s ability to compete depends predominantly on its costs and its capacity, and not on other factors such as experience or reputation in the relevant market, a supplier with efficient idle capacity, or readily available “swing” capacity currently used in adjacent markets that can easily and profitably be shifted to serve the relevant market, may be a rapid entrant. However, idle capacity may be inefficient, and capacity used in adjacent markets may not be available, so a firm’s possession of idle or swing capacity alone does not make that firm a rapid entrant.

B. Market Shares

The Agencies normally calculate product market shares for all firms that currently supply products (or consume products, when buyers merge) in a relevant market, subject to the availability of data. The Agencies measure each firm’s market share using the metrics that are informative about the commercial realities of competition in the particular market and firms’ future competitive significance. When interpreting shares based on historical data, the Agencies may consider whether significant recent or reasonably foreseeable changes to market conditions suggest that a firm’s shares overstate or understate its future competitive significance.

How market shares are calculated may further depend on the characteristics of a particular market, and on the availability of data. Moreover, multiple metrics may be informative in any particular case. For example:

- Revenues in a relevant market often provide a readily available basis on which to compute shares and are often a good measure of attractiveness to customers.
- Unit sales may provide a useful measure of competitive significance in cases where one unit of a low-priced product can serve as a close substitute for one unit of a higher-priced product. For example, a new, much less expensive product may have great competitive significance if it substantially erodes the revenues earned by older, higher-priced products, even if it earns relatively low revenues.
- Revenues earned from recently acquired customers (or paid to recently acquired buyers, in the case of merging buyers) may provide a useful measure of competitive significance of firms in cases where trading partners sign long-term contracts, face switching costs, or tend to re-evaluate their relationships only occasionally.
- Measures based on capacities or reserves may be used to calculate market shares in markets for homogeneous products where a firm's competitive significance may derive principally from its ability and incentive to rapidly expand production in a relevant market in response to a price increase or output reduction by others in that market (or to rapidly expand its purchasing in the case of merging buyers).
- Non-price indicators, such as number of users or frequency of use, may be useful indicators in markets where price forms a relatively small or no part of the exchange of value.

NOTES AND QUESTIONS

1. *History of the guidelines*. In 1968, the Department of Justice announced an initial set of guidelines regarding acquisitions and mergers. Those guidelines evolved over time, beginning with a new version in 1982. In 1984, the Department issued what it called non-horizontal merger guidelines. In 1992, the Department of Justice and the Federal Trade Commission joined together to issue new merger guidelines, which were followed by amendments in 1997, and then revised more broadly in 2010. New vertical merger guidelines were issue by the Department and the FTC in 2020, but the FTC withdrew from them on September 15, 2021, describing them as based on a "flawed approach" and "unsound economic theories." On July 19, 2023, the Department and the FTC released the draft merger guidelines that you just read, which cover both horizontal and non-horizontal mergers. When the draft guidelines were released, the FTC had only three commissioners, rather than its usual five, and all three were from the same party.

2. *Ideas behind the revisions*. In her statement on the release of the draft guidelines, FTC Chair Lina Khan said: "Three principal goals drove our proposed revisions. First, we sought to ensure the guidelines reflect the reality of how firms do business in the modern economy. Second, we wanted to ensure the guidelines faithfully reflect the full scope of the laws that Congress passed and prevailing legal precedent. And third, we sought to ensure the guidelines provide a clear and administrable framework that courts and market participants can apply."

3. *Purpose of the guidelines and guideline style*. Since the first version of the guidelines, they have served two principal purposes. The first is to set forth how the agencies will exercise their prosecutorial discretion as they consider whether to challenge proposed mergers. The second is to provide a roadmap for courts about how to think about antitrust issues raised by mergers. All of the guidelines prior to the recent draft set out an analytical framework, but they did so without citation to case law or secondary literature. The new draft guidelines depart from that approach with extensive citations to case law.

4. *Up and down with HHIs*. The 1982 Guidelines effectively set out a grid for horizontal mergers based on the post-merger HHI in the industry as well as the increase in HHI that would be generated were the proposed merger to go through. Markets with a post-merger HHI of under 1000 were "unconcentrated," and DOJ stated that it was unlikely to challenge mergers in that region. Markets with a post-merger HHI of 1000 to 1800 were deemed "moderately concentrated,"

and the Department would more likely than not challenge a merger in that range if it would increase the HHI by more than 100 points. For mergers where the market post-merger would be "highly concentrated"—meaning a post-merger HHI above 1800, the Department planned to look carefully at mergers that boosted HHI from 50 to 100 points and was likely to challenge those with increases of 100 points or more. The 2010 Guidelines had used the same framework of analysis, but set forth higher HHI thresholds (for post-merger HHIs: unconcentrated, below 1500; moderately concentrated, 1500 to 2500; and highly concentrated, above 2500 and for increases corresponding the three categories, below 100; 100 to 200; and above 200). The Guidelines explained that these thresholds more accurately reflected actual merger challenges by the agencies. Perhaps more important, reflecting enforcement practice and court decisions since at least the 1980s, the 2010 Guidelines were more concerned about how to analyze the likely effects of a particular merger than about HHI thresholds.

In Guideline 1, the new proposed guidelines return to the 1982 thresholds, although they described the thresholds as triggering a "structural presumption" of illegality, not just describing a likely enforcement decision. Guideline 1 also incorporates a new presumption not in the 1982 guidelines triggered when the merged firm's market share is greater than 30% and the change in HHI is greater than 100. The 30% is taken from the Supreme Court's decision in *Philadelphia National Bank* (see page 693 in the main text).

As we have seen in the cases over the past several decades, merger enforcement has involved much more than examination of market share and other structural attributes. The agencies and the courts have looked for evidence that would shed light on whether the merger would be likely to have adverse effects on customers or suppliers. The new draft guidelines put more emphasis on structural factors and pay less attention to how adverse effects might be analyzed. How should we evaluate these changes? The agencies plainly want to make merger enforcement more aggressive. To that end, they have called for lower HHI thresholds and presumptions of unlawfulness that seek to shift the burden of proof to the merging parties. Notably, the difference between a HHI threshold of 1800 and one of 2500 is difference between challenging mergers that shrink a market from 6 equal sized players to 5 equal sized players as opposed to ones that shrink a market from 5 equal sized players to 4 equal sized players.

5. *What animates the new guidelines?* Merger guidelines since 1968 have embodied a judgment that merger enforcement policy

should be aimed at prohibiting only mergers that are likely to reduce economic welfare by increasing market power and thus reducing output. The new HHI levels and burden-shifting approach could be thought to further than objective. It might be intended to reflect new economic learning about the concentration levels that pose a risk of economic harm. Or to shift the relative risk of false positives and false negatives because of a view that past merger enforcement has failed to prevent mergers that caused economic harm. Alternatively, the new approach might be intended to block mergers based on size and market shares alone, regardless whether they are likely to have adverse economic effects.

6. *The role of efficiencies.* In earlier guidelines, the claimed benefits of the merger were part of the assessment of likely competitive effects because the parties could argue that the merger will enable increased output or other benefits for trading partners. When you look at the combination of structural presumptions and the treatment of efficiencies in the guidelines, do you think the new guidelines are intended to diminish the importance of efficiencies in merger analysis?

7. *Understanding precedent.* One of the broad trends in U.S. antitrust caselaw is that practices that were once condemned as per se illegal are now evaluated instead under the rule of reason. To take just two examples, group boycotts were per se illegal until *Northwest Wholesale Stationers* (1985) (page 300 in the main text) moved away from the doctrine. Compare cases like *Fashion Originators' Guild* (1941) (page 287 in the main text). And *Leegin* (2007) (page 393 in the main text) overruled *Dr. Miles* (1911) in holding that the rule of reason applied to minimum resale prices. In both situations, the Court had established a rule, time passed, new situations arose, and the Court was eventually presented with a case in which it could choose to adhere to its prior rule or instead to reset the doctrine. But, of course, in some cases, the Court has chosen to continue to apply its prior rules, even in the face of strong arguments to change course. Recall the byplay between Justice Stevens's opinion for the Court in *Jefferson Parish* (1984) (page 556 in the main text), continuing to treat tying as subject to a form of per se analysis, and Justice O'Connor's concurring opinion arguing in favor of switching tying to rule of reason treatment. In short, antitrust doctrine has evolved through changing court decisions. A decision by the Supreme Court fixes the doctrinal rule at a particular point in time, but in antitrust, as elsewhere, as time passes and circumstances evolve, new cases arise that may test the continued applicability of the doctrine as announced by the Court.

The Supreme Court used to play a decisive role in merger enforcement and the evolution of merger law. The Expediting Act of 1903 provided a path for direct appeal to the Supreme Court in antitrust cases where the United States was a party. The fact that the Court had to take these cases meant that there was less opportunity for evolution of doctrine in the lower courts. But a 1974 amendment to the statute changed the direct appeal rule; and since the passage of Hart-Scott-Rodino Act in 1976, most merger matters have been resolved during the pre-merger agency review process. Since then, the Supreme Court has decided only a handful of merger cases.

The draft merger guidelines cite many Supreme Court cases that were decided some time ago, perhaps most prominently, *Brown Shoe* (U.S. 1962) and *Philadelphia National Bank* (U.S. 1963) (page 693 in the main text). The draft guidelines give little attention to the many lower court merger decisions from the post-Expediting Act era—1975 forward. How should we assess that? The Supreme Court hasn't jumped in to address merger issues even as the lower court decisions may have drifted away from the doctrine announced in *Brown Shoe*, *PNB*, and other earlier cases. Should lower courts adhere firmly to the doctrine of these Supreme Court cases—binding legal precedent as the guidelines put it—or should they continue to evolve doctrine to reflect, as Chair Khan put it in her initial statement on the guidelines, "the reality of how firms do business in the modern economy?"

The guidelines suggest that *Brown Shoe* and *PNB* remain governing precedent. The agencies have stated that these cases have not been overruled and remain good law. Others argue that they have been implicitly overruled at least in part by subsequent Supreme Court decisions, including *United States v. Marine Bancorp.*, 418 U.S. 602 (1974), and *Cargill, Inc. v. Monfort of Colorado*, 479 U.S. 104 (1986). Modern lower court merger cases have in any event taken a more empirically grounded approach focused more on likely effects and less on market structure. Were the agencies right to emphasize these 1960s cases? Is there something distinctive about merger law—perhaps the language or meaning of Section 7 of the Clayton Act—that should cause lower courts to be more deferential to Supreme Court precedent than in other areas of antitrust or outside of antitrust? Does the language of Section 7 require courts to take a more structural approach than that taken by many of the more modern merger cases?

Chapter 6.3.A.2 Note About Airline Mergers

[insert on p. 718, after Note About Hospital Mergers]

The recent history of merger review in the airline industry might be characterized as "too little, too late" or, perhaps more recently, "better late than never." As a group of commentators noted in 2020, "between 2005 and 2014, the Antitrust Division reviewed seven airline mergers, in five of those cases, there were no challenges, and the Antitrust Division settled the other two. Now, four airlines control almost 70 percent of domestic air travel in the United States." Bill Baer et al, *Restoring Competition in the United States* 28 (Nov. 2020).[3]. According to an analysis in the New York Times, "[a] decade of consolidation has reduced the number of airlines competing in many markets, making it easier for dominant carriers to charge more for flights." Jad Mouawad, Airlines Reap Record Profits, and Passengers Get Peanuts, N.Y. TIMES (Feb. 6, 2016).

Notwithstanding industry consolidation, there have been no new airline entrants over the last twenty years. This could reflect the incumbents' advantages from economies of scale and scope, but it more likely underscores the considerable barriers to entry. Airline slots at commercial airports are often very scarce, and the incumbent airlines have been effective in repelling new entrants by aggressive price cutting and output responses. Recall, for example, that the Tenth Circuit turned away a predatory pricing case against American Airlines in the early 2000s (discussed at pages 535-42). *See also* C. Scott Hemphill & Philip J. Weiser, Beyond Brooke Group: Bringing Reality to the Law of Predatory Pricing, 127 YALE L.J. 2048 (2018).

The first recent challenges to airline consolidation came in the early 2020s, in two cases against the once upstart carrier, JetBlue. First, the Department of Justice successfully challenged a partnership between America Airlines and JetBlue. *United States v. American Airlines Group and Jet Blue Corporation*, Civ. No. 21-11558 (D. Mass., May 19, 2023). Under that partnership, the two carriers were able to coordinate schedules, have reciprocity on frequent flier miles, and engage in certain revenue sharing opportunities. The judge ruled that the partnership violated Section 1 of the Sherman Act as it led to decreased capacity, less frequent flights, and fewer choices—as well as a diminished incentive for the firms to compete against one another. Jet Blue announced it will not appeal and will wind down the partnership. As of this writing, American Airlines appears set to

[3] https://faculty.haas.berkeley.edu/shapiro/restoringcompetition.pdf

continue its appeal, although it is not clear whether the dispute remains a live one given Jet Blue's decision to end the agreement.

One reason Jet Blue abandoned its partnership with American Airlines is that it is focusing instead on its merger with Spirit Airlines. Jet Blue announced the $3.7 billion merger in 2022, and the U.S. Department of Justice (and a coalition of states) filed a complaint challenging the merger in May 2023. Complaint, United States v. Jetblue Airways Corporation and Spirit Airways (D. Mass, March 7, 2023). The Department alleges that the merger would end "Spirit's low-cost, no-frills flying option," which has made "it possible for more Americans—particularly price sensitive consumers who pay their own fares—to travel," and that, if the merger were to proceed, it would remove 50% of the "ultra low cost" capacity from the U.S. A trial is set for the case in the Fall of 2023.

Chapter 6.3.A.3: Note on Sprint/T-Mobile

[insert at the end of p. 734, after the Notes on Maverick Firms]

The wireless marketplace is a valuable case study in merger law. In August of 2011, the Justice Department sued to block the merger of AT&T, then the second-largest wireless provider, and T-Mobile, then the fourth-largest wireless provider. In that case, the Justice Department defined the market as comprised of the four national wireless services, namely, AT&T, T-Mobile, Verizon, and Sprint. In its Complaint, the Department cited the level of concentration in this market (an HHI above 3100) as well as that "the innovation that an independent T-Mobile brings to the market – as reflected in the array of industry 'firsts' it has introduced in the past, such as the first Android phone, Blackberry e-mail, and the Sidekick – would also be lost, depriving consumers of important benefits." Shortly after the Department filed suit, AT&T abandoned its merger of T-Mobile.

In the wake of the Department's action, Antitrust Division Chief Bill Baer celebrated the importance of preserving competition in wireless and T-Mobile's role as a maverick. As he stated with regard to preserving an independent T-Mobile, "[t]his really demonstrates that competition can work. . . When you have feisty rivals whose survival depends on innovating and differentiating, they can gain market share and loosen the oligopoly. That's exactly what T-Mobile

has done."[4] Following this line of thinking, Baer and FCC Chair Tom Wheeler discouraged Sprint from merging with T-Mobile in 2014. After merger talks fell through, Wheeler celebrated the outcome, stating "four national wireless provides is good for American consumers. . . Sprint now has an opportunity to focus its efforts on robust competition."[5]

In 2018, T-Mobile and Sprint decided to merge, arguing that the consolidation would enable them to compete more effectively with the top two providers, Verizon and AT&T. In the spring of 2019, Federal Communications Commission Chairman Ajit Pai concluded that the merger was procompetitive, stating that he supported approving the transaction, citing commitments from the merging parties to deploy a wireless broadband network (using "5G" technology) that would cover 97% of the U.S. population within three years of consummating the merger.[6] By contrast, a number of State Attorneys General sued to challenge the transaction, concluding that "[d]irect competition between Sprint and T-Mobile has led to lower prices, higher quality service, and more features for consumers [and that, if] consummated, the merger will eliminate the competition between Sprint and T-Mobile and will increase the ability of the three remaining MNOs to coordinate on pricing."[7] The Justice Department, however, approved the merger on the basis of the merged firms' commitment to divest significant assets (including spectrum and their pre-paid services business) and provide wholesale support to DISH Network, which indicated its interest in using these assets to build a nationwide wireless broadband network.[8] The State Attorneys General concluded that DISH was unlikely to emerge as an effective

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[4] James B. Stewart, *Brash C.E.O. Keeps the Giants of Mobile Off Balance,* N.Y. Times, https://www.nytimes.com/2013/11/30/business/brash-ceo-revives-a-moribund-t-mobile.html

[5] Gina Chon, *FCC's Tom Wheeler Applauds Collapse of T-Mobile-Sprint Deal*, Financial Times, https://www.ft.com/content/64872a46-f8c0-11e3-815f-00144feabdc0

[6] FCC chairman backs T-Mobile, Sprint merger, CNBC, https://www.cnbc.com/2019/05/20/fcc-will-not-formally-approve-t-mobile-sprint-merger-on-monday-because-it-must-still-draft-order-reuters.html

[7]https://ag.ny.gov/sites/default/files/6.11.19_new_york_attorney_general_james_moves_to_block_t-mobile_and_sprint_megamerger.pdf

[8] https://www.justice.gov/opa/press-release/file/1189336/download

competitor to the three major surviving providers, rejected the settlement,[9] and filed suit to block the merger.

After a full trial, the district court rejected the States' challenges to the Sprint/T-Mobile merger, taking what might be described as a pragmatic—albeit unconventional—approach to merger law. The unconventional aspect of the district court's ruling was that it concluded that the merger triggered the "structural presumption"—meaning it was facially anticompetitive—but nonetheless did not violate the Clayton Act. To reach this conclusion, the court invoked a number of practical business issues, including its conclusion that Sprint was a "weakened competitor." The court also invoked the efficiency defense and the Justice Department-ordered remedy as reasons to uphold the merger. In short, the district court relied on a combination of factors rarely invoked—a weakened competitor defense, an efficiency defense, and a "fix" to the merger—to uphold the merger and overcome the structurally presumption.

Chapter 6.3.D: Monopsony

United States v. Bertelsmann SE & Co.

United States District Court for the District of Columbia, 2022.
2022 WL 16748157.

[insert on page 764, after Note About Monopsony Power"]

FLORENCE Y. PAN, Circuit Judge. John Steinbeck famously said, "I guess there are never enough books." He apparently meant that in the figurative sense, as a comment on the power of books to educate, to enrich, and to explore. But today, his statement also rings true in the economic sense: The retail market for books in the United States was over $11.5 billion in 2019 and has only continued to expand.

Penguin Random House ("PRH") is by far the largest book publisher in the United States. Owned by Bertelsmann SE & Co. KGaA ("Bertelsmann"), an international media and services company, PRH annually publishes over 2,000 new books in the U.S. and generates nearly $2.5 billion in revenue. Simon & Schuster, Inc. ("S&S"), owned by the media giant Paramount Global (formerly ViacomCBS), is the third-largest publisher in the U.S. S&S publishes

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9 https://ag.ny.gov/press-release/ag-james-t-mobilesprint-megamerger-remains-bad-deal-consumers-innovation-and-workers

about 1,000 new titles yearly and reported over $760 million in net sales in 2020.

In March 2020, ViacomCBS announced that it planned to sell S&S. Following a multi-round bidding process, Bertelsmann and PRH signed an agreement with ViacomCBS and S&S in November 2020 to purchase S&S for $2.175 billion. The acquisition of S&S would cement PRH's position as the "number one" publisher in the United States, increasing its retail market share to almost three times that of its closest competitor.

In November 2021, the Antitrust Division of the United States Department of Justice ("the government") brought this action against PRH, S&S, and their parent companies ("the defendants"), seeking to block the merger of PRH and S&S under Section 7 of the Clayton Act. The government's case sounds in "monopsony," a market condition where a buyer with too much market power can lower prices or otherwise harm sellers. Essentially, the government alleges that the merger will increase market concentration in the publishing industry, which will allow publishing companies to pay certain authors less money for the rights to publish their books. [After a 12 day trial and thorough review of the evidence, the judge decided to enjoin the merger.]

I. BACKGROUND

A. The Industry

The book industry is dominated by five major publishing houses—PRH, HarperCollins Publishers, S&S, Hachette Book Group, and Macmillan Publishing Group, LLC—which are known as the "Big Five." Together, the Big Five held nearly 60 percent of the market for the sale of trade books in 2021 (*i.e.*, books intended for general readership, as opposed to specialized books like textbooks or manuals).

The Big Five have achieved their market dominance in part by acquiring other publishers, contributing to a trend toward consolidation in the industry.

All publishers and editors are highly motivated to secure the rights to publish new books; indeed, identifying and acquiring books that people want to read is the essence of the business. Yet only 35 out of 100 books turn a profit, and breakout titles drive revenues—the top 4 percent of profitable titles generate 60 percent of profitability. Publishing has therefore been described by insiders as a "portfolio business": The business model is to acquire a large number of high-quality books, knowing that a substantial percentage of the titles will not be profitable.

B. Acquiring Books for Publication

Books begin, of course, with authors. Authors often spend years developing their ideas, conducting research, and refining their manuscripts or proposals before submitting them for publication.

A publisher that hopes to acquire a desirable book must offer a competitive advance to be in the running. Editors and publishers determine how much their imprint is willing to pay for a given book. . . . Ultimately, there is a correlation between high advances and high book sales. Books that sell well tend to have garnered high advances, and books that receive high advances tend to sell well.

C. The Competition for Books

Regardless of the method used to acquire a book's publishing rights, the amount that is paid is inexorably determined by competition. . . . Competition is also a key factor in one-on-one negotiations, where publishers must offer high advances because they know that the agent always has the option of breaking off negotiations and selling the book on the market.

In competing for the most attractive new books, the Big Five have significant advantages over smaller publishers. Most critically, the Big Five have the capital to take chances and place bigger bets on a book's success; that is, they can offer higher advances for more books. . . . The Big Five also offer significant advantages in ensuring a book's presence in the media and visibility to its target audience.

The Big Five's sales teams can help ensure that stores not only buy books but place them in prominent displays. The Big Five edge extends to the virtual marketplace; for instance, PRH hires data scientists to study Amazon's search algorithms and spends money to get books better positioned in Amazon's search results.

By contrast, smaller publishers might have a handful of staff doing all the editing, marketing, publicity, and sales work on a book. [And self-publishing] is not a significant factor in the publishing industry.

II. LEGAL STANDARDS

The D.C. Circuit has taken a burden-shifting approach to Section 7 cases. *See United States v. Baker Hughes Inc.*, 908 F.2d 981, 982–83 (D.C. Cir. 1990). The *Baker Hughes* test, as it has come to be known, has a preliminary requirement and three steps. At the threshold, the government must demonstrate the existence of a relevant market. Once it has done so, the first step of the test allows the government to establish a prima facie case and a presumption of anticompetitive effects by demonstrating undue concentration within

that relevant market. The second step shifts the burden to the defendants, who must demonstrate in rebuttal that real-world conditions make market concentration alone an unreliable predictor of the merger's anticompetitive effects. If the defendants successfully rebut the prima facie case, the burden shifts back to the government in the third step "and merges with the ultimate burden of persuasion, which remains with the government at all times." *Baker Hughes*, 908 F.2d at 983.

III. ANALYSIS

The government contends that the merger of PRH and S&S would harm competition to acquire the publishing rights to "anticipated top-selling books," resulting in lower advances for the authors of such books and less favorable contract terms. The defendants do not dispute that if advances are significantly decreased, some authors will not be able to write, resulting in fewer books being published, less variety in the marketplace of ideas, and an inevitable loss of intellectual and creative output. The defendants vigorously contest, however, whether advances would decrease after the merger: They contend that competition would not be harmed and that advances would actually rise.

A. Market Definition

The first step in merger analysis is the identification of a relevant market. Market definition "helps specify the line of commerce and section of the country in which the competitive concern arises"; and allows the Court to evaluate any anticompetitive effects by "identify[ing] market participants and measur[ing] market shares and market concentration." Merger Guidelines § 4.

The government defines the relevant product market as the one for publishing rights to anticipated top-selling books. Anticipated top-selling books are those that are expected to yield significant sales, and for which authors therefore receive higher advances. The government contends that such books have distinctive characteristics, including the need for extra marketing, publicity, and sales support to allow them to reach broader audiences.

The proposed market for anticipated top-selling books is a submarket of the broader publishing market for all trade books. Under the government's monopsony theory, the authors of anticipated top-selling books are "targeted sellers" against whom the merged defendants might lower the prices paid for the authors' wares. *See* Merger Guidelines § 4.1.4 (If a monopsonist could "profitably target a subset of [sellers] for price [de]creases, the [government] may identify relevant markets defined around those targeted [sellers].").

Courts evaluate relevant product markets in the monopsony context in two ways: by considering qualitative, "practical indicia" as described by the Supreme Court in the *Brown Shoe* case, 370 U.S. 294, 325 (1962); and by examining "supply substitution" and applying the "hypothetical monopsonist test," which are discussed in detail, *infra*. The parties in this case focus their arguments on whether "practical indicia" support the finding of a market to publish "anticipated top-selling books." Because the parties choose to fight on the battlefield of "practical indicia," that is where the Court begins its analysis.

1. Practical Indicia

"[W]ithin [a] broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct [sellers], distinct prices, sensitivity to price changes, and specialized vendors." *Brown Shoe*, 370 U.S. at 325.

Brown Shoe's practical indicia also may help identify a market of targeted sellers. *See FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1038–39 (D.C. Cir. 2008) (citing *Brown Shoe*, 370 U.S. at 325). For example, a market of "distinct [sellers]," as posited by the government, may find "a particular [set of buyers] 'uniquely attractive'" and "the only realistic choice" for their products.

i. The $250,000 Threshold

In the publishing market for anticipated top-selling books, the Big Five publishers hold 91 percent of the market share, while smaller publishers collectively hold only 9 percent. By contrast, in the publishing market for books that earn advances below $250,000, the non-Big Five publishers have a much more substantial market share of 45 percent.

As an initial matter, the government's use of high advances as a proxy for anticipated book sales is logical and supported by market realities. In publishing, advances are correlated with expected sales because books that are expected to sell well receive higher advances. In fact, advance levels are set by using P&L's, and the defining feature of a P&L is the sales estimate. Moreover, industry practices indicate that $250,000 is a reasonable place to draw the line: S&S and two of the three PRH adult divisions require approval from senior publishers or executives for advance offers of $250,000 or more; and *Publishers Marketplace*, a major industry publication, categorizes deals for $250,000 or more as "significant." This evidence is probative of

"industry or public recognition" of a distinct category of books that receive advances at or above the $250,000 level. *Brown Shoe*, 370 U.S. at 325.

The defendants' excessive concern over the specific dollar threshold betrays a misunderstanding of why the threshold was chosen. The market that the government seeks to define is the one for anticipated top-selling books, and the $250,000 demarcation was adopted only as an analytical tool to help it group together the books in question. The government's economic expert, Dr. Nicholas Hill, also conducted his analyses at other numerical thresholds (including $150,000, $250,000, $500,000, and $1 million) and observed consistent outcomes at those various high-dollar amounts. Thus, the $250,000 cutoff is merely useful; it is not intended to be a rigid bright line, but rather is helpful "[f]or analytical purposes" to facilitate the assessment of anticompetitive effects.

ii. The Remaining *Brown Shoe* Factors

Aside from distinct pricing, the government argues that the remaining *Brown Shoe* factors demonstrate that there is a relevant submarket for the publishing rights to anticipated top-selling books. The government contends that such books have "peculiar characteristics and uses," in that they require stronger marketing, publicity, and sales support, which allow them to reach a broader audience of readers. In addition, authors of anticipated top-selling books are "distinct sellers," in that they (1) care more about their publishers' reputation and services, which ensure wider distribution of their books; (2) may receive more favorable contract terms than other authors; and (3) face different competitive conditions, as demonstrated by the dominant market share of the Big Five (91%) in publishing anticipated top sellers. For all those reasons, the government argues, anticipated top-selling books are in a different category from books that are expected to sell relatively few copies, and publishers can target their authors for price decreases.

The defendants, however, insist that all books are in the same market. They argue that books at all advance levels go through an identical editing, marketing, and distribution process; that there is no difference in the personnel who handle such books; that the contracts for all books are negotiated in the same way; and that any special terms in the contracts for some books simply result from an agent's leverage. Further, they contend that publishers cannot predict which books will be top sellers.

The Court has no trouble recognizing that anticipated top-selling books are distinct from the vast majority of books that do not

carry the same expectations for success. . . . Beyond advances, contracts for books that are expected to sell well are more likely to include favorable terms like higher royalty rates, higher levels of marketing support, "glam" packages (*e.g.*, for hair, makeup, and wardrobe services), and airfare for authors. Publishers print more of the books they think will do well; circulate more advance copies of such books to reviewers or influencers to create excitement; push for interviews with more media outlets; and schedule book-tour appearances in more locations. Anticipated top-selling books also get more attention from marketing and sales teams.

The fact that the Big Five publish 91 percent of anticipated top sellers also supports a finding that the authors of such books have unique needs and preferences.

In sum, this case demonstrates that "[w]hatever the market urged by the [government], the other party can usually contend plausibly that something relevant was left out, that too much was included, or that dividing lines between inclusion and exclusion were arbitrary." *FTC v. Tronox Ltd.*, 332 F. Supp. 3d 187, 202 (D.D.C. 2018) (quoting 2B Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 530d (4th ed. 2014) [hereinafter Areeda, *Antitrust Law*]). Yet "[t]he Supreme Court has wisely recognized there is 'some artificiality' in any boundaries, but that 'such fuzziness' is inherent in bounding any market." *Id.* (quoting Areeda, *Antitrust Law* ¶ 530d).

2. Supply Substitution

The traditional way to define a relevant market in the monopsony context would be to examine "the commonality and interchangeability of the buyers" of a certain good. *Todd v. Exxon Corp.*, 275 F.3d 191, 202 (2d Cir. 2001).

To test the proposed market boundaries, courts commonly turn to the "hypothetical [monopsonist] test." *FTC v. Sysco*, 113 F. Supp. 3d 1, 38 (D.D.C. 2015). The hypothetical monopsonist test "ensures that markets are not defined too narrowly," on the theory that if the test identifies substitute buyers for the product in question, such buyers should be included in the market. *See* Merger Guidelines § 4.1.1 (describing hypothetical monopolist test).

The government's expert, Dr. Hill, estimated what "actual diversions" would be for the defined market, *i.e.*, the percentage of authors who would switch to self-publishing in the face of a "small but significant and non-transitory [de]crease" in advances paid for anticipated top-selling books. He found that even if some small number of authors switched to self-publishing, it would be profitable for publishers to decrease advances—that is, the defection of authors

in response to the lowered advances would be far less than what would be necessary to make the decrease unprofitable.

B. Prima Facie Case

1. *Market Concentration*

Once the relevant market has been established, the next step is straightforward: "[T]he government must show that the merger would produce 'a firm controlling an undue percentage share of the relevant market, and would result in a significant increase in the concentration of firms in that market.'" *See FTC v. H.J. Heinz* Co., 246 F.3d 708, 715 (D.C. Cir. 2001) (quoting *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 363 (1963) (alterations omitted)).

The government's expert, Dr. Hill, calculated market shares based on a comprehensive set of data from more than sixty publishers. According to his calculations, the merging firms account for nearly half (49 percent) of the publishing market for anticipated top-selling books, and the newly constituted "Big Four" that would emerge after the deal would control approximately 91 percent.

The second-largest market participant post-merger would be [Redacted] with 24 percent of the market, while [Redacted] and [Redacted] would have 10 percent and 9 percent, respectively. The non-Big Four would have the remaining 9 percent. . . . The 49-percent share that the post-merger PRH would hold is far above the levels deemed too high in other cases. *See, e.g.*, *Phila. Nat'l Bank*, 374 U.S. at 364 (36%); *cf. Heinz*, 246 F.3d at 711, 715–17 (32.8%).

The post-merger market also would be unduly concentrated under the Herfindahl-Hirschman Index ("HHI"), a measure commonly used to evaluate market concentration. The HHI is a formula "used to estimate the competitiveness of the market on the basis of the number and size of the firms." Areeda, *Antitrust Law* ¶ 930a. . . . Here, the post-merger HHI would be 3,111, with an increase of 891, well above the thresholds required to trigger the presumption under the Guidelines.

2. Other Evidence

The government does not rely solely on the high degree of market concentration that would result from the merger, and the attendant presumption of anti-competitive harm; instead, the government also "bolster[s] its prima facie case by offering additional evidence." *FTC v. Wilh. Wilhelmsen Holding ASA*, 341 F.Supp.3d 27, 59 (D.D.C. 2018). The government presents evidence that (1) the merger will cause anticompetitive effects from the elimination of competition between PRH and S&S, and (2) the higher concentration

in the post-merger market will increase the risk of coordinated anticompetitive conduct by the largest publishers.

i. Unilateral Effects

Mergers necessarily eliminate the competition between the merging companies. *See Heinz*, 246 F.3d at 717. The government contends that PRH and S&S currently compete "fiercely" to publish anticipated top-selling books, and that eliminating direct competition between them is likely to harm authors. . . .. As explained by the Merger Guidelines, "[a] merger can enhance market power simply by eliminating competition between the merging parties. This effect can arise even if the merger causes no changes in the way other firms behave." Merger Guidelines § 1. Unilateral effects may be especially acute in a "highly concentrated market." *FTC v. Staples Inc.*, 970 F. Supp. 1066, 1083 (D.D.C. 1997) ("*Staples I*").

a. Head-to-Head Competition

The analysis of unilateral effects focuses on how closely the merging firms currently compete, in order to extrapolate the effects of eliminating that competition. *See* Merger Guidelines § 6.2. Evidence in the record demonstrates that PRH and S&S are close competitors for anticipated top-selling books. Specifically, PRH is the publisher against which S&S competes the most frequently and to which S&S loses the most. Meanwhile, S&S is a significant competitor to PRH, and makes a particularly strong showing in biographies, memoirs, political nonfiction, and books about current events.

The government's expert, Dr. Hill, conducted a variety of economic analyses that assess how closely PRH and S&S compete. Dr. Hill used four different methods to calculate "diversion ratios," which measure head-to head competition between the merging parties by asking the following question: If one merging party lowered advance levels, what percentage of its authors would "divert" their business to the other merging party, as opposed to diverting to other firms in the industry? A higher diversion ratio indicates that the merging parties are close competitors and that the merger is more likely to lead to harm. . . .Specifically, [the government's expert] Dr. Hill's diversion ratios indicate that if PRH lowered advances, between 19 and 27 percent of its authors would divert to S&S; and that if S&S lowered advances, between 42 and 59 percent of its authors would divert to PRH.

The defendants' expert, Professor Snyder, calculated his own diversion ratios, using a less reliable data set assembled from the records of eighteen agents who responded to subpoenas ("agency data"). Although Professor Snyder's ratios were lower, he also found

that PRH is S&S's closest competitor. Professor Snyder determined that the diversion ratio from PRH to S&S is 20 percent, and the diversion ratio from S&S to PRH is 27 percent.

iii. Coordinated Effects

Another avenue for the government to prove competitive harm is by showing a likelihood of "coordinated effects," which occur when market participants mutually decrease competition in the relevant market. *United States v. AT&T*, 310 F.Supp.3d 161, 246 (D.D.C. 2018) ("A proposed merger may violate Section 7 by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers." (cleaned up)).

Coordinated effects are likelier in concentrated markets; indeed, the idea that concentration tends to produce anticompetitive coordination is central to merger law. *See Heinz*, 246 F.3d at 716 ("Merger law 'rests upon the theory that, where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels.'") (quoting *FTC v. PPG Indus.*, 798 F.2d 1500, 1503 (D.C. Cir. 1986)).

As an initial matter, a history of collusion or attempted collusion is highly probative of likely harm from a merger. *See Hosp. Corp. of Am. v. FTC*, 807 F.2d 1381, 1388 (7th Cir. 1986); *see also FTC v. Elders Grain, Inc.*, 868 F.2d 901, 906 (7th Cir. 1989) ("[A]n acquisition which reduces the number of significant sellers in a market already highly concentrated and prone to collusion by reason of its history and circumstances is unlawful in the absence of special circumstances."); Merger Guidelines § 7.2. Thus, it is significant that in *United States v. Apple, Inc.*, the Second Circuit upheld a finding that between 2009 and 2019, all the "Big Six" publishers, except for Random House, participated in a "horizontal conspiracy ... to raise e[-]book prices." *See* 791 F.3d at 339. . . . Although Random House did not participate in the conspiracy, Penguin Books and S&S both did, *see id.* at 308, and this "history of successful cooperation establishes a precondition to effective collusion—mutual trust and forbearance." *See Hosp. Corp.*, 807 F.2d at 1388. The case portrays an industry already "prone to collusion," which may become "even more prone to collusion" after the proposed merger of its largest and third-largest competitors. *See Elders Grain*, 868 F.2d at 905–06.

The *Apple* case provides the backdrop for trends in the industry that appear to demonstrate that the Big Five are already engaging in tacit collusion or parallel accommodating conduct when acquiring books. Recent years have seen the industry-wide standardization of

certain contract terms—involving payment structure, audio rights, and e-book royalties—in ways that favor publishers over authors, suggesting that the top publishers have engaged in coordinated conduct.

Finally, it is significant that in a market already prone to collusion, where coordinated conduct already appears to be rampant, PRH's acquisition of S&S would reinforce the market's oligopsonistic structure and create a behemoth industry leader that other market participants could easily follow.

C. Rebuttal

The government is entitled to a presumption of anticompetitive effects and has also met its burden to establish a prima facie case. The defendants, therefore, now have the burden to rebut the government's case by "show[ing] that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition." *See Baker Hughes*, 908 F.2d at 981.

1. Existing Competition

The defendants assert that existing competition can and will constrain the merged company more than market shares or the government's evidence would suggest. The defendants point to competition from other publishers, competition from self-publishing, and internal competition within publishing houses.

i. Other Publishers

The defendants argue that a combined PRH and S&S would be constrained by other publishers, who do not plan to lower their advance offers or change their bidding strategies. . . . The defendants' reliance on such assurances from their competitors is insufficient. It is not necessary for other publishers to change their maximum advances or bidding strategies for anticompetitive unilateral effects to occur. First, and most obviously, with respect to book acquisitions where PRH and S&S would have been the winner and runner-up, the merged entity will acquire such books for lower advances regardless of the other publishers' bids. *See supra* Section III.B.1, Section III.B.2.i.

Second, in situations where PRH or S&S would have won a book, regardless of the runner-up, the merged entity might submit a lower bid due to its decreased motivation to achieve organic growth. *See supra* Section III.B.2. In such a case, another publisher could win the book instead, for a lower advance than what PRH or S&S would have offered as standalone entities.

ii. Internal Competition

The defendants argue that internal imprint competition increases competition in the market beyond that represented in market shares. That argument is undermined by the presumption that "[c]ompanies with multiple divisions must be viewed as a single actor, and each division will act to pursue the common interests of the whole corporation." *United States v. AT&T, Inc.*, 916 F.3d 1029, 1043 (D.C. Cir. 2019). This presumption "was adopted as a principle of antitrust law," *id.*, in *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 771 (1984) ("[T]he coordinated activity of a parent and its wholly owned subsidiary must be viewed as that of a single enterprise .... A parent and its wholly owned subsidiary have a complete unity of interest."). Consistent with economic principles and common sense, internal imprint competition should be considered only to the extent that it maximizes the profits of the publishing house. *See* Areeda, *Antitrust Law* ¶ 964b ("Antitrust law generally presumes that a firm maximizes its profits in the environment in which it finds itself ....").

iii. Self-Publishing

The defendants argue that self-publishing is a competitive constraint on the market, particularly for celebrity and romance authors. But, as previously discussed, self-publishing is not a reasonable substitute for traditional publishers in the market for anticipated top-selling books. *See supra* Section I.C, Section II.A.2.

2. Barriers to Entry and Expansion

The defendants argue that there are few barriers to entry that would prevent new or existing publishers from competing effectively with the merged company. . . . Contrary to the defendants' contentions, the evidence demonstrates that there are substantial barriers to entry and expansion in the publishing market for anticipated top-selling books. Established publishers have many advantages that are not easily replicated, including: (1) back lists that generate substantial and consistent revenue, which in turn supports risky acquisitions of high-advance books; (2) large and effective marketing, sales, and distribution teams that have relationships with media and retailers; (3) excellent reputations and track records of success that attract authors; and (4) lower variable costs due to economies of scale. . . . The best proof that would-be new competitors face formidable barriers to entry is the stability of market shares in the industry: No publisher has entered the market and become a strong competitor against the Big Five in the past thirty years.

Although the defendants argue that social media like "BookTok" and Amazon's online bookstore level the playing field for

smaller publishers, those platforms are not new and are far from "game-changing." Despite the current availability of "BookTok" and virtual storefronts, the Big Five still consistently acquire the publishing rights for 91 percent of anticipated top-selling books, demonstrating that the playing field has not been leveled in any meaningful way.

Two well-funded companies outside the Big Five highlighted by the defendants are Amazon and Disney. Amazon acquired several high-priced books when it first started its publishing business about a decade ago, but it has failed to make significant headway in the industry. From 2019 to 2021, Amazon's share in acquiring the publishing rights to anticipated top-selling books declined from under [Redacted] to under [Redacted]. Amazon also struggles with selling its books outside of its own platform. The Court therefore is not convinced that Amazon is a significant competitive constraint in the relevant market. The defendants argue that [Redacted]. While Disney may have the motivation and financial resources to execute the alleged plan, it will still face many of the previously discussed barriers to entry. There is no evidence to suggest that Disney is better equipped than Amazon to succeed in the relevant market. In addition, it is a strain to characterize Disney's five-year aspirational plan as evidence of "timely" market entry. *See FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 133 (D.D.C. 2016) ("The relevant time frame for consideration in this forward looking exercise is two to three years.").

3. Additional Arguments

The defendants raise a medley of other arguments based on (1) the power of literary agents to constrain anticompetitive behavior by publishers; (2) efficiencies from the merger that will offset anticompetitive effects; (3) the lack of negative effects from the last major merger in the publishing industry; and (4) the parties' interest in finding the "best home" for S&S. The Court [rejects] each of these in turn. [discussion omitted]

CONCLUSION

The government has presented a compelling case that predicts substantial harm to competition as a result of the proposed merger of PRH and S&S. It has properly defined a relevant market—focused on publishing rights for anticipated top-selling books—that encompasses 70 percent of the advances that publishers pay to authors. The post-merger concentration of the relevant market would be concerningly high: The merged entity would have a 49-percent market share, more than twice that of its closest competitor. Moreover, the top two competitors would hold 74 percent of the market; and the top four

market participants would control 91 percent. The government has buttressed its market-share analysis with strong evidence of likely unilateral effects and coordinated effects that would hurt competition.

The defendants have failed to show that the relevant market is not well defined; have failed to establish that the market-share data inaccurately reflects market conditions; and have failed to rebut the government's affirmative evidence of anticompetitive harm. . . .Accordingly, the Court finds that the proposed merger of PRH and S&S violates Section 7 of the Clayton Act because it is likely to substantially lessen competition in the market for the publishing rights to anticipated top-selling books. The Court therefore will enjoin the merger.

NOTES AND QUESTIONS

1. *The importance of market definition*. It is often the case in merger challenges that market definition is the whole ballgame. In this case, the acceptance of a market definition around high profile authors with advances above $250,000 made the case very hard to win for the merging parties. The court in this case utilized a number of aids to define the market—looking not only at the hypothetical monopolist (or monopsonist) test, but also at the diversion ratios, testimony on how the industry operates, and other practical indicia of market realities.

2. *Submarkets and targeted customers*. In its opinion, the court used the *Brown Shoe* term of "submarkets." The most recent version of the Merger Guidelines does not include that concept, but rather says that a "market" can be defined around "targeted customers." That means that, even if most customers (or suppliers) would not be harmed by a merger, the merger could still be enjoined on the ground that others were adversely affected. Critics suggest such market definitions—such as the market definition in *Staples II*, see pp. 746-761—are jerry-rigged. What do you think?

Suppose that two out of dozens of coffee shop chains in a town merge and expect to reduce the number of coffee shops they operate from 20 to 18 in order to realize some efficiencies. Customers who prefer the two shops that will be closed, perhaps because of location, will be adversely affected; and the merger efficiencies will benefit only the customers of the other 18 shops. Can the merger be blocked on the ground that these "targeted customers" will be harmed? If not, why not?

3. *Monopsony*. This case is unusual in that it blocks a merger based on an anticompetitive impact on sellers. The theory of the case

is that suppressed payments to authors will lead to lower quality and fewer books. What if, for example, there was evidence showing that authors never (or extremely rarely) wrote for the money? Would that support the conclusion the threatened harm would not happen. Why did the government choose to litigate this case based on the impact on high-priced authors rather than consumers? Can harm to consumers be inferred from increased buyer power in the upstream market? (See the Note About Monopsony at pages 542-45 of the main text.)

4. *Diversion ratios*. The rate at which business goes to the next closest rival can be critical in assessing the effect of a merger on the merged party's post-merger conduct, a so-called "unilateral effect" of a merger. In this case, the question was if "one merging party lowered advance levels, what percentage of its authors would 'divert' their business to the other merging party, as opposed to diverting to other firms in the industry?" The higher the diversion ratio, the more likely it is that the merger will lead to unilateral price increases (or decreases, in the case of a merger of buyers) by one of the merging entities because a higher portion of the business lost as a result of the price increase will divert to the other of the combined businesses. Recall that was the issue in the Vail ski resort merger discussed on pages 735-743.

5. *History of collusion*. With respect to the likelihood of coordinated anticompetitive effects, the government pointed to the *Apple* case (discussed on pages 306-339). Recall that, in that case, Apple organized an antitrust conspiracy between all of the publishers and its e-book platform to aid its efforts to compete against Amazon in selling e-books. The court in *Bertelsmann* said that collusion is more likely where there is a past history of collusion. Was the court correct in giving weight to the *Apple* case even though that case involved a downstream market for the distribution of ebooks, not the upstream market for publishing rights to anticipated top-selling books?

6. Staples II *and Amazon redux*. Ironically, Amazon played two roles in this case—first, it was the impetus for the conspiracy in the *Apple* case and, second, it was what the merging parties thought could be their ace in the hole. This argument failed here, as did similar arguments in *Staples II*. In fact, the court cited that case for the proposition that, as outlined in the Merger Guidelines, the "time frame for consideration [of new entry] in this forward looking exercise is two to three years." Given the already limited impact that Amazon has had in this market over the last three years, the court was disinclined to view it—or Disney—as a competitive threat.

7. *Competing Against Yourself?* The merging parties made a surprising argument that the court made quick work of—there would still be considerable competition because different components of the same company could compete against one another, thereby providing authors with a basis for competition even in a more concentrated market. The court's response cited *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 771 (1984), noting that "a parent and its wholly owned subsidiary have a complete unity of interest." In short, the intra-enterprise competition argument is one that antitrust law categorically rejects, at least absent proof of unusual circumstances in which a firm's profits would be increased by such competition. Can you think of any such circumstances?

8. *The ghost of private equity*. In a part of the opinion that is omitted, the court rejects the defense that, if the merger is barred, Simon & Schuster could be sold to a private equity firm and destroyed, as happened to a prior book publisher. The court rejected this argument as speculative. Are there times when a court should allow an otherwise anticompetitive merger because the alternative buyer would not run the firm well?

Chapter 6.4.C: Federal Enforcement Against Vertical Mergers in the 1990s

United States v. AT&T, Inc.

United States Court of Appeals, District of Columbia Circuit, 2019.
916 F.3d 1029.

[insert after discussion of the Comcast/NBC merger, on page 829]

ROGERS, Circuit Judge. On October 22, 2016, AT&T Inc. announced a proposed merger with Time Warner Inc. The government sued to enjoin this vertical merger under Section 7 of the Clayton Act, 15 U.S.C. § 18, and now appeals the denial of its request for a permanent injunction. . . . [T]he government on appeal challenges only the district court's findings on its increased leverage theory whereby costs for Turner Broadcasting System's content would increase after the merger, principally through threats of long-term "blackouts" during affiliate negotiations.

At trial, the government presented expert opinion on the likely anticompetitive effects of the proposed merger on the video programming and distribution industry as forecast by economic principles and a quantitative model. It also presented statements by the defendants in administrative proceedings about the

anticompetitive effects of a proposed vertical merger in the industry seven years earlier. The defendants responded with an expert's analysis of real-world data for prior vertical mergers in the industry that showed "no statistically significant effect on content prices." The government offered no comparable analysis of data and its expert opinion and modeling predicting such increases failed to take into account Turner Broadcasting System's post-litigation irrevocable offers of no-blackout arbitration agreements, which a government expert acknowledged would require a new model. Evidence also indicated that the industry had become dynamic in recent years with the emergence, for example, of Netflix and Hulu. In this evidentiary context, the government's objections that the district court misunderstood and misapplied economic principles and clearly erred in rejecting the quantitative model are unpersuasive. Accordingly, we affirm.

I.

* * *

Neither the government nor the defendants challenge application of the burden-shifting framework in *United States v. Baker Hughes*, 908 F.2d 981, 982-83 (D.C. Cir. 1990), for horizontal mergers that the district court applied to consider the effect of the proposed vertical merger of AT&T and Time Warner on competition. Under this framework, the government must first establish a prima facie case that the merger is likely to substantially lessen competition in the relevant market. But unlike horizontal mergers, the government cannot use a short cut to establish a presumption of anticompetitive effect through statistics about the change in market concentration, because vertical mergers produce no immediate change in the relevant market share. . . . Instead, the government must make a "fact-specific" showing that the proposed merger is "likely to be anticompetitive." Joint Statement on the Burden of Proof at Trial at 3-4. Once the prima facie case is established, the burden shifts to the defendant to present evidence that the prima facie case "inaccurately predicts the relevant transaction's probable effect on future competition" or to "sufficiently discredit" the evidence underlying the prima facie case, id. Upon such rebuttal, "the burden of producing additional evidence of anticompetitive effects shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times.

The relevant market definition is also undisputed by the government and the defendants. The district court accepted the government's proposal that the product market is the market for

multichannel video distribution. . . . The district court also accepted the government's proposed geographic market, which included over 1,100 local multichannel video distribution markets. . . .

. . . [T]he question for this court is whether the district court's factual findings are clearly erroneous. . . .

* * *

In Part II, we provide an overview of the video programming and distribution industry. Then, as relevant to the issues on appeal, we summarize the evidence before the district court and its findings. In Part III, we address the government's challenges to the district court's findings.

II.

A.

The video programming and distribution industry traditionally operates in a three-stage chain of production. Studios or networks create content. Then, programmers package content into networks and license those networks to video distributors. Finally, distributors sell bundles of networks to subscribers. For example, a studio may create a television show and sell it to Turner Broadcasting System ("Turner Broadcasting"), a programmer, which would package that television show into one of its networks, such as CNN or TNT. Turner Broadcasting would then license its networks to distributors, such as DirecTV or Comcast.

Programmers license their content to distributors through affiliate agreements, and distributors pay "affiliate fees" to programmers. Programmers and distributors engage in what are oftentimes referred to as "affiliate negotiations," which . . . can be lengthy and complicated. If a programmer and a distributor fail to reach an agreement, then the distributor will lose the rights to display the programmer's content to its customers. This situation, known as a "blackout" or "going dark," is generally costly for both the programmer, which loses affiliate fee revenues, and the distributor, which risks losing subscribers. Therefore, blackouts rarely occur, and long-term blackouts are especially rare. The evidence indicated, however, that programmers and distributors often threaten blackouts as a negotiating tactic, and both may perform "go dark" analyses to estimate the potential impact of a blackout in preparation for negotiations.

The evidence before the district court also showed that the industry has been changing in recent years. Multichannel video programming distributors ("MVPDs") . . . distribute channels to

subscribers on cable or by satellite. Recently, "virtual" MVPDs have also emerged. They distribute live videos and on-demand videos to subscribers over the internet and compete with traditional MVPDs for subscribers. Virtual MVPDs, such as DirecTV Now and YouTube TV, have been gaining market share . . . .

In addition, subscription video on demand services ("SVODs") have also emerged on the market. SVODs, such as Netflix, do not offer live video content but have large libraries of content that a viewer may access on demand. SVODs also offer low-cost subscription plans and have been gaining market share recently. Increasingly, cable customers are "cutting the cord" and terminating MVPD service altogether. . . .

Leading SVODs are vertically integrated, which means they create content and also distribute it. Traditional MVPDs typically are not vertically integrated with programmers. In 2009, however, Comcast Corporation ("Comcast") (a distributor and the largest cable company in the United States) announced a $30 billion merger with NBC Universal, Inc. ("NBCU") (a content creator and programmer), whereby it would control popular video programming that included the NBC broadcast network and the cable networks of NBC Universal, Inc. The government sued to permanently enjoin the merger under Section 7, alleging that Comcast's "majority control of highly valued video programming ... would prevent rival video-distribution companies from competing against the post-merger entity." The district court, with the defendants' agreement and at the government's urging, allowed the merger to proceed subject to certain remedies for the alleged anticompetitive conduct post-merger, including remedies ordered in a related proceeding before the Federal Communications Commission ("FCC"). One remedy in the Comcast-NBCU merger was an agreement by the defendants to submit, at a distributor's option, to "baseball style" arbitration — in which each side makes a final offer and the arbitrator chooses between them — if parties did not reach a renewal agreement. During the arbitration, the distributor would retain access to NBC content, thereby mitigating concerns that Comcast-NBCU may withhold NBC programming during negotiations in order to benefit Comcast's distribution subscriptions. Comcast-NBCU currently operates as a "vertically integrated" programmer and distributor.

. . . . AT&T Inc. announced its plan to acquire Time Warner Inc. ("Time Warner") as part of a $108 billion transaction. AT&T Inc. is a distribution company with two traditional MVPD products: DirecTV and U-verse. DirecTV transmits programming over satellite,

while U-verse transmits programming over cable. Time Warner, by contrast, is a content creator and programmer and has three units: Warner Bros., Turner Broadcasting, and Home Box Office Programming ("HBO"). Warner Bros. creates movies, television shows, and other video programs. Turner Broadcasting packages content into various networks, such as TNT, TBS, and CNN, and licenses its networks to third-party MVPDs. HBO is a "premium" network that provides on-demand content to subscribers either directly through HBO Now or through licenses with third-party distributors. The merged firm would operate both AT&T MVPDs (DirecTV and U-verse) and Turner Broadcasting networks (which license to other MVPDs). . . .

A week after the government filed suit to stop the proposed merger, Turner Broadcasting sent letters to approximately 1,000 distributors "irrevocably offering" to engage in "baseball style" arbitration at any time within a seven-year period, subject to certain conditions not relevant here. . . . In the event of a failure to agree on renewal terms, Turner Broadcasting agreed that the distributor would have the right to continue carrying Turner networks pending arbitration, subject to the same terms and conditions in the distributor's existing contract.

B.

The government's increased leverage theory is that "by combining Time Warner's programming and DirecTV's distribution, the merger would give Time Warner increased bargaining leverage in negotiations with rival distributors, leading to higher, supracompetitive prices for millions of consumers." Under this theory, Turner Broadcasting's bargaining position in affiliate negotiations will change after the merger due to its relationship with AT&T because the cost of a blackout will be lower. Prior to the merger, if Turner Broadcasting failed to reach a deal with a distributor and engaged in a long-term blackout, then it would lose affiliate fees and advertising revenues. After the merger, some costs of a blackout would be offset because some customers would leave the rival distributor due to Turner Broadcasting's blackout and a portion of those customers would switch to AT&T distributor services. The merged AT&T-Turner Broadcasting entity would earn a profit margin on these new customers. Because Turner Broadcasting would make a profit from switched customers, the cost of a long-term blackout would decrease after the merger and thereby give it increased bargaining leverage during affiliate negotiations with rival distributors sufficient to enable

it to secure higher affiliate fees from distributors, which would result in higher prices for consumers.

The government also presented . . . [expert testimony] on the likely anticompetitive effect of the proposed merger. He opined, based on the economic theory of bargaining — here, the Nash bargaining theory — that Turner Broadcasting's bargaining leverage would increase after the merger because the cost of a long-term blackout would decrease. His quantitative model predicted net price increases to consumers. Specifically, his model predicted increases in fees paid by rival distributors for Turner Broadcasting content and cost savings for AT&T through elimination of double marginalization ("EDM"). The fee increases for rival distributors were based on the expected benefit to AT&T of a Turner Broadcasting blackout after the merger. . . .

AT&T responded by pointing to testimony of executives' past experience in affiliate negotiations, and presenting testimony by its experts . . . [that] critiqued the "inputs" used by [the government'; expert] in his quantitative model, opining for instance that values he used for subscriber loss rate and diversion rate were not calculated through reliable methods.. . .

* * *

The district court . . . concluded that the government failed to present persuasive evidence that Turner Broadcasting's bargaining leverage would "materially increase" as a result of the merger or that the merger would lead to "*any* raised costs" for rival distributors or consumers. It therefore did not address the . . . question whether any increased costs would result in a substantial lessening of competition.

III.

On appeal, the government contends that the district court court (1) misapplied economic principles, (2) used internally inconsistent logic when evaluating industry evidence, and (3) clearly erred in rejecting [its expert's] quantitative model. . . .

(1) Application of economic principles. The government contends that in evaluating the evidence in support of its increased leverage theory, the district court erroneously discarded or otherwise misapplied two economic principles — the Nash bargaining theory and corporate-wide profit maximization.

(a) Nash bargaining theory. The Nash bargaining theory is used to analyze two-party bargaining situations, specifically where both parties are ultimately better off by reaching an agreement. John F. Nash, Jr., *The Bargaining Problem,* 18 *Econometrica* 155 (1950). The theory posits that an important factor affecting the ultimate

agreement is each party's relative loss in the event the parties fail to agree: when a party would have a greater loss from failing to reach an agreement, the other party has increased bargaining leverage. In other words, the relative loss for each party affects bargaining leverage and when a party has more bargaining leverage, that party is more likely to achieve a favorable price in the negotiation.

The district court had to determine whether the economic theory applied to the particular market by considering evidence about the "structure, history, and probable future" of the video programming and distribution industry. . . . The district court concluded that the government presented insufficient real-world evidence to support the prediction under the Nash bargaining theory of a material increase of Turner Broadcasting's post-merger bargaining leverage in affiliate negotiations by reason of less-costly long-term blackouts. The government's real-world evidence consisted of statements by AT&T Inc. and DirecTV in FCC regulatory filings that vertical integration, such as in the proposed Comcast-NBCU merger, can give distributors an incentive to charge higher affiliate fees and expert opinion and a quantitative model prepared by [its expert]. The expert opinion and model were subject to deficiencies identified by AT&T's experts, some of which [the government's expert] conceded. By contrast, AT&T's expert's econometric analysis of real-world data showed that content pricing in prior vertical mergers in the industry had not increased as the Nash bargaining theory and the model predicted. Given evidence the industry was now "remarkably dynamic," the district court credited CEO testimony about the null effect of vertical integration on affiliate negotiations..

In other words, the record shows that the district court accepted the Nash bargaining theory as an economic principle generally but rejected its specific prediction in light of the evidence that the district court credited. . . .

More concerning is the government's contention that the district court misapplied the Nash bargaining theory in a manner that negated its acceptance of the economics of bargaining by erroneously focusing on whether long-term blackouts would actually occur after the merger, rather than on the changes in stakes of such a blackout for Turner Broadcasting. The government points to the district court's statements . . . that "a blackout would be infeasible." The district court also stated that "there has never been, and is likely never going to be, an actual long-term blackout of Turner [Broadcasting] content". . . .

The question posed by the Nash bargaining theory is whether Turner Broadcasting would be more favorably positioned after the

merger to assert its leverage in affiliate negotiations whereby the cost of its content would increase. Considered in isolation, the district court's statements could be viewed as addressing the wrong question. Considered as part of the district court's analysis of whether the stakes for Turner Broadcasting would change and if so by how much, the statements address whether the threat of long-term blackouts would be credible, as posited by the government's increased leverage theory. The district court found that after the merger the stakes for Turner Broadcasting would change only slightly, so its threat of a long-term blackout "will only be somewhat less incredible". . . . [T]he district court rejected the assumption underlying the government's theory that Turner Broadcasting would gain increased leverage from this slight change in stakes. . . .

The district court's statements identified by the government, then, do not indicate that the district court misunderstood or misapplied the Nash bargaining theory but rather, upon considering whether in the context of a dynamic market where a similar merger had not resulted in a "statistically significant increase in content costs," the district court concluded that the theory inaccurately predicted the post-merger increase in content costs during affiliate negotiations.

. . . The district court reasoned that because long-term blackouts are very costly and would therefore be infeasible for Turner Broadcasting even after the merger, there was insufficient evidence that "a post-merger Turner [Broadcasting] would, or even could, drive up prices by *threatening* distributors with long-term blackouts". . . . [T]he district court reached a fact-specific conclusion based on real-world evidence that, contrary to the Nash bargaining theory and government expert opinion on increased content costs, the post-merger cost of a long-term blackout would not sufficiently change to enable Turner Broadcasting to secure higher affiliate fees. . . .

Not to be overlooked, the district court also credited the efficacy of Turner Broadcasting's "irrevocable" offer of arbitration agreements with a no-blackout guarantee. It characterized the no-blackout agreements as "extra icing on a cake already frosted". . . . [T]he district court explained that it was appropriate to consider the analysis of the Comcast-NBCU merger because the Comcast-NBCU merger was similar to the proposed merger — a vertical merger in the video programming and distribution industry. There the government had recognized, "'especially in vertical mergers, that conduct remedies,' such as the ones proposed [in the *Comcast* case], 'can be a very useful tool to address the competitive problems while preserving competition

and allowing efficiencies' that 'may result from the transaction.'" Like there, the district court concluded the Turner arbitration agreements would have "real-world effect."

* * *

(b) Corporate-wide profit maximization. Still, the government maintains that the reliance on past negotiation experience indicates that the district court misunderstood, and failed to apply, the principle of corporate-wide profit maximization by treating the principle as a question of fact, when "[t]he assumption of profit maximization is 'crucial' in predicting business behavior." Appellant Br. 50 (citation omitted). This principle posits that a business with multiple divisions will seek to maximize its total profits. It was adopted as a principle of antitrust law in *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 771 (1984), holding that a parent and a wholly-owned subsidiary are not capable of conspiracy against each other under Section 1 of the Sherman Antitrust Act. Companies with multiple divisions must be viewed as a single actor, and each division will act to pursue the common interests of the whole corporation.

The . . . government's position that the district court never accepted this economic principle overlooks that it did "accept [the expert's] (and the Government's) argument that generally, 'a firm with multiple divisions will act to maximize profits across them.'" And it ignores that if the merged firm was unable to exert the leverage required by the government's increased leverage theory, then inquiring (as the district court did of [the government's expert]) about an independent basis to conclude that the firm did have such leverage is not a rejection of the corporate-wide profit maximization principle.

The government maintains that the district court's misapplication of the principle of corporate-wide profit maximization is evident from its statement the evidence suggests "vertically integrated corporations have previously determined that the best way to increase company wide profits is for the programming and distribution components to separately maximize their respective revenues" . . . . The district court can be viewed as conveying its understanding that Turner Broadcasting's interest in spreading its content among distributors, not imposing long-term blackouts, would redound to the merged firm's financial benefit, not that Turner Broadcasting would act in a manner contrary to the merged firm's financial benefit.

. . . [T]he government . . . gives no credence to the district court's focus on "the best way to increase company wide profits," referring to the merged firm. *AT&T,* In other words, the district court

was explaining that real-world evidence reflected the profit-maximization principle. . . .

* * *

Similarly, contrary to the government's position, the district court's findings about post-merger negotiating are not internally inconsistent with its finding on the cost savings of the merger. The district court found, and the government agreed, that the merger would result in cost savings as a result of EDM. Pre-merger, both Turner Broadcasting and AT&T earned margins over cost before their products reached consumers: Turner Broadcasting earned a profit margin when it licensed content to AT&T, and AT&T earned a profit margin when it sold content to consumers. Post-merger, Turner Broadcasting would not earn a profit margin when licensing content to AT&T because the merged entity would eliminate that cost and . . . pass on some of those cost savings to consumers in order to attract additional subscribers. For there to be EDM savings, . . . the merged firm must act on its unified interest across divisions. Thus, Turner Broadcasting, instead of maximizing its own revenue, would license its programming to AT&T for a lower price. . . .

(2) Inconsistent reasoning in evaluating trial testimony. The government further maintains that the district court used internally inconsistent reasoning when evaluating testimony from witnesses in the industry.

At trial, third-party distributors and executives from Comcast-NBCU and Time Warner testified about negotiations in the video programming and distribution industry. Third-party distributors testified about their concerns, and their reasons, that Turner Broadcasting would gain increased bargaining leverage as a result of the proposed merger. . . . The district court declined to credit the third-party distributors' testimony because "there is a threat that [third-party distributor] testimony reflects self-interest" yet dismissed the suggestion that testimony from the Time Warner executives should be discounted as potentially biased due to self-interest.

The government contends this reasoning was inconsistent because self-interest existed on both sides of the issue of whether the proposed merger would have anticompetitive effects. Even so, the potential for self-interest was not the only reason the district court found third-party distributor testimony of little probative value. Much of the third-party competitor testimony, the district court found, "consisted of speculative concerns" and did not contain any analysis or factual basis to support key assumptions, such as how Turner Broadcasting's bargaining leverage would change and how many

subscribers distributors would lose in a blackout. By contrast, the Time Warner executives' testimony did "not involve promises or speculations about the employees' future, post-merger behavior" and instead recounted "what these executives previously experienced when working within a vertically integrated company." Their testimony was uniform among all testifying witnesses and corroborated by that of a Comcast-NBCU executive — a competitor of AT&T. . . .

(3) Rejection of [the government expert's] quantitative model. Finally, the government contends that the district court clearly erred in rejecting [its expert's] quantitative bargaining model. . . .

Preliminarily, the court does not hold that quantitative evidence of price increase is required in order to prevail on a Section 7 challenge. Vertical mergers can create harms beyond higher prices for consumers, including decreased product quality and reduced innovation. Indeed, the Supreme Court upheld the Federal Trade Commission's Section 7 challenge to Ford Motor Company's proposed vertical merger with a major spark plug manufacturer without quantitative evidence about price increases. *Ford Motor Co. v. United States*, 405 U.S. 562, 567-69, 578 (1972). Here, however, the government did not present its challenge to the AT&T-Time Warner merger in terms of creating non-price related harms in the video programming and distribution industry. . . .

. . . .The district court accepted [the government expert's] testimony about the $352 million cost savings from the merger. But it found that insufficient evidence supported the inputs and assumptions used to estimate the annual costs increases for rival distributors . . . . Indeed, the district court found that the quantitative model . . . did not provide an adequate basis to conclude that the merger will lead to "*any*" raised costs for distributors or consumers, "much less consumer harms that outweigh the conceded $350 million in annual cost savings to AT&T's customers."

Whatever errors the district court may have made in evaluating the inputs for [the expert's] quantitative model, the model did not take into account long-term contracts, which would constrain Turner Broadcasting's ability to raise content prices for distributors. The district court found that the real-world effects of Turner Broadcasting's existing contracts would be "significant" until 2021 and that it would be difficult to predict price increases farther into the future, particularly given that the industry is continually changing and experiencing increasing competition. This failure, the district court found, resulted in overestimation of how quickly the harms would occur. [The expert] acknowledged that predictions farther into

the future, after the long-term contracts expire, are more difficult. Neither [the expert's] opinion testimony nor his quantitative model considered the effect of the post-litigation offer of arbitration agreements, something he acknowledged would require a new model. And the video programming and distribution industry had experienced "ever-increasing competitiveness" in recent years. Taken together, the government's clear-error contention therefore fails.

* * *

Accordingly, because the district court did not abuse its discretion in denying injunctive relief, we affirm the district court's order denying a permanent injunction of the merger.

NOTES AND QUESTIONS

1. *Nash bargaining theory*. Nash bargaining theory, on which the government's case was largely based, is named after its author, Nobel laureate John Nash, and is widely accepted among economists. The idea, in a nutshell, is that parties reach agreement only when both are better off agreeing than not agreeing and that the terms on which the parties are likely to agree are driven largely by the relative costs to the parties of failing to reach a deal. If party A would be harmed more by the failure to reach agreement than party B, the terms of the deal will be relatively favorable to party B, and vice versa. In a simple buy/sell transaction regarding property for a retail store, for example, the buyer should be willing to pay (its "reservation price") up to the cost to it of not reaching agreement; that might be the cost of buying an equivalent property from a different seller or the cost to the business of having to settle for an inferior alternative or none at all. The seller should be willing to accept (its "reservation price") any price greater than its next best alternative, which might be the price it could get by selling the property to someone else. The difference between the parties' reservation prices are the "gains from trade," and the parties negotiate over how the gains from trade will be allocated. If the parties are otherwise equally skilled negotiators, the price should be midway between the parties' reservation prices. If market circumstances cause one party's reservation price to change, the expected transaction price will also change. The theory does not require that failure to reach agreement is a common or likely outcome, but it does require that one or both parties can credibly threaten not to reach agreement if their proposed terms are not accepted. These notions can be formalized in rigorous mathematical models.

The intuition underlying Nash bargaining theory is similar to the price theory notions that have long been fundamental to antitrust law.

If S is a monopoly, the costs to the customer of not reaching agreement with S will be greater than if S has several competitors to which the customer can turn. The customer can therefore be expected to pay a higher price if S is a monopoly. Nash bargaining theory, however, focuses on bargaining between two parties rather than on the performance of larger, multiparty markets.

2. *Vertical mergers in the past.* The government's theory in the Comcast/NBC merger (page 800) was that rival MVPDs would be excluded as a result of the merger. The government reasoned that NBC would not forego profitable dealing with other MVPDs prior to the merger but that the merged firm would forego those profits in order to increase the size and power of the Comcast MVPD business. As explained in the note about How Vertical Mergers Can Harm Competition (pages 794-798), that is the kind of theory on which vertical mergers have been challenged in the past.

In AT&T/TW, however, the government did not argue that TW would refuse to license some or all of its content to rival distributors or that it would increase prices to above profit-maximizing levels in order to harm the rivals. Instead, it argued that the merger would make such actions less costly to the merged firm (because some of the lost sales to rivals would result in customers switching to AT&T) and would thereby increase TW's bargaining leverage over rival distributors and enable it to charge higher prices, which would benefit both TW and AT&T. In other words, the government did not argue that the merger would give TW an incentive to sacrifice profits in order to benefit AT&T; it argued instead that the merger would enable TW to increase both its profits and AT&T's. The court accepted the government's theory but held that the government had failed on the facts.

3. *Higher prices and injury to competition.* Is the government's theory sound as a matter of law? The government did not try to prove that the higher prices would harm competition among MVPDs by showing, for example, that the higher prices would materially weaken AT&T's MVPD rivals or would create a price umbrella under which AT&T could exercise market power. Can such harm be presumed? If not, is the government alleging injury to competition or just higher prices, which are not themselves enough to establish a violation of the antitrust laws? (With respect to whether high prices are themselves unlawful, see *Rambus* (Chapter 8) and *NYNEX* (Chapter 10); see also *Trinko* (Chapter 5).) Is the idea that the merger injured competition because it reduced the competitive constraints on TW by diminishing the ability of consumers to switch to unaffiliated MVPDs?

4. *Double marginalization*. Double marginalization arises when providers of complements, including vertically related firms, seek to exercise market power in the markets in which the complements are sold. As explained in Chapter 4 (pages 352-58), if the firms do not coordinate their prices, they will in aggregate charge more than the profit-maximizing price to the detriment of both consumers and the firms themselves. The ATT&T/TW court found that the merger would enable the merged firm to coordinate the AT&T and TW prices and thus eliminate pre-merger double marginalization. Why do you suppose the parties could not have eliminated the double marginalization without a merger? Should the merging parties have the burden of proving that double marginalization could not be eliminated absent the merger in order to rely on EDM as defense?

5. *Litigate or settle*. DOJ passed up an opportunity to settle the AT&T/TW case on terms reportedly similar to those in the Comcast/NBC settlement. DOJ explained its view that complex conduct remedies are burdensome and often ineffective and that the better course would be to block the merger altogether, but DOJ lost and thus ended up with no remedy. Did DOJ make a mistake in choosing the litigate? Or does the outcome prove that a remedy would not have been warranted?

Merger cases almost always involve predictions about the future. There is therefore almost always some uncertainty, not just about litigation risk, but about the substantive question whether the merger will be anticompetitive. How should an enforcement agency take such substantive uncertainty into account in making enforcement decisions?

6. *Never mind*. On May 17, 2021, AT&T announced that it was undoing the Time-Warner merger. The spin-off transaction is substantially more complicated than that as it also involved folding in certain assets from Discovery, but once again, Time-Warner was involved in a major merger only to have it undone at a later date. (As you may recall, amidst the internet boom, in 2000, AOL and Time-Warner merged only to undo the merger in 2009.) Does the fact that AT&T has now backed away from the Time-Warner merger cause you to change your view of any of the issues raised in the case?

Chapter 6.4.C: Note on Potential Competition Merger Cases

[Insert on p. 830 at the end of Note on Potential Competition Merger Cases]

In *In re Meta Platforms and Within Limited*, Dkt. No. 9411 (Feb. 24, 2023), the Federal Trade Commission dismissed one of the rare potential competition cases brought by the antitrust agencies. The filing of the complaint in August 2022 followed guidance from FTC Chair Lina Khan that the agency should be "forward-looking" in its enforcement actions and pay close attention to "next-generation technologies, innovations, and nascent industries across sectors." The case involved the decision by Meta (formerly known as Facebook) to acquire Within, a leading virtual reality company. The FTC argued that Meta was intent on expanding its position in the virtual reality (VR) fitness app markets and regarded the acquisition of an existing VR fitness app as an alternative to entering on its own. Thus, on the FTC's theory, Meta was an "actual potential entrant," and the acquisition would mean less competition in the VR fitness app markets.

The *Meta/Within* case was brought as an administrative proceeding and sought to try it before an Administrative Law Judge of the FTC. The FTC also proceeded in federal court to enjoin the merger, but the judge rejected the FTC's theory on the ground that there was insufficient evidence to support the claim that Meta would enter the markets on its own and the FTC was relying on little more than speculation. In the face of the denial of its preliminary injunction motion, the FTC then dismissed the case. Like all actual potential competition cases, which inevitably entail substantial uncertainty, *Meta/Within* implicitly raised the question of how antitrust courts and enforcement agencies should weigh the competing risks of false positives (blocking possibly procompetitive conduct) and false negatives (permitting possibly anticompetitive conduct).

The difficult question of how to decide antitrust issues when there is substantial uncertainty is also presented by the FTC's subsequent administrative proceeding challenging Amgen's acquisition of Horizon Therapeutics, *In re Amgen and Horizon Therapeutics,* Dkt.9414 (filed June 22, 2023). Amgen is one of the world's largest biopharmaceutical companies and has a large portfolio of drugs that it commonly promotes by offering rebates to purchasers of bundles of its various products. Horizon is a smaller pharmaceutical company, but it has the only FDA-approved treatments for thyroid eye disease and chronic refractory gout. The FTC's theory does not fall neatly into traditional "horizontal" or "vertical" theories of competitive

harm. Rather, citing Amgen's "history of leveraging its broad portfolio of blockbuster drugs to gain advantages over potential rivals," the FTC alleges that the acquisition would enable Amgen, by bundling the Horizon drugs with its large portfolio of drugs, to entrench Horizon's existing monopoly products against expected competition from new drugs. Because Amgen does not compete with Horizon's monopoly products, the merger is best understood as a merger of complements. In response to the challenge, the merging firms have called the allegations "far too speculative" to violate the antitrust laws. The parties have pushed for a trial in the fall of 2023 that would allow them, if they prevail in the litigation, to close the deal by the end of the year.

Chapter 6.4.D: "Litigating The Fix"

[Insert on p. 838 after "C. The Limits of Divestitures and Accompanying Remedies"]

An increasingly common strategy for merging firms is to propose divestitures or other "fixes" to the merger as a defense to a legal challenge. Under this approach, rather than litigate the legality of the merger submitted to the antitrust agencies under the HSR Act, merging parties ask courts to consider the "fix" in assessing the lawfulness of the merger. In 2022, for example, UnitedHealth Group Inc. successfully defended its vertical merger with Change Healthcare by UnitedHealth Group Inc. by promising to divest a particular unit to a private equity firm.

There are actually a few different types of "litigating the fix" strategies. As in the *UnitedHealth/Change* transaction, a company can promise to sell off certain units after the merger closes. Or, as noted below as to the FTC's failed challenge of Microsoft/Activision deal, the merging firms make a commitment to a certain course of conduct, such as selling valuable inputs to competitors, limiting future price increases, or establishing internal firewalls to prevent the transmission of nonpublic information about customers or suppliers from being transmitted to different components of the merged firms. Firms might propose more than one such "fix" for a particular merger.

Conceptually, there are three possible ways that court might respond to these strategies. Courts might disregard them on the ground that they are unreliable or that they in effect ask the agencies to assess the lawfulness of a transaction different from the transaction reported to the agency under the Hart-Scott-Rodino Act. Courts might exclude them from consideration when evaluating the plaintiff's prima facie case and, if the plaintiff succeeds in establishing a prima facie

violation, consider the proposed "fix" as part of the merging parties' affirmative defense. And courts might consider them only as part of the remedy proceedings after they have determined that the proposed merger is unlawful. The last of these alternatives is the most problematic from the perspective of the merging parties because, instead of considering the proposed "fix" as part of its overall assessment of the merger, the court would accept the "fix" only if it found that it would eliminate the harms that would be caused by the merger without the fix. In *United States v. Aetna Inc.*, 240 F.Supp.3d 70, 72-73. (D.D.C. 2017), for example, the court concluded that the divestiture of a portion of the parties' Medicare Advantage business to a third party would not replicate the lost competition. *See*; see generally, Steven C. Salop and Jennifer E. Sturiale, *Fixing "Litigating the Fix,"* __ Antitrust L.J. __, __ (2023. (arguing that courts should require a "remedy filing" that details the proposed fix with specificity and allow for the agency to issue relevant information requests on the proposed remedy).[10]

Section 7 of the Clayton Act prohibits acquisitions where "the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." With advance notification of proposed mergers under Hart/Scott/Rodino and where the FTC may seek, as it did in *Microsoft/Activision*, to preliminarily enjoin a merger, applying the statutory standard is necessarily predictive. In the *Activision* case, a critical issue was the prediction as to whether or not a combined Microsoft/Activision would withhold the popular Call of Duty video game from the Sony PlayStation game console. Microsoft sought to shape how the court would see that likelihood by offering to commit to license the game to Sony for 10 years. That put the litigating-the-fix issue squarely on the table. Should the merger be considered straight up without the proposed fix? Should instead the court take into account the proposed commitment, and, if so, should it do that in assessing the lawfulness of the merger in the first instance or only if and when it gets to the remedy phase after finding the merger to be unlawful? Should it matter if the parties withdrew the initial pre-merger filing and refiled after the fix was already in place? Should it matter whether the fix is structural in nature (e.g., divesting assets) or behavioral (e.g., selling inputs to a competitor)? Should it matter when the "fix" was proposed in relation to the initial pre-merger notification or in relation to the close of discovery or that start of trial? The state of merger law and practice in this area remains very much

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[10] Available at https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=3488&context=facpub.

a work in progress, and it remains to be seen how courts will ultimately treat "litigate the fix" strategies.

Chapter 6.4.E: *Steves and Sons* And Remedies In Private Merger Cases

[on page 843, at the end of Chapter 6]

The Supreme Court made clear more than thirty year ago that the Clayton Act authorizes divestiture in private cases "when it is appropriate under equitable principles" to protect plaintiffs from "threatened loss or damage by a violation of the antitrust laws." California v. American Stores Co., 495 U.S. 271, 280, 285 (1990). Until this year, however, no court had ordered divestiture in a private case.

In *Steves and Sons v. JELD-WEN, Inc.*, 988 F.3d 690 (4th Cir. 2021), the Court of Appeals affirmed a district court decision ordering divestiture of assets acquired in what the court found to be an unlawful merger that had been consummated nine years earlier. The merger involved two of the three manufacturers of molded doorskins—a critical component needed to build doors. The plaintiff, Steves and Sons, was an independent door manufacturer. The district court found that, prior to the merger, the three molded doorskin manufacturers "competed vigorously in selling doorskins to Steves and the other independent (non-integrated) door manufacturers." *Steves and Sons, Inc. v. JELD-WEN, Inc.*, 345 F.Supp.3d 614, 631 (2018). The three manufacturers were Masonite, which had a 46% market share; JELD-WEN, 38%; and CMI, 16%.

JELD-WEN agreed to acquire CMI in 2012. Shortly thereafter, and before filing its premerger notification under the Hart-Scott-Rodino Act, JELD-WEN entered into multi-year supply agreements with Steves and other independent door manufacturers. The agreement with Steve's specified the price for the doorskins; it did not, however, specify quality requirements, reimbursement terms, or other important matters. The agreement was for seven years but would automatically renew unless terminated by one of the parties.

After the agreements were entered into, JELD-WEN filed its premerger notification. The Department of Justice investigated the proposed merger, but, in the absence of any complaints from customers (who had entered into long-term supply agreements, like Steves's), it declined to challenge it. The merger was consummated in the Fall of 2012.

The supply agreements proved to be of limited value. JELD-WEN increased the prices for Steves to almost eight percent more than

that authorized under its agreement and changed its policy on reimbursing Steves for the cost of doors rendered defective by flawed doorskins. When Masonite announced in 2014 that it would not sell doorskins to independent door manufactures, Steves lost the alternative supply option it had used to put pressure on JELD-WEN when it negotiated its last agreement.

In the face of worsening supply conditions, Steves asked the Justice Department to reexamine the merger. After the Department declined to take action, Steves sued JELD-WEN in 2016, alleging that its acquisition of CMI was illegal and that it had breached the 2012 supply agreement. After a jury trial, the district court held that the acquisition of CMI violated Section 7 of the Clayton Act, ordered JELD-WEN to divest the doorskin plant it had acquired from CMI, and awarded Steves damages for breach of the supply agreement.

The Fourth Circuit Court of Appeals affirmed these aspects of the district court's decision. The court emphasized that the merger caused the HHI of the doorskin market to increase roughly 1,200-points—six times the threshold for presumed illegality under the Merger Guidelines, 988 F.3d at 715, and that JELD-WEN did not present any evidence to defend the merger on the merits. The court held that Steves had suffered antitrust injury because the merger denied Steves the option of a competing supplier (CMI) and because the supply agreement did not require JELD-WEN to supply high-quality products or maintain a liberal reimbursement policy and the merger reduced its competitive incentives to do so. Id. at 711.

The court also rejected JELD-WEN's argument that Steves' claim should be barred by the doctrine of laches because Steves waited several years to challenge the merger.[11] The court said that Steves could not have anticipated its potential loss of access to doorskins when the supply agreement was in effect and Masonite was an available alternative, id. at 717-18.

[11] Laches is an equitable doctrine, roughly analogous to the statute of limitations applicable to actions for damages, that "bars a plaintiff from maintaining a suit if he unreasonably delays in filing a suit and as a result harms the defendant." *Nat'l R.R. Passenger Corp. v. Morgan*, 536 U.S. 101, 121 (2002). Because of its similarity to the statute of limitations, which is four years for antitrust actions, courts often begin with the presumption that equitable claims under the antitrust laws should be brought within four years of the time the cause of action accrued. E.g., *Menominee Indian Tribe of Wisconsin v. United States*, 614 F.3d 519, 531 (D.C. Cir. 2010).

The court held that divestiture is an equitable remedy the appropriateness of which is to be assessed by consideration of the same four factors used to assess all equitable remedies: whether the plaintiff faces a threat of irreparable injury, whether there is an adequate remedy at law, the balance of hardships between the parties, and the public interest. It concluded that divestiture was appropriate in this case largely because the elimination of competition caused by the merger threatened Steves' survival and divestiture would promote competition in the doorskin market. Id. at 719-20.

The case touches upon several important issues and raises many interesting questions, including the following:

1. The court's discussion of the antitrust injury issue illustrates some of the ways in which a merger of suppliers can impact their customers. No doubt because it anticipated that its customers might be concerned about the merger, JELD-WEN did what many merging parties do: It entered into agreements with customers regarding post-merger conduct in order to reduce or eliminate the customers' incentives to complain about the merger or even to provide testimony that might support a case by the government challenging the merger. From the government's perspective, do these agreements eliminate the antitrust concerns about the merger? If not, should the government challenge the merger and try to persuade the court to disregard the absence of support for the challenge by the very customers most likely to be harmed by a reduction in competition? How likely do you think the government is to win the case under those circumstances?

2. As we have seen elsewhere, many aspects of antitrust law, especially under the Sherman Act, often favor defendants because of the courts' concern that more aggressive or ambiguous standards might be abused by opportunistic private plaintiffs whose interests are not aligned with those of the public. The court in Steves expressed no such concern. What makes this case different? Should the court have been more skeptical of Steves' case?

3. Steves did not file suit until nearly 4 years after the merger had been consummated and JELD-WEN had made substantial investments to integrate the CMI plant into its operations. Was the court correct in rejecting JELD-WEN's laches argument? Is there an inconsistency between the court's holding on antitrust injury and its laches holding? Didn't Steves know about the effect of the merger on market competition back in 2012? Is it appropriate for Steves to enter into the supply agreement and then decide, years later, whether it prefers the alternative of antitrust litigation or that it made a bad deal? (And we should flag for you the increased importance of the

laches defense. With a change of administrations in Washington D.C. and the resulting turnover at the Antitrust Division and the Federal Trade Commission, there might be an increased number of cases challenging previously consummated mergers. The pending litigation over Facebook's purchases of Instagram and WhatsApp is an obvious example of this. While the federal enforcement agencies cannot be barred by a laches defense, the laches issue is an important defense in the lawsuit brought by many state attorneys general challenging those acquisitions.)

Chapter 7: Competition Law in the Global Economy

Note About Animal Science Prods., Inc. V. Hebei Welcome Pharmaceutical Co. Ltd.

United States Supreme Court, 2018.
138 S. Ct. 1865.
[insert before 3. Export Commerce, on p. 881]

From time to time, firms find themselves in the cross-hairs of conflicting national laws, with very little room to maneuver. This might be what happened in *Animal Science Prods., Inc. v. Hebei Welcome Pharm. Co. Ltd.*, 138 S. Ct. 1865 (2018), which involved a challenge to an alleged Chinese cartel that was fixing the price of Vitamin C that was manufactured in China and imported into the United States. On the surface, this was a relatively routine cartel case, in which a class of U.S. plaintiffs' were complaining about direct sales at anticompetitively high prices. But the complication was this: the four defendant Chinese corporations asserted that the Chinese government had compelled them to become members of the Chamber of Commerce of Medicines and Health Products Importers and Exporters ("the Chamber") and that the Chamber fixed the prices the member companies had to charge, and the quantities they were permitted to sell, to U.S. customers. The Chinese sellers thus moved to dismiss the complaint on the ground that Chinese law compelled their actions—in other words, they invoked the "foreign sovereign compulsion" defense. They were backed up in this assertion by a brief *amicus curiae* filed by the Ministry of Commerce of the People's Republic of China; the Ministry confirmed that the Chamber was under direct government supervision and that the alleged conspiracy was in fact "a regulatory pricing regime mandated by the government of China." *Id.* at 1870.

The district court held that Chinese law did not excuse the companies' price-fixing, and after a trial it awarded the plaintiffs $147

million in treble damages. It also enjoined the plaintiffs from further violations of the Sherman Act. The court said that, while the Ministry's statements about Chinese law were "entitled to substantial deference," they were not "conclusive." The court noted, among other things, an earlier Chamber announcement that the manufacturers had reached a "self-regulated agreement" pursuant to which they would "voluntarily control" the quantity of exports, *id*., at 1871, and China's statement to the World Trade Organization that its "export administration" of Vitamin C ended in 2002. *Id*.

The Court of Appeals for the Second Circuit reversed. It reasoned that the case turned on whether it was impossible for the Chinese sellers to obey both Chinese and U.S. law at the same time and that determination of that question depended on "the amount of deference" owed to the Ministry's characterization of Chinese law. *Id*. at 1872. As to the deference question, the appeals court held that a U.S. court should not challenge "a foreign government's official representation" about its law, as long as its description of the law is "reasonable." *Id*.

The Supreme Court granted *certiorari* to review the question whether "a federal court determining foreign law … [is] required to treat as conclusive a submission from the foreign government describing its own law." *Id.* at 1872. The Court answered that question in the negative. It noted that Federal Rule of Civil Procedure 44.1 entrusts the district court with the duty of ascertaining foreign law (and that this is a "question of law" for the court, not a matter of "fact"). It held in particular that "a government's expressed view of its own law is ordinarily entitled to substantial but not conclusive weight." *Id.* at 1875. Elaborating, it said that "the appropriate weight in each case will depend upon the circumstances; a federal court is neither bound to adopt the foreign government's characterization nor required to ignore other relevant materials. When a foreign government makes conflicting statements … or, as here, offers an account in the context of litigation, there may be cause for caution in evaluating the foreign government's submission." *Id.* at 1873.

This holding will make life difficult for companies that face seemingly inconsistent rules. They will be faced with the unpalatable choice of (a) violating their home country law; (b) running the risk that, if they comply with their home country law, a U.S. court will construe it differently; (c) foregoing the U.S. market; or (d) pushing to see whether there is some flexibility in the home country law that might enable compliance with both laws. The final wrinkle is that many countries (including China) have competition laws that are, at least on paper, compatible with U.S. law. It remains to be seen

whether that substantive convergence will provide some kind of relief for companies in countries that permit certain cartels or monopolies to exist.

On August 10, 2021, the Second Circuit concluded that Chinese law required the defendants in the original action to engage in price fixing and ordered the district court, under the principles of international comity, to dismiss the action with prejudice. See *Animal Science Products, Inc. v. Hebei Welcome Pharmaceutical Co.*, 13-4791-cv (2nd Cir. August 10, 2021).

Chapter 8.2.B.2: The Special Problem of Patent Uncertainty

[insert after note 7 on page 923 of the main text]

8. *Too many patents?*. Critics have long been concerned about the aggregation of large patent portfolios that might be used to insulate from judicial review patents that are likely to be invalid. The concern is that, while an alleged infringer might challenge the validity of one or two patents asserted against it, it is unlikely to litigate a claim that it is infringing dozens of patents because of the unlikelihood that it will run the table and prove all of them to be invalid. Do the same concerns apply when a firm just receives lots of patents through the normal processes of the U.S. Patent and Trademark Office?

In *Mayor and City Council of Baltimore v. AbbVie, Inc.*, 42 F.4th 709 (7th Cir. 2022), plaintiffs alleged that AbbVie had created a "patent thicket" that violated Section 2 of the Sherman Act when it obtained 132 patents from the U.S.P.T.O., some of which the plaintiffs believed were invalid. The court affirmed the lower court's dismissal of the complaint. The court acknowledged that "*invalid* patents cannot be used to create or protect a monopoly," but it reasoned that the plaintiffs had neither challenged the validity of the patents nor alleged that they were obtained by fraud or other misconduct. The court thus rejected what it characterized as plaintiffs' effort "to conjure liability out of successful petitions for governmental aid in blocking competition" on the ground that it "runs into the *Noerr-Pennington* doctrine," which exempts from antitrust liability successful efforts to petition the government. Id. at 713.

By implicitly assuming a simple dichotomy between valid and invalid patents, did the court fail to take into account the alleged practical effect of the patent thicket in insulating potentially invalid patents from challenge? If some of those patents were found to be invalid, rivals might be able to enter into commercial activity

otherwise closed to them. Is there a role for antitrust courts to remedy the practical shortcomings of the patent system when they harm competition? Or is asking antitrust courts to evaluate the validity of patents—apparently the concern of the court—a bridge too far?

Might the court have reached a different result if AbbVie had accumulated its portfolio by acquisition from multiple patent holders instead of applying for and obtaining the patents from the Patent Office? Notably, the acquisition of substitute patents would be treated as, in effect, a horizontal merger and would be unlawful if it were found to give the acquiring entity market power in a product or technology licensing market by eliminating competition among competing patented technologies.

Aggregation of complementary patents is usually thought to be very different because it does not eliminate competition and might have the benefit of avoiding the "double marginalization problem," thus reducing both transaction costs and prices. (See pages 352-56 in the main text for a discussion of that issue.) Critics of patent aggregation, however, are concerned that those benefits might be outweighed by the adverse effects of insulating weak patents from challenge. In *Intel Corporation v. Fortress Investment Group LLC*, No. 21-16817 (9th Cir. 2022), in an unpublished opinion, the court rejected a challenge to acquisition-based patent aggregation by a patent assertion entity that allegedly used the aggregation model to extract excessive royalties on the ground that aggregation of complementary patents does not reduce competition. Might the court have reached a different result if the patent portfolio had been used to exclude competitors in order to maintain a monopoly? Does this issue constitute a competition policy problem that, if not remediable by antitrust law, might require other measures?

Chapter 8.3: Standard Setting

Federal Trade Commission v. Qualcomm Incorporated

United States Court of Appeals, Ninth Circuit, 2020.
969 F.3d 974.

[Insert after Notes and Questions on page 951]

CALLAHAN, Circuit Judge. This case asks us to draw the line between *anti*competitive behavior, which is illegal under federal antitrust law, and *hyper*competitive behavior, which is not. The

Federal Trade Commission ("FTC") contends that Qualcomm Incorporated ("Qualcomm") violated the Sherman Act, 15 U.S.C. §§ 1, 2, by unreasonably restraining trade in, and unlawfully monopolizing, the code division multiple access ("CDMA")a and premium long-term evolution ("LTE") cellular modem chip markets. After a ten-day bench trial, the district court agreed and ordered a permanent, worldwide injunction prohibiting several of Qualcomm's core business practices. We granted Qualcomm's request for a stay of the district court's injunction pending appeal. *FTC v. Qualcomm Inc*., 935 F.3d 752 (9th Cir. 2019). At that time, we characterized the district court's order and injunction as either "a trailblazing application of the antitrust laws" or "an improper excursion beyond the outer limits of the Sherman Act." *Id.* at 757. We now hold that the district court went beyond the scope of the Sherman Act, and we reverse.

I.

A.

Founded in 1985, Qualcomm dubs itself "the world's leading cellular technology company." Over the past several decades, the company has made significant contributions to the technological innovations underlying modern cellular systems, including third-generation ("3G") CDMA and fourth-generation ("4G") LTE cellular standards—the standards practiced in most modern cellphones and "smartphones." Qualcomm protects and profits from its technological innovations through its patents, which it licenses to original equipment manufacturers ("OEMs") whose products (usually cellphones, but also smart cars and other products with cellular applications) practice one or more of Qualcomm's patented technologies.

Qualcomm's patents include cellular standard essential patents ("SEPs"), non-cellular SEPs, and non-SEPs. Cellular SEPs are patents on technologies that international standard-setting organizations ("SSOs") choose to include in technical standards practiced by each new generation of cellular technology. . . . Cellular SEPs are necessary to practice a particular cellular standard. Because SEP holders could prevent industry participants from implementing a standard by selectively refusing to license, SSOs require patent holders to commit to license their SEPs on fair, reasonable, and nondiscriminatory ("FRAND") terms before their patents are incorporated into standards.

. . . . Rather than license its patents individually, Qualcomm generally offers its customers various "patent portfolio" options,

whereby the customer/licensee pays for and receives the right to practice all three types of Qualcomm patents (SEPs, non-cellular SEPs, and non-SEPs).

Qualcomm's patent licensing business is very profitable, representing around two-thirds of the company's value. But Qualcomm is no one-trick pony. The company also manufactures and sells cellular modem chips, the hardware that enables cellular devices to practice CDMA and premium LTE technologies and thereby communicate with each other across cellular networks. This makes Qualcomm somewhat unique in the broader cellular services industry. Companies such as Nokia, Ericsson, and Interdigital have comparable SEP portfolios but do not compete with Qualcomm in the modem chip markets. On the other hand, Qualcomm's main competitors in the modem chip markets—companies such as MediaTek, HiSilicon, Samsung LSI, ST-Ericsson, and VIA Telecom (purchased by Intel in 2015)—do not hold or have not held comparable SEP portfolios.

Like its licensing business, Qualcomm's modem chip business has been very successful. From 2006 to 2016, Qualcomm possessed monopoly power in the CDMA modem chip market, including over 90% of market share. From 2011 to 2016, Qualcomm possessed monopoly power in the premium LTE modem chip market, including at least 70% of market share. During these timeframes, Qualcomm leveraged its monopoly power to "charge monopoly prices on [its] modem chips." *Qualcomm*, 411 F. Supp. 3d at 800. Around 2015, however, Qualcomm's dominant position in the modem chip markets began to recede, as competitors like Intel and MediaTek found ways to successfully compete. Based on projections from 2017 to 2018, Qualcomm maintains approximately a 79% share of the CDMA modem chip market and a 64% share of the premium LTE modem chip market.

B.

Qualcomm licenses its patent portfolios exclusively at the OEM level, setting the royalty rates on its CDMA and LTE patent portfolios as a percentage of the end-product sales price. This practice is not unique to Qualcomm. As the district court found, "[f]ollowing Qualcomm's lead, other SEP licensors like Nokia and Ericsson have concluded that licensing only OEMs is more lucrative, and structured their practices accordingly." OEM-level licensing allows these companies to obtain the maximum value for their patented technologies while avoiding the problem of patent exhaustion, whereby "the initial authorized [or licensed] sale of a

patented item terminates all patent rights to that item." *Quanta Comput., Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 625 (2008). Due to patent exhaustion, if Qualcomm licensed its SEPs further "upstream" in the manufacturing process to competing chip suppliers, then its patent rights would be exhausted when these rivals sold their products to OEMs. OEMs would then have little incentive to pay Qualcomm for patent licenses, as they could instead become "downstream" recipients of the already exhausted patents embodied in these rivals' products.

Because rival chip manufacturers practice many of Qualcomm's SEPs by necessity, Qualcomm offers these companies what it terms "CDMA ASIC Agreements," wherein Qualcomm promises not to assert its patents in exchange for the company promising not to sell its chips to unlicensed OEMs. . . .

Qualcomm reinforces these practices with its so-called "no license, no chips" policy, under which Qualcomm refuses to sell modem chips to OEMs that do not take licenses to practice Qualcomm's SEPs. Otherwise, because of patent exhaustion, OEMs could decline to take licenses, arguing instead that their purchase of chips from Qualcomm extinguished Qualcomm's patent rights with respect to any CDMA or premium LTE technologies embodied in the chips. This would not only prevent Qualcomm from obtaining the maximum value for its patents, it would result in OEMs having to pay more money (in licensing royalties) to purchase and use a competitor's chips, which are unlicensed. Instead, Qualcomm's practices, taken together, are "chip supplier neutral"—that is, OEMs are required to pay a per-unit licensing royalty to Qualcomm for its patent portfolios regardless of which company they choose to source their chips from.

Although Qualcomm's licensing and modem chip businesses have made it a major player in the broader cellular technology market, the company is not an OEM. That is, Qualcomm does not manufacture and sell cellphones and other end-use products (like smart cars) that consumers purchase and use. Thus, it does not "compete"—in the antitrust sense—against OEMs like Apple and Samsung in these product markets. Instead, these OEMs are Qualcomm's *customers*.

C.

* * *

Qualcomm's competitors in the modem chip markets contend that Qualcomm's business practices, in particular its refusal to license them, have hampered or slowed their ability to develop and

retain OEM customer bases, limited their growth, delayed or prevented their entry into the market, and in some cases forced them out of the market entirely. These competitors contend that this result is not just anticompetitive, but a violation of Qualcomm's contractual commitments to two cellular SSOs . . . to license its SEPs "to all applicants" on FRAND terms. . . .

In 2011 and 2013, Qualcomm signed agreements with Apple under which Qualcomm offered Apple billions of dollars in incentive payments contingent on Apple sourcing its iPhone modem chips exclusively from Qualcomm and committing to purchase certain quantities of chips each year. Again, rivals such as Intel—as well as Apple itself, which was interested in using Intel as an alternative chip supplier— complained that Qualcomm was engaging in anticompetitive business practices designed to maintain its monopolies in the CDMA and premium LTE modem chip markets while making it impossible for rivals to compete. In 2014, Apple decided to terminate these agreements and source its modem chips from Intel for its 2016 model iPhone.

D.

In January 2017, the FTC sued Qualcomm for equitable relief, alleging that Qualcomm's interrelated policies and practices excluded competitors and harmed competition in the modem chip markets, in violation § 5(a) of the FTC Act, 15 U.S.C. § 45(a), and §§ 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2. After a ten-day bench trial, the district court concluded that "Qualcomm's licensing practices are an unreasonable restraint of trade under § 1 of the Sherman Act and exclusionary conduct under § 2 of the Sherman Act." The district court ordered a permanent, worldwide injunction prohibiting Qualcomm's core business practices.

* * *

II.

* * *

A.

. . . [N]ovel business practices—*especially* in technology markets—should not be "conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." *Microsoft*, 253 F.3d at 91. . . ; *see also* Rachel S. Tennis & Alexander Baier Schwab, *Business Model Innovation and Antitrust Law*, 29 Yale J. on Reg. 307, 319 (2012) (explaining how "antitrust economists,

and in turn lawyers and judges, tend to treat novel products or business practices as anticompetitive" and "are likely to decide cases wrongly in rapidly changing dynamic markets," which can have long-lasting effects particularly in technological markets, where innovation "is essential to economic growth and social welfare" and "an erroneous decision will deny large consumer benefits").

Regardless of whether the alleged antitrust violation involves concerted anticompetitive conduct under § 1 or independent anticompetitive conduct under § 2, the three- part burden-shifting test under the rule of reason is essentially the same. . . . Under § 1, "the plaintiff has the initial burden to prove that the challenged restraint has a substantial anticompetitive effect that harms consumers in the relevant market". . . . "If the plaintiff carries its burden, then the burden shifts to the defendant to show a procompetitive rationale for the restraint". . . . "If the defendant makes this showing, then the burden shifts back to the plaintiff to demonstrate that the procompetitive efficiencies could be reasonably achieved through less anticompetitive means."

Likewise, "if a plaintiff successfully establishes a *prima facie* case under § 2 by demonstrating anticompetitive effect, then the monopolist may proffer a 'procompetitive justification' for its conduct." *Microsoft*, 253 F.3d at 59. "If the monopolist asserts a procompetitive justification—a nonpretextual claim that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal—then the burden shifts back to the plaintiff to rebut that claim." *Id.* If the plaintiff cannot rebut the monopolist's procompetitive justification, "then the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit." *Id.*

The similarity of the burden-shifting tests under §§ 1 and 2 means that courts often review claims under each section simultaneously. . . . However, although the tests are largely similar, a plaintiff may not use *indirect* evidence to prove unlawful monopoly maintenance via anticompetitive conduct under § 2. . . .

B.

A threshold step in any antitrust case is to accurately define the relevant market, which refers to "the area of effective competition." *Am. Express*, 138 S. Ct. at 2285 (citation omitted). . . .

Here, the district court correctly defined the relevant markets as "the market for CDMA modem chips and the market

for premium LTE modem chips." Nevertheless, its analysis of Qualcomm's business practices and their anticompetitive impact looked beyond these markets to the much larger market of cellular services generally. Thus, a substantial portion of the district court's ruling considered alleged economic harms to OEMs—who are Qualcomm's *customers*, not its competitors—resulting in higher prices to consumers. These harms, even if real, are not "anticompetitive" in the antitrust sense—at least not *directly*—because they do not involve restraints on trade or exclusionary conduct in "the area of effective competition." *Am. Express*, 138 S. Ct. at 2285.

* * *

III.

Accordingly, we reframe the issues to focus on the impact, if any, of Qualcomm's practices in the area of effective competition: the markets for CDMA and premium LTE modem chips. Thus, we begin by examining the district court's conclusion that Qualcomm has an antitrust duty to license its SEPs to its direct competitors in the modem chip markets.

* * *

A.

"As the Supreme Court has repeatedly emphasized, there is 'no duty to deal under the terms and conditions preferred by [a competitor's] rivals[.]" Likewise, "the Sherman Act 'does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.'" *Trinko*, 540 U.S. at 408 (alteration in original). . . .

The one, limited exception to this general rule that there is no antitrust duty to deal comes under the Supreme Court's decision in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985). There, the Court held that a company engages in prohibited, anticompetitive conduct when (1) it "unilateral[ly] terminat[es] . . . a voluntary and profitable course of dealing"; (2) "the only conceivable rationale or purpose is 'to sacrifice short- term benefits in order to obtain higher profits in the long run from the exclusion of competition'"; and (3) the refusal to deal involves products that the defendant already sells in the existing market to other similarly situated customers. The Supreme Court later characterized the *Aspen Skiing* exception as "at or near the outer boundary of § 2 liability." *Trinko*, 540 U.S. at 409.

The district court's conclusion that Qualcomm's refusal to provide exhaustive SEP licenses to rival chip suppliers meets the *Aspen Skiing* exception ignores critical differences between Qualcomm's business practices and the conduct at issue in *Aspen Skiing*, and it ignores the Supreme Court's subsequent warning in *Trinko* that the *Aspen Skiing* exception should be applied only in rare circumstances. . . .

First, the district court was incorrect that "Qualcomm terminated a 'voluntary and profitable course of dealing'" with respect to its previous practice of licensing at the chip- manufacturer level. In support of this finding, the district court cited a single piece of record evidence: an email from a Qualcomm lawyer regarding 3%-royalty-bearing licenses for modem chip suppliers. But this email was sent in 1999, seven years before Qualcomm gained monopoly power in the CDMA modem chip market. Furthermore, Qualcomm claims that it never granted exhaustive licenses to rival chip suppliers. Instead, as the 1999 email suggests, it entered into "non-exhaustive, royalty-bearing agreements with chipmakers that explicitly did not grant rights to the chipmaker's customers."

According to Qualcomm, it ceased this practice in response to developments in patent law's exhaustion doctrine, which made it harder for Qualcomm to argue that it could provide "non-exhaustive" licenses in the form of royalty agreements. Nothing in the record or in the district court's factual findings rebuts these claims. The FTC offered no evidence that, from the time Qualcomm first gained monopoly power in the modem chip market in 2006 until now, it ever had a practice of providing exhaustive licenses at the modem chip level rather than the OEM level.

Second, Qualcomm's rationale for "switching" to OEM- level licensing was not "to sacrifice short-term benefits in order to obtain higher profits in the long run from the exclusion of competition," the second element of the *Aspen Skiing* exception. Instead, Qualcomm responded to the change in patent-exhaustion law by choosing the path that was "far more lucrative," both in the short term *and* the long term, regardless of any impacts on competition. The district court itself acknowledged that this was Qualcomm's purpose, observing: "Following Qualcomm's lead, other SEP licensors like Nokia and Ericsson have concluded that licensing only OEMs is more lucrative, and structured their practices accordingly."

Finally, unlike in *Aspen Skiing*, the district court found no evidence that Qualcomm singles out any specific chip supplier for anticompetitive treatment in its SEP-licensing. In *Aspen Skiing*, the

defendant refused to sell its lift tickets to a smaller, rival ski resort even as it sold the same lift tickets to any other willing buyer (including any *other* ski resort); moreover, this refusal was designed specifically to put the smaller, nearby rival out of business. Qualcomm applies its OEM-level licensing policy equally with respect to all competitors in the modem chip markets and declines to enforce its patents against these rivals even though they practice Qualcomm's patents (royalty-free). . . .

As none of the required elements for the *Aspen Skiing* exception are present, let alone all of them, the district court erred in holding that Qualcomm is under an antitrust duty to license rival chip manufacturers. We hold that Qualcomm's OEM-level licensing policy, however novel, is not an anticompetitive violation of the Sherman Act.

B.

Conceding error in the district court's conclusion that Qualcomm is subject to an antitrust duty to deal under *Aspen Skiing*, the FTC contends that this court may nevertheless hold that Qualcomm engaged in anticompetitive conduct in violation of § 2. This is so, the FTC urges, because

"Qualcomm entered into a voluntary contractual commitment to deal with its rivals as part of the SSO process, which is itself a derogation from normal market competition," and (2) Qualcomm's breach of this contractual commitment "satisfies traditional Section 2 standards [in that] it 'tends to impair the opportunities of rivals and . . . does not further competition on the merits.'" We disagree.

Even if the district court is correct that Qualcomm is contractually obligated via its SSO commitments to license rival chip suppliers—a conclusion we need not and do not reach—the FTC still does not satisfactorily explain how Qualcomm's alleged breach of this contractual commitment *itself* impairs the opportunities of rivals. It argues the breach "facilitat[es] Qualcomm's collection of a surcharge from rivals' customers." Appellee's Br. at 77. But this refers to a distinct business practice, licensing royalties, and alleged harm to OEMs, not rival chipmakers. In any case, Qualcomm's royalties are "chip-supplier neutral" because Qualcomm collects them from *all* OEMs that license its patents, not just "rivals' customers." The FTC argues that Qualcomm's breach directly impacts rivals by "otherwise deterring [their] entry and investment." But this ignores that Qualcomm's "CDMA ASIC Agreements" functionally act as de facto licenses ("no license, no problem") by allowing competitors to practice

Qualcomm's SEPs (royalty-free) before selling their chips to downstream OEMs. Furthermore, in order to make out a § 2 violation, the anticompetitive harm identified must be to *competition itself*, not merely to competitors. The FTC identifies no such harm to competition.

The FTC's conclusion that OEM-level licensing does not further competition on the merits is not only belied by MediaTek and Intel's entries into the modem chip markets in the 2015–2016 timeframe, it also gives inadequate weight to Qualcomm's reasonable, procompetitive justification that licensing at the OEM and chip-supplier levels simultaneously would require the company to engage in "multi-level licensing," leading to inefficiencies and less profit. Qualcomm's procompetitive justification is supported by at least two other companies—Nokia and Dolby—with similar SEP portfolios to Qualcomm's.[12]**17** More critically, this part of the FTC's argument skips ahead to an examination of Qualcomm's procompetitive justifications, failing to recognize that the burden does not shift to Qualcomm to provide such justifications unless and until the FTC meets its initial burden of proving anticompetitive harm. Because the FTC has not met its initial burden under the rule of reason framework, we are less critical of Qualcomm's procompetitive justifications for its OEM-level licensing policy—which, in any case, appear to be reasonable and consistent with current industry practice.

* * *

Finally, we note the persuasive policy arguments of several academics and practitioners with significant experience in SSOs, FRAND, and antitrust enforcement, who have expressed caution about using the antitrust laws to remedy what are essentially

[1] *See* Br. of Amicus Curiae Nokia Technologies Oy at 18–19 (noting that "[t]here are good reasons for SEP owners to structure their licensing programs to license end-user products," including the reduction of "transaction costs and complexities associated with negotiating and executing licenses at multiple points in the supply chain," the avoidance of "overlapping and duplicative licensing," "expedite[d] access to SEPs for the entire supply chain," and "greater visibility to what products are actually licensed, for example, for auditing purposes"); Br. of Amicus Curiae Dolby Laboratories, Inc. at 28 ("Forcing SEP holders to license component suppliers would interfere with historical precedents and established practices, and produce significant inefficiencies and lack of transparency regarding whether products in the stream of commerce are in fact licensed.").

contractual disputes between private parties engaged in the pursuit of technological innovation.

* * *

C.

We next address the district court's primary theory of anticompetitive harm: Qualcomm's imposition of an "anticompetitive surcharge" on rival chip suppliers via its licensing royalty rates. According to the district court, Qualcomm's unreasonably high royalty rates enable Qualcomm to control rivals' prices because Qualcomm receives the royalty even when an OEM uses one of Qualcomm's rival's chips. Thus, the "all-in" price of any modem chip sold by one of Qualcomm's rivals effectively includes two components: (1) the nominal chip price; and (2) Qualcomm's royalty surcharge.

This central component of the district court's ruling is premised on the district court's findings that Qualcomm's royalty rates are (1) "unreasonably high" because they are improperly based on Qualcomm's monopoly chip market share and handset price instead of the "fair value of Qualcomm's patents," and (2) anticompetitive because they raise costs to OEMs, who pass the extra costs along to consumers and are forced to invest less in other handset features. . . .

We hold that the district court's "anticompetitive surcharge" theory fails to state a cogent theory of anticompetitive harm. . . .

1.

First, the district court's determination that Qualcomm's royalty rates are "unreasonable" because they are based on handset prices misinterprets Federal Circuit law regarding "the patent rule of apportionment" and the smallest salable patent-practicing unit ("SSPPU"). The district court observed "that 'it is generally required that royalties be based not on the entire product, but instead on the [SSPPU].'" *Qualcomm*, 411 F. Supp. 3d at 783.

Even if we accept that the modem chip in a cellphone is the cellphone's SSPPU, the district court's analysis is still fundamentally flawed. No court has held that the SSPPU concept is a per se rule for "reasonable royalty" calculations; instead, the concept is used as a tool in jury cases to minimize potential jury confusion when the jury is weighing complex expert testimony about patent damages. . . .

* * *

A second problem with the district court's "unreasonable royalty rate" conclusion is that it erroneously assumes that royalties

are "anticompetitive"—in the antitrust sense— unless they precisely reflect a patent's current, intrinsic value and are in line with the rates other companies charge for their own patent portfolios. Neither the district court nor the FTC provides any case law to support this proposition, which sounds in patent law, not antitrust law. . . . We decline to adopt a theory of antitrust liability that would presume anticompetitive conduct any time a company could not prove that the "fair value" of its SEP portfolios corresponds to the prices the market appears willing to pay for those SEPs in the form of licensing royalty rates.

Finally, even assuming that a deviation between licensing royalty rates and a patent portfolio's "fair value" could amount to "anticompetitive harm" in the antitrust sense, the primary harms the district court identified here were to the OEMs who agreed to pay Qualcomm's royalty rates—that is, Qualcomm's *customers*, not its *competitors*. These harms were thus located outside the "areas of effective competition"—the markets for CDMA and premium LTE modem chips—and had no direct impact on competition in those markets. *See Rambus*, 522 F.3d at 464 (noting that if a practice "raises the price secured by a seller" or otherwise harms customers, "but does so without harming competition, it is beyond the antitrust laws' reach").

2.

Regardless of the "reasonableness" of Qualcomm's royalty rates, the district court erred in finding that these royalties constitute an "artificial surcharge" on rivals' chip sales. In *Caldera, Inc. v. Microsoft Corp.*, 87 F. Supp. 2d 1244 (D. Utah 1999), the primary case relied upon by the district court for its surcharging theory, Microsoft required OEMs "to pay [it] a royalty on every machine the OEM shipped regardless of whether the machine contained MS DOS or another operating system." This resulted in OEMs having to pay two royalties instead of one for a portion of their product base unless they chose to exclusively install Microsoft's operating system in their products. Microsoft's policy thus had "the practical effect of exclusivity," as it imposed a naked tax on rivals' software even when the end-product—an individual computer installed with a non-Microsoft operating system— contained no added value from Microsoft. . . .

Qualcomm's licensing royalties are qualitatively different from the per-unit operating-system royalties at issue in *Caldera*. When Qualcomm licenses its SEPs to an OEM, those patent licenses have value—indeed, they are necessary to the OEM's ability to

market and sell its cellular products to consumers—regardless of whether the OEM uses Qualcomm's modem chips or chips manufactured and sold by one of Qualcomm's rivals. And unlike *Caldera*, where OEMs who installed non-Microsoft operating systems in some of their products were required to pay royalties for both the actual operating system *and* MS DOS (which was not installed), here OEMs do not pay twice for SEP licenses when they use non-Qualcomm modem chips. Thus, unlike Microsoft's practice, Qualcomm's practice does not have the "practical effect of exclusivity". . . .

In its complaint and in its briefing, the FTC suggests that Qualcomm's royalty rates impose an anticompetitive surcharge on its rivals' sales not for the reasons at play in *Caldera*, but rather because Qualcomm uses its licensing royalties to charge anticompetitive, ultralow prices on its own modem chips—pushing out rivals by squeezing their profit margins and preventing them from making necessary investments in research and development.**[21]** But this type of "margin squeeze" was rejected as a basis for antitrust liability in *linkLine*. 555 U.S. at 451–52, 457. There, multiple digital subscriber line ("DSL") high-speed internet service providers complained that AT&T was selling them access to AT&T's must-have telephone lines and facilities at inflated wholesale rates and then shifting those increased profits to charge ultra-low rates for DSL services at retail, effectively squeezing these DSL competitors out of the market. The Court rejected the plaintiffs' assertion of anticompetitive harm, holding that AT&T was under no antitrust duty to deal with its competitors on the wholesale level, and that the plaintiffs failed to introduce evidence of predatory pricing (that is, charging below cost) at the retail level.

Here, not only did the FTC offer no evidence that Qualcomm engaged in predatory pricing, the district court's entire antitrust analysis is premised on the opposite proposition: that Qualcomm "charge[s] monopoly prices on modem chips." Indeed, the district court faulted Qualcomm for lowering its prices only when other companies introduced CDMA modem chips to the market to effectively compete. We agree with Qualcomm that this is exactly the type of "garden-variety price competition that the law encourages," and are aware of no authority holding that a monopolist may not lower its rates in response to a competitor's entry into the market with a lower-priced product.

D.

As with its critique of Qualcomm's royalty rates, the district court's analysis of Qualcomm's "no license, no chips" policy focuses almost exclusively on alleged "anticompetitive harms" to OEMs—that is, impacts outside the relevant antitrust market. The district court labeled Qualcomm's policy "anticompetitive conduct against OEMs" and an "anticompetitive practice[] in patent license negotiations." But the district court failed to identify how the policy directly impacted Qualcomm's competitors or distorted "the area of effective competition." *Am. Express*, 138 S. Ct. at 2285.

* * *

According to the FTC, the problem with "no license, no chips" is that, under the policy, "Qualcomm will not sell chips to a cellphone [OEM] like Apple or Samsung unless the OEM agrees to a license that requires it to pay a substantial per-phone surcharge *even on phones that use rivals' chips*." But this argument is self-defeating: if the condition imposed on gaining access to Qualcomm's chip supply applies regardless of whether the OEM chooses Qualcomm or a competitor (in fact, this appears to be the essence of Qualcomm's policy), then the condition by definition does not distort the "area of effective competition" or impact competitors. At worst, the policy raises the "all-in" price that an OEM must pay for modem chips (chipset + licensing royalties) regardless of which chip supplier the OEM chooses to source its chips from. As we have already discussed, whether that all-in price is reasonable or unreasonable is an issue that sounds in patent law, not antitrust law. Additionally, it involves potential harms to Qualcomm's *customers*, not its competitors, and thus falls outside the relevant antitrust markets.

* * *

E.

Having addressed the primary components of the district court's antitrust ruling with respect to Qualcomm's general business practices, we now address the district court's more specific finding that from 2011 to 2015, Qualcomm violated both sections of the Sherman Act by signing "exclusive deals" with Apple that "foreclosed a 'substantial share' of the [CDMA] modem chip market."

* * *

Qualcomm argues that its agreements with Apple were "volume discount contracts, not exclusive dealings contracts." Unlike exclusive dealing arrangements, "volume discount contracts

are legal under antitrust law . . . [b]ecause the contracts do not preclude consumers from using other . . . services." Likewise, conditional agreements that provide "substantial discounts to customers that actually purchase[] a high percentage of their . . . requirements from" a firm are not exclusive dealing arrangements, de facto or actual, unless they "prevent[] the buyer from purchasing a given good from any other vendor."

* * *

There is some merit in the district court's conclusion that the Apple agreements were structured more like exclusive dealing contracts than volume discount contracts. However, we do not agree that these agreements had the actual or practical effect of substantially foreclosing competition in the CDMA modem chip market, or that injunctive relief is warranted.

During the relevant time period (2011–2015), the record suggests that the only serious competition Qualcomm faced with respect to the Apple contracts was from Intel, a company from whom Apple had considered purchasing modem chips prior to signing the 2013 agreement with Qualcomm. The district court made no finding that any other specific competitor or potential competitor was affected by either of Qualcomm's agreements with Apple, and it is undisputed that Intel won Apple's business *the very next year*, in 2014, when Apple's engineering team unanimously recommended that the company select Intel as an alternative supplier of modem chips. The district court found that "Qualcomm's exclusive deals . . . delayed Intel's ability to sell modem chips to Apple until September 2016." There is no indication in the record, however, that Intel was a viable competitor to Qualcomm prior to 2014– 2015, or that the 2013 agreement delayed Apple's transition to Intel by any more than one year. Given these undisputed facts, we conclude that the 2011 and 2013 agreements did not have the actual or practical effect of substantially foreclosing competition in the CDMA modem chip market.

* * *

We therefore **REVERSE** the district court's judgment and **VACATE** its injunction as well as its partial grant of summary judgment.

NOTES AND QUESTIONS

1. *Rule of reason.* Was the court correct when it said that "the three- part burden-shifting test under the rule of reason is

essentially the same" under Section 1 and Section 2 of the Sherman Act? Was it correct that "a plaintiff may not use *indirect* evidence to prove unlawful monopoly maintenance via anticompetitive conduct under § 2"? If so, is that a sensible rule?

2. *The "no license/no chips" policy*. Qualcomm's no license/no chip policy was the core of the FTC's case. The court's opinion does not fully describe the policy or the issues it raises.

Ordinarily, when a firm sells a product that includes patented technologies, like Qualcomm's chips, the buyer acquires both the product and, as a matter of law, an implied patent license. The buyer does not need to obtain an additional or separate license to the patented technologies in the product, and she may resell the product to another buyer, who is also not required to obtain an additional or separate patent license. The initial sale of the product is deemed, as a matter of law, to "exhaust" the seller's rights in the patents covering technologies implemented in the product. *See Quanta Comput., Inc. v. LG Elecs., Inc.*, 553 U.S. 617 (2008). The seller almost always charges the buyer a single price that encompasses both the product and the implied patent license.

Patents are also often licensed in transactions that do not involve the sale of products. The licensors in these transactions might be technology firms, or patent assertion entities whose business is to acquire and then license patents, that do not sell any products; or they might be firms that both sell products and license their patented technologies separately when they are used in other products. Especially in the information technology industry, in which products like mobile phones can include technologies claimed by literally tens of thousands of patents, these licensing transactions commonly take place after the implementer has manufactured and sold the allegedly infringing products. At that point, if the patents are valid and infringed, the implementer has no legal right to refuse take a license.

When patents are licensed separately, the royalty or price is constrained by the often substantial likelihood that the patent would if litigated be found to be invalid or not infringed and by the parties' estimate of the "reasonable royalty" remedy a court would order if they fail to reach agreement and the matter is litigated in a patent infringement suit. When, as in the *Qualcomm* case, SEPs are involved, the price is also constrained by the FRAND commitment.

Qualcomm's no license/no chips policy is a hybrid of these two licensing methods. Qualcomm requires OEMs to agree to a separate patent license on terms specified by it in order to buy chips. If the

license applied only to Qualcomm chips, the policy would be of no substantive consequence. Qualcomm could allocate the monopoly price that it would otherwise charge for the chips with an implied patent license partly to the chips and partly to the license, but the total monopoly price would remain the same.

The problem, according to the FTC, is that Qualcomm's no license/no chips policy requires OEMs, as a condition of purchasing chips from Qualcomm, to agree to a patent license, on terms specified by it, that covers both Qualcomm's chips and chips manufactured by Qualcomm's competitors. Chips manufactured by Qualcomm's competitors, like Qualcomm's chips, use technologies claimed by Qualcomm's patents. Because Qualcomm has a substantial monopoly in chips, OEMs are required as a practical matter to buy at least some of their chips from Qualcomm. The no license/no chips policy thus means that OEMs have to agree to license terms specified by Qualcomm for both Qualcomm chips and chips manufactured by others.

The district court found that, by using the monopoly power of its chips to insist on its desired royalties, Qualcomm is able to extract patent royalties higher than those that would have been agreed to if the patent license were negotiated separately and constrained by the risks of invalidity and non-infringement, the prospect of a "reasonable royalty" remedy in infringement litigation, and the Qualcomm's FRAND commitment. The district court called the difference in royalty amounts a "surcharge." The FTC argued that that surcharge increases the cost to OEMs of using chips sold by Qualcomm's competitors, reduces their demand for competitors' chips, and thus serves to maintain Qualcomm's chip monopoly.

The district court agreed with the FTC and held that the no license/no chips policy violated the Sherman Act. The court of appeals reversed the district court on that issue for three reasons.

(a) First, the court reasoned that the harm from the policy is that it allegedly results in increased license fees paid by device manufacturers, that a mere price increase is not injury to competition for antitrust purposes, and that in any event the price increase harms OEMs and the harm thus occurs outside the relevant antitrust market. Do you think the court's reasoning is correct? Could similar reasoning have been used to find for the defendant in *United States v. Microsoft Corp*., 253 F.3d 34 (D.C. Cir. 2001) (en banc), on the ground that the harm there was to competing browsers and was thus outside the relevant OS market? What about a loyalty discount case in which the defendant charges customers higher prices

if they deal with competitors? (Loyalty discounts are discussed at pp 617-623 in the main text.)

(b) Second, the court repeatedly said that the policy is "chip supplier neutral" and held that, even if the license fee is inflated by the policy, it does not harm competition because the same fee applies to both Qualcomm chips and rival chips. Do you think the court's reasoning is correct? Is the policy really chip supplier neutral if, as the court found, Qualcomm offsets the high license fees by reducing the price of Qualcomm chips but provides no offset when the OEM purchased rivals' chips? Even if Qualcomm had not offset the license fee increase, would the policy be chip supplier neutral given that the increased license fee is paid to Qualcomm but not to its competitors?

(c) Third, the court held that, to the extent that the FTC was complaining that Qualcomm reduced the prices for its chips and thus squeezed competitors' margins, it was engaged in a lawful "margin squeeze" under *linkLine*. Do you think the court was correct? In thinking about that question, you might consider the following:

- In *linkLine*, the defendant sold inputs in the upstream market to firms with which it competed in the downstream market. Qualcomm does not sell to its competitors (chip makers) in the upstream (licensing) market, and it does not sell anything in the downstream (mobile phone) market.
- In *John Doe v. Abbott Laboratories*, 571 F.3d 930 (9th Cir. 2009), plaintiffs alleged that competing suppliers of protease inhibitors used to treat HIV were harmed because the defendant increased the price of a complementary drug used to "boost" protease inhibitors, over which the defendant had a monopoly, but did not increase the price of its "boosted" protease inhibitor. The court held that the claim was barred by *linkLine*. In both *John Doe* and *linkLine*, the allegedly excessive price for the input or complement reflected the defendant's market power over that product; in *Qualcomm*, by contrast, the FTC alleged that the excessive price of the patent license reflected the market power of a different product, Qualcomm's chips.
- The rationale of *linkLine* was that the defendant could not cause more harm by selling an input at a high price than by exercising its lawful right to refuse to sell the input altogether. 555 U.S. at 450. Qualcomm, however, could not inflict the same or worse harm by refusing to license

its patents to OEMs because Qualcomm was required to license its SEPs on reasonable (FRAND) terms.

3. *Business justification.* The no license/no chips policy enables Qualcomm to deal with OEMs in one transaction covering chip sales and patent licenses for chips sold by its competitors and thus to avoid the risk that OEMs might buy chips from Qualcomm and make Qualcomm sue it to collect patent royalties on its competitors' chips. Assuming that the no license/no chips policy does harm rival chip makers and help maintain Qualcomm's chip monopoly, do you think this transaction cost saving is sufficient to justify the policy under the Sherman Act? In thinking about this question, bear in mind that cost savings are ordinarily passed on at least in part to customers but the district court found that the no license/no chips policy results in higher prices for buyers. Consider also (i) the fact that the no license/no chips policy is unique and patent holders generally must deal with transaction costs and litigation risks when licensing their patents and (ii) the court's concern about hostility to novel business practices, which is discussed in the next paragraph.

4. *Novel business practices.* The court repeatedly expressed the concern that antitrust law might be too quick to condemn novel business practices that disadvantage customers and competitors but are in fact valuable and efficient innovations for reasons that might not be readily apparent to the court. Does this concern seem realistic? Should the law deal with that risk by being especially skeptical of antitrust challenges to novel business practices? Might such skepticism encourage firms to devise novel business strategies to exclude rivals and then argue that antitrust law should be especially cautious because the conduct is unfamiliar? How else might the law deal with that risk?

5. *Is the antitrust analysis different because patents are involved?* Should the antitrust analysis be different in the *Qualcomm* case from that in an ordinary case because the case involved patent licenses? If so, why and how should the analysis differ? As discussed in the main text (pp 891-892, 908-910), patents differ from tangible property because patents are nonrivalrous, they are for a limited term, and the validity and scope of patents are often uncertain. Should any of these differences affect the analysis in the *Qualcomm* case? Are there any other differences between patents and other kinds of property that should affect the analysis?

Chapter 8.4.A: Payment Systems

Ohio v. American Express Co.

Supreme Court of the United States, 2018.
585 U.S. _, 138 S.Ct. 2274.

[replace the *Visa* decision and the lower court *American Express* decision at pp. 956-995]

THOMAS, J., delivered the opinion of the Court. American Express Company and American Express Travel Related Services Company (collectively, Amex) provide credit-card services to both merchants and cardholders. When a cardholder buys something from a merchant who accepts Amex credit cards, Amex processes the transaction through its network, promptly pays the merchant, and subtracts a fee. If a merchant wants to accept Amex credit cards—and attract Amex cardholders to its business—Amex requires the merchant to agree to an anti-steering contractual provision. The anti-steering provision prohibits merchants from discouraging customers from using their Amex card after they have already entered the store and are about to buy something, thereby avoiding Amex's fee. In this case, we must decide whether Amex's anti-steering provisions violate federal antitrust law. We conclude they do not.

I.

A.

Credit cards have become a primary way that consumers in the United States purchase goods and services. When a cardholder uses a credit card to buy something from a merchant, the transaction is facilitated by a credit card network. The network provides separate but interrelated services to both cardholders and merchants. For cardholders, the network extends them credit, which allows them to make purchases without cash and to defer payment until later. Cardholders also can receive rewards based on the amount of money they spend, such as airline miles, points for travel, or cash back. For merchants, the network allows them to avoid the cost of processing transactions and offers them quick, guaranteed payment. This saves merchants the trouble and risk of extending credit to customers, and it increases the number and value of sales that they can make.

By providing these services to cardholders and merchants, credit-card companies bring these parties together, and therefore operate what economists call a "two-sided platform." As the name implies, a two-sided platform offers different products or services to two different groups who both depend on the platform to intermediate

between them. For credit cards, that interaction is a transaction. Thus, credit-card networks are a special type of two-sided platform known as a "transaction" platform. The key feature of transaction platforms is that they cannot make a sale to one side of the platform without simultaneously making a sale to the other. For example, no credit card transaction can occur unless both the merchant and the cardholder simultaneously agree to use the same credit-card network.

Two-sided platforms differ from traditional markets in important ways. Most relevant here, two-sided platforms often exhibit what economists call "indirect network effects." Indirect network effects exist where the value of the two-sided platform to one group of participants depends on how many members of a different group participate. In other words, the value of the services that a two-sided platform provides increases as the number of participants on both sides of the platform increases. A credit card, for example, is more valuable to cardholders when more merchants accept it, and is more valuable to merchants when more cardholders use it. To ensure sufficient participation, two-sided platforms must be sensitive to the prices that they charge each side. Raising the price on side A risks losing participation on that side, which decreases the value of the platform to side B. If participants on side B leave due to this loss in value, then the platform has even less value to side A—risking a feedback loop of declining demand. Two-sided platforms therefore must take these indirect network effects into account before making a change in price on either side.

Sometimes indirect network effects require two-sided platforms to charge one side much more than the other. For two-sided platforms, "'the [relative] price structure matters, and platforms must design it so as to bring both sides on board.'" The optimal price might require charging the side with more elastic demand a below-cost (or even negative) price. With credit cards, for example, networks often charge cardholders a lower fee than merchants because cardholders are more price sensitive. In fact, the network might well lose money on the cardholder side by offering rewards such as cash back, airline miles, or gift cards. The network can do this because increasing the number of cardholders increases the value of accepting the card to merchants and, thus, increases the number of merchants who accept it. Networks can then charge those merchants a fee for every transaction (typically a percentage of the purchase price). Striking the optimal balance of the prices charged on each side of the platform is essential for two-sided platforms to maximize the value of their services and to compete with their rivals.

B.

Amex, Visa, MasterCard, and Discover are the four dominant participants in the credit-card market. Visa, which is by far the largest, has 45% of the market as measured by transaction volume. Amex and MasterCard trail with 26.4% and 23.3%, respectively, while Discover has just 5.3% of the market. Visa and MasterCard have significant structural advantages over Amex. Visa and MasterCard began as bank cooperatives and thus almost every bank that offers credit cards is in the Visa or MasterCard network. This makes it very likely that the average consumer carries, and the average merchant accepts, Visa or MasterCard. As a result, the vast majority of Amex cardholders have a Visa or MasterCard, but only a small number of Visa and MasterCard cardholders have an Amex. Indeed, Visa and MasterCard account for more than 432 million cards in circulation in the United States, while Amex has only 53 million. And while 3.4 million merchants at 6.4 million locations accept Amex, nearly three million more locations accept Visa, MasterCard, and Discover.

Amex competes with Visa and MasterCard by using a different business model. While Visa and MasterCard earn half of their revenue by collecting interest from their cardholders, Amex does not. Amex instead earns most of its revenue from merchant fees. Amex's business model thus focuses on cardholder spending rather than cardholder lending. To encourage cardholder spending, Amex provides better rewards than other networks. Due to its superior rewards, Amex tends to attract cardholders who are wealthier and spend more money. Merchants place a higher value on these cardholders, and Amex uses this advantage to recruit merchants.

Amex's business model has significantly influenced the credit-card market. To compete for the valuable cardholders that Amex attracts, both Visa and MasterCard have introduced premium cards that, like Amex, charge merchants higher fees and offer cardholders better rewards. To maintain their lower merchant fees, Visa and MasterCard have created a sliding scale for their various cards—charging merchants less for low-reward cards and more for high-reward cards. This differs from Amex's strategy, which is to charge merchants the same fee no matter the rewards that its card offers. Another way that Amex has influenced the credit-card market is by making banking and card-payment services available to low-income individuals, who otherwise could not qualify for a credit card and could not afford the fees that traditional banks charge. . . .

Despite these improvements, Amex's business model sometimes causes friction with merchants. To maintain the loyalty of

its cardholders, Amex must continually invest in its rewards program. But, to fund those investments, Amex must charge merchants higher fees than its rivals. Even though Amex's investments benefit merchants by encouraging cardholders to spend more money, merchants would prefer not to pay the higher fees. One way that merchants try to avoid them, while still enticing Amex's cardholders to shop at their stores, is by dissuading cardholders from using Amex at the point of sale. This practice is known as "steering."

Amex has prohibited steering since the 1950s by placing anti-steering provisions in its contracts with merchants. These anti-steering provisions prohibit merchants from implying a preference for non-Amex cards; dissuading customers from using Amex cards; persuading customers to use other cards; imposing any special restrictions, conditions, disadvantages, or fees on Amex cards; or promoting other cards more than Amex. The anti-steering provisions do not, however, prevent merchants from steering customers toward debit cards, checks, or cash.

C.

In October 2010, the United States and several States (collectively, plaintiffs) sued Amex, claiming that its anti-steering provisions violate §1 of the Sherman Act. After a 7-week trial, the District Court agreed that Amex's anti-steering provisions violate §1. It found that the credit-card market should be treated as two separate markets—one for merchants and one for cardholders. Evaluating the effects on the merchant side of the market, the District Court found that Amex's anti-steering provisions are anticompetitive because they result in higher merchant fees.

The Court of Appeals for the Second Circuit reversed. It concluded that the credit-card market is one market, not two. Evaluating the credit card market as a whole, the Second Circuit concluded that Amex's anti-steering provisions were not anticompetitive and did not violate §1. We granted certiorari and now affirm.

II.

Section 1 of the Sherman Act prohibits "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States." 15 U. S. C. §1. This Court has long recognized that, "[i]n view of the common law and the law in this country" when the Sherman Act was passed, the phrase "restraint of trade" is best read to mean "undue restraint." *Standard Oil Co. of N. J. v. United States*, 221 U.S. 1, 59-60 (1911).

This Court's precedents have thus understood §1 "to outlaw only *unreasonable* restraints." *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997) (emphasis added).

Restraints can be unreasonable in one of two ways. A small group of restraints are unreasonable per se because they "'"always or almost always tend to restrict competition and decrease output."'" *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 723 (1988). Typically only "horizontal" restraints—restraints "imposed by agreement between competitors"—qualify as unreasonable per se. Id., at 730. Restraints that are not unreasonable per se are judged under the "rule of reason." Id., at 723. The rule of reason requires courts to conduct a fact-specific assessment of "market power and market structure . . . to assess the [restraint]'s actual effect" on competition. *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768 (1984). The goal is to "distinguis[h] between restraints with anticompetitive effect that are harmful to the consumer and restraints stimulating competition that are in the consumer's best interest." *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 886 (2007).

In this case, both sides correctly acknowledge that Amex's anti-steering provisions are vertical restraints— i.e., restraints "imposed by agreement between firms at different levels of distribution." Business Electronics, supra, at 730. The parties also correctly acknowledge that, like nearly every other vertical restraint, the anti-steering provisions should be assessed under the rule of reason.

To determine whether a restraint violates the rule of reason, the parties agree that a three-step, burden shifting framework applies. Under this framework, the plaintiff has the initial burden to prove that the challenged restraint has a substantial anticompetitive effect that harms consumers in the relevant market. If the plaintiff carries its burden, then the burden shifts to the defendant to show a procompetitive rationale for the restraint. If the defendant makes this showing, then the burden shifts back to the plaintiff to demonstrate that the procompetitive efficiencies could be reasonably achieved through less anticompetitive means.

Here, the parties ask us to decide whether the plaintiffs have carried their initial burden of proving that Amex's anti-steering provisions have an anticompetitive effect. The plaintiffs can make this showing directly or indirectly. Direct evidence of anticompetitive effects would be "'proof of actual detrimental effects [on competition],'" *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 460 (1986), such as reduced output, increased prices, or decreased quality in the

relevant market. Indirect evidence would be proof of market power plus some evidence that the challenged restraint harms competition.

Here, the plaintiffs rely exclusively on direct evidence to prove that Amex's anti-steering provisions have caused anticompetitive effects in the credit-card market. To assess this evidence, we must first define the relevant market. Once defined, it becomes clear that the plaintiffs' evidence is insufficient to carry their burden.

A.

Because "[l]egal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law," *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 466–467 (1992), courts usually cannot properly apply the rule of reason without an accurate definition of the relevant market.[7] "Without a definition of [the] market there is no way to measure [the defendant's] ability to lessen or destroy competition." *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*, 382 U.S. 172, 177 (1965). Thus, the relevant market is defined as "the area of effective competition." Ibid. Typically this is the "arena within which significant substitution in consumption or production occurs" [citation omitted]. But courts should "combin[e]" different products or services into "a single market" when "that combination reflects commercial realities." *United States v. Grinnell Corp.*, 384 U.S. at 572.

As explained, credit-card networks are two-sided platforms. Due to indirect network effects, two-sided platforms cannot raise prices on one side without risking a feedback loop of declining demand. And the fact that two-sided platforms charge one side a price that is below or above cost reflects differences in the two sides' demand elasticity, not market power or anticompetitive pricing. Price increases

[7] The plaintiffs argue that we need not define the relevant market in this case because they have offered actual evidence of adverse effects on competition—namely, increased merchant fees. We disagree. The cases that the plaintiffs cite for this proposition evaluated whether horizontal restraints had an adverse effect on competition. Given that horizontal restraints involve agreements between competitors not to compete in some way, this Court concluded that it did not need to precisely define the relevant market to conclude that these agreements were anticompetitive. Vertical restraints often pose no risk to competition unless the entity imposing them has market power, which cannot be evaluated unless the Court first defines the relevant market. See Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L. J. 135, 160 (1984) ("[T]he possibly anticompetitive manifestations of vertical arrangements can occur only if there is market power").

on one side of the platform likewise do not suggest anticompetitive effects without some evidence that they have increased the overall cost of the platform's services. Thus, courts must include both sides of the platform—merchants and cardholders—when defining the credit-card market.

To be sure, it is not always necessary to consider both sides of a two-sided platform. A market should be treated as one sided when the impacts of indirect network effects and relative pricing in that market are minor. Newspapers that sell advertisements, for example, arguably operate a two-sided platform because the value of an advertisement increases as more people read the newspaper. But in the newspaper-advertisement market, the indirect networks effects operate in only one direction; newspaper readers are largely indifferent to the amount of advertising that a newspaper contains. Because of these weak indirect network effects, the market for newspaper advertising behaves much like a one-sided market and should be analyzed as such.

But two-sided transaction platforms, like the credit-card market, are different. These platforms facilitate a single, simultaneous transaction between participants. For credit cards, the network can sell its services only if a merchant and cardholder both simultaneously choose to use the network. Thus, whenever a credit-card network sells one transaction's worth of card-acceptance services to a merchant it also must sell one transaction's worth of card payment services to a cardholder. It cannot sell transaction services to either cardholders or merchants individually. To optimize sales, the network must find the balance of pricing that encourages the greatest number of matches between cardholders and merchants.

Because they cannot make a sale unless both sides of the platform simultaneously agree to use their services, two-sided transaction platforms exhibit more pronounced indirect network effects and interconnected pricing and demand. Transaction platforms are thus better understood as "suppl[ying] only one product"—transactions. [Klein, Lerner, Murphy, & Plache, *Competition in Two-Sided Markets: The Antitrust Economics of Payment Card Interchange Fees*, 73 Antitrust L. J. 571, 580 (2006)]. . . . Tellingly, credit cards determine their market share by measuring the volume of transactions they have sold.[8]

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[8] Contrary to the dissent's assertion, merchant services and cardholder services are not complements. A two-sided market is different from markets for complementary products, in which both products are bought

Evaluating both sides of a two-sided transaction platform is also necessary to accurately assess competition. Only other two-sided platforms can compete with a two-sided platform for transactions. A credit-card company that processed transactions for merchants, but that had no cardholders willing to use its card, could not compete with Amex. Only a company that had both cardholders and merchants willing to use its network could sell transactions and compete in the credit card market. Similarly, if a merchant accepts the four major credit cards, but a cardholder only uses Visa or Amex, only those two cards can compete for the particular transaction. Thus, competition cannot be accurately assessed by looking at only one side of the platform in isolation.[9]

For all these reasons, in two-sided transaction markets, only one market should be defined. Any other analysis would lead to “““mistaken inferences””” of the kind that could “““chill the very conduct the antitrust laws are designed to protect.””” *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226 (1993). Accordingly, we will analyze the two-sided market for credit-card transactions as a whole to determine whether the plaintiffs have shown that Amex’s anti-steering provisions have anticompetitive effects.

B.

The plaintiffs have not carried their burden to prove anticompetitive effects in the relevant market. The plaintiffs stake their entire case on proving that Amex’s agreements increase merchant fees. We find this argument unpersuasive. As an initial matter, the plaintiffs’ argument about merchant fees wrongly focuses on only one side of the two-sided credit-card market. As explained, the credit-card market must be defined to include both merchants and cardholders. Focusing on merchant fees alone misses the mark because the product that credit-card companies sell is transactions, not services to merchants, and the competitive effects of a restraint on transactions cannot be judged by looking at merchants alone. Evidence of a price increase on one side of a two-sided transaction platform cannot by itself demonstrate an anticompetitive exercise of market power. To demonstrate anticompetitive effects on the two-sided credit-

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by the same buyers, who, in their buying decisions, can therefore be expected to take into account both prices. . . .

[9] Non-transaction platforms, by contrast, often do compete with companies that do not operate on both sides of their platform. A newspaper that sells advertising, for example, might have to compete with a television network, even though the two do not meaningfully compete for viewers.

card market as a whole, the plaintiffs must prove that Amex's anti-steering provisions increased the cost of credit-card transactions above a competitive level, reduced the number of credit-card transactions, or otherwise stifled competition in the credit-card market. They failed to do so.

1.

The plaintiffs did not offer any evidence that the price of credit-card transactions was higher than the price one would expect to find in a competitive market. As the District Court found, the plaintiffs failed to offer any reliable measure of Amex's transaction price or profit margins. And the evidence about whether Amex charges more than its competitors was ultimately inconclusive.

Amex's increased merchant fees reflect increases in the value of its services and the cost of its transactions, not an ability to charge above a competitive price. . . . As explained, Amex has historically charged higher merchant fees than these competitors because it delivers wealthier cardholders who spend more money. Amex's higher merchant fees are based on a careful study of how much additional value its cardholders offer merchants. On the other side of the market, Amex uses its higher merchant fees to offer its cardholders a more robust rewards program, which is necessary to maintain cardholder loyalty and encourage the level of spending that makes Amex valuable to merchants. That Amex allocates prices between merchants and cardholders differently from Visa and MasterCard is simply not evidence that it wields market power to achieve anticompetitive ends.

In addition, the evidence that does exist cuts against the plaintiffs' view that Amex's anti-steering provisions are the cause of any increases in merchant fees. Visa and MasterCard's merchant fees have continued to increase, even at merchant locations where Amex is not accepted and, thus, Amex's anti-steering provisions do not apply. This suggests that the cause of increased merchant fees is not Amex's anti-steering provisions, but rather increased competition for cardholders and a corresponding marketwide adjustment in the relative price charged to merchants.

2.

The plaintiffs did offer evidence that Amex increased the percentage of the purchase price that it charges merchants by an average of 0.09% between 2005 and 2010 and that this increase was not entirely spent on cardholder rewards. . . . [T]his evidence does not prove that Amex's anti-steering provisions gave it the power to charge anticompetitive prices. . . . This Court will "not infer competitive injury

from price and output data absent some evidence that tends to prove that output was restricted or prices were above a competitive level." Brooke Group Ltd., 509 U. S., at 237. There is no such evidence in this case. The output of credit-card transactions grew dramatically from 2008 to 2013, increasing 30%. "Where . . . output is expanding at the same time prices are increasing, rising prices are equally consistent with growing product demand." Brooke Group Ltd., supra, at 237. And, as previously explained, the plaintiffs did not show that Amex charged more than its competitors.

3.

The plaintiffs also failed to prove that Amex's anti-steering provisions have stifled competition among credit-card companies. To the contrary, while these agreements have been in place, the credit-card market experienced expanding output and improved quality. Amex's business model spurred Visa and MasterCard to offer new premium card categories with higher rewards. And it has increased the availability of card services, including free banking and card-payment services for low-income customers who otherwise would not be served. Indeed, between 1970 and 2001, the percentage of households with credit cards more than quadrupled, and the proportion of households in the bottom-income quintile with credit cards grew from just 2% to over 38%.

Nor have Amex's anti-steering provisions ended competition between credit-card networks with respect to merchant fees. Instead, fierce competition between networks has constrained Amex's ability to raise these fees and has, at times, forced Amex to lower them. For instance, when Amex raised its merchant prices between 2005 and 2010, some merchants chose to leave its network. And when its remaining merchants complained, Amex stopped raising its merchant prices. In another instance in the late 1980s and early 1990s, competition forced Amex to offer lower merchant fees to "everyday spend" merchants—supermarkets, gas stations, pharmacies, and the like—to persuade them to accept Amex.

In addition, Amex's competitors have exploited its higher merchant fees to their advantage. By charging lower merchant fees, Visa, MasterCard, and Discover have achieved broader merchant acceptance—approximately 3 million more locations than Amex. This broader merchant acceptance is a major advantage for these networks and a significant challenge for Amex, since consumers prefer cards that will be accepted everywhere. And to compete even further with Amex, Visa and MasterCard charge different merchant fees for different types of cards to maintain their comparatively lower

merchant fees and broader acceptance. Over the long run, this competition has created a trend of declining merchant fees in the credit-card market. In fact, since the first credit card was introduced in the 1950s, merchant fees— including Amex's merchant fees—have decreased by more than half.

Lastly, there is nothing inherently anticompetitive about Amex's anti-steering provisions. These agreements actually stem negative externalities in the credit-card market and promote interbrand competition. When merchants steer cardholders away from Amex at the point of sale, it undermines the cardholder's expectation of "welcome acceptance"—the promise of a frictionless transaction. A lack of welcome acceptance at one merchant makes a cardholder less likely to use Amex at all other merchants. This externality endangers the viability of the entire Amex network. And it undermines the investments that Amex has made to encourage increased cardholder spending, which discourages investments in rewards and ultimately harms both cardholders and merchants. Perhaps most importantly, anti-steering provisions do not prevent Visa, MasterCard, or Discover from competing against Amex by offering lower merchant fees or promoting their broader merchant acceptance.

In sum, the plaintiffs have not satisfied the first step of the rule of reason. They have not carried their burden of proving that Amex's anti-steering provisions have anticompetitive effects. Amex's business model has spurred robust interbrand competition and has increased the quality and quantity of credit-card transactions. . . . Because Amex's anti-steering provisions do not unreasonably restrain trade, we affirm the judgment of the Court of Appeals.

It is so ordered.

BREYER, J., with whom GINSBURG, SOTOMAYOR, and KAGAN, J., join, dissenting: For more than 120 years, the American economy has prospered by charting a middle path between pure laissez-faire and state capitalism, governed by an antitrust law dedicated to the principle that markets, not individual firms and certainly not political power, produce the optimal mixture of goods and services. By means of a strong antitrust law, the United States has sought to avoid the danger of monopoly capitalism. Long gone, we hope, are the days when the great trusts presided unfettered by competition over the American economy.

This lawsuit is emblematic of the American approach. Many governments around the world have responded to concerns about the high fees that credit-card companies often charge merchants by regulating such fees directly. The United States has not followed that

approach. The Government instead filed this lawsuit, which seeks to restore market competition over credit-card merchant fees by eliminating a contractual barrier with anticompetitive effects. The majority rejects that effort. But because the challenged contractual term clearly has serious anticompetitive effects, I dissent.

I.

I agree with the majority and the parties that this case is properly evaluated under the three-step "rule of reason" that governs many antitrust lawsuits. Under that approach, a court looks first at the agreement or restraint at issue to assess whether it has had, or is likely to have, anticompetitive effects. In doing so, the court normally asks whether the restraint may tend to impede competition and, if so, whether those who have entered into that restraint have sufficient economic or commercial power for the agreement to make a negative difference. Sometimes, but not always, a court will try to determine the appropriate market (the market that the agreement affects) and determine whether those entering into that agreement have the power to raise prices above the competitive level in that market.

It is important here to understand that in cases under §1 of the Sherman Act (unlike in cases challenging a merger under §7 of the Clayton Act, 15 U. S. C. §18), it may well be unnecessary to undertake a sometimes complex, market power inquiry: "Since the purpose [in a Sherman Act §1 case] of the inquiries into . . . market power is [simply] to determine whether an arrangement has the potential for genuine adverse effects on competition, 'proof of actual detrimental effects, such as a reduction in output,' can obviate the need for an inquiry into market power, which is but a 'surrogate for detrimental effects.'" *Indiana Federation of Dentists*, supra, at 460–461.

Second, if an antitrust plaintiff meets the initial burden of showing that an agreement will likely have anticompetitive effects, normally the burden shifts to the defendant to show that the restraint in fact serves a legitimate objective.

Third, if the defendant successfully bears this burden, the antitrust plaintiff may still carry the day by showing that it is possible to meet the legitimate objective in less restrictive ways, or, perhaps by showing that the legitimate objective does not outweigh the harm that competition will suffer, i.e., that the agreement "on balance" remains unreasonable.

Like the Court of Appeals and the parties, the majority addresses only the first step of that three-step framework.

II.

A.

This case concerns the credit-card business. As the majority explains, that business involves the selling of two different but related card services. First, when a shopper uses a credit card to buy something from a participating merchant, the credit-card company pays the merchant the amount of money that the merchant's customer has charged to his card and charges the merchant a fee, say 5%, for that speedy-payment service. I shall refer to that kind of transaction as a merchant-related card service. Second, the credit-card company then sends a bill to the merchant's customer, the shopper who holds the card; and the shopper pays the card company the sum that merchant charged the shopper for the goods or services he or she bought. The cardholder also often pays the card company a fee, such as an annual fee for the card or an interest charge for delayed payment. I shall call that kind of transaction a shopper-related card service. The credit card company can earn revenue from the sale (directly or indirectly) of each of these services: (1) speedy payment for merchants, and (2) credit for shoppers. (I say "indirectly" to reflect the fact that card companies often create or use networks of banks as part of the process—but I have found nothing here suggesting that that fact makes a significant difference to my analysis.)

Sales of the two basic card services are related. A shopper can pay for a purchase with a particular credit card only if the merchant has signed up for merchant-related card services with the company that issued the credit card that the shopper wishes to use. A firm in the credit-card business is therefore unlikely to make money unless quite a few merchants agree to accept that firm's card and quite a few shoppers agree to carry and use it. In general, the more merchants that sign up with a particular card company, the more useful that card is likely to prove to shoppers and so the more shoppers will sign up; so too, the more shoppers that carry a particular card, the more useful that card is likely to prove to merchants (as it obviously helps them obtain the shoppers' business) and so the more merchants will sign up. Moreover, as a rough rule of thumb (and assuming constant charges), the larger the networks of paying merchants and paying shoppers that a card firm maintains, the larger the revenues that the firm will likely receive, since more payments will be processed using its cards. Thus, it is not surprising that a card company may offer shoppers incentives (say, points redeemable for merchandise or travel) for using its card or that a firm might want merchants to accept its card exclusively.

B.

This case focuses upon a practice called "steering." American Express has historically charged higher merchant fees than its competitors. Hence, fewer merchants accept American Express' cards than its competitors'. But, perhaps because American Express cardholders are, on average, wealthier, higher-spending, or more loyal to American Express than other cardholders, vast numbers of merchants still accept American Express cards. Those who do, however, would (in order to avoid the higher American Express fee) often prefer that their customers use a different card to charge a purchase. Thus, the merchant has a monetary incentive to "steer" the customer towards the use of a different card. A merchant might tell the customer, for example, "American Express costs us more," or "please use Visa if you can," or "free shipping if you use Discover."

Steering makes a difference, because without it, the shopper does not care whether the merchant pays more to American Express than it would pay to a different card company—the shopper pays the same price either way. But if steering works, then American Express will find it more difficult to charge more than its competitors for merchant-related services, because merchants will respond by steering their customers, encouraging them to use other cards. Thus, American Express dislikes steering; the merchants like it; and the shoppers may benefit from it, whether because merchants will offer them incentives to use less expensive cards or in the form of lower retail prices overall.

In response to its competitors' efforts to convince merchants to steer shoppers to use less expensive cards, American Express tried to stop, or at least to limit, steering by placing anti-steering provisions in most of its contracts with merchants. It called those provisions "nondiscrimination provisions." They prohibited steering of the forms I have described above (and others as well). After placing them in its agreements, American Express found it could maintain, or even raise, its higher merchant prices without losing too many transactions to other firms. These agreements—the "nondiscrimination provisions"—led to this lawsuit.

C.

In 2010 the United States and 17 States brought this antitrust case against American Express. They claimed that the "nondiscrimination provisions" in its contracts with merchants created an unreasonable restraint of trade. (Initially Visa and MasterCard were also defendants, but they entered into consent judgments, dropping similar provisions from their contracts with merchants).

After a 7-week bench trial, the District Court entered judgment for the Government, setting forth its findings of fact and conclusions of law in a 97-page opinion.

Because the majority devotes little attention to the District Court's detailed factual findings, I will summarize some of the more significant ones here. Among other things, the District Court found that beginning in 2005 and during the next five years, American Express raised the prices it charged merchants on 20 separate occasions. In doing so, American Express did not take account of the possibility that large merchants would respond to the price increases by encouraging shoppers to use a different credit card because the nondiscrimination provisions prohibited any such steering. The District Court pointed to merchants' testimony stating that, had it not been for those provisions, the large merchants would have responded to the price increases by encouraging customers to use other, less-expensive cards.

The District Court also found that even though American Express raised its merchant prices 20 times in this 5year period, it did not lose the business of any large merchant. Nor did American Express increase benefits (or cut credit-card prices) to American Express cardholders in tandem with the merchant price increases. Even had there been no direct evidence of injury to competition, American Express' ability to raise merchant prices without losing any meaningful market share, in the District Court's view, showed that American Express possessed power in the relevant market.

The District Court also found that, in the absence of the provisions, prices to merchants would likely have been lower. It wrote that in the late 1990's, Discover, one of American Express' competitors, had tried to develop a business model that involved charging lower prices to merchants than the other companies charged. Discover then invited each "merchant to save money by shifting volume to Discover," while simultaneously offering merchants additional discounts "if they would steer customers to Discover." The court determined that these efforts failed because of American Express' (and the other card companies') "nondiscrimination provisions." These provisions, the court found, "denied merchants the ability to express a preference for Discover or to employ any other tool by which they might steer share to Discover's lower-priced network." Because the provisions eliminated any advantage that lower prices might produce, Discover "abandoned its low-price business model" and raised its merchant fees to match those of its competitors. This series of events, the court concluded was

"emblematic of the harm done to the competitive process" by the "nondiscrimination provisions."

The District Court added that it found no offsetting procompetitive benefit to shoppers. Indeed, it found no offsetting benefit of any kind. American Express appealed, and the U. S. Court of Appeals for the Second Circuit held in its favor. The Court of Appeals did not reject any fact found by the District Court as "clearly erroneous." Rather, it concluded that the District Court had erred in step 1 of its rule-of-reason analysis by failing to account for what the Second Circuit called the credit-card business's "two-sided market" (or "two-sided platform").

III.

The majority, like the Court of Appeals, reaches only step 1 in its "rule of reason" analysis. To repeat, that step consists of determining whether the challenged "nondiscrimination provisions" have had, or are likely to have, anticompetitive effects. Do those provisions tend to impede competition? And if so, does American Express, which imposed that restraint as a condition of doing business with its merchant customers, have sufficient economic or commercial power for the provision to make a negative difference?

A.

Here the District Court found that the challenged provisions have had significant anticompetitive effects. In particular, it found that the provisions have limited or prevented price competition among credit-card firms for the business of merchants. That conclusion makes sense: In the provisions, American Express required the merchants to agree not to encourage customers to use American Express' competitors' credit cards, even cards from those competitors, such as Discover, dissenting that intended to charge the merchants lower prices. By doing so, American Express has "disrupt[ed] the normal price-setting mechanism" in the market. As a result of the provisions, the District Court found, American Express was able to raise merchant prices repeatedly without any significant loss of business, because merchants were unable to respond to such price increases by encouraging shoppers to pay with other cards. The provisions also meant that competitors like Discover had little incentive to lower their merchant prices, because doing so did not lead to any additional market share. . . . Consumers throughout the economy paid higher retail prices as a result, and they were denied the opportunity to accept incentives that merchants might otherwise have offered to use less-expensive cards. I should think that, considering step 1 alone, there is little more that need be said.

The majority, like the Court of Appeals, says that the District Court should have looked not only at the market for the card companies' merchant-related services but also at the market for the card companies' shopper-related services, and that it should have combined them, treating them as a single market. But I am not aware of any support for that view in antitrust law. Indeed, this Court has held to the contrary.

In *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 610 (1953), the Court held that an antitrust court should begin its definition of a relevant market by focusing narrowly on the good or service directly affected by a challenged restraint. The Government in that case claimed that a newspaper's advertising policy violated the Sherman Act's "rule of reason.". . . [The Supreme Court] explained that "every newspaper is a dual trader in separate though interdependent markets; it sells the paper's news and advertising content to its readers; in effect that readership is in turn sold to the buyers of advertising space." We then added:

> "This case concerns solely one of those markets. The Publishing Company stands accused not of tying sales to its readers but only to buyers of general and classified space in its papers. For this reason, dominance in the advertising market, not in readership, must be decisive in gauging the legality of the Company's unit plan."

Here, American Express stands accused not of limiting or harming competition for shopper-related card services, but only of merchant-related card services, because the challenged contract provisions appear only in American Express' contracts with merchants. That is why the District Court was correct in considering, at step 1, simply whether the agreement had diminished competition in merchant-related services.

* * *

C.

. . . [A] discussion of market definition was legally unnecessary at step 1. That is because the District Court found strong direct evidence of anticompetitive effects flowing from the challenged restraint. As I said, this evidence included Discover's efforts to break into the credit-card business by charging lower prices for merchant-related services, only to find that the "nondiscrimination provisions," by preventing merchants from encouraging shoppers to use Discover cards, meant that lower merchant prices did not result in any additional transactions using Discover credit cards. The direct

evidence also included the fact that American Express raised its merchant prices 20 times in five years without losing any appreciable market share. It also included the testimony of numerous merchants that they would have steered shoppers away from American Express cards in response to merchant price increases (thereby checking the ability of American Express to raise prices) had it not been for the nondiscrimination provisions. It included the factual finding that American Express "did not even account for the possibility that [large] merchants would respond to its price increases by attempting to shift share to a competitor's network" because the nondiscrimination provisions prohibited steering. It included the District Court's ultimate finding of fact, not overturned by the Court of Appeals, that the challenged provisions "were integral to" American Express' "[price] increases and thereby caused merchants to pay higher prices."

As I explained above, this Court has stated that "[s]ince the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, proof of actual detrimental effects . . . can obviate the need for" those inquiries. That statement is fully applicable here. Doubts about the District Court's market-definition analysis are beside the point in the face of the District Court's findings of actual anticompetitive harm.

The majority disagrees that market definition is irrelevant. The majority explains that market definition is necessary because the nondiscrimination provisions are "vertical restraints" and "[v]ertical restraints often pose no risk to competition unless the entity imposing them has market power, which cannot be evaluated unless the Court first determines the relevant market." Ante, at n. 7. The majority thus, in a footnote, seems categorically to exempt vertical restraints from the ordinary "rule of reason" analysis that has applied to them since the Sherman Act's enactment in 1890. The majority's only support for this novel exemption is *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007). But *Leegin* held that the "rule of reason" applied to the vertical restraint at issue in that case. See id., at 898–899. It said nothing to suggest that vertical restraints are not subject to the usual "rule of reason" analysis.

One critical point that the majority's argument ignores is that proof of actual adverse effects on competition is, a fortiori, proof of market power. Without such power, the restraints could not have brought about the anticompetitive effects that the plaintiff proved. See *Indiana Federation of Dentists*, supra, at 460 ("[T]he purpose of the inquiries into market definition and market power is to determine

whether an arrangement has the potential for genuine adverse effects on competition" (emphasis added)). The District Court's findings of actual anticompetitive harm from the nondiscrimination provisions thus showed that, whatever the relevant market might be, American Express had enough power in that market to cause that harm. There is no reason to require a separate showing of market definition and market power under such circumstances. And so the majority's extensive discussion of market definition is legally unnecessary.

D.

The majority's discussion of market definition is also wrong. . . . [T]he majority agrees with the Court of Appeals that the market for American Express' card services is special because it is a "two-sided transaction platform." The majority explains that credit-card firms connect two distinct groups of customers: First, merchants who accept credit cards, and second, shoppers who use the cards. The majority adds that "no credit-card transaction can occur unless both the merchant and the cardholder simultaneously agree to use to the same credit-card network." And it explains that the credit-card market involves "indirect network effects," by which it means that shoppers want a card that many merchants will accept and merchants want to accept those cards that many customers have and use. Ibid. From this, the majority concludes that "courts must include both sides of the platform—merchants and cardholders—when defining the credit-card market."

1.

Missing from the majority's analysis is any explanation as to why, given the purposes that market definition serves in antitrust law, the fact that a credit-card firm can be said to operate a "two-sided transaction platform" means that its merchant-related and shopper-related services should be combined into a single market. . . . The majority defines the phrase as covering a business that "offers different products or services to two different groups who both depend on the platform to intermediate between them," where the business "cannot make a sale to one side of the platform without simultaneously making a sale to the other" side of the platform. I take from that definition that there are four relevant features of such businesses on the majority's account: they (1) offer different products or services, (2) to different groups of customers, (3) whom the "platform" connects, (4) in simultaneous transactions.

What is it about businesses with those four features that the majority thinks justifies a special market definition approach for them? It cannot be the first two features—that the company sells

different products to different groups of customers. Companies that sell multiple products to multiple types of customers are commonplace. . . . I have already explained that, ordinarily, antitrust law will not group the two non-substitutable products together for step 1 purposes.

Neither should it normally matter whether a company sells related, or complementary, products, i.e., products which must both be purchased to have any function, such as ignition switches and tires, or cameras and film. It is well established that an antitrust court in such cases looks at the product where the attacked restraint has an anticompetitive effect. The court does not combine the customers for the separate, non-substitutable goods and see if "overall" the restraint has a negative effect. . . .

The majority disputes my characterization of merchant related and shopper related services as "complements." See ante, n. 8. . . . I agree that two-sided platforms—at least as some academics define them—may be distinct from some types of complements in the respect the majority mentions (even though the services resemble complements because they must be used together for either to have value). But the distinction the majority mentions has nothing to do with the relevant question. The relevant question is whether merchant-related and shopper-related services are substitutes, one for the other, so that customers can respond to a price increase for one service by switching to the other service. As I have explained, the two types of services are not substitutes in this way. . . .

What about the last two features—that the company connects the two groups of customers to each other, in simultaneous transactions? That, too, is commonplace. Consider a farmers' market. It brings local farmers and local shoppers together, and transactions will occur only if a farmer and a shopper simultaneously agree to engage in one. Should courts abandon their ordinary step 1 inquiry if several competing farmers' markets in a city agree that only certain kinds of farmers can participate, or if a farmers' market charges a higher fee than its competitors do and prohibits participating farmers from raising their prices to cover it? Why? If farmers' markets are special, what about travel agents that connect airlines and passengers? What about internet retailers, who, in addition to selling their own goods, allow (for a fee) other goods producers to sell over their networks? Each of those businesses seems to meet the majority's four-prong definition.

Apparently as its justification for applying a special market-definition rule to "two-sided transaction platforms," the majority explains that such platforms "often exhibit" what it calls "indirect

network effects." By this, the majority means that sales of merchant-related card services and (different) shopper-related card services are interconnected, in that increased merchant-buyers mean increased shopper-buyers (the more stores in the card's network, the more customers likely to use the card), and vice versa. But this, too, is commonplace. Consider, again, a farmers' market. The more farmers that participate (within physical and esthetic limits), the more customers the market will likely attract, and vice versa. So too with travel agents: the more airlines whose tickets a travel agent sells, the more potential passengers will likely use that travel agent, and the more potential passengers that use the travel agent, the easier it will likely be to convince airlines to sell through the travel agent. And so forth. Nothing in antitrust law, to my knowledge, suggests that a court, when presented with an agreement that restricts competition in any one of the markets my examples suggest, should abandon traditional market-definition approaches and include in the relevant market services that are complements, not substitutes, of the restrained good.

* * *

E.

Put all of those substantial problems with the majority's reasoning aside, though. Even if the majority were right to say that market definition was relevant, and even if the majority were right to further say that the District Court should have defined the market in this case to include shopper-related services as well as merchant-related services, that still would not justify the majority in affirming the Court of Appeals. That is because, as the majority is forced to admit, the plaintiffs made the factual showing that the majority thinks is required.

Recall why it is that the majority says that market definition matters: because if the relevant market includes both merchant-related services and card-related services, then the plaintiffs had the burden to show that as a result of the nondiscrimination provisions, "the price of credit card transactions"—considering both fees charged to merchants and rewards paid to cardholders— "was higher than the price one would expect to find in a competitive market.". . .

The problem with this reasoning, aside from it being wrong, is that the majority admits that the plaintiffs did show this: they "offer[ed] evidence" that American Express "increased the percentage of the purchase price that it charges merchants . . . and that this increase was not entirely spent on cardholder rewards.". . .

In the face of this problem, the majority retreats to saying that even net price increases do not matter after all, absent a showing of lower output, because if output is increasing, "'rising prices are equally consistent with growing product demand.'" This argument, unlike the price argument, has nothing to do with the credit-card market being a "two-sided transaction platform," so if this is the basis for the majority's holding, then nearly all of the opinion is dicta. The argument is also wrong. It is true as an economic matter that a firm exercises market power by restricting output in order to raise prices. But the relevant restriction of output is as compared with a hypothetical world in which the restraint was not present and prices were lower. The fact that credit-card use in general has grown over the last decade, as the majority says, says nothing about whether such use would have grown more or less without the nondiscrimination provisions. And because the relevant question is a comparison between reality and a hypothetical state of affairs, to require actual proof of reduced output is often to require the impossible—tantamount to saying that the Sherman Act does not apply at all. In any event, there are features of the credit-card market that may tend to limit the usual relationship between price and output. In particular, merchants generally spread the costs of credit-card acceptance across all their customers (whatever payment method they may use), while the benefits of card use go only to the cardholders. Thus, higher credit-card merchant fees may have only a limited effect on credit card transaction volume, even as they disrupt the marketplace by extracting anticompetitive profits.

IV.

A.

For the reasons I have stated, the Second Circuit was wrong to lump together the two different services sold, at step 1. But I recognize that the Court of Appeals has not yet considered whether the relationship between the two services might make a difference at steps 2 and 3. That is to say, American Express might wish to argue that the nondiscrimination provisions, while anticompetitive in respect to merchant-related services, nonetheless have an adequate offsetting procompetitive benefit in respect to its shopper-related services. I believe that American Express should have an opportunity to ask the Court of Appeals to consider that matter. American Express might face an uphill battle. A Sherman Act §1 defendant can rarely, if ever, show that a procompetitive benefit in the market for one product offsets an anticompetitive harm in the market for another.

* * *

B.

The majority charts a different path. Notwithstanding its purported acceptance of the three-step, burden-shifting framework I have described, the majority addresses American Express' procompetitive justifications now, at step 1 of the analysis. And in doing so, the majority inexplicably ignores the District Court's factual findings on the subject.

The majority reasons that the challenged nondiscrimination provisions "stem negative externalities in the credit card market and promote interbrand competition." The "negative externality" the majority has in mind is this: If one merchant persuades a shopper not to use his American Express card at that merchant's store, that shopper becomes less likely to use his American Express card at other merchants' stores. The majority worries that this "endangers the viability of the entire [American Express] network," but if so that is simply a consequence of American Express' merchant fees being higher than a competitive market will support. . . . If American Express' merchant fees are so high that merchants successfully induce their customers to use other cards, American Express can remedy that problem by lowering those fees or by spending more on cardholder rewards so that cardholders decline such requests. What it may not do is demand contractual protection from price competition.

In any event, the majority ignores the fact that the District Court, in addition to saying what I have just said, also rejected this argument on independent factual grounds. It explained that American Express "presented no expert testimony, financial analysis, or other direct evidence establishing that without its [nondiscrimination provisions] it will, in fact, be unable to adapt its business to a more competitive market." It further explained that the testimony that was provided on the topic "was notably inconsistent," with some of American Express' witnesses saying only that invalidation of the provisions "would require American Express to adapt its current business model." After an extensive discussion of the record, the District Court found that "American Express possesses the flexibility and expertise necessary to adapt its business model to suit a market in which it is required to compete on both the cardholder and merchant sides of the [credit-card] platform." The majority evidently rejects these factual findings, even though no one has challenged them as clearly erroneous.

Similarly, the majority refers to the nondiscrimination provisions as preventing "free riding" on American Express' "investments in rewards" for cardholders. But as the District Court

explained, "[p]lainly . . . investments tied to card use (such as Membership Rewards points, purchase protection, and the like) are not subject to free-riding, since the network does not incur any cost if the cardholder is successfully steered away from using his or her American Express card." This, I should think, is an unassailable conclusion: American Express pays rewards to cardholders only for transactions in which cardholders use their American Express cards, so if a steering effort succeeds, no rewards are paid. As for concerns about free riding on American Express' fixed expenses, including its investments in its brand, the District Court acknowledged that free-riding was in theory possible, but explained that American Express "ma[de] no effort to identify the fixed expenses to which its experts referred or to explain how they are subject to free riding.". . . Finally, the majority reasons that the nondiscrimination provisions "do not prevent Visa, MasterCard, or Discover from competing against [American Express] by offering lower merchant fees or promoting their broader merchant acceptance." But again, the District Court's factual findings were to the contrary. As I laid out above, the District Court found that the nondiscrimination provisions in fact did prevent Discover from pursuing a low merchant-fee business model, by "den[ying] merchants the ability to express a preference for Discover or to employ any other tool by which they might steer share to Discover's lower-priced network." The majority's statements that the nondiscrimination provisions are procompetitive are directly contradicted by this and other factual findings.

* * *

For the reasons I have explained, the majority's decision in this case is contrary to basic principles of antitrust law, and it ignores and contradicts the District Court's detailed factual findings, which were based on an extensive trial record. I respectfully dissent.

* * *

ADDENDUM (from the Court of Appeals Decision)

Figure 1

The basic functions of as many as five distinct actors comprising the Visa and MasterCard cooperative, open-loop systems.

	Cardholder Side		NETWORK	Merchant Side	
Actor	Card holder	Issuer	NETWORK	Acquirer	Merchant
Function	Purchases goods and services from merchants.	Cardholder's bank. Provides cards to cardholders, collects payment, and commonly provides cardholder rewards such as cash back or airline miles.	Middleman. Brings together merchants & acquirers with cardholders & issuers.	Merchant's bank. Responsible for both merchant acquisition and accepting card transaction data from merchants for verification and processing.	Sells good and services to cardholders
Examples		Citibank; JPMorgan Chase; Bank of America; Capital One	Visa; MasterCard	First Data Corporation; Chase Paymentech	

Figure 2

The basic relationships and interactions between actors in the Visa and MasterCard cooperative, open-loop networks.

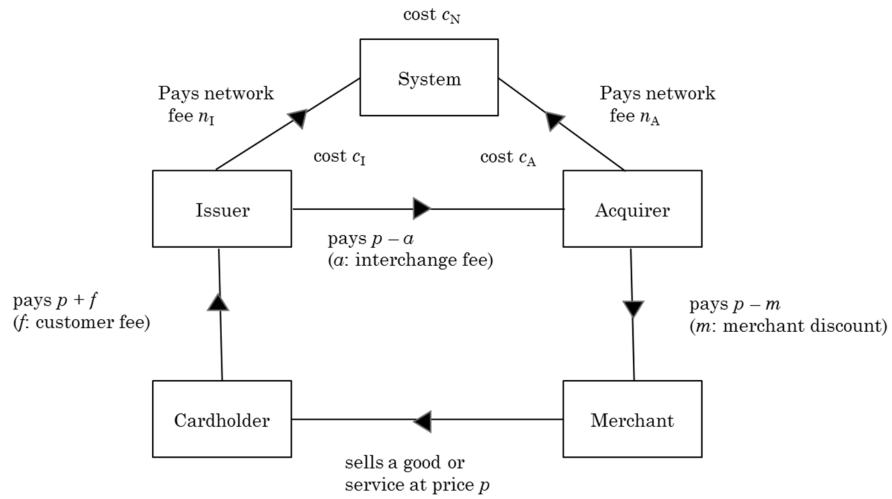


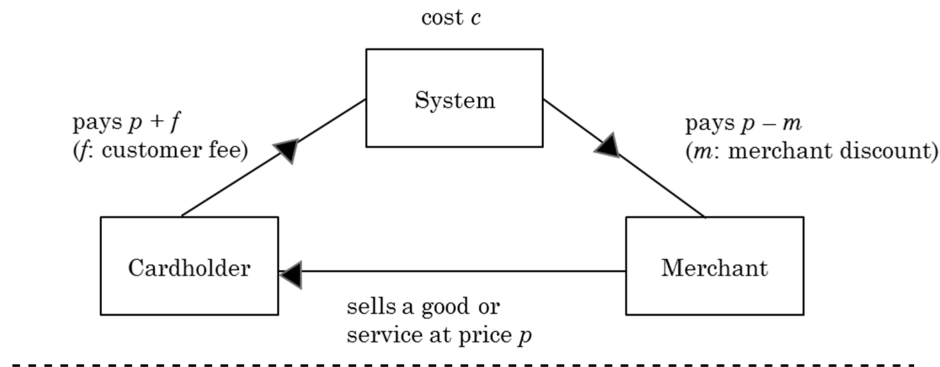
Figure 3

The basic functions of the three actors in the American Express proprietary, closed-loop system.

	Cardholder Side	AMERICAN EXPRESS			Merchant Side
Actor	Cardholder	Issuer	NETWORK	Acquirer	Merchant
Function	Purchases goods and services from merchants.	Provides cards to cardholders, collects payment, and commonly provides cardholder rewards such as cash back or airline miles.	Middleman. Brings together merchants & acquirers with cardholders & issuers.	Responsible for both merchant acquisition and accepting card transaction data from merchants for verification and processing.	Sells goods and services to cardholders
Examples		American Express	American Express	American Express	

Figure 4

The basic relationships and interactions between the actors in the proprietary, closed-loop American Express system.



NOTES AND QUESTIONS

1. *Considering two-sidedness*. Try to frame the two-sided argument here. American Express assembles a pool of potential customers for merchants. That is effectively what Amex is doing in issuing cards to consumers. There is no reason that the demographics of Amex card holders should be identical to those of Visa and MasterCard. And one of the competitive tools that Amex might bring to bear in the competition between card platforms is the high quality of their consumer pool, i.e., a group of cardholders that tend to spend more at merchants. Amex then goes to a merchant to try to get it to take the Amex card. Amex notes that it charges a higher interchange fee than Visa or MasterCard, but Amex says that it needs to do that to fund the attractive benefits that it offers to build its pool of card holders. All of that seems perfectly plausible and a legitimate way to organize competition between the card platforms.

Once the customer has arrived in the store or on its website, the merchant will prefer that she use a card for which the merchant will be charged a lower fee. Amex, however, will almost certainly care what happens once an Amex cardholder walks into a merchant. Amex will contend that the fact that the merchant accepts the American Express card will be an important reason for an Amex cardholder to shop at the merchant in the first place. Amex wants to make sure that merchant who gets the benefit of advertising that they accept the Amex card—Amex customers walk into the store—also pays its fair share of the costs of building that customer pool in the first place. Amex wants to police free riding, where a merchant advertises acceptance of the Amex card, gets the benefit of having that customer in the store, but then avoids paying the costs of that by suggesting that the consumer pay with a card with a lower interchange fee (Visa or MasterCard).

Does that analysis seem right? Does that link together the behavior across both sides of the market and in doing so account for the ways that merchants might seek to avoid the costs of serving the other side of the market?

2. *Relevant market*. The Court held that, in a vertical case, it is necessary to define a relevant market in order to assess the competitive effects of the conduct at issue (see fn. 7). Is that correct? Suppose, for example, that some states at various times had rules prohibiting Amex from applying no-steering rules to in-state merchants and the evidence showed that, when those laws were in effect, there were more credit card transactions at lower cost to consumers and merchants in those states (1) than at other times and

(2) relative to transactions and costs in other states. Would it make sense to require proof of a market if those were the facts?

3. *Market definition*. The Court held that both cardholders and merchants should be included in a single relevant market on the ground that Amex and other credit card platforms are what the Court called "two-sided transaction platforms" that "facilitate a single, simultaneous transaction" involving both cardholders and merchants. Cases and the Merger Guidelines state that markets are defined with respect to buyers. Cardholders are not buyers of the network services purchased by merchants, so how can they be included in a market for the sale of such services?

The dissent noted that market definition entails identifying a group of products or services that buyers regard as substitutes and that therefore compete with and constrain one another. Are the substitutes for Amex from the perspective of cardholders the same as the substitutes from the perspective of merchants? Many merchants that take Visa and MasterCard do not take Amex, presumably because of the high fees charged by Amex. Would including both sides of the platform in a single market when the substitutes on one side might be different from those on the other side render the concept of a relevant market incoherent? Even if the market were defined with respect to only one side, the other side could affect the market definition. For example, assume that, if a monopolist of the hypothetical credit card market for merchants increased the merchant fee to above competitive levels, some merchants would drop the card, but not enough to themselves cause the price increase to be unprofitable. Assume further that the reduction in the number of merchants accepting the card would cause a reduction in the number of card holders and that the combination of the loss of some merchants and the reduction in the number of card holders would cause the increase in the merchant fee to be unprofitable. In that case, should it be concluded that the hypothetical market is not a market even on the merchant side? And if the price increase would be profitable after taking into account the loss of both merchants and cardholders, should it be concluded that it is a market? If feedback effects and indirect network effects can be taken into account in defining a market on one side of the platform, what is gained by trying to define a market that includes both sides?

4. *Identifying the competitors*. One way to make defining a two-sided market workable would be to ask what combination of alternatives on the two sides would, if monopolized, enable supracompetitive pricing. That way, an alternative on one side could be included in the market even though customers on the other side

would not consider it to be an alternative for their purposes. But there might a several different markets that would meet that test. For example, in the ride sharing business, one market might consist of Uber and Lyft on the rider side and Grub Hub on the driver side, while another market might consist of Uber, Lyft, and taxicabs.

The Court appears not to have had that kind of market definition in mind. It stated that "only other two-sided platforms can compete with a two-sided platform for transactions." In *United States v. Sabre Corp*., 452 F.Supp.3d 97 (D. Del. 2020), a case brought by the Justice Department to block Sabre's acquisition of Farelogix, the district court found that the two firms viewed each other as major competitors, the record reflected that competition, and their airline customers regarded them as differentiated alternatives. Nevertheless, relying on the quoted language from the *American Express* opinion, the court rejected the challenge to the merger on the ground that, as a matter of law, the two merging parties could not be included in the same market. The court reasoned that, while Sabre was a two-sided platform, Farelogix was not and the two firms therefore could not be included in the same market. Did the *Sabre* court read *American Express* correctly? Should it have treated the quoted language as factually inaccurate dicta or as a binding legal rule? Should it have construed that language as simply describing *transactions* and not as intended to describe the boundaries of the relevant market?

5. *Market power*. If, as the dissent says, market definition is simply an aid in assessing market power, might it have been better for the Court to ignore the market definition issue and ask directly the question whether Amex had market power? How might a court determine whether Amex had market power without defining a market?

6. *Quality-adjusted prices*. Does an increase in the nominal merchant fee mean that quality-adjusted prices (i.e., prices adjusted to reflect changes in the quality of the product or service) increased? Suppose the fee increase enabled Amex to increase cardholder benefits and the increased benefits increased both the number of Amex cardholders and their willingness to use the Amex card in order to obtain the benefits. If by this mechanism the increase in the merchant fee generated sales increases for the merchants sufficient for the merchants on balance to profit from the fee increase, can it be concluded that the fee increase constituted a price increase for antitrust purposes? In determining how much the merchants benefitted from increased sales to Amex cardholders, should the court

subtract sales that reflected cardholder shifting to Amex from other cards on the ground the merchants would have made those sales anyhow and they cannot be attributed to the Amex fee increase?

7. *Injury to competition*. The ultimate issue in the case was whether the no-steering rules unlawfully impeded Amex's rivals. The majority said that "plaintiffs did not offer any evidence that the price of credit-card transactions was higher than the price one would expect to find in a competitive market." Is that the correct test if the no-steering provision prevented merchants from passing on to consumers the lower fees charged by other card platforms and thus resulted in prices that were higher than they would have been without the no-steering rules?

It seems clear that the rules did harm the rivals because the rules materially reduced their ability to compete on price on the merchant side. Is that enough to find injury to competition? In thinking about this question, consider exclusive dealing agreements. Suppose firm A enters into exclusive dealing agreements with several distributors. That might harm A's rivals because they would lose access to the distributors, but the agreements might still be legal if there are offsetting efficiencies.

Suppose A is able to show that the exclusive distributors are still better off – perhaps by being paid in money or services for their exclusivity -- even though they are unable to deal with A's competitors. Would that be sufficient to justify the exclusivity agreements? Or is the question whether output increased in the market as a whole? Similarly, in the Amex case, would the no-steering rules be lawful if they increased Amex's output but reduced credit card transactions overall?

The dissent suggested that there might often be no way to know whether the no-steering rules increased total output because that requires us to know what would have happened in a hypothetical world without the no-steering rules. If that is correct, how can a court decide whether the benefits of avoiding merchant free riding on the promotional efforts of Amex outweigh the harms to Amex's rivals?

8. *Two-sided price level*. The Court held that harm to competition cannot be inferred from the merchant fees themselves and can be inferred from prices only if the plaintiffs proved that the defendant's conduct elevated the platform's two-sided price (i.e., the sum of the prices it charges to the two sides for a transaction). In the Court's view, Amex sold a single product, transactions, and the relevant price is the two-sided price of the transactions.

The Court focused entirely on price *level* and overlooked the importance in two-sided markets of the price *structure* – the relative prices on the two sides. For example, suppose Amex increases the merchant fee and increases cardholder rewards (i.e., reduces price on the cardholder side) slightly more; in that case, the two-sided price would be slightly reduced. The cardholders might benefit from the increased rewards, and the transaction volume on American Express cards could rise as consumers choose to use those cards more frequently. But the change could nevertheless reduce economic welfare.

Merchants might benefit from additional consumer purchases stimulated by the increase in consumer rewards, but such gains would be offset (and maybe exceeded) by the increased merchant fees for all purchases on American Express cards. Moreover, some of the additional American Express transactions induced by the increased rewards might simply replace purchases that the consumer would otherwise have made using alternative payment methods equally or less costly to merchants. The change in the price structure could thus increase the merchants' fees while generating little increase in merchant sales and might, on balance, harm merchants. In addition, if the increased rewards are worth less to consumers than the increased fees cost the merchants, both would be better off if the merchants are able to induce the cardholder to choose a different payment method by passing on to consumers part of the cost saving to the merchant resulting from the use of the alternative method. Also, if some merchants stop accepting American Express cards because of the increased fees, cardholders could be worse off from the reduced ability to use their cards even though they get increased rewards when they do use the cards. These and other problems with a two-side price test are discussed in Michael L. Katz, *Platform Economics and Antitrust Enforcement: A Little Knowledge Is a Dangerous Thing*, 28 J. ECON. & MGMT. STRATEGY 138 (2019).

9. *Efficiency and other justifications*. The majority said that the no-steering rules served the legitimate purpose of preventing free-riding on Amex's investments in cardholder services. The idea is evidently that Amex cardholders are drawn to merchants that accept Amex cards and then, if there were no rules, the merchants might steer the cardholders to use lower-cost cards. Is that a legitimate justification or, as the dissent suggests, is it better understood as a means of insulating Amex from price competition?

Is the free-riding argument a legitimate justification if it protects Amex from a loss of goodwill; or does the justification depend on

showing that it is necessary to prevent harm to the market as a whole, taking into account the output of both Amex and competing cards?

If it is a legitimate justification, might there be less restrictive alternatives such as (i) applying the no-steering rules to only those merchants that advertise that they accept Amex cards or (ii) permitting merchants to pass lower costs of other cards on to consumers by price reductions and limiting no-steering rules to other forms of steering that might more explicitly harm the Amex brand?

With respect to the latter, is Amex telling merchants they cannot pass lower costs on to consumers any different from Gucci telling department stores that sell its handbags that they cannot charge consumers lower prices for handbags for which the stores are charged a lower wholesale price? What if Gucci can show that many consumers come to the stores because they carry Gucci handbags? If merchants were permitted to pass cost differences on to consumers, would they have any other reason to steer Amex cardholders to other cards?

10. *Creating a new externality*. The no-steering rules prevented retailers from charging holders of Visa, Mastercard and Discover lower prices to reflect the lower merchant fees on those cards. The rules thus restricted price competition and created something of a price umbrella for Amex so that it could charge high merchant fees. From this perspective, the rules could be seen as shifting some of Amex's costs to holders of other cards. Moreover, if the merchant cannot require Amex cardholders to pay the higher merchant fees, it will pass its increased costs on to all customers in the form of higher merchandise prices. How should that externality affect the antitrust analysis?

11. *Benefits and harms on different sides of the platform*. The dissent suggested that harm on the merchant side cannot be justified by benefits on the cardholder side. It referred to case law to the effect that harm in one market cannot be justified by benefits in a different market. Should that principle apply here, or are platforms different because the harms on one side are inextricably linked to the benefits on the other side?

If effects on both sides of the market need to be considered, how should they be compared? What is the metric for weighing harm on one side against benefit on the other? If the plaintiff is able to show harm on the merchant side, should it have the burden of showing that there are no offsetting benefits on the cardholder side? Or should the defendant have the burden of proof on that issue on the ground that it is an affirmative defense, that the defendant has better access to information about the other side of the platform, or that a party should not be required to prove a negative?

12. *Post-*Amex *case developments*. *Amex* is an important case. Part of that has to do with the shape of the modern economy where internet and device platforms shape much of our day-to-day lives. But another part of that is the apparent breadth of the two-sided markets idea discussed in *Amex* and the understandable desire of potential antitrust defendants to want to use *Amex* to shield themselves from potential antitrust liability. You can run searches on Westlaw and Lexis just like we can and we urge you to do that, but we will highlight a couple of key cases. *U.S. Airways, Inc. v. Sabre Holdings Corp.*, 938 F.3d 43 (2nd Cir. 2019), is an intriguing case set in the world of reservation systems for airlines, but the case is also procedurally a little awkward. The original litigation in the case occurred before the Supreme Court's opinion in *Amex,* but the case came to the Second Circuit after the Supreme Court had reset the law in this area. That makes the case a difficult one for useful generalizations.

And staying in the airline reservation business, we turn to a proposed merger between Sabre and Farelogix. The U.S. government brought a challenge to the proposed merger, but that challenge was rejected in April 2020 in a lengthy opinion by Judge Leonard P. Stark of the U.S. District Court for the District of Delaware. The result in *Farelogix*, which is discussed briefly in Note 4 above, was seen by many as an unfortunate extension of the analysis in *Amex*. But after the Competition and Markets Authority of the United Kingdom blocked the merger, the parties abandoned it, and on July 20, 2020, the Third Circuit vacated the district's court opinion. It did note that its order "should not be construed as detracting from the persuasive force of the District Court's decision, should courts and litigants find its reasoning persuasive."

13. *But what does the Supreme Court think about the case?* One final point. Sometimes you can assess the importance of a case by how often it is cited in another opinion, but in other cases, the fact that a case isn't cited is really what is noteworthy. In Chapter 10, you will read the 2019 Supreme Court decision in *Apple v. Pepper*. The issue there is standing in connection with possible antitrust actions over how Apple operates the App Store for iOS devices like the iPhone and the iPad. That type of platform is a standard example of a two-sided transaction market and hence you might have expected the Supreme Court to develop its *Amex* jurisprudence in this important area. Yet the Supreme Court decided *Apple v. Pepper* without a single citation to *Amex* by either the majority or the dissent. Remember this note when you read *Pepper*.

* * *

Chapter 8.4.C.2: Competition Law Enforcement Against Google in Europe

European Commission – Press Release
Antitrust: Commission fines Google €4.34 billion for illegal practices regarding Android mobile devices to strengthen dominance of Google's search engine

Brussels, 18 July 2018

[insert after the discussion of Google/Shopping, at the bottom of p. 1049]

The European Commission has fined Google €4.34 billion for breaching EU antitrust rules. Since 2011, Google has imposed illegal restrictions on Android device manufacturers and mobile network operators to cement its dominant position in general internetsearch.

Google must now bring the conduct effectively to an end within 90 days or face penalty payments of up to 5% of the average daily worldwide turnover of Alphabet, Google's parent company.

Commissioner Margrethe **Vestager**, in charge of competition policy, said: "*Today, mobile internet makes up more than half of global internet traffic. It has changed the lives of millions of Europeans. Our case is about three types of restrictions that Google has imposed on Android device manufacturers and network operators to ensure that traffic on Android devices goes to the Google search engine. In this way, Google has used Android as a vehicle to cement the dominance of its search engine. These practices have denied rivals the chance to innovate and compete on the merits. They have denied European consumers the benefits of effective competition in the important mobile sphere. This is illegal under EU antitrust rules.*"

In particular, Google:

- has required manufacturers to pre-install the Google Search app and browser app (Chrome), as a condition for licensing Google's app store (the Play Store);
- made payments to certain large manufacturers and mobile network operators on condition that they exclusively pre-installed the Google Search app on their devices; and
- has prevented manufacturers wishing to pre-install Google apps from selling even a single smart mobile device running on alternative versions of Android that were not approved by Google (so- called "Android forks").

Google's strategy and the scope of the Commission investigation

Google obtains the vast majority of its revenues via its flagship product, the Google search engine. The company understood early on that the shift from desktop PCs to mobile internet, which started in the mid-2000s, would be a fundamental change for Google Search. So, Google developed a strategy to anticipate the effects of this shift, and to make sure that users would continue to use Google Search also on their mobile devices.

In 2005, Google bought the original developer of the Android mobile operating system and has continued to develop Android ever since. Today, about 80% of smart mobile devices in Europe, and worldwide, run on Android.

When Google develops a new version of Android it publishes the source code online. This in principle allows third parties to download and modify this code to create Android forks. The openly accessible Android source code covers basic features of a smart mobile operating system but not Google's proprietary Android apps and services. Device manufacturers who wish to obtain Google's proprietary Android apps and services need to enter into contracts with Google, as part of which Google imposes a number of restrictions. Google also entered into contracts and applied some of these restrictions to certain large mobile network operators, who can also determine which apps and services are installed on devices sold to end users.

The Commission decision concerns three specific types of contractual restrictions that Google has imposed on device manufacturers and mobile network operators. These have enabled Google to use Android as a vehicle to cement the dominance of its search engine. In other words, the Commission decision does not question the open source model or the Android operating system as such.

Google's dominance

The Commission decision concludes that Google is dominant in the markets **for general internet search services, licensable smart mobile operating systems and app stores for the Android mobile operating system.**

General search services

Google is dominant in the national markets for general internet search throughout the European Economic Area (EEA), i.e. in

all 31 EEA Member States. Google has shares of more than 90% in most EEA Member States. There are high barriers to enter these markets. This has also been concluded in the Google Shopping decision of June 2017.

Smart mobile operating systems available for licence

Android is a licensable smart mobile operating system. This means that third party manufacturers of smart mobile devices can license and run Android on their devices.

Through its control over Android, Google is dominant in the worldwide market (excluding China) for licensable smart mobile operating systems, with a market share of more than 95%. There are high barriers to entry in part due to network effects: the more users use a smart mobile operating system, the more developers write apps for that system – which in turn attracts more users. Furthermore, significant resources are required to develop a successful licensable smart mobile operating system.

As a licensable operating system, Android is different from operating systems exclusively used by vertically integrated developers (like Apple iOS or Blackberry). Those are not part of the same market because they are not available for licence by third party device manufacturers.

Nevertheless, the Commission investigated to what extent competition for end users (downstream), in particular between **Apple** and Android devices, could indirectly constrain Google's market power for the licensing of Android to device manufacturers (upstream). The Commission found that this competition does not sufficiently constrain Google upstream for a number of reasons, including:

- end user purchasing decisions are influenced by a variety of factors (such as hardware features or device brand), which are independent from the mobile operating system;
- Apple devices are typically priced higher than Android devices and may therefore not be accessible to a large part of the Android device user base;
- Android device users face switching costs when switching to Apple devices, such as losing their apps, data and contacts, and having to learn how to use a new operating system; and
- even if end users were to switch from Android to Apple devices, this would have limited impact on Google's core business. That's because Google Search is set as the default search engine on Apple devices and Apple users are therefore likely to

continue using Google Search for their queries.

App stores for the Android mobile operating system

Google is dominant in the worldwide market (excluding China) for app stores for the Android mobile operating system. Google's app store, the Play Store, accounts for more than 90% of apps downloaded on Android devices. This market is also characterised by high barriers to entry. For similar reasons to those already listed above, Google's app store dominance is not constrained by Apple's App Store, which is only available on iOS devices.

Breach of EU antitrust rules

Market dominance is, as such, not illegal under EU antitrust rules. However, dominant companies have a special responsibility not to abuse their powerful market position by restricting competition, either in the market where they are dominant or in separate markets.

Google has engaged in three separate types of practices, which all had the aim of cementing Google's dominant position in general internet search.

1) Illegal tying of Google's search and browser apps

Google offers its mobile apps and services to device manufacturers as a bundle, which includes the Google Play Store, the Google Search app and the Google Chrome browser. Google's licensing conditions make it impossible for manufacturers to pre-install some apps but not others.

As part of the Commission investigation, device manufacturers confirmed that the Play Store is a "must-have" app, as users expect to find it pre-installed on their devices (not least because they cannot lawfully download it themselves).

The Commission decision has concluded that Google has engaged in two instances of illegal tying:

- First, the **tying of the Google Search app**. As a result, Google has ensured that its Google Search app is pre-installed on practically all Android devices sold in the EEA. Search apps represent an important entry point for search queries on mobile devices. The Commission has found this tying conduct to be illegal as of 2011, which is the date Google became dominant in the market for app stores for the Android mobile operating system.
- Second, the **tying of the Google Chrome browser**. As a result, Google has ensured that its mobile browser is pre-

installed on practically all Android devices sold in the EEA. Browsers also represent an important entry point for search queries on mobile devices and Google Search is the default search engine on Google Chrome. The Commission found this tying conduct to be illegal as of 2012, which is the date from which Google has included the Chrome browser in its app bundle.

Pre-installation can create a *status quo* bias. Users who find search and browser apps pre-installed on their devices are likely to stick to these apps. For example, the Commission has found evidence that the Google Search app is consistently used more on Android devices, where it is pre-installed, than on Windows Mobile devices, where users must download it. This also shows that users do not download competing apps in numbers that can offset the significant commercial advantage derived through pre- installation. For example, in 2016:

- on **Android** devices (with Google Search and Chrome pre-installed) more than 95% of all search queries were made via Google Search; and
- on **Windows Mobile** devices (Google Search and Chrome are not pre-installed) less than 25% of all search queries were made via Google Search. More than 75% of search queries happened on Microsoft's Bing search engine, which is pre-installed on Windows Mobile devices.

Google's practice has therefore reduced the incentives of manufacturers to pre-install competing search and browser apps, as well as the incentives of users to download such apps. This reduced the ability of rivals to compete effectively with Google.

The Commission also assessed in detail Google's arguments that the tying of the Google Search app and Chrome browser were necessary, in particular to allow Google to monetise its investment in Android, and concluded that these arguments were not well founded. Google achieves billions of dollars in annual revenues with the Google Play Store alone, it collects a lot of data that is valuable to Google's search and advertising business from Android devices, and it would still have benefitted from a significant stream of revenue from search advertising without the restrictions.

2) Illegal payments conditional on exclusive pre-installation of Google Search

Google granted significant financial incentives to some of the largest device manufacturers as well as mobile network operators on condition that they **exclusively** pre-installed Google Search across their entire portfolio of Android devices. This harmed competition by significantly reducing their incentives to pre-install competing search apps.

The Commission's investigation showed that a rival search engine would have been unable to compensate a device manufacturer or mobile network operator for the loss of the revenue share payments from Google and still make profits. That is because, even if the rival search engine was pre- installed on only some devices, they would have to compensate the device manufacturer or mobile network operator for a loss of revenue share from Google across all devices.

In line with the recent EU court ruling in Intel, the Commission has considered, amongst other factors, the conditions under which the incentives were granted, their amount, the share of the market covered by these agreements and their duration.

On this basis, the Commission found Google's conduct to be illegal between 2011 and 2014. In 2013 (after the Commission started to look into this issue), Google started to gradually lift the requirement. The illegal practice effectively ceased as of 2014.

The Commission also assessed in detail Google's arguments that the granting of financial incentives for exclusive pre-installation of Google Search across the entire portfolio of Android devices was necessary. In this regard, the Commission dismissed Google's claim that payments based on exclusivity were necessary to convince device manufacturers and mobile network operators to produce devices for the Android ecosystem.

3) Illegal obstruction of development and distribution of competing Android operating systems

Google has prevented device manufacturers from using any alternative version of Android that was not approved by Google (Android forks). In order to be able to pre-install on their devices Google's proprietary apps, including the Play Store and Google Search, manufacturers had to commit not to develop or sell even a single device running on an Android fork. The Commission found that this conduct was abusive as of 2011, which is the date Google became dominant in the market for app stores for the Android mobile operating system.

This practice reduced the opportunity for devices running on Android forks to be developed and sold. For example, the Commission has found evidence that Google's conduct prevented a number of large

manufacturers from developing and selling devices based on Amazon's Android fork called "Fire OS".

In doing so, Google has also closed off an important channel for competitors to introduce apps and services, in particular general search services, which could be pre-installed on Android forks. Therefore, Google's conduct has had a direct impact on users, denying them access to further innovation and smart mobile devices based on alternative versions of the Android operating system. In other words, as a result of this practice, it was Google – and not users, app developers and the market – that effectively determined which operating systems could prosper.

The Commission also assessed in detail Google's arguments that these restrictions were necessary to prevent a "fragmentation" of the Android ecosystem, and concluded that these were not well founded. First, Google could have ensured that Android devices using Google proprietary apps and services were compliant with Google's technical requirements, without preventing the emergence of Android forks. Second, Google did not provide any credible evidence that Android forks would be affected by technical failures or fail to support apps.

The effects of Google's illegal practices

The Commission decision concludes that these three types of abuse form part of an overall strategy by Google to cement its

dominance in general internet search, at a time when the importance of mobile internet was growing significantly.

First, Google's practices have denied rival search engines the possibility to compete on the merits. The tying practices ensured the pre-installation of Google's search engine and browser on practically all Google Android devices and the exclusivity payments strongly reduced the incentive to pre-install competing search engines. Google also obstructed the development of Android forks, which could have provided a platform for rival search engines to gain traffic. Google's strategy has also prevented rival search engines from collecting more data from smart mobile devices, including search and mobile location data, which helped Google to cement its dominance as a search engine.

Furthermore, Google's practices also harmed competition and further innovation in the wider mobile space, beyond just internet search. That's because they prevented other mobile browsers from competing effectively with the pre-installed Google Chrome browser. Finally, Google obstructed the development of Android forks, which could have provided a platform also for other app developers to thrive.

Consequences of the decision

The Commission's fine of **€4 342 865 000** takes account of the duration and gravity of the infringement. In accordance with the Commission's 2006 Guidelines on fines (see press release and MEMO), the fine has been calculated on the basis of the value of Google's revenue from search advertising services on Android devices in the EEA.

The Commission decision requires Google to bring its illegal conduct to an end in an effective manner within 90 days of the decision.

At a minimum, Google has to stop and to not re-engage in any of the three types of practices. The decision also requires Google to refrain from any measure that has the same or an equivalent object or effect as these practices.

The decision does not prevent Google from putting in place a reasonable, fair and objective system to ensure the correct functioning of Android devices using Google proprietary apps and services, without however affecting device manufacturers' freedom to produce devices based on Android forks.

It is Google's sole responsibility to ensure compliance with the Commission decision. The Commission will monitor Google's compliance closely and Google is under an obligation to keep the Commission informed of how it will comply with its obligations.

If Google fails to ensure compliance with the Commission decision, itwould be liable for non-compliance payments of up to 5% of the average daily worldwide turnover of Alphabet, Google's parent company. The Commission would have to determine such non-compliance in a separate decision, with any payment backdated to when the non-compliance started.

Finally, Google is also liable to face civil actions for damages that can be brought before the courts of the Member States by any person or business affected by its anti-competitive behaviour. The new EU Antitrust Damages Directive makes it easier for victims of anti-competitive practices to obtain damages.

Other Google cases

In June 2017, the Commission fined Google €2.42 billion for abusing its dominance as a search engine by giving an illegal advantage to Google's own comparison shopping service. The Commission is currently actively monitoring Google's compliance with that decision.

The Commission also continues to investigate restrictions that Google has placed on the ability of certain third party websites to display search advertisements from Google's competitors (the AdSense case). In July 2016, the Commission came to the preliminary conclusion that Google has abused its dominant position in a case concerning AdSense.

Background

Today's decision is addressed to Google LLC (previously Google Inc.) and Alphabet Inc., Google's parent company. The Commission opened proceedings concerning Google's conduct as regards the Android operating system and applications in April 2015 and sent a Statement of Objections to Google in April 2016.

Article 102 of the Treaty on the Functioning of the European Union (TFEU) and Article 54 of the EEA Agreement prohibit abuse of a dominant position.

More information on this investigation is available on the Commission's competition website, in the public case register under the case number 40099.

NOTES AND QUESTIONS

1. *In the beginning*. Be sure to step back and consider the posture that Google was in when it decided to move into the smartphone operating system market by buying Android in mid-2005. In 2007,

based on worldwide sales, Nokia's Symbian operating system had 63.5% of the market; Microsoft Windows Mobile, 12%; and RIM's Blackberry, 9.6%. Apple introduced the iPhone in January 2007 to rave reviews, but you couldn't buy it until later that year. Microsoft was not in the handset market but instead was trying to replicate the strategy it had used to enormous success in the PC market. That meant selling software for a fee and getting handset markets to adopt it. We know, after the fact of course, that the iPhone would transform the smartphone market. Apple, as it had with the Macintosh, was vertically integrated: Apple hardware combined with Apple software and both of those were available only through Apple. What strategy would you have advised Google to try? Vertically integrate? Charge a fee for the smartphone OS software as Microsoft was doing? How would you describe Google's strategy and why did they adopt it?

2. *Consumers speak*. What do you make of the fact that the combination of the introduction of the iPhone and then Android-based smartphones completely displaced the positions of the preexisting sophisticated phone makers? Said, again, Nokia, Microsoft and RIM were pushed to the side by Apple and the ecosystem that Google created. Did that happen through anti-competitive behavior? If so, when did that anti-competitive behavior begin?

3. *Defining markets*. The EC excluded Apple from the relevant market because it defined the market in issue as that for licensable smartphone OSs and Apple doesn't license iOS separately. Is that the right approach? Might competition between the iPhone and Android phones constrain Google's ability to increase prices to firms licensing Android?

4. *Dominance and contractual practices*. The EC might concede that Google's entry into smartphones was procompetitive. The actual Android decision—and recall, as this supplement went to press we have available only the press release set out above—focused on how Google behaved once it achieved a dominant position in the market for licensable smartphone OSs. The Google Play store had become dominant, and the EC found that Google was tying various search software to Google Play. Given the EC decision, how should Google have changed its practices once it had achieved a dominant position in the market? Should Google have revisited its decision to not charge a fee for licensing Android? Should it do so now? If Google had (or now does) move to charging a fee, how would that change competition in the smartphone OS market and the search market? In that regard, it is worth nothing that Google is reported to pay Apple a substantial amount of money to get its search software preinstalled on the iPhone.

5. *The choice screen*. The EC ruling required Google to implement a remedy, and on August 2, 2019, Google announced that it would be incorporating a choice screen into Android. The simple version of that idea is that a user of a new Android phone would be presented with a list of search engines the first time the user went to run a search. The user could then designate any one of the listed search engines as the default search engine going forward. (This should sound very much like the browser choice screen that was implemented in Europe to settle the browser case brought by the Commission against Microsoft.) The idea behind the choice screen is simple enough, though the next question is how to populate the list of presented search engines and choose a sequence for the listing. Exactly how that was done has changed during the last two years, moving from an auction model to one in which different search engines are listed for free. As to the possible efficacy of this type of remedy, visit statcounter.com and run a few searches on Europe and the United States to see what search engines get used on mobile devices.

ADDITIONAL EUROPEAN DEVELOPMENTS

1. *Google AdSense fine*. On March 20, 2019, the European Commission issued its third fine against Google, this time in the amount of €1.49 billion for what the commission found to be abusive practices in online advertising. The core of the violation was Google's contracting practices in connection with its AdSense product. In 2006, Google had inserted certain exclusivity clauses in its contracts for search advertising. While those clauses evolved over time, Google continued to use contracts to limit the ability of firms to compete with Google's advertising product.

2. *Amazon investigation*. On July 17, 2019, the European Commission announced that it had opened an investigation into Amazon:

> The European Commission has opened a formal antitrust investigation to assess whether Amazon's use of sensitive data from independent retailers who sell on its marketplace is in breach of EU competition rules.
>
> Commissioner Margrethe Vestager, in charge of competition policy, said: *"European consumers are increasingly shopping online. E-commerce has boosted retail competition and brought more choice and better prices. We need to ensure that large online platforms don't eliminate these benefits through anti-competitive behaviour. I have therefore decided to take a very close look at Amazon's business practices and its dual role as*

> *marketplace and retailer, to assess its compliance with EU competition rules."*
>
> Amazon has a dual role as a platform: (i) it sells products on its website as a retailer; and (ii) it provides a marketplace where independent sellers can sell products directly to consumers.
>
> When providing a marketplace for independent sellers, Amazon continuously collects data about the activity on its platform. Based on the Commission's preliminary fact-finding, Amazon appears to use competitively sensitive information – about marketplace sellers, their products and transactions on the marketplace.
>
> As part of its in-depth investigation the Commission will look into:
>
> - the standard agreements between Amazon and marketplace sellers, which allow Amazon's retail business to analyse and use third party seller data. In particular, the Commission will focus on whether and how the use of accumulated marketplace seller data by Amazon as a retailer affects competition.
> - the role of data in the selection of the winners of the "Buy Box" and the impact of Amazon's potential use of competitively sensitive marketplace seller information on that selection. The "Buy Box" is displayed prominently on Amazon and allows customers to add items from a specific retailer directly into their shopping carts. Winning the "Buy Box" seems key for marketplace sellers as a vast majority of transactions are done through it.
>
> If proven, the practices under investigation may breach EU competition rules on anticompetitive agreements between companies (Article 101 of the Treaty on the Functioning of the European Union (TFEU)) and/or on the abuse of a dominant position (Articles 102 TFEU).
>
> The Commission will now carry out its in-depth investigation as a matter of priority. The opening of a formal investigation does not prejudge its outcome.

3. *Apple investigations*. On June 16, 2020, the European Commission announced that it had opened two investigations into Apple's practices. One related to how Apple runs the App Store. The Commission had received two complaints regarding the App Store rules, one from Spotify on March 11, 2019 and the second from an

unnamed e-book and audiobook distributor on March 5, 2020. Based on those complaints, the Commission is investigating Apple's requirement that app developers use Apple's in-app purchase system for sales within an app (including a 30% royalty rate to Apple for subscription fees). The Commission is also looking at allegations that Apple restricts the ability of app providers to inform customers from within the app of ways of purchasing books and more outside of the app.

The second investigation is looking at claims that Apple is limiting competition in payments markets in restricting access to functionality on iOS devices. The technology in question is the built-in near field communication (NFC) technology that makes possible tap-and-go payments at stores. The Commission is concerned about the possibility that in restricting access to that technology to the benefit of Apple Pay Apple is distorting competition in the digital wallets market.

Beyond Antitrust?: Regulating Big Tech

[insert at the top of page 1050 of the main text]

If the core of the Sherman Act is based upon an assessment of fault—a restraint of trade in Section 1, monopolization in section 2—what happens when a firm achieves a leading position—even a dominant one—but does so through legitimate competition? The emergence of firms like Apple, Google, Amazon, Microsoft, and Meta have prompted renewed interest in this question. Some argue that the pending antitrust actions against the large tech platforms around the world demonstrate that antitrust laws are sufficient to address the competition problems they create. Others suggest that the multiplicity of such actions demonstrates, to the contrary, that the antitrust laws are not well-suited to address those problems and look for guidance to other forms of government regulation of business activities, including sector-specific competition measures like those included in the Telecommunications Act of 1996.

For proponents of sector specific regulation, the question is what stricter controls are desired and what would that look like? Even as bills have been considered in Congress, Europe has moved forward most notably with the Digital Markets Act ("DMA"), dated as of September 14, 2002, and a second act, the Digital Services Act, which came into force as of November 16, 2022. We will focus on the DMA here. The DMA's focus is on "contestable and fair markets in the digital sector." Fairness, of course, is in the eye of the beholder, while contestability, suggests the idea of a market is up for grabs, where

multiple firms have a chance to compete and win in that market. The DMA is organized around the idea of "gatekeepers,"and the text makes clear that there is a belief that gatekeepers pose problems, even if they are "not necessarily dominant in competition law terms."

On July 4, 2023, Thierry Breton, the European Commission's Internal Market commissioner announced that seven firms had declared that they met the thresholds under the DMA to qualify as gatekeepers. Those were Alphabet, Amazon, Apple, ByteDance, Meta, Microsoft, and Samsung. There had been questions about whether some travel-related platforms, such as Booking.com, Airbnb, Uber and more might qualify, but so far not. Commissioner Breton highlighted the consequences of the designation and the steps forward:

> "We will now check their submissions and designate the gatekeepers for specific platform services by 6 September (within 45 working days from their submission). And then, gatekeepers will have 6 months to comply with the DMA rules.
>
> "They will no longer be able to lock in users in their ecosystem. They will no longer be able to decide which apps you need to have pre-installed on your devices; which app store you have to use. They will not be able to 'self-preference': exploiting the advantage of being the gatekeeper by treating their own products and services more favorably. Their messaging apps will have to interoperate with others. And so on …
>
> **"Consumers will have more services to choose from**, more opportunities to switch providers, and will benefit from better prices and higher quality services. **Innovative companies will no longer be prevented from reaching new customers.** That is what the DMA is all about" (emphasis in original).

As Commissioner Breton's statement suggests, the DMA imposes rules on the gatekeepers, many of which are clearly targeted at particular Big Tech situations. The idea here is to regulate behavior that the European Commission may not be able to reach under traditional EU competition law approaches. The DMA looks much more like the laws that regulate industries like telecommunications or electricity, which are thought to be natural monopolies. It focuses on the digital sector, including online search engines, social networking services, operating systems, web browsers, and cloud computing, and imposes a variety of limits on what gatekeepers can do regarding the use of data.

In an effort to limit the effect of default setting on devices, the DMA requires the presentation of choice screens the first time an end-user wants to use a search engine, a virtual assistant, or a web browser. These mandatory choice screens echo remedies that were imposed by the European Union in its Microsoft cases and the Google Android case.

Also, as Commissioner Breton notes, Apple will be forced to open up its platform to competing app stores. That has been a point of competition between Apple and Android, which has permitted competing app stores, but now instead will be controlled by law. A gatekeeper search engine—and here we mean Google though perhaps Bing will qualify as well—is required to license "ranking, query, click and view" data to third parties on fair, reasonable, and nondiscriminatory terms in an effort to reduce barriers to entry.

The DMA might not be the last step. There have been parallel efforts in the U.S., perhaps most notably, S.2992, the American Innovation and Choice Online Act, introduced by Sen. Amy Klobuchar in the 117th Congress. That bill paralleled steps taken in the DMA but was not brought to the floor of the Senate for a vote.

Regulations like those provided by the DMA could be seen as efforts to achieve the economic objectives of the antitrust laws in a more immediate and predictable way, with a different combination of false positives (prohibiting conduct that promotes competition and economic welfare) and false negatives (permitting conduct that harms competition and economic welfare). To the extent that is their purpose, they reflect a judgment that antitrust law's after-the-fact toolkit for reviewing single firm conduct is inadequate to advancing effective competition policy and that a menu of before-the-fact regulatory remedies is necessary and appropriate. But DMA and similar proposed regulations are intended by at least some of their proponents to serve a broader interest in diminishing the size and power of the large digital platforms that is not addressed by the antitrust laws.

Chapter 8.4.D: Smartphones and App Stores

Epic Games, Inc. v. Apple, Inc.

United States Court of Appeals, Ninth Circuit, 2023.

Nos. 21-16506, 21-16695

[insert following Chapter 8.4.C, at page 1051]

M. SMITH, Circuit Judge.Epic Games, Inc. sued Apple, Inc. pursuant to the Sherman Act, 15 U.S.C. §§ 1-2, and California's Unfair Competition Law (UCL), Cal. Bus. & Prof. Code § 17200 *et seq*. Epic contends that Apple acted unlawfully by restricting app distribution on iOS devices to Apple's App Store, requiring in-app purchases on iOS devices to use Apple's in-app payment processor, and limiting the ability of app developers to communicate the availability of alternative payment options to iOS device users.

After a sixteen-day bench trial involving dozens of witnesses and nine hundred exhibits, the district court rejected Epic's Sherman Act claims challenging the first and second of the above restrictions—principally on the factual grounds that Epic failed to propose viable less restrictive alternatives to Apple's restrictions. The court then concluded that the third restriction is unfair pursuant to the UCL and enjoined Apple from enforcing it against any developer. Epic appeals the district court's Sherman Act rulings; Apple cross-appeals the district court's UCL rulings. We affirm the district court.

FACTUAL AND PROCEDURAL HISTORY

I. The Parties

Apple is a multi-trillion-dollar technology company that, of particular relevance here, sells desktop and laptop computers (Macs), smartphones (iPhones), and tablets (iPads). In 2007, Apple entered, and revolutionized, the smartphone market with the iPhone—offering consumers, through a then-novel multi-touch interface, access to email, the internet, and several preinstalled "native" apps that Apple had developed itself. Shortly after the iPhone's debut, Apple decided to move on from its native-apps-only approach and open the iPhone's (and later, the iPad's) operating system (iOS) to third-party apps.

This approach created a "symbiotic" relationship: Apple provides app developers with a substantial consumer base, and Apple benefits from increased consumer appeal given the ever-expanding pool of iOS apps. Apple now has about a 15% market share in the global smartphone market with over 1 billion iPhone users, and there are over 30 million iOS app developers. Considering only video game

apps, the number of iOS games has grown from 131 in the early days of the iPhone to over 300,000 by the time this case was brought to trial. These gaming apps generate an estimated $100 billion in annual revenue.

Despite this general symbiosis, there is periodic friction between Apple and app developers. That is because Apple, when it opened the iPhone to third-party developers, did not create an entirely open ecosystem in which developers and users could transact freely without any mediation. Instead, Apple created a "walled garden" in which Apple plays a significant curating role. Developers can distribute their apps to iOS devices only through Apple's App Store and after Apple has reviewed an app to ensure that it meets certain security, privacy, content, and reliability requirements. Developers are also required to use Apple's in-app payment processor (IAP) for any purchases that occur within their apps. Subject to some exceptions, Apple collects a 30% commission on initial app purchases (downloading an app from the App Store) and subsequent in-app purchases (purchasing add-on content within an app).

Epic is a multi-billion-dollar video game company with three primary lines of business, each of which figures into various aspects of the parties' appeals. First, Epic is a video game developer—best known for the immensely popular *Fortnite,* which has over 400 million users worldwide across gaming consoles, computers, smartphones, and tablets. Epic monetizes *Fortnite* using a "freemium" model: The game is free to download, but a user can purchase certain content within the game, ranging from game modes to cosmetic upgrades for the user's character. . . .

Second, Epic is the parent company of a gaming-software developer. . . .

Third, Epic is a video game publisher and distributor. It offers the Epic Games Store as a game-transaction platform on PC computers and Macs and seeks to do the same for iOS devices. As a distributor, Epic makes a game available for download on the Epic Games Store and covers the direct costs of distribution; in exchange, Epic receives a 12% commission—a below-cost commission that sacrifices short-term profitability to build market share. The Epic Games Store has over 180 million registered accounts and over 50 million monthly active users. Through the Epic Games Store, Epic is a would-be competitor of Apple for iOS game distribution and a direct competitor when it comes to games that feature cross-platform functionality like *Fortnite.*

II. The Developer Program Licensing Agreement

Apple creates its walled-garden ecosystem through both technical and contractual means. To distribute apps to iOS users, a developer must pay a flat $99 fee and execute the Developer Program Licensing Agreement (DPLA). The DPLA is a contract of adhesion; out of the millions of registered iOS developers, only a handful have convinced Apple to modify its terms.

By agreeing to the DPLA, developers unlock access to Apple's vast consumer base—the over 1 billion users that make up about 15% of global smartphone users. They also receive tools that facilitate the development of iOS aps, including advanced application-programming interfaces, beta software, and an app-testing software. In essence, Apple uses the DPLA to license its IP to developers in exchange for a $99 fee and an ongoing 30% commission on developers' iOS revenue.

The DPLA contains the three provisions that give rise to this lawsuit and were mentioned in the introduction. First, developers can distribute iOS apps only through the App Store (the distribution restriction). Epic Games, for example, cannot make the Epic Games Store available as an iOS app and then offer *Fortnite* for download through that app. Second, developers must use Apple's IAP to process in-app payments (the IAP requirement). Both initial downloads (where an app is not free) and in-app payments are subject to a 30% commission. Third, developers cannot communicate out-of-app payment methods through certain mechanisms such as in-app links (the anti-steering provision). . . .

III. Apple and Epic's Business Relationship

In 2010, Epic agreed to the DPLA. Over the next few years, Epic released three games for iOS, each of which Apple promoted at major events. In 2015, however, Epic began objecting to Apple's walled-garden approach. Epic's CEO Tim Sweeney argued, in an email seeking a meeting with Apple senior leadership, that it "doesn't seem tenable for Apple to be the sole arbiter of expression and commerce" for iOS users, and explained that Epic runs a competing game-transaction platform that it "would love to eventually" offer on iOS. Nothing came of this email, and Epic continued to offer games on iOS while complying with the DPLA's terms. In 2018, Epic released *Fortnite* on iOS— amassing about 115 million iOS users.

In 2020, Epic renewed the DPLA with Apple, but sought a "side letter" modifying its terms. In particular, Epic desired to offer iOS users alternatives for distribution (the Epic Games Store) and in-app payment processing (Epic Direct Pay). Apple flatly rejected this offer, stating: "We understand this might be in Epic's financial interests, but

Apple strongly believes these rules are vital to the health of the Apple platform and carry enormous benefits for both consumers and developers. The guiding principle of the App Store is to prove a safe, secure, and reliable experience for users . . . ."

Once Apple rejected its offer, Epic kicked into full gear an initiative called "Project Liberty": a two-part plan it had been developing since 2019 to undermine Apple's control over software distribution and payment processing on iOS devices, as well as Google's influence over Android devices. Project Liberty coupled a media campaign against Apple and Google with a software update expressly designed to circumvent Apple's IAP restriction. On the media-campaign side, Epic lowered the price of *Fortnite*'s in-app purchases on all platforms but Apple's App Store and Google's Google Play Store; it formed an advocacy group (the Coalition for App Fairness), tasking it with "generating continuous media. . . pressure" on Apple and Google; and it ran advertisements portraying Apple and Google as the "bad guys" standing in the way of Epic's attempt to pass cost-savings onto consumers.

On the IAP-circumvention side, Epic submitted a *Fortnite* software update (which Epic calls a "hotfix") to Apple for review containing undisclosed code that, once activated, would enable *Fortnite* users to make in-game purchases without using Apple's IAP. Unaware of this undisclosed code, Apple approved the update and it was made available to iOS users. Shortly thereafter, Epic activated the undisclosed code and opened its IAP alternative to users. That same day, Apple became aware of the hotfix and removed *Fortnite* from the App Store. Apple informed Epic that it had two weeks to cure its breaches of the DPLA, or otherwise Apple would terminate Epic Games' developer account.

IV. Procedural History

Only three days after Apple removed *Fortnite* from the App Store, Epic filed a 62-page complaint against Apple in the Northern District of California . . . . Epic brought claims for permanent injunctive relief pursuant to the Sherman Act and the UCL. Epic's requested relief, though somewhat vague, would essentially convert iOS into an entirely open platform: Developers would be free to distribute apps through any means they wish and use any in-app payment processor they choose. Taken together, this relief would create a pathway for developers to bypass Apple's 30% commission altogether, though Epic made open-ended assurances at trial that its relief would allow Apple to collect a commission—just not in the manner that the DPLA establishes. Apple brought counter-claims for

breach of contract and indemnification for its attorney fees related to this litigation. . . . After a sixteen-day bench trial, the district court issued a 180-page order pursuant to Federal Rule 52 detailing its findings of facts and conclusions of law.

ANALYSIS

On appeal, Epic challenges the district court's Sherman Act and breach of contract rulings. We affirm the district court's denial of antitrust liability and its corresponding rejection of Epic's illegality defense to Apple's breach of contract counter-claim. Though the district court erred as a matter of law on several issues, those errors were harmless. Independent of the district court's errors, Epic failed to establish—as a factual matter—its proposed market definition and the existence of any substantially less restrictive alternative means for Apple to accomplish the procompetitive justifications supporting iOS's walled-garden ecosystem. * * *

I. Market Definition

[The court affirmed the district court's holding that the relevant market was the market for "mobile game transactions" and its rejection of Epic's proposed aftermarkets for iOS app distribution and iOS in-app payment systems. The court reasoned the Epic had failed to prove that consumers were unaware of Apple's app distribution restrictions when they purchased iOS devices and apps, which, among other things, must be proven to establish a single-brand aftermarket.]

II. Sherman Act Section 1: Unreasonable Restraint

With the relevant market for Epic's antitrust claims established (mobile-game transactions), we turn to the district court's rejection of Epic's Sherman Act Section 1 restraint-of-trade claim. Section 1 prohibits "[e]very contract, combination . . ., or conspiracy, in restraint of trade." 15 U.S.C. § 1. Courts have long read Section 1 to "outlawonly *unreasonable* restraints." Ohio v. American Express Co., 138 S. Ct. 2274, 2283 (2018) (quoting *State Oil v. Khan,* 522 U.S. 3, 10 (1997)). . . . While a restraint can be unreasonable *per se* or pursuant to the Rule of Reason, the parties agree that the latter standard applies here. . . .

A. Existence of a Contract

The district court erred when it held that a non-negotiated contract of adhesion like the DPLA falls outside of the scope of Section 1. That holding plainly contradicts Section 1's text, which reaches "[*e*]*very contract,* combination . . ., or conspiracy" that unreasonably restrains trade. 15 U.S.C. § 1 (emphasis added). To hold that a contract

is exempt from antitrust scrutiny simply because one party "reluctant[ly]" accepted its terms"would be to read the word[] 'contract'" out of the statute. *Systemcare, Inc. v. Wang Lab'ys Corp.,* 117 F.3d 1137, 1143 (10th Cir. 1997).

* * *

B. Rule of Reason Step One: Anticompetitive Effects

The district court did not err when it found that Epic made the Rule of Reason's required step-one showing. At step one, "the plaintiff has the initial burden to prove that the challenged restraint has a substantial anticompetitive effect that harms consumers in the relevant market." *Amex,* 138 S. Ct. at 2284. Antitrust plaintiffs can make their step-one showing either "directly or indirectly." *Id.*

* * *

Here, the district concluded that Epic produced both sufficient direct and indirect evidence to show that Apple's distribution and IAP restrictions impose substantial anticompetitive effects. . . .

1. Direct Evidence

Apple challenges both the district court's direct- and indirect-evidence conclusions on several grounds—some legal, some factual. We are not persuaded that the district court erred at step one of the Rule of Reason.

First, Apple argues that the district court's direct-evidence conclusion cannot stand because Epic did not show that Apple's restrictions reduced output. We squarely rejected this argument in *O'Bannon.* There, the NCAA similarly argued that liability was foreclosed because output in the relevant market "increased steadily over time." *O'Bannon v. National Collegiate Athletic Ass'n*, 802 F.3d 1049, 1070 (9th Cir 2015). "Although output reductions are one common kind of anticompetitive effect in antitrust cases, a `reduction in output is not the *only* measure of anticompetitive effect.'" *Id.* (citation omitted). Nor does *Amex* displace our holding in *O'Bannon.* A showing of decreased output was essential in that case because the plaintiff "failed to offer any reliable measure of Amex's transaction price or profit margins" and "the evidence about whether Amex charges more than its competitors was ultimately inconclusive." *Amex,* 138 S. Ct. at 2288.

Second, Apple argues that Epic's evidence of supracompetitive pricing fails as a matter of law because Apple never raised its commission. A supracompetitive price is simply a "price[] above competitive levels." *Rebel Oil Co. v. Atlantic Richfield Co.,* 51 F.3d 1421, 1434 (9th Cir. 1995). Apple cites no binding precedent in support

of its proposition that the charging of a supracompetitive price must always entail a price increase, though we recognize that it ordinarily does.

Third, Apple attacks the supracompetitive-pricing finding on factual grounds by asserting that Apple charges a substantially similar commission as its competitors. That assertion is true as far as *headline* rates go, but the district court reasonably based its supracompetitive-price finding on *effective* commission rates instead of headline rates. The district court found Apple's reliance on headline rates to be "suspect" because, unlike the App Store, other platforms "frequently negotiate[] down" the rates they charge developers. The court noted that Amazon has a headline rate of 30% but an effective commission rate of 18%. And it credited testimony that game-console transaction platforms often "negotiate special deals for large developers.". . .

Fourth, Apple argues that the district court's direct-evidence finding fails as a matter of law because *Amex* requires Epic to establish anticompetitive effects on both sides of the two-sided market for mobile-game transactions (developers and users). Apple's argument falls short both legally and factually. We have previously held: "*Amex* does not require a plaintiff to [show] harm to participants on both sides of the market. All *Amex* held is that to establish that a practice is anticompetitive in certain two-sided markets, the plaintiff must establish an anticompetitive impact on the 'market as a whole.'" *PLS.com, LLC v. Nat'l Ass'n of Realtors,* 32 F.4th 824,839 (9th Cir. 2022) (quoting *Amex,* 138 S. Ct. at 2287). In any event, the district court found that, while Apple's restrictions "certainly impact developers," there was "some evidence" that the restrictions also "impact[] consumers when those costs are passed on."

2. Indirect Evidence

We are not persuaded by Apple's argument that the district court erred in concluding that Epic failed to establish indirect evidence of anticompetitive effects. Apple does not take issue with the district court's finding of a 52 to 55% market share (other than noting it was the court's "own. . . calculation"); nor does Apple challenge the court's barriers-to-entry finding. It instead argues that the finding that Apple wields its market power in an anticompetitive manner is speculative. But, supported by basic economic presumptions, the district court reasonably found that, without Apple's restrictions, would-be competitors could offer iOS users alternatives that would differentiate themselves from the App Store on price as well as consumer-appeal features like searchability, security, privacy, and payment processing.

Indeed, it found competition in the PC-gaming market to be a "vivid illustration": Steam had long charged a 30% commission, but upon Epic's entry into the market, it lowered its commission to 20%. Epic's indirect-evidence showing was sufficient.

C. Step Two: Procompetitive Rationales

The district court correctly held that Apple offered non-pretextual, legally cognizable procompetitive rationales for its app-distribution and IAP restrictions. If a plaintiff establishes at step one that the defendant's restraints impose substantial anticompetitive effects, then the burden shifts back to the defendant to "show a procompetitive rationale for the restraint[s]." *NCAA v. Alston,* 141 S. Ct. 2141, 2160 (2021).

Here, the district court accepted two sets of rationales as non-pretextual and legally cognizable. First, it found that Apple implemented the restrictions to improve device security and user privacy—thereby enhancing consumer appeal and differentiating iOS devices and the App Store from those products' respective competitors. Second, the court *partially* accepted Apple's argument that it implemented the restrictions to be compensated for its IP investment. While the court credited the IP-compensation rationale generally, it rejected the rationale "with respect to the 30% commission rate specifically." On appeal, Epic raises three arguments challenging Apple's rationales as legally non-cognizable.

1. Partial Acceptance of Apple's IP-Compensation Rationale

Epic argues that the district court may not credit Apple's IP-compensation rationale while finding that the rationale was pretextual "with respect to the 30% commission rate *specifically*" (emphasis added). We have held that IP-compensation is a cognizable procompetitive rationale, and we find no error in the district court's *partial* crediting of that rationale here.

The district court's acceptance of the rationale generally, while rejecting a specific application of it, resembles the district court's analysis in the NCAA litigation that culminated in *Alston,* 141 S. Ct. 2141. There, the district court credited the NCAA's amateurism-as-consumer-appeal rationale but found that the NCAA's "rules and restrictions on [amateurism] ha[d] shifted markedly over time," that the NCAA adopted some restrictions "without any reference to considerations of consumer demand," and that some were "not necessary to consumer demand." *Id.* at 2163. The court did not, as Epic requests here, resolve the case at step two and hold that the NCAA's shaky proof meant it lacked *any* procompetitive rationale. Instead, the "deficiencies in the NCAA's proof of procompetitive benefits at the

second step influenced the analysis at the third [step]." *Id.* at 2162. Because the NCAA's amateurism-as-consumer-appeal rationale was nebulously defined and weakly substantiated, the plaintiffs had more flexibility at step three to fashion less restrictive alternatives.

The same is true here. Because the district court accepted only a general version of Apple's IP-compensation rationale (that Apple was entitled to "*some* compensation"), Epic at step three needed only to fashion a less-restrictive alternative calibrated to achieving that general goal, instead of one achieving the level of compensation that Apple currently achieves through its 30% commission. There is no legal requirement—as Epic suggests—that district courts make pretext findings on an all-or-nothing basis. When district courts at step two partially credit a rationale, step three will necessarily take that partial finding into account.

2. Cognizability of Apple's Privacy/Security Rationales

Epic and its *amici* next argue that Apple's security and privacy rationales are *social,* not procompetitive, rationales and therefore fall outside the purview of antitrust law. We reject this argument. . . .

Epic's argument characterizes Apple as asserting security and privacy as independent justifications in and of themselves. But, throughout the record, Apple makes clear that by improving security and privacy features, it is tapping into consumer demand and differentiating its products from those of its competitors—goals that are plainly procompetitive rationales. Consumer surveys in the record show that security and privacy is an important aspect of a device purchase for 50% to 62% of iPhone users and 76% to 89% of iPad users worldwide. Even Epic's CEO testified that he purchased an iPhone over an Android smartphone in part because it offers "better security and privacy." And the district court found that, because Apple creates a "trusted app environment, users make greater use of their devices."

With Apple's restrictions in place, users are free to decide which kind of app-transaction platform to use. Users who value security and privacy can select (by purchasing an iPhone) Apple's closed platform and pay a marginally higher price for apps. Users who place a premium on low prices can (by purchasing an Android device) select one of the several open app-transaction platforms, which provide marginally less security and privacy. Apple's restrictions create a heterogenous market for app-transaction platforms which, as a result, increases interbrand competition—the primary goal of antitrust law. Antitrust law assumes that competition best allocates resources by allowing firms to compete on "all elements of a bargain—quality, service, safety, and durability—and not just the immediate cost." *Nat'l*

Soc'y of Pro. Eng'rs v. United States, 435 U.S. 679 (1978). If we were to accept Epic and its *amici*'s argument, then no defendant could cite competing on non-price features as a procompetitive rationale.

To avoid this conclusion, Epic and its *amici* rely on a line of cases stemming from *National Society of Professional Engineers*. But neither that case nor its progeny support their argument that improved quality is a social, rather than procompetitive, rationale. Instead, the *Professional Engineers* line of cases holds that a defendant cannot severely limit interbrand competition on the theory that *competition itself* is ill-suited to a certain market or industry. *See id.* at 694-96. Epic's selection of quotes from *Professional Engineers* and other cases—without acknowledging the distinct context in which they occurred— is unconvincing.

In *Professional Engineers,* a professional association with about 12,000 engineers adopted a rule prohibiting its members from engaging in competitive bidding on construction projects. *Id.* at 681. This "absolute ban" on competitive bidding imposed substantial anticompetitive effects, and the Society's sole justification was that competition in the construction-engineering market would lead engineers to perform "inferior work with consequent risk to safety and health." *Id.* at 692-94. In other words, competition in the construction engineering industry was not in the "public benefit." *Id.* The Supreme Court rejected this request for a judge-made exemption from the Rule of Reason, which "does not support a defense based on the assumption that competition itself is unreasonable," and stated that the Society's argument should be "addressed to Congress." *Id.* at 696. . . .

The Supreme Court followed suit last term in *Alston* when it rejected the NCAA's sweeping plea for leniency. The NCAA argued that something more deferential than the Rule of Reason should apply to its restrictions on student-athlete compensation because the NCAA's amateurism restrictions advance the "societally important non-commercial objective of higher education." *Alston,* 141 S. Ct. at 2158. The Supreme Court held that this argument— that the NCAA "should be exempt from the usual operation of the antitrust laws"— should be directed to Congress, not a court. *Id.* at 2160.

Apple's rationales categorically differ from those asserted in the above cases. Apple did not agree with other app-transaction platforms (*e.g.,* the Google Play Store) to eliminate *interbrand* competition and then invoke security and privacy to avoid the "normal operation" of the Rule of Reason. *Id.* at 2147. Rather, Apple imposed *intrabrand* limitations (that iOS devices use Apple distribution and payment-processing channels) and contends that these restrictions tap

into consumer demand for a private and secure user experience and distinguish the App Store from its open-platform competitors.

3. Cognizability of Cross-Market Rationales

[Epic argued that the security and privacy restrictions provide benefits in a market different from the relevant market defined by the court. The court noted that neither the Supreme Court nor the Ninth Circuit had resolved the question whether benefits in one market may justify harm to competition in a different market, but it declined to decide the issue on the ground that Epic did not raise the argument in the trial court or in its opening brief on appeal.]

D. Step Three: Substantially Less Restrictive Means

The district court did not clearly err when it held that Epic failed to prove the existence of substantially less restrictive alternatives (LRAs) to achieve Apple's procompetitive rationales. At step three of the Rule of Reason, "the burden shifts back to the plaintiff to demonstrate that the procompetitive efficiencies could be reasonably achieved through less anticompetitive means." *Alston,* 141 S Ct. at 2160 (quoting *Amex,* 138 S. Ct. at 2284). When evaluating proposed alternative means, courts "must give wide berth to [defendants'] business judgments" and "must resist the temptation to require that enterprises employ the least restrictive means of achieving their legitimate business objectives." *Id.* at 2163, 2166; *see also id.* at 2161 ("[A]ntitrust law does not require businesses to use anything like the least restrictive means of achieving legitimate business purposes."). As such, this circuit's test—which the Supreme Court approved in *Alston*—requires a "*substantially* less restrictive" alternative. *O'Bannon,* 802 F.3d at 1070 (emphasis added). To qualify as "substantially less restrictive," an alternative means "must be `virtually as effective' in serving the [defendant's] procompetitive purposes . . . without significantly increased cost." *Id.* at 1074 (quoting *County of Tuolumne v. Sonora Cmty. Hosp.,* 236 F.3d 1148, 1159 (9th Cir. 2001)). . . .

Epic argues that Apple already has an LRA at its disposal for the distribution restriction: the "notarization model" that Apple uses for app distribution on its desktop and laptop operating system (macOS). The notarization model sits somewhere between iOS's "walled garden" and the open-platform model that characterizes some app-transaction platforms. Unlike on iOS, the Mac Store (the Apple-run equivalent of the iOS App Store for Mac computers) is *not* the exclusive means for macOS users to download apps; instead, users can download apps from the Mac Store or anywhere else on the internet. Also unlike on iOS, a developer can distribute a macOS app to users

without first submitting it to Apple. But, regardless of how the developer distributes that app, it will carry a warning that Apple has not scanned it for malware. . . .

The malware scanning that Apple performs in the notarization model is not the same as the full app review that it conducts on iOS apps. Importantly, the notarization model does not include *human* review—a contextual review that, as found by the district court, cannot currently be automated. As part of iOS human review, a reviewer confirms that an app corresponds to its marketing description to weed out "Trojan Horse" apps or "social engineering" attacks that trick users into downloading by posing as something they are not. The reviewer also checks that the app's entitlements are reasonable for its purpose—rejecting, for example, a Tic-Tac-Toe game that asks for camera access and health data, while approving camera access for a social media app. On occasion, human review also detects novel, well-disguised malware attacks. Despite Epic carrying the burden at step three of the Rule of Reason, it was not clear before the district court—and still is not entirely clear—how Epic proposes that the notarization model translates from macOS to iOS. In particular, it is unclear whether the proposed model would incorporate human review and what type (if any) of licensing scheme Apple could implement to complement the notarization model. Whatever the precise form of Epic's proposed notarization model, the district court did not err in rejecting it.

First, to the extent Epic argues that Apple could jot-for-jot adopt macOS's notarization model without adding human review, Epic failed to establish that this model would be "virtually as effective" in accomplishing Apple's procompetitive rationales of enhancing consumer appeal and distinguishing the App Store from competitor app-transaction platforms by improving user security and privacy. *See O'Bannon,* 802 F.3d at1073. . . . Moreover, the district court found "compelling" Apple's explanation of why human review is necessary "against certain types of attacks." And it found that "Epic Games did not explain how, if at all" a purely automated process could screen for such threats. . . .

Second, to the extent Epic proposes a notarization model that incorporates human app review, Epic failed to develop how Apple could be compensated in such a model for third-party developers' use of its IP. . . .The district court accordingly found that Epic's proposed distribution LRAs "leave unclear whether Apple can collect licensing royalties and, if so, how it would do so" and thus declined to consider them as "not sufficiently developed."

It is, however, Epic's burden at step three to prove that a tiered licensing scheme (or some other payment mechanism) *could* achieve Apple's IP-compensation rationale. Without any evidence in the record of what this tiered licensing scheme would look like, we cannot say that it would be "virtually as effective" without "significantly increased cost." *O'Bannon,* 802 F.3d at 1074. Nor can we even "explain" it, let alone direct the district court to craft an injunction that it could "adequately and reasonably supervise." *Alston,* 141 S. Ct. at 2163.

Epic proposes access to competing payment processors as an LRA to Apple's IAP requirement. Like the distribution requirement LRA, this LRA suffers from a failure of proof on how it would achieve Apple's IP-compensation rationale. As the district court noted, in a world where Apple maintains its distribution restriction but payment processing is opened up, Apple would still be contractually entitled to its 30% commission on in-app purchasers. Apart from any argument by Epic, the district court "presume[d]" that Apple could "utilize[e] a contractual right to audit developers . . . to ensure compliance with its commissions." But the court then rejected such audits as an LRA because they "would seemingly impose both increased monetary and time costs."

E. Step Four: Balancing

Epic—along with several *amici,* including the United States and thirty-four state attorneys general—argue that the district court erred by not proceeding to a fourth, totality-of-the-circumstances step in the Rule of Reason and balancing the anticompetitive effects of Apple's conduct against its procompetitive benefits. . . .

* * *

We are skeptical of the wisdom of superimposing a totality-of-the-circumstances balancing step onto a three-part test that is already intended to assess a restraint's overall effect. Neither Epic nor any *amicus* has articulated what this balancing really entails in a given case. Epic argues only that the district court must "weigh[]" anticompetitive harms against procompetitive benefits, and the United States describes step four as a "qualitative assessment of whether the harms or benefits predominate.". . .

Nonetheless, we are bound by *County of Tuolumne* and mindful of *Alston*'s warning that the first three steps of the Rule of Reason are not a "rote checklist." Therefore, where a plaintiff's case comes up short at step three, the district court must proceed to step four and balance the restriction's anticompetitive harms against its procompetitive benefits. In most instances, this will require nothing more than—as in *County of Tuolumne*—briefly confirming the result

suggested by a step-three failure: that a business practice without a less restrictive alternative is not, on balance, anticompetitive.

Turning to the record here, the district court's failure to explicitly reach the fourth step was harmless. Even though it did not expressly reference step four, it stated that it "carefully considered the evidence in the record and. . . determined, based on the rule of reason," that the distribution and IAP restrictions "have procompetitive effects that *offset* their anticompetitive effects" (emphasis added). This analysis satisfied the court's obligation pursuant to *County of Tuolumne,* and the court's failure to expressly give this analysis a step-four label was harmless.

III. Sherman Act Section 1: Tying

In addition to its general restraint-of-trade claim, Epic brought a Section 1 claim asserting that Apple unlawfully tied together app distribution (the App Store) and in-app payment processing (IAP). On appeal, Epic argues that (1) the district court clearly erred when it found that Epic did not identify separate products, and (2) we can enter judgment in its favor because the tie is unlawful, either *per se* or pursuant to the Rule of Reason. We agree with Epic that the district court clearly erred in its separate-products finding, but we find that error to be harmless. The Rule of Reason applies to the tie involved here, and, for the reasons already explained, Epic failed to establish that Apple's design of the iOS ecosystem—which ties the App Store and IAP together—is anticompetitive.

* * *

. . . [W]e join the D.C. Circuit in holding that *per se* condemnation is inappropriate for ties "involv[ing] software that serves as a platform for third-party applications." *United States v. Microsoft,* 253 F.3d 34,89 (D.C. Cir. 2001) (en banc). "It is only after considerable experience with certain business relationships that courts classify them as *per se* violations." *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.,* 441 U.S. 1, 9 (1979). That is because *per se* condemnation embodies a judicial assessment that a category of restraints is "plainly anticompetitive" and "lack[ing] . . . [in] any redeeming virtue" such that it can be "conclusively presumed illegal." *Id.* at 7-8 (citations omitted). Given the costs of improperly condemning a practice across the board, extending a *per se* rule requires caution and judicial humility. Based on the record, we do not have the level of confidence needed to universally condemn ties related to app-transaction platforms that combine multiple functionalities. *See Microsoft,* 253 F.3d at 93 ("[B]ecause of the pervasively innovative character of platform software markets, tying in such markets may

produce efficiencies that courts have not previously encountered and thus the Supreme Court had not factored into the per se rule as originally conceived.").

The tie in this case differs markedly from those the Supreme Court considered in *Jefferson Parish* and prior tying cases. Particularly, "[i]n none of these cases was the tied good . . . technologically integrated with the tying good." *Microsoft,* 253 F.3d at 90. Moreover, none of the ties presented any purported procompetitive benefits that could not be achieved by adopting quality standards for third-party suppliers of the tied good, as Apple does here.

Moreover, while *Jefferson Parish*'s separate-products test filters out procompetitive bundles from *per se* scrutiny in traditional markets, we are skeptical that it does so in the market involved here. Software markets are highly innovative and feature short product lifetimes—with a constant process of bundling, unbundling, and rebundling of various functions. In such a market, any first-mover product risks being labeled a tie pursuant to the separate-products test. *See Microsoft,* 253 F.3d at 92. If *per se* condemnation were to follow, we could remove would-be popular products from the market—dampening innovation and undermining the very competitive process that antitrust law is meant to protect. The Rule of Reason guards against that risk by "afford[ing] the first mover an opportunity to demonstrate that an efficiency gain from its `tie' adequately offsets any distortion of consumer choice." *Id.*

Applying the Rule of Reason to the tie involved here, it is clearly lawful. Epic's tying claim (that app distribution and payment processing are tied together) is simply a repackaging of its generic Section 1 claim (that the conditions under which Apple offers its app-transactions product are unreasonable). For the reasons we explained above, Epic failed to carry its burden of proving that Apple's structure of the iOS ecosystem is unreasonable. *See supra* section II.

* * *

VI. California's Unfair Competition Law

We now turn to Apple's cross-appeal, beginning with its arguments concerning the UCL. The district court . . . concluded that Apple's anti-steering provision violates the UCL's unfair prong, and entered an injunction prohibiting Apple from enforcing the anti-steering provision against any developer. Apple challenges each aspect on appeal. We affirm.

* * *

B. Merits

As relevant here, the UCL prohibits "any [1] unlawful, [2] unfair or [3] fraudulent business act or practice." Cal. Bus. & Prof. Code § 17200. As the UCL's three-prong structure makes clear, a business practice may be "unfair," and therefore illegal under the UCL, "even if not specifically proscribed by some other law." *Cel-Tech Commc'ns, Inc. v. L.A. Cellular Tel. Co.,* 20 Cal. 4th 163, 180 (1999). The unfair prong is "intentionally framed in its broad, sweeping language, precisely to enable judicial tribunals to deal with the innumerable `new schemes which the fertility of man's invention would contrive.'" *Id.*

The California Supreme Court has refined this "wide standard," *Cel-Tech,* 20 Cal. 4th at 181, into two tests relevant to this litigation. First, to support "any finding of unfairness to *competitors,*" a court uses the "tethering" test, which asks whether the defendant's conduct "threatens an incipient violation of an antitrust law, or violates the policy or spirit of one of those laws because its effects are comparable to or the same as a violation of the law, or otherwise significantly threatens or harms competition." *Id.* at 186-87 (emphasis added). Second, to support a finding of unfairness to *consumers,* a court uses the balancing test, which "weigh[s] the utility of the defendant's conduct against the gravity of the harm to the alleged victim." *Progressive W. Ins. Co. v. Super. Ct.,* 135 Cal. App. 4th 263, 285 (2005) (citation omitted).

Here, the district court applied both tests. Through the Epic Games Store, Epic is a games-distribution competitor of Apple—triggering the competitor test. Through its subsidiaries that have apps on the App Store, Epic consumes the app transactions that Apple offers in a two-sided market—triggering the consumer test. *Cf. Amex,* 138 S. Ct. at 2286 (each side of two-sided market "jointly consume[s] a single product" (citation omitted)). Applying the tethering test, the court found that the anti-steering provisions "decrease [consumer] information," enabling supracompetitive profits and resulting in decreased innovation. It relied on Apple's own internal communications for the proposition that the anti-steering provision prevents developers from using two of the three "most effective marketing activities," push notifications and email outreach. It then reiterated these factual findings to conclude that the provision also violates the balancing test.

Apple does not directly challenge the district court's application of the UCL's tethering and balancing tests to the facts of

this case. Instead, Apple makes two arguments attacking UCL liability as a matter of law. Neither is supported by California law.

1. Safe-Harbor Doctrine

Apple argues that Epic's failure to establish Sherman Act liability forecloses UCL liability pursuant to the UCL's "safe harbor" doctrine, which bars a UCL action where California or federal statutory law "absolutely preclude[s] private causes of action or clearly permit[s] the defendant's conduct." *Zhang v. Sup. Ct.,* 57 Cal. 4th 364, 379-80 (2013). The safe-harbor doctrine emphasizes that there is a "difference between (1) not making an activity unlawful, and (2) making that activity lawful." *Cel-Tech,* 20 Cal. 4th at 183. Accordingly, in every instance where a court found the Sherman Act to preclude a UCL action, a *categorical* antitrust rule formed the basis of the decision. We held that the judge-made baseball exemption—that "the business of providing public baseball games for profit . . . [is] not within the scope of the federal antitrust laws"—precluded a UCL action. A California Court of Appeal similarly held that the *Colgate* doctrine—that it is lawful for a company to unilaterally announce the terms on which it will deal—precluded a UCL action.

Neither Apple nor any of its *amici* cite a single case in which a court has held that, when a federal antitrust claim suffers from a *proof deficiency,* rather than a *categorical legal bar,* the conduct underlying the antitrust claim cannot be deemed unfair pursuant to the UCL. . . .

2. Importation of Sherman Act Principles

Apple next argues that two principles from Sherman Act case law preclude UCL liability here. We find neither argument persuasive. First, Apple contends that the Supreme Court's decision in *Amex*—finding in favor of American Express in a suit challenging its anti-steering provision—bars UCL liability stemming from Apple's anti-steering provision. Apple does not explain how *Amex*'s fact- and market-specific application of the first prong of the Rule of Reason establishes a categorical rule approving anti-steering provisions, much less one that sweeps beyond the Sherman Act to reach the UCL. *Amex* was based on the plaintiff's failure to establish direct evidence of anticompetitive effects through a reduction in output, supracompetitive pricing, or excessively high profit margins; it was not a blanket approval of anti-steering provisions.

Second, Apple argues that the UCL mandates trial courts to define a relevant market and then conduct the balancing test within that market (similar to the Rule of Reason). Again, Apple does not cite any California authority for this proposition. Moreover, such a rule runs contrary to California courts' repeated instruction that "[n]o

inflexible rule can be laid down as to what conduct will constitute unfair competition." *E.g., Pohl v. Anderson,* 13 Cal. App. 2d 241, 242 (1936) (citation omitted). . . .

C. Injunctive Relief

Apple also argues that the district court . . . abused its discretion when applying the injunction against all developers, not just Epic's subsidiaries that have apps on the App Store. We disagree. . . .

The district court found that the anti-steering provision harmed Epic by (1) increasing the costs of Epics' subsidiaries' apps that are still on the App Store, and (2) preventing other apps' users from becoming would-be Epic Games Store consumers. Because Epic benefits in this second way from consumers of other developers' apps making purchases through the Epic Games Store, an injunction limited to Epic's subsidiaries would fail to address the full harm caused by the anti-steering provision.

* * *

CONCLUSION

To echo our observation from the NCAA student-athlete litigation: There is a lively and important debate about the role played in our economy and democracy by online transaction platforms with market power. Our job as a federal Court of Appeals, however, is not to resolve that debate—nor could we even attempt to do so. Instead, in this decision, we faithfully applied existing precedent to the facts as the parties developed them below.

NOTES AND QUESTIONS

1. *Anticompetitive impact.* The court rejected Apple's argument that a plaintiff must establish harm to competition on both sides of a two-sided market and held that a plaintiff is required to show only an anticompetitive impact in the "market as a whole." What does that mean? What if, as Apple seemed to argue, its restrictions increased output on the consumer side of the market by increasing the attractiveness of its product but increased the price of distribution on the app developer side of the market? Would that constitute an anticompetitive impact in the market as a whole? Does it help to think of the increased price as the anticompetitive impact and the increased output as a procompetitive justification? If so, does that mean that a harmful impact on one side of the market is enough for step one of the rule of reason? Did the court in either its discussion of step one or in its subsequent discussion of balancing explain how courts are to weigh

harms and benefits in deciding whether there has been an anticompetitive impact in the market as a whole?

2. *Compensation for IP*. The court held that the desire to be compensated for investment in intellectual property is a "cognizable procompetitive rationale." The court presumably did not mean that a holder of IP could enter into a price-fixing arrangement to obtain compensation for its IP. (Indeed, recall that Apple got tagged for price-fixing with a group of book publishers when it opened the iBookstore as part of the launch of the iPad in 2010. See *United States v. Apple, Inc.*, 791 F.3d 290 (2nd Cir. 2015).) Did the court set forth any limits on the scope of the compensation justification? The court cited the Supreme Court decision in *Alston*, but that case turned on the qualitative distinction between amateur and professional athletes. Did the court in *Epic v. Apple* suggest any similar qualitative limit on the compensation rationale? Was it suggesting that courts should engage in price regulation? Was it suggesting that holders of intellectual property should be permitted to engage in otherwise anticompetitive conduct in order to ensure some measure of compensation that could not be obtained simply by enforcing intellectual property rights in a competitive market?

3. *Privacy and security justification*. The court held that the restraints could be justified as means to increase the security and privacy features of apps used on iOS devices. It reasoned that those features increased the value of iOS products and promoted competition by enabling Apple to differentiate the iOS environment from the competing Android environment. The court distinguished the Supreme Court's decision in *National Society of Professional Engineers* (see page 1071 in the main text) on the ground that that case involved a restraint on interbrand competition and Apple's restrictions imposed only "*intrabrand* limitations (that iOS devices use Apple distribution and payment-processing channels)."

- Was the court correct in saying that the case involved restrictions on only intrabrand competition? Epic operated its own app distribution store but was prohibited by its contract from competing against Apple's App Store. Although Apple's restrictions restrained third parties like Epic, it restrained them only with respect to the sale of complements—distribution, payment, and app features—for its iOS products. Are restrictions imposed by the operator of a platform on competition among competing providers in the sale of complements for the platform

properly regarded as restrictions on only intrabrand competition?

- Even if the restrictions are properly characterized as intrabrand restraints, is that sufficient to uphold them even in the absence of evidence that consumers would blame Apple, and that the value of its platform and products would be diminished, for harms they incur as a result of having purchased from Epic or other third-party suppliers apps that provided less security and privacy protection?

4. *Privacy and security, again.* If Apple's restraints were deemed to affect only intrabrand competition and were upheld on the ground that they promoted interbrand competition between Apple and other platforms, the fact that safety and privacy were involved would seem to be immaterial. The court's rationale would seem equally applicable to restraints intended to ensure that all complements of the iOS platform had any feature or attribute that might plausibly increase demand for the platform and thus further interbrand competition with other platforms.

Now, suppose that the court had regarded the restraints as reducing interbrand competition in the sale of after-market complements for Apple's platform and had rejected the idea that the restraints could be justified as promoting competition between Apple and competing platforms. And suppose further that Apple had sought to justify the restraints on the ground that they increased security and privacy protections and thus benefitted consumers. Would protecting consumers from harms caused by apps and distribution channels that offered less security and privacy safeguards be a cognizable defense to an antitrust violation? There was no suggestion in the opinion of the Ninth Circuit or that of the district court that Apple's security and privacy requirements benefitted anyone other than the purchasers of the affected apps. There was no suggestion that an inferior or insecure app threatened either the operation of the iOS device itself or the network of other users of the app or the iOS device. Absent evidence of such externalities, Apple's argument seems to be that it could justify restrictions on competition in order to require users to buy higher quality and higher priced apps, even if they would prefer to pay less for less privacy and security protection. If so, how do the restrictions promote competition? They are not needed to enable Apple to offer better privacy and security in apps acquired in its App Store. Are they any different in this respect from the restrictions found to be unlawful in *National Society of Professional Engineers*?

5. *Tying*. The court followed the earlier decision of the D.C Circuit in *United States v. Microsoft* (see page 998 of the main text) in holding that the per se rule does not apply to tying arrangements involving software that serves as a platform for third-party applications. *Microsoft* concerned an alleged tie between the Windows operating system and Microsoft's Internet Explorer browser, which were bound together by comingled software code and distributed together. The third-party apps at issue in *Epic v. Apple*, by contrast, were not technologically bundled together; they were just complements capable of being connected. Some observers expected that the *Microsoft* decision in 2001 would trigger a broader erosion of the per se tying rule. *Epic v. Apple* might signal a delayed beginning of that process.

6. *California Unfair Competition Law*. The UCL prohibits any "unfair" business act or practice, even if it does not violate any other law. The court held that the anti-steering provision in Apple's contract with app developers violated the UCL even though it also held that that provision did not violate the Sherman Act. The court reasoned that the provision harmed Epic's competing app store in ways similar to those of an antitrust violation and that the harm it caused Epic as a consumer of Apple's app distribution services exceeded the utility of the provision. Is there any articulable limit to the reach of the UCL to conduct that disadvantages a competitor or consumer? Does it undermine or further antitrust policy to use a general provision about unfair conduct to prohibit conduct that does not violate the antitrust laws but causes harms similar to those caused by antitrust violations?

Compare the efforts of the courts to define the limits of the prohibition on "unfair methods of competition" in Section 5 of the Federal Trade Commission Act (which you can find at pages 1151-64 of the main text). The limits of Section 5 are likely to be the subject of litigation when the FTC releases the final version of a proposed new rule prohibiting non-compete agreements in many circumstances.

Chapter 8.4.D: Ride-Hailing Services

[insert following Chapter 8.4.D, at page 1051]

The ride-hailing companies Uber and Lyft have generated an enormous amount of attention; and their entry into local transportation markets has raised some tricky legal questions, especially in labor law and antitrust. We are still at early days in litigation over those issues; but as you read the next three case, you should have a few questions firmly in mind. First, what would the antitrust issues look like if Uber was just a corporation that hired

drivers as Uber's employees? That arrangement would almost certainly trigger the application of any number of local, state or federal labor and employment laws, but that isn't our issue here. Our focus is on the antitrust issues that arrangement might give rise to. Second, try a different configuration of "Uber." Uber enters a local transportation market and requires all of its independent drivers in that market to agree to charge prices for their services specified by Uber. Uber isn't a driver, but it is the company organizing the drivers. And in this version, the drivers are not employees of Uber but instead are treated under applicable labor and employment law as independent contractors. What antitrust issues might that arrangement pose? Try a third configuration. Uber calls itself a platform—whatever that is exactly—and says that it matches drivers with passengers. Again, the drivers remain as independent contractors. Consider a couple flavors of the third hypo. Suppose Uber just matches drivers and passengers who then separately negotiate a price for a ride. Uber gets paid for the matching service. Alternatively, suppose Uber provides a platform service that both matches drivers and passengers and informs them of the price for their transaction, which Uber determines by using the vast amount of data available to it to match supply and demand in the local market.

As you read the next three cases, consider your answers to the above questions. What is Uber exactly, and how does that matter for antitrust?

Meyer v. Kalanick

United States District Court for the Southern District of New York, 2016.
174 F.Supp.3d 817.

JED S. RAKOFF, UNITED STATES DISTRICT JUDGE: On December 16, 2015, plaintiff Spencer Meyer, on behalf of himself and those similarly situated, filed this putative antitrust class action lawsuit against defendant Travis Kalanick, CEO and co-founder of Uber Technologies, Inc. ("Uber"). Mr. Meyer's First Amended Complaint, filed on January 29, 2016, alleged that Mr. Kalanick had orchestrated and facilitated an illegal price-fixing conspiracy in violation of Section 1 of the federal Sherman Antitrust Act, 15 U.S.C. § 1, and the New York State Donnelly Act, New York General Business Law § 340. Plaintiff claimed, in essence, that Mr. Kalanick, while disclaiming that he was running a transportation company, had conspired with Uber drivers to use Uber's pricing algorithm to set the prices charged to Uber riders, thereby restricting price competition among drivers to the detriment of Uber riders, such as plaintiff Meyer.

On February 8, 2016, defendant Kalanick moved to dismiss the Amended Complaint. Plaintiff opposed on February 18, 2016; defendant replied on February 25, 2016; and oral argument was held on March 9, 2016. Having considered all of the parties' submissions and arguments, the Court hereby denies defendant's motion to dismiss.

In ruling on a motion to dismiss, the Court accepts as true the factual allegations in the complaint and draws all reasonable inferences in favor of the plaintiff. * * * In the antitrust context, stating a claim under Section 1 of the Sherman Act "requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made. Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556 (2007).

The relevant allegations of the Amended Complaint are as follows. Uber, founded in 2009, is a technology company that produces an application for smartphone devices ("the Uber App") that matches riders with drivers (called "driver-partners"). Uber states that it is not a transportation company and does not employ drivers. Defendant Kalanick, in addition to being the co-founder and CEO of Uber, is a driver who has used the Uber app. Plaintiff Meyer is a resident of Connecticut, who has used Uber car services in New York.

Through the Uber App, users can request private drivers to pick them up and drive them to their desired location. Uber facilitates payment of the fare by charging the user's credit card or other payment information on file. Uber collects a percentage of the fare as a software licensing fee and remits the remainder to the driver. Drivers using the Uber app do not compete on price, and cannot negotiate fares with drivers for rides. Instead, drivers charge the fares set by the Uber algorithm. Though Uber claims to allow drivers to depart downward from the fare set by the algorithm, there is no practical mechanism by which drivers can do so. Uber's "surge pricing" model, designed by Mr. Kalanick, permits fares to rise up to ten times the standard fare during times of high demand. Plaintiff alleges that the drivers have a "common motive to conspire" because adhering to Uber's pricing algorithm can yield supra-competitive prices, and that if the drivers were acting independently instead of in concert, "some significant portion" would not agree to follow the Uber pricing algorithm..

Plaintiff further claims that the drivers "have had many opportunities to meet and enforce their commitment to the unlawful

agreement." Plaintiff alleges that Uber holds meetings with potential drivers when Mr. Kalanick and his subordinates decide to offer Uber App services in a new geographic location. Uber also organizes events for its drivers to get together, such as a picnic in September 2015 in Oregon with over 150 drivers and their families in attendance, and other "partner appreciation" events in places including New York City. Uber provides drivers with information regarding upcoming events likely to create high demand for transportation and informs the drivers what their increased earnings might have been if they had logged on to the Uber App during busy periods. Moreover, plaintiff alleges, in September 2014 drivers using the Uber App in New York City colluded with one another to negotiate the reinstitution of higher fares for riders using Uber-BLACK and UberSUV services (certain Uber car service "experiences"). Mr. Kalanick, as Uber's CEO, directed or ratified negotiations between Uber and these drivers, and Uber ultimately agreed to raise fares.

As to market definition, plaintiff alleges that Uber competes in the "relatively new mobile app-generated ride-share service market," of which Uber has an approximately 80% market share. Uber's chief competitor in this market, Lyft, has only a 20% market share, and a third competitor, Sidecar, left the market at the end of 2015. Although, plaintiff contends, neither taxis nor traditional cars for hire are reasonable substitutes for mobile app-generated ride-share service, Uber's own experts have suggested that in certain cities in the U.S., Uber captures 50% to 70% of business customers in the combined market of taxis, cars for hire, and mobile-app generated ride-share services.

Plaintiff claims to sue on behalf of the following class: "all persons in the United States who, on one or more occasions, have used the Uber App to obtain rides from uber driver-partners and paid fares for their rides set by the Uber pricing algorithm," with certain exclusions, such as Mr. Kalanick. Plaintiff also identifies a "subclass" of riders who have paid fares based on surge pricing. Plaintiff alleges that he and the putative class have suffered antitrust injury because, were it not for Mr. Kalanick's conspiracy to fix the fares charged by Uber drivers, drivers would have competed on price and Uber's fares would have been "substantially lower." Plaintiff also contends that Mr. Kalanick's design has reduced output and that, as "independent studies have shown," the effect of surge pricing is to lower demand so that prices remain artificially high. Based on these allegations, plaintiff claims that Mr. Kalanick has violated the Sherman Act, 15 U.S.C. § 1, and the Donnelly Act, New York General Business Law § 340.

In the instant case, the Court finds that plaintiff has adequately pled both a horizontal and a vertical conspiracy. As to the horizontal conspiracy, plaintiff alleges that Uber drivers agree to participate in a conspiracy among themselves when they assent to the terms of Uber's written agreement (the "Driver Terms") and accept riders using the Uber App. In doing so, plaintiff indicates, drivers agree to collect fares through the Uber App, which sets fares for all Uber drivers according to the Uber pricing algorithm. In plaintiff's view, Uber drivers forgo competition in which they would otherwise have engaged because they "are guaranteed that other Uber drivers will not undercut them on price." Without the assurance that all drivers will charge the price set by Uber, plaintiff contends, adopting Uber's pricing algorithm would often not be in an individual driver's best interest, since not competing with other Uber drivers on price may result in lost business opportunities. The capacity to generate "supra-competitive prices" through agreement to the Uber pricing algorithm thus provides, according to plaintiff, a "common motive to conspire" on the part of Uber drivers. Plaintiff also draws on its allegations about meetings among Uber drivers and the "September 2014 conspiracy," in which Uber agreed to reinstitute higher fares after negotiations with drivers, to bolster its claim of a horizontal conspiracy. In plaintiff's view, defendant Kalanick is liable as the organizer of the price-fixing conspiracy, and as an Uber driver himself.

Defendant Kalanick argues, however, that the drivers' agreement to Uber's Driver Terms evinces no horizontal agreement among drivers themselves, as distinct from vertical agreements between each driver and Uber. According to Mr. Kalanick, drivers' individual decisions to enter into contractual arrangements with Uber constitute mere independent action that is insufficient to support plaintiff's claim of a conspiracy. Defendant asserts that the most "natural" explanation for drivers' conduct is that each driver "independently decided it was in his or her best interest to enter a vertical agreement with Uber," and doing so could be in a driver's best interest because, for example, Uber matches riders with drivers and processes payment. In defendant's view, the fact that "a condition of [the agreement with Uber] was that the driver-partner agree to use Uber's pricing algorithm" does not diminish the independence of drivers' decisions. See id. at 13. It follows, defendant contends, that such vertical arrangements do not support a horizontal conspiracy claim.

The Court, however, is not persuaded to dismiss plaintiff's horizontal conspiracy claim. In *Interstate Circuit v. United States*, 306 U.S. 208 (1939), the Supreme Court held that competing movie

distributors had unlawfully restrained trade when they each agreed to a theater operator's terms, including price restrictions, as indicated in a letter addressed to all the distributors. For an illegal conspiracy to exist, the Supreme Court stated:

> It was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it.... Acceptance by competitors, without previous agreement, of an invitation to participate in a plan, the necessary consequence of which, if carried out, is restraint of interstate commerce, is sufficient to establish an unlawful conspiracy under the Sherman Act.

Interstate Circuit, 306 U.S. at 226-27. Much more recently, the Second Circuit stated:

> [C]ourts have long recognized the existence of "hub-and-spoke" conspiracies in which an entity at one level of the market structure, the "hub," coordinates an agreement among competitors at a different level, the "spokes." These arrangements consist of both vertical agreements between the hub and each spoke and a horizontal agreement among the spokes to adhere to the [hub's] terms, often because the spokes would not have gone along with [the vertical agreements] except on the understanding that the other [spokes] were agreeing to the same thing.

United States v. Apple, Inc., 791 F.3d 290, 314 (2d Cir.2015), (internal citation and quotation marks omitted).

In this case, plaintiff has alleged that drivers agree with Uber to charge certain fares with the clear understanding that all other Uber drivers are agreeing to charge the same fares. These agreements are organized and facilitated by defendant Kalanick, who as at least an occasional Uber driver, is also a member of the horizontal conspiracy.

On a motion to dismiss, the Court is required to draw all reasonable inferences in plaintiff's favor. Given this standard, the Court finds that plaintiffs have plausibly alleged a conspiracy in which drivers sign up for Uber precisely "on the understanding that the other [drivers] were agreeing to the same" pricing algorithm, and in which drivers' agreements with Uber would "be against their own interests were they acting independently." *Apple*, 791 F.3d at 314, 320. Further, drivers' ability to benefit from reduced price competition with other

drivers by agreeing to Uber's Driver Terms plausibly constitutes "a common motive to conspire." *Apex Oil Co. v. DiMauro*, 822 F.2d 246, 254 (2d Cir. 1987). The fact that drivers may also, in signing up for Uber, seek to benefit from other services that Uber provides, such as connecting riders to drivers and processing payment, is not to the contrary. Of course, whether plaintiff's allegations are in fact accurate is a different matter, to be left to the fact-finding process.

The Court's conclusion that plaintiff has alleged a plausible horizontal conspiracy is bolstered by plaintiff's other allegations concerning agreement among drivers. Plaintiff, as noted supra, contends that Uber organizes events for drivers to get together, and, more importantly, that Mr. Kalanick agreed to raise fares following drivers' efforts to negotiate higher rates in September 2014. While it is true that these allegations about agreements among drivers reaching even beyond acceptance of Uber's Driver Terms are not extensive, nonetheless, they provide additional support for a horizontal conspiracy, and plaintiff need not present a direct, "smoking gun" evidence of a conspiracy, particularly at the pleading stage. *Mayor & City Council of Baltimore, Md. v. Citigroup, Inc.*, 709 F.3d 129, 136 (2d Cir. 2013).

More basically, it is well to remember that a Sherman Act conspiracy is but one form of conspiracy, a concept that is as ancient as it is broad. It is fundamental to the law of conspiracy that the agreements that form the essence of the misconduct are not to be judged by technical niceties but by practical realities. Sophisticated conspirators often reach their agreements as much by the wink and the nod as by explicit agreement, and the implicit agreement may be far more potent, and sinister, just by virtue of being implicit. * * * In the instant case, Uber's digitally decentralized nature does not prevent the App from constituting a "marketplace" through which Mr. Kalanick organized a horizontal conspiracy among drivers.

Defendant argues, however, that plaintiff's alleged conspiracy is "wildly implausible" and "physically impossible," since it involves agreement "among hundreds of thousands of independent transportation providers all across the United States." Yet as plaintiff's counsel pointed out at oral argument, the capacity to orchestrate such an agreement is the "genius" of Mr. Kalanick and his company, which, through the magic of smartphone technology, can invite hundreds of thousands of drivers in far-flung locations to agree to Uber's terms. The advancement of technological means for the orchestration of large-scale price-fixing conspiracies need not leave antitrust law behind. The fact that Uber goes to such lengths to

portray itself—one might even say disguise itself—as the mere purveyor of an "app" cannot shield it from the consequences of its operating as much more.

Recent jurisprudence on vertical resale price maintenance agreements does not, as defendant would have it, undermine plaintiff's claim of an illegal horizontal agreement. In *Leegin*, the Supreme Court held that resale price maintenance agreements—e.g., a retailer's agreement with a manufacturer not to discount the manufacturer's goods beneath a certain price—are to be judged by the rule of reason, unlike horizontal agreements to fix prices, which are per se illegal. See *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 886 (2007). The Court cited various "procompetitive justifications for a manufacturer's use of resale price maintenance," and concluded that although this practice may also have anticompetitive effects, the rule of reason is the best approach to distinguishing resale price maintenance agreements that violate the antitrust laws from those that do not..

Here, unlike in *Leegin*, Uber is not selling anything to drivers that is then resold to riders. Moreover, the justifications for rule of reason treatment of resale price maintenance agreements offered in *Leegin* are not directly applicable to the instant case. In particular, the Court's attention has not been drawn to concerns about free-riding Uber drivers, or to efforts that Uber drivers could make to promote the App that will be under-provided if Uber does not set a pricing algorithm. See *Leegin*, 551 U.S. at 890-91. While Mr. Kalanick asserts that Uber's pricing algorithm facilitates its market entry as a new brand, this observation—which is fairly conclusory—does not rule out a horizontal conspiracy among Uber drivers, facilitated by Mr. Kalanick both as Uber's CEO and as a driver himself. The Court therefore finds that plaintiff has adequately pleaded a horizontal antitrust conspiracy under Section 1 of the Sherman Act.

As to plaintiff's claim of a vertical conspiracy, a threshold question is whether plaintiff has alleged a vertical conspiracy in the Amended Complaint, which defendant denies. Although plaintiff's allegations of a vertical conspiracy are much more sparse than his contentions about a horizontal conspiracy, the Court finds that the Amended Complaint adequately pleads a vertical conspiracy between each driver and Mr. Kalanick. In particular, plaintiff alleges that "[a]ll of the independent driver-partners have agreed to charge the fares set by Uber's pricing algorithm," and that Mr. Kalanick designed this business model. The Amended Complaint also includes several allegations that would be pertinent to a rule of reason, vertical price-

fixing theory. Under the Sherman Act count, plaintiff states that the "unlawful arrangement consists of a series of agreements between Kalanick and each of the Uber driver-partners, as well as a conscious commitment among the Uber driver-partners to the common scheme of adopting the Uber pricing algorithm..." Plaintiff claims that Mr. Kalanick is per se liable as organizer of the conspiracy and as an occasional Uber driver, and then states that "[i]n the alternative, Kalanick is also liable under Section 1 of the Sherman Act under a `quick look' or `rule of reason' analysis." In the Court's view, these allegations of legal theory, when coupled with the allegations of pertinent facts, are sufficient to plead a vertical conspiracy theory.

The question, then, is whether this theory is plausible under a "rule of reason" analysis. Under this analysis, "plaintiff bears the initial burden of showing that the challenged action has had an actual adverse effect on competition as a whole in the relevant market." *Capital Imaging Associates, P.C. v. Mohawk Valley Med. Associates, Inc.*, 996 F.2d 537, 543 (2d Cir. 1993). "To survive a Rule 12(b)(6) motion to dismiss, an alleged product market must bear a rational relation to the methodology courts prescribe to define a market for antitrust purposes—analysis of the interchangeability of use or the cross-elasticity of demand, and it must be plausible." *Todd v. Exxon Corp.*, 275 F.3d 191, 200 (2d Cir. 2001) (internal citation and quotation marks omitted).

As to market definition, plaintiff defines the relevant market as the "mobile app-generated ride-share service market." Plaintiff alleges that Uber has an approximately 80% market share in the United States in this market; Uber's chief competitor Lyft has nearly a 20% market share; and a third competitor, Sidecar, left the market at the end of 2015. Plaintiff then explains that traditional taxi service is not a reasonable substitute for Uber, since, for example, rides generated by a mobile app can be arranged at the push of a button and tracked on riders' mobile phones; riders need not carry cash or a credit card, or, upon arrival, spend time paying for the ride; and riders can rate drivers and see some information on them before entering the vehicle. Indeed, plaintiff claims, Uber has itself stated that it does not view taxis as ride-sharing competition.

Plaintiff also alleges that traditional cars for hire are not reasonable substitutes, since they generally need to be scheduled in advance for prearranged locations. Id. ¶ 106. However, plaintiff nevertheless contends that "Uber has obtained a significant share of business in the combined markets of taxis, cars for hire, and mobile-app generated ride-share services," and that Uber's own experts have

suggested that in some U.S. cities, Uber has 50% to 70% of business customers "among all types of rides," which seems to refer to these combined markets.

Defendant contests plaintiff's proposed market definition, arguing that plaintiff provides inadequate justification for the exclusion not just of taxis and car services, but also of public transit such as subways and buses, personal vehicle use, and walking. In defendant's view, "[e]ach of these alternatives is a clear substitute for the services provided by driver-partners."

One could argue this either way (and defendant's attorneys are encouraged to hereinafter walk from their offices to the courthouse to put their theory to the test). But for present purposes, plaintiff has provided plausible explanations for its proposed market definition, and the accuracy of these explanations may be tested through discovery and, if necessary, trial. "Market definition is a deeply fact-intensive inquiry [and] courts [therefore] hesitate to grant motions to dismiss for failure to plead a relevant product market." *Chapman v. New York State Div. for Youth*, 546 F.3d 230, 238 (2d Cir. 2008). Plaintiff's allegation that Uber—an industry member—recognizes that it does not compete with taxis also deserves consideration. The Court finds that plaintiff has pleaded a plausible relevant product market.

The Court further finds that plaintiff has adequately pleaded adverse effects in the relevant market. Specifically, plaintiff pleads that "Kalanick's actions have further restrained competition by decreasing output,"; "Uber's market position has already helped force Sidecar out of the marketplace"; "Uber's dominant position and considerable name recognition has also made it difficult for potential competitors to enter the marketplace". ¶ 103.

Defendant counters that Uber provides many pro-competitive benefits, see Def. Reply Br. at 9, and also disputes the conclusions that plaintiff purports to draw from the cited studies. See Def. Letter. Defendant's counter-assertions, while certainly well worth a fact-finder's consideration, do not persuade the Court to grant a motion to dismiss. The Court hence determines that plaintiff has plausibly pleaded adverse effects in the relevant market. Consequently, the Court finds that plaintiff has presented a plausible claim of a vertical conspiracy under Section 1 of the Sherman Act. * * * For these reasons, the Court denies defendant Kalanick's motion to dismiss. * * *

Philadelphia Taxi Ass'n, Inc. v. Uber Technologies, Inc.

United States Court of Appeals, Third Circuit, 2018.
886 F.3d 332.

RENDELL, Circuit Judge: Philadelphia taxicab drivers, aggrieved by the influx of taxis hailed at the touch of an app on one's phone, brought this antitrust action to protest the entry of Appellee Uber Technologies, Inc. ("Uber") into the Philadelphia taxicab market. The Philadelphia Taxi Association ("PTA"), along with 80 individual taxicab companies (collectively, "Appellants"), appeal the District Court's dismissal of their Second Amended Complaint ("SAC") alleging one count of attempted monopolization under Section 2 of the Sherman Act, 15 U.S.C. § 2, and seeking injunctive relief and treble damages under Section 4 of the Clayton Act, 15 U.S.C. § 15.

Appellants urge us to reverse the District Court's Order, contending that Uber violated the antitrust laws because its entry into the Philadelphia taxicab market was illegal, predatory, and led to a sharp drop in the value of taxicab medallions as well as a loss of profits. They contend that this is evidence that Uber's operation in Philadelphia was anticompetitive and caused them to suffer an antitrust injury. However, the conduct they allege falls short of the conduct that would constitute an attempted monopoly in contravention of the antitrust laws. Thus, we will affirm the District Court's dismissal of the SAC for failure to state a claim for attempted monopolization and failure to state an antitrust injury.

I. Background & Procedural History

From March of 2005 to October of 2014, taxicabs operating in Philadelphia were required to have a medallion and a certificate of public convenience, issued by the Philadelphia Parking Authority ("PPA"). Medallions are property, and are often pledged as collateral to borrow funds to finance the purchase of the cab or to "upgrade and improve the operations of taxicabs." 53 Pa. C.S.A. § 5712(a). Once medallion-holders comply with the obligatory standards for taxicabs, they may obtain a certificate of public convenience. Those standards, which provide for safety and uniformity among taxicabs, require vehicles to be insured and in proper condition, and mandate that drivers are paid the prevailing minimum wage, are proficient in English, and have the appropriate drivers' licenses.

As alleged in the SAC, when the medallion system was mandated in Philadelphia in 2005, a medallion was worth only $65,000. In October of 2014, there were approximately 500 taxicab

companies in Philadelphia. Together, 7,000 drivers held 1610 medallions, each valued at an average of $545,000.

Appellants are 80 of those 500 companies, which collectively hold 240 of the 1610 medallions, as well as PTA, which was incorporated to advance the legal interests of its members—the 80 individual medallion taxicab companies.

Uber began operating in Philadelphia in October of 2014 without securing medallions or certificates of public convenience for its vehicles. While a potential rider can avail himself of a medallion taxicab by calling a dispatcher or hailing an available cab, to use Uber, he can download the Uber application onto his mobile phone and request that the vehicle come to his location, wherever he is. Passengers enter payment information, which is retained by Uber and automatically processed at the end of each ride. Uber does not own or assume legal responsibility for the vehicles or their operation, nor does it hire the drivers as its employees. Uber did not pay fines to the PPA or comply with its regulations when it first entered the Philadelphia taxi market, as is otherwise required for medallion taxicabs. Appellants maintain that this rendered Uber's operation illegal, and enabled the company to cut operating costs considerably.

In October of 2016, the Pennsylvania state legislature passed a law approving Uber's operation in Philadelphia, under the authority of the PPA. The law, which went into effect in November of 2016, allows the PPA to regulate both medallion taxicab companies and Transportation Network Companies ("TNCs")—a classification that includes Uber and other vehicle-for-hire companies that operate through digital apps—in Philadelphia. TNCs must now obtain licenses to operate and comply with certain requirements, including insurance obligations and safety standards for drivers and vehicles. The law also exempts TNCs from disclosing the number of drivers or vehicles operating in the city, and allows TNCs to set their own fares, unlike medallion taxicab companies, which comply with established rates, minimum wages, and have a limited number of vehicles and medallions operating at once in Philadelphia.

Before this law passed, in Uber's first two years in Philadelphia, nearly 1200 medallion taxicab drivers left their respective companies and began to drive for Uber. In those two years, there were 1700 Uber drivers and vehicles operating in Philadelphia, serving over 700,000 riders, for more than one million trips. Simultaneously, medallion taxi rides reduced by about 30 percent, and thus Appellants experienced a 30 percent decrease in earnings. The value of each medallion dropped significantly, to approximately

$80,000 in November of 2016. Fifteen percent of medallions have been confiscated by the lenders due to default by drivers.

The PTA and 75 individual taxicab companies filed a Complaint, alleging three counts: attempted monopolization under Section 2 of the Sherman Act, tortious interference with contract under Pennsylvania law, and unfair competition under Pennsylvania law. Uber moved to dismiss the Complaint.

Appellants, the PTA and now 80 individual taxicab companies, then filed an Amended Complaint, alleging the same three counts. Uber moved to dismiss the Amended Complaint. The District Court granted the dismissal, without prejudice. The District Court noted that Plaintiffs alleged merely harm to their business after Uber entered the Philadelphia taxicab market, and that Plaintiffs pointed to Uber's supposed illegal participation in the taxicab market as evidence of attempted monopolization. However, the District Court concluded that these harms are "not the type of injuries that antitrust laws were intended to prevent, and thus do not establish antitrust standing." *Phila. Taxi Ass'n, Inc. v. Uber Techs., Inc.*, 218 F.Supp.3d 389, 392 (E.D. Pa. 2016). The Court also dismissed the state law claims, for failure to plead the proper elements of an unfair competition or a tortious interference claim.

Appellants then filed the SAC, alleging one count of attempted monopolization under Section 2 of the Sherman Act and seeking treble damages under Section 4 of the Clayton Act. Uber responded with a Motion to Dismiss, which the District Court granted, with prejudice. The District Court held that Appellants, in spite of multiple opportunities for amendment, had pled no antitrust injury sufficient for antitrust standing, and were unlikely to cure the lack of standing with any amendments to the SAC. The Court also held that the PTA could not satisfy the requirements for associational standing because the association's members lacked standing to sue on their own. * * *

III. Discussion

* * * If the challenged conduct has an effect on "prices, quantity or quality of goods or services," *Mathews v. Lancaster Gen. Hosp.*, 87 F.3d 624, 641 (3d Cir. 1996), we will find a violation of antitrust laws only when that effect harms the market, and thereby harms the consumer.

Anticompetitive conduct is the hallmark of an antitrust claim. An allegation of anticompetitive conduct is necessary both to: (1) state a claim for attempted monopolization; and (2) aver that a private plaintiff has suffered an antitrust injury. Appellants' SAC, however, is deficient in averring conduct that is, in fact, anticompetitive.

While our caselaw is unresolved regarding which to address first—an antitrust violation or an antitrust injury—we need not resolve that here, because Appellants' claim fails on both counts. We begin by discussing how Appellants' allegations in the SAC fall short of demonstrating anticompetitive conduct, and thus fail to state a claim for attempted monopolization, and then discuss how in the alternative, Appellants fail to allege antitrust injury to have antitrust standing. For both reasons, we affirm the judgment of the District Court dismissing the SAC with prejudice.

A. Attempted Monopolization

To prevail on a claim under Sherman Act Section 2 for attempted monopolization, a plaintiff must prove: "(1) that the defendant has engaged in predatory or anticompetitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power." *Mylan Pharm. Inc. v. Warner Chilcott Pub. Ltd. Co.*, 838 F.3d 421, 433 (3d Cir. 2016) (quoting *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 317 (3d Cir. 2007). * * * Liability hinges on whether valid business reasons, as part of the ordinary competitive process, can explain the defendant's actions that resulted in a dangerous probability of achieving monopoly power. See *Avaya Inc., RP v. Telecom Labs, Inc.*, 838 F.3d 354, 393 (3d Cir. 2016).

In the SAC, Appellants allege that Uber: (1) flooded the market with non-medallion taxicabs, entered the market illegally without purchasing medallions, operated at a lower cost by failing to comply with statutory requirements and regulations, and lured away drivers from Individual Plaintiffs, which allegedly impaired the competitive market for medallion taxicabs; (2) knew of PPA's regulatory jurisdiction over vehicles for hire, purposefully ignored or avoided the regulations and rulings of the Court of Common Pleas, and thereby excluded rivals from competing in the taxicab market; and (3) is dangerously close to achieving monopoly power with its market share and by operating in an unfair playing field with the "financial ability" to be the only market player and to destroy competitors' business. SAC ¶ 83. Appellants also complain that the new legislation authorizing the TNCs' operation would facilitate the creation of an illegal monopoly.

We find that the SAC fails to plausibly allege any of the three elements of an attempted monopolization claim.

1. Anticompetitive Conduct

Allegations of purportedly anticompetitive conduct are meritless if those acts would cause no deleterious effect on competition. This is where the SAC falters: Appellants set forth a litany of ways in which Uber's entry into the market has harmed Appellants' business

and their investment in medallions; yet none of the allegations demonstrate a harmful effect on competition.

To determine whether conduct is anticompetitive, "courts must look to the monopolist's conduct taken as a whole rather than considering each aspect in isolation." *LePage's Inc. v. 3M*, 324 F.3d 141, 162 (3d Cir. 2003) (en banc).

Here, Appellants claim that Uber inundated the Philadelphia taxicab market illegally with their non-medallion vehicles. They contend that Uber's entry into the market was predatory because it failed to comply with statutory and regulatory requirements, failed to purchase medallions, failed to pay drivers a minimum wage, and failed to obtain the proper insurance, among other actions. All of these actions, Appellants assert, enabled Uber to operate at a significantly lower cost than the medallion companies, and thereby acquire a stronghold in the Philadelphia taxicab market.

Appellants also maintain that Uber "flooded" the Philadelphia taxicab market by improperly luring drivers away from medallion companies, including Individual Plaintiffs. Appellants cite Uber's practice of sending representatives to 30th Street Station and the Philadelphia International Airport, where medallion taxicab drivers often congregate, to disseminate information about its services and to recruit potential drivers. They argue that Uber promised new drivers financial inducements, such as reimbursements for the cost of gasoline, as an incentive to leave their medallion companies and instead drive for Uber.

Considering the averments regarding Uber's conduct in their totality, Uber's elimination of medallion taxicab competition did not constitute anticompetitive conduct violative of the antitrust laws.

First, inundating the Philadelphia taxicab market with Uber vehicles, even if it served to eliminate competitors, was not anticompetitive. Rather, this bolstered competition by offering customers lower prices, more available taxicabs, and a high-tech alternative to the customary method of hailing taxicabs and paying for rides. It is well established that lower prices, as long as they are not predatory, benefit consumers—"regardless of how those prices are set." *Atl. Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990). "Cutting prices in order to increase business often is the very essence of competition." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 592 (1986). Thus, lost business alone cannot be deemed a consequence of "anticompetitive" acts by the defendant. See *Atl. Richfield*, 495 U.S. at 337.

Second, Uber's ability to operate at a lower cost is not anticompetitive. Running a business with greater economic efficiency is to be encouraged, because that often translates to enhanced competition among market players, better products, and lower prices for consumers. Even if Uber were able to cut costs by allegedly violating PPA regulations, Appellants cannot use the antitrust laws to hold Uber liable for these violations absent proof of anticompetitive conduct. Even unlawful conduct is "of no concern to the antitrust laws" unless it produces an anticompetitive effect. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 487 (1977).

Finally, hiring rivals may be anticompetitive, but only in certain cases. For example, if rival employees were hired in an attempt to exclude competitors from the market for some basis other than efficiency or merit, such as to acquire monopoly power or to merely deny the employees to the rival, this could violate the antitrust laws if injurious to the rival and to competition at large.

However, Appellants acknowledge that the nearly 1200 medallion taxicab drivers that Uber recruited did not remain idle, but rather they drove for Uber. In sum, what Appellants allege does not give rise to an inference of anticompetitive or exclusionary conduct and suggests, if anything, that Uber's ability to attract these drivers was due to its cost efficiency and competitive advantage.

Thus, the SAC is devoid of allegations of truly anticompetitive conduct.

2. Specific Intent to Monopolize

Appellants allege specific intent to monopolize from Uber's knowledge that the PPA maintained regulatory authority over vehicles-for-hire, and its choice to avoid regulation by being a TNC that neither owned vehicles nor employed drivers. They also point to Uber's alleged willful disregard of the rulings of the Court of Common Pleas. Appellants' claim, in essence, is that Uber's knowledge that their operation was illegal reveals a specific intent to monopolize.

"[I]n a traditional § 2 claim, a plaintiff would have to point to specific, egregious conduct that evinced a predatory motivation and a specific intent to monopolize." *Avaya*, 838 F.3d at 406 (citing *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993)). * * *

While Uber's alleged conduct might have formed the basis of a regulatory violation, its knowledge of existing regulations alone cannot reasonably be said to demonstrate specific intent to monopolize. Further, Uber's choice to distinguish itself from other vehicles-for-hire, eschewing medallions in favor of independent drivers who operate

their own cars at will, can instead be reasonably viewed as "predominantly motivated by legitimate business aims." *Times Picayune Publ'g Co. v. United States*, 345 U.S. 594, 627 (1953). Appellants have not averred any other motive. The allegations suggest that these business choices allowed Uber to operate more efficiently, and to offer a service that consumers find attractive, thus enabling it to acquire a share of the Philadelphia taxicab market.

Thus, Uber's alleged competitive strategy of creating a vehicle-for-hire business model, presumably to acquire customers, does not reflect specific intent to monopolize. Accordingly, Appellants have failed to allege specific intent on Uber's part.

3. Dangerous Probability of Achieving Monopoly Power

We held in *Broadcom Corp. v. Qualcomm Inc.* that because the dangerous probability standard is a complex and "fact-intensive" inquiry, courts "typically should not resolve this question at the pleading stage 'unless it is clear on the face of the complaint that the "dangerous probability" standard cannot be met as a matter of law.'" 501 F.3d at 318-19 (quoting *Brader v. Allegheny Gen. Hosp.*, 64 F.3d 869, 877 (3d Cir. 1995)).

We may consider factors such as "significant market share coupled with anticompetitive practices, barriers to entry, the strength of competition, the probable development of the industry, and the elasticity of consumer demand" to determine whether dangerous probability was alleged in the pleadings. Id. Entry barriers include "regulatory requirements, high capital costs, or technological obstacles[] that prevent new competition from entering a market." Id. at 307 (citations omitted). "No single factor is dispositive." Id. at 318.

Appellants argue that Uber has a dangerous probability of achieving monopoly power because it has pushed numerous competitors out of the market. As discussed, however, the SAC fails to allege anticompetitive practices by Uber. Nor does the SAC mention Uber's market share; it merely suggests that Uber and medallion taxicabs had similar numbers of vehicles operating in Philadelphia as of October 2016. This allegation falls short of indicating Uber's market share in the context of all the competitors in the Philadelphia taxicab market, such as other TNCs.

Similarly, the SAC makes no allegation of current barriers to entry or weak competition from other market participants. Appellants make the bold allegation that Uber holds the power to raise barriers to entry in the market, without any factual support. In fact, the SAC alleges that Uber was readily able to enter the Philadelphia market. *

* * Surely other competitors, such as Lyft, are able to enter without difficulty, as well.

Nor does the SAC describe any potentially harmful industry developments. It only vaguely claims that Uber may be able to drive out competition and raise entry barriers. Appellants assert in the SAC that once Uber becomes the dominant competitor, it would be able to charge higher prices, and consumers who do not own smartphones would be deprived of the ability to hail taxis on the street. Absent any allegations of a dangerous probability of achieving monopoly power, this argument fails. And, as counsel for Uber stated at oral argument, if Uber raised its prices, this would encourage other rivals to enter the market and charge lower prices, battling Uber through price competition.

Because the elements of attempted monopolization are often interdependent, proof of one element may provide "permissible inferences" of other elements. *Broadcom*, 501 F.3d at 318 (quoting *Barr Labs., Inc. v. Abbott Labs.*, 978 F.2d 98, 112 (3d Cir. 1992)). Even so, none of the other elements of attempted monopolization allow us to infer a dangerous probability that Uber will achieve monopoly power. Acknowledging Broadcom's reticence to resolve the dangerous probability question at the pleadings stage, we nevertheless find that the SAC does not allege any of the relevant factors to prove that Uber had a dangerous probability of achieving monopoly power.

In sum, Appellants have failed to set forth a plausible claim of attempted monopolization under Section 2 of the Sherman Act, as a matter of law. * * *

V. Conclusion

Appellants may have been better off, financially, if Uber had not entered the Philadelphia taxicab market. However, Appellants have no right to exclude competitors from the taxicab market, even if those new entrants failed to obtain medallions or certificates of public convenience. See *Ill. Transp. Trade Ass'n v. City of Chicago*, 839 F.3d 594, 597 (7th Cir. 2016) (Posner, J.).

If medallion taxicabs could prevent TNCs from entering the Philadelphia market, and if incumbents could prevent new entrants or new technologies from competing because they fear loss of profits, then "economic progress might grind to a halt." Id. at 596-97. "Instead of taxis we might have horse and buggies; instead of the telephone, the telegraph; instead of computers, slide rules." Id. at 597.

Absent any allegations of anticompetitive conduct, Appellants fail to allege any of the elements for a claim for attempted

monopolization under Section 2 of the Sherman Act and fail to allege antitrust standing.

For the foregoing reasons, the judgment of the District Court is AFFIRMED.

Chamber of Commerce of the United States of America v. City of Seattle

United States Court of Appeals, Ninth Circuit, 2020.
890 F.3d 769.

M. SMITH, Circuit Judge: On December 14, 2015, the Seattle City Council enacted into law Ordinance 124968, an Ordinance Relating to Taxicab, Transportation Network Company, and For-Hire Vehicle Drivers (Ordinance). The Ordinance was the first municipal ordinance of its kind in the United States, and authorizes a collective-bargaining process between "driver coordinators"—like Uber Technologies (Uber), Lyft, Inc. (Lyft), and Eastside for Hire, Inc. (Eastside)—and independent contractors who work as for-hire drivers. The Ordinance permits independent-contractor drivers, represented by an entity denominated an "exclusive driver representative," and driver coordinators to agree on the "nature and amount of payments to be made by, or withheld from, the driver coordinator to or by the drivers." Seattle, Wash., Municipal Code § 6.310.735(H)(1). This provision of the Ordinance is the crux of this case.

Acting on behalf of its members Uber, Lyft, and Eastside, Plaintiff-Appellant the Chamber of Commerce of the United States of America, together with Plaintiff-Appellant Rasier, LLC, a subsidiary of Uber (collectively, the Chamber), sued Defendants-Appellees the City of Seattle, the Seattle Department of Finance and Administrative Services (the Department), and the Department's Director, Fred Podesta (collectively, the City), challenging the Ordinance on federal antitrust and labor law grounds. First, the Chamber asserts that the Ordinance violates, and is preempted by, section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1, because the Ordinance sanctions price-fixing of ride-referral service fees by private cartels of independent-contractor drivers. Second, the Chamber claims that the Ordinance is preempted by the National Labor Relations Act (NLRA), 29 U.S.C. §§ 151-169, under *Machinists* and *Garmon* preemption.

The district court dismissed the case, holding that the state-action immunity doctrine exempts the Ordinance from preemption by

the Sherman Act, and that the NLRA does not preempt the Ordinance. The Chamber appealed both holdings.

We have jurisdiction over this appeal pursuant to 28 U.S.C. § 1291. We reverse the district court's dismissal of the Chamber's federal antitrust claims, and remand the federal antitrust claims to the district court for further proceedings. We also affirm the district court's dismissal of the Chamber's NLRA preemption claims.

FACTUAL AND PROCEDURAL BACKGROUND

A. Ride-Referral Companies

Eastside is the largest dispatcher of taxicab and for-hire vehicles in the Pacific Northwest. Eastside provides licensed taxicab and for-hire vehicle drivers with dispatch, advertising, payment processing, and other administrative services, in exchange for a weekly fee, payable by drivers to Eastside. Relying on advertising and a preexisting client base, Eastside generates transportation requests from passengers, who call, text-message, or email Eastside to request a ride. Eastside then refers ride requests to drivers through a mobile data terminal. If a passenger uses a credit card to pay a driver, Eastside processes the transaction and remits the payment to the driver. The drivers who pay for Eastside's services are independent contractors—Eastside does not dictate how the drivers operate their transportation businesses. For example, some drivers own licensed vehicles, whereas others lease them.

Uber and Lyft, founded in 2009 and 2012, respectively, have ushered ride-referral services into the digital age. Uber and Lyft have developed proprietary smartphone applications (apps) that enable an online platform, or digital marketplace, for ride-referral services, often referred to as "ridesharing" services. After downloading the Uber or Lyft app onto their smartphones, riders request rides through the app, which transmits ride requests to available drivers nearby. Drivers are free to accept or ignore a ride request. If a driver accepts a ride request, he or she is matched electronically with the rider, and then proceeds to the rider's location and fulfills the ride request. If a driver ignores a ride request, the digital platform transmits the request to another nearby driver. Drivers may cancel a ride request, even after initially accepting it, at any point prior to the commencement of the ride. Riders, too, may decide whether or not to accept a ride from any of the drivers contacted through the app. After a ride is completed, riders pay drivers via the Uber or Lyft app, using a payment method, such as a credit card, placed on file with Uber or Lyft.

Uber and Lyft's business models have facilitated the rise of the so-called "gig economy." In order to receive ride requests through the

apps, drivers contract with, and pay a technology licensing fee to, Uber or Lyft. These licensing fees are a percentage of riders' paid fares: Uber and Lyft subtract their technology licensing fees from riders' payments, and remit the remainder to drivers. Drivers' contractual agreements with either Uber or Lyft are not exclusive—in fact, many drivers use several ridesharing apps and even operate multiple apps simultaneously. Drivers may use the Uber and Lyft apps for however long and whenever they wish, if they wish to use them at all.

B. The Ordinance

On December 14, 2015, the Seattle City Council adopted Ordinance 124968. The stated purpose of the Ordinance is to "allow[] taxicab, transportation network company, and for-hire vehicle drivers ('for-hire drivers') to modify specific agreements collectively with the entities that hire, direct, arrange, or manage their work," in order to "better ensure that [for-hire drivers] can perform their services in a safe, reliable, stable, cost-effective, and economically viable manner." Seattle, Wash., Ordinance 124968, pmbl.

The Ordinance requires "driver coordinators" to bargain collectively with for-hire drivers. Id. § 1(I). A "driver coordinator" is defined as "an entity that hires, contracts with, or partners with for-hire drivers for the purpose of assisting them with, or facilitating them in, providing for-hire services to the public." Seattle, Wash., Municipal Code § 6.310.110. The Ordinance applies only to drivers who contract with a driver coordinator "other than in the context of an employer-employee relationship"—in other words, the Ordinance applies only to independent contractors. Id. § 6.310.735(D).

The collective-bargaining process begins with the election of a "qualified driver representative," or QDR. Id. §§ 6.310.110, 6.310.735(C). An entity seeking to represent for-hire drivers operating within Seattle first submits a request to the Director of Finance and Administrative Services (the Director) for approval to be a QDR. Id. § 6.310.735(C). Once approved by the City, the QDR must notify the driver coordinator of its intent to represent the driver coordinator's for-hire drivers. Id. § 6.310.735(C)(2).

Upon receiving proper notice from the QDR, the driver coordinator must provide the QDR with the names, addresses, email addresses, and phone numbers of all "qualifying drivers." Id. § 6.310.735(D). This disclosure requirement applies only to driver coordinators that have "hired, contracted with, partnered with, or maintained a contractual relationship or partnership with, 50 or more for-hire drivers in the 30 days prior to the commencement date" set by the Director. Id.

The QDR then contacts the qualifying drivers to solicit their interest in being represented by the QDR. Id. § 6.310.735(E). Within 120 days of receiving the qualifying drivers' contact information, the QDR submits to the Director statements of interest from qualifying drivers indicating that they wish to be represented by the QDR in collective-bargaining negotiations with the driver coordinator. Id. § 6.310.735(F)(1). If a majority of qualifying drivers consent to representation by the QDR, the Director certifies the QDR as the "exclusive driver representative" (EDR) for all for-hire drivers for that particular driver coordinator. Id. § 6.310.735(F)(2).

Once the Director certifies the EDR, the driver coordinator and the EDR shall meet and negotiate in good faith certain subjects to be specified in rules or regulations promulgated by the Director including, but not limited to, best practices regarding vehicle equipment standards; safe driving practices; the manner in which the driver coordinator will conduct criminal background checks of all prospective drivers; *the nature and amount of payments to be made by, or withheld from, the driver coordinator to or by the drivers*; minimum hours of work, conditions of work, and applicable rules. Id. § 6.310.735(H)(1) (emphasis added).

If an agreement is reached, the driver coordinator and the EDR submit the written agreement to the Director. Id. § 6.310.735(H)(2). The Director reviews the agreement for compliance with the Ordinance and Chapter 6.310 of the Seattle Municipal Code, which governs taxicabs and for-hire vehicles. Id. In conducting this review, the Director is to "ensure that the substance of the agreement promotes the provision of safe, reliable, and economical for-hire transportation services and otherwise advance[s] the public policy goals set forth in Chapter 6.310 and in the [Ordinance]." Id.

The Director's review is not limited to the parties' submissions or the terms of the proposed agreement. Id. Rather, the Director may gather and consider additional evidence, conduct public hearings, and request information from the EDR and the driver coordinator. Id.

The agreement becomes final and binding on all parties if the Director finds the agreement compliant. Id. § 6.310.735(H)(2)(a). The agreement does not take effect until the Director makes such an affirmative determination. Id. § 6.310.735(H)(2)(c). If the Director finds the agreement noncompliant, the Director remands it to the parties with a written explanation of the agreement's failures, and may offer recommendations for remedying the agreement's inadequacies. Id. § 6.310.735(H)(2)(b).

If the driver coordinator and the EDR do not reach an agreement, "either party must submit to interest arbitration upon the request of the other," in accordance with the procedures and criteria specified in the Ordinance. Id. § 6.310.735(I). The interest arbitrator must propose an agreement compliant with Chapter 6.310 and in line with the City's public policy goals. Id. § 6.310.735(I)(2). The term of an agreement proposed by the interest arbitrator may not exceed two years. Id.

The interest arbitrator submits the proposed agreement to the Director, who reviews the agreement for compliance with the Ordinance and Chapter 6.310, in the same manner the Director reviews an agreement proposed by the parties. Id. § 6.310.735(I)(3).

The parties may discuss additional terms and propose amendments to an approved agreement. Id. § 6.310.735(J). The parties must submit any proposed amendments to the Director for approval. Id. The Director has the authority to withdraw approval of an agreement during its term, if the Director finds that the agreement no longer complies with the Ordinance or furthers the City's public policy goals. Id. § 6.310.735(J)(1).

* * *

ANALYSIS

I. State-Action Immunity Does Not Protect the Ordinance from Preemption by Section 1 of the Sherman Act.

We turn first to the Chamber's federal antitrust claims, and hold that the Ordinance does not meet the requirements for state-action immunity.

A. Preemption

In determining whether the Sherman Act preempts a state or local law pursuant to the Supremacy Clause, we apply the principles of conflict preemption. "As in the typical pre-emption case, the inquiry is whether there exists an irreconcilable conflict between the federal and state [or local] regulatory schemes." *Rice v. Norman Williams Co.*, 458 U.S. 654, 659 (1982).

A state or local law, "when considered in the abstract, may be condemned under the antitrust laws," and thus preempted, "only if it mandates or authorizes conduct that necessarily constitutes a violation of the antitrust laws in all cases, or if it places irresistible pressure on a private party to violate the antitrust laws in order to comply with the statute." Id. at 661. "Such condemnation will follow under [section] 1 of the Sherman Act when the conduct contemplated by the statute is in all cases a per se violation." Id. However, "[i]f the

activity addressed by the statute does not fall into that category, and therefore must be analyzed under the rule of reason, the statute cannot be condemned in the abstract." Id. Unlike the categorical analysis under the per se rule of illegality, "[a]nalysis under the rule of reason requires an examination of the circumstances underlying a particular economic practice, and therefore does not lend itself to a conclusion that a statute is facially inconsistent with federal antitrust laws." Id. In short, the Ordinance may be preempted facially by federal antitrust law if it authorizes a per se violation of section 1 of the Sherman Act, but not if it must be analyzed under the rule of reason.

* * *

Here, the district court assumed, without deciding, "that collusion between independent economic actors to set the prices they will accept for their services in the market is a per se antitrust violation." On appeal, the City acknowledges that it "did not challenge the Chamber's contention that collective negotiations regarding topics such as payments to drivers could, absent Parker immunity, constitute per se antitrust violations." Because the district court dismissed the Chamber's federal antitrust claims solely on the basis of state-action immunity, we limit our analysis to that issue. We accept, without reaching the merits of the question, that the Ordinance authorizes a per se antitrust violation. The parties may address on remand which mode of antitrust analysis—the per se rule of illegality or the rule of reason—applies.

B. The Requirements for State-Action Immunity

The state-action immunity doctrine derives from *Parker v. Brown*, 317 U.S. 341 (1943). In *Parker*, the Supreme Court held that "because 'nothing in the language of the Sherman Act ... or in its history' suggested that Congress intended to restrict the sovereign capacity of the States to regulate their economies, the Act should not be read to bar States from imposing market restraints 'as an act of government.'" *FTC v. Phoebe Putney Health Sys., Inc.*, 568 U.S. 216, 224 (2013) (quoting *Parker*, 317 U.S. at 350, 352). Following *Parker*, the Supreme Court has, "under certain circumstances," extended immunity from federal antitrust laws to "nonstate actors carrying out the State's regulatory program." Id. at 224-25.

State-action immunity is the exception rather than the rule. * * * The Supreme Court uses a two-part test, sometimes referred to as the *Midcal* test, to "determin[e] whether the anticompetitive acts of private parties are entitled to immunity." Id. First, "the challenged restraint [must] be one clearly articulated and affirmatively expressed as state policy," and second, "the policy [must] be actively supervised

by the State." Id. (quoting *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980)).

"Because municipalities and other political subdivisions are not themselves sovereign, state-action immunity under Parker does not apply to them directly." Id. As such, "immunity will only attach to the activities of local governmental entities if they are undertaken pursuant to a 'clearly articulated and affirmatively expressed' state policy to displace competition." Id. at 226, (quoting *Cmty. Commc'ns Co. v. Boulder*, 455 U.S. 40, 52 (1982)). Local governmental entities, "unlike private parties, . . . are not subject to the 'active state supervision requirement' because they have less of an incentive to pursue their own self-interest under the guise of implementing state policies." Id. (quoting *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 46-47 (1985)). "Where state or municipal regulation by a private party is involved, however, active state supervision must be shown, even where a clearly articulated state policy exists." *Hallie*, 471 U.S. at 46 n.10.

i. The Clear-Articulation Test

We conclude that the anticompetitive restraint challenged in this case fails the first prong of the *Midcal* test. The State of Washington has not "clearly articulated and affirmatively expressed" a state policy authorizing private parties to price-fix the fees for-hire drivers pay to companies like Uber or Lyft in exchange for ride-referral services.

The clear-articulation test is met "if the anticompetitive effect was the 'foreseeable result' of what the State authorized." *Phoebe Putney*, 568 U.S. at 226-27 (quoting *Hallie*, 471 U.S. at 42). "'[T]o pass the "clear articulation" test,' a state legislature need not 'expressly state in a statute or its legislative history that the legislature intends for the delegated action to have anticompetitive effects.'" Id. at 226 (alteration in original) (quoting *Hallie*, 471 U.S. at 43). * * *

Our inquiry with respect to the clear-articulation test is a precise one. "[T]he relevant question is whether the regulatory structure which has been adopted by the state has *specifically authorized the conduct* alleged to violate the Sherman Act." *Cost Mgmt. Servs., Inc. v. Wash. Nat. Gas Co.*, 99 F.3d 937, 942 (9th Cir. 1996) (emphasis added). The state's authorization must be plain and clear: The relevant statutory provisions must "'plainly show' that the [state] legislature *contemplated* the sort of activity that is challenged," which occurs where they "confer 'express authority to take action that *foreseeably* will result in anticompetitive effects.'" *Hass v. Or. State Bar*, 883 F.2d 1453, 1457 (9th Cir. 1989) (first emphasis added)

(quoting *Hallie*, 471 U.S. at 43-44). The state, in its sovereign capacity, must "clearly intend[] to displace competition in a particular field with a regulatory structure ... in the relevant market." *S. Motor Carriers Rate Conference, Inc. v. United States*, 471 U.S. 48, 64 (1985).

Once we determine that there is express state authorization, we then turn to the concept of foreseeability, which "is to be used in deciding the *reach* of antitrust immunity that stems from an *already authorized* monopoly, price regulation, or other disruption in economic competition." *Shames*, 626 F.3d at 1084 (second emphasis added). A foreseeable result cannot circumvent the requirement that there be express authorization in the first place: "[A] foreseeable result cannot create state authorization itself," but must itself stem from express authorization, which is "the necessary predicate for the Supreme Court's foreseeability test." Id. (quoting *Columbia Steel Casting Co. v. Portland Gen. Elec. Co.*, 111 F.3d 1427, 1444 (9th Cir. 1996)). We must be careful not to "appl[y] the concept of 'foreseeability' from [the] clear-articulation test too loosely." *Phoebe Putney*, 568 U.S. at 229.

Applying these principles to the Ordinance, we conclude that the clear-articulation requirement has not been satisfied. The state statutes relied upon by the City Council in enacting the Ordinance—Revised Code of Washington sections 46.72.001, 46.72.160, 81.72.200, and 81.72.210—do not "plainly show" that the Washington legislature "contemplated" allowing for-hire drivers to price-fix their compensation. Nor is such an anticompetitive result foreseeable.

We examine the state statutes in turn. First, Revised Code of Washington section 46.72.001 provides:

> The legislature finds and declares that privately operated for hire transportation service is a vital part of the transportation system within the state. Consequently, the safety, reliability, and stability of privately operated for hire transportation services are matters of statewide importance. The regulation of privately operated for hire transportation services is thus an essential governmental function. Therefore, it is the intent of the legislature to permit political subdivisions of the state to regulate for hire transportation services without liability under federal antitrust laws.

That the Washington state legislature "inten[ded] ... to permit political subdivisions of the state to regulate for hire transportation services without liability under federal antitrust laws," id., is insufficient to bring the Ordinance within the protective ambit of state-action immunity. We are mindful of the Supreme Court's instruction that "a State may not confer antitrust immunity on private

persons by fiat," *Ticor Title*, 504 U.S. at 633, and that a "State may not validate a municipality's anticompetitive conduct simply by declaring it to be lawful," *Hallie*, 471 U.S. at 39. Rather, it must first meet the Midcal requirements: A state "may displace competition with active state supervision [only] if the displacement is both intended by the State and implemented in its specific details." *Ticor Title*, 504 U.S. at 633. We may not "defer[] to private pricefixing arrangements under the general auspices of state law," but instead must ensure that the "precondition[s] for immunity from federal law," such as "[a]ctual state involvement," are met. Id. After all, "[i]mmunity is conferred out of respect for ongoing regulation by the State, not out of respect for the economics of price restraint." Id.

The plain language of the statute centers on the provision of "privately operated for hire transportation services," Wash. Rev. Code § 46.72.001, not the contractual payment arrangements between for-hire drivers and driver coordinators for use of the latter's smartphone apps or ride-referral services. Although driver coordinators like Uber and Lyft contract with providers of transportation services, they do not fulfill the requests for transportation services—the drivers do. Nothing in the statute evinces a clearly articulated state policy to displace competition in the market for ride-referral service fees charged by companies like Uber, Lyft, and Eastside. In other words, although the statute addresses the provision of transportation services, it is silent on the issue of compensation contracts between for-hire drivers and driver coordinators. To read into the plain text of the statute implicit state authorization and intent to displace competition with respect to for-hire drivers' compensation would be to apply the clear-articulation test "too loosely." *Phoebe Putney*, 568 U.S. at 229. * * *

The regulation of rates in one area—i.e., the regulation of rates charged to passengers for transportation services—does not confer the shield of state-action immunity onto anticompetitive conduct in a related market—i.e., price-fixing the fees for-hire drivers pay to Uber and Lyft in order to use their digital platforms.

In cases in which the Supreme Court found the clear-articulation test to be satisfied, the initial state authorization clearly contemplated and plainly encompassed the challenged anticompetitive conduct. * * * Tellingly, Uber and Lyft did not exist when the Washington statutes were enacted. The very concept of digital ridesharing services was probably well beyond the imaginations of lawmakers two to three decades ago, much less foreseeable. But the fact that technology has advanced leaps and bounds beyond the contemplation of the state legislature is not, on its own, the dispositive

factor in our holding today. Digital platforms like Uber and Lyft have become "highly interconnected with modern economic and social life," *Fields v. Twitter, Inc.*, 881 F.3d 739, 749 (9th Cir. 2018), and present novel challenges and contexts for regulation. Nevertheless, it is not our role to make policy judgments properly left to the Washington state legislature. Instead, we must tread carefully in the area of state-action immunity, lest "a broad interpretation of the doctrine ... inadvertently extend immunity to anticompetitive activity which the states did not intend to sanction," or "a broad application of the doctrine ... impede states' freedom by threatening to hold them accountable for private activity they do not condone 'whenever they enter the realm of economic regulation.'" *Cost Mgmt. Servs.*, 99 F.3d at 941 (quoting *Ticor Title*, 504 U.S. at 635-36).

Applying governing law, we hold that the clear-articulation requirement for state-action immunity is not satisfied in this case.

ii. The Active-Supervision Requirement

We next hold that the Ordinance does not meet the active-supervision requirement for Parker immunity.

"The active supervision requirement demands ... 'that state officials have and exercise power to review particular anticompetitive acts of private parties and disapprove those that fail to accord with state policy.'" *N.C. State Bd. of Dental Examiners v. FTC*, ___ U.S. ___ (2015) (quoting *Patrick v. Burget*, 486 U.S. 94, 101 (1988)). Because "[e]ntities purporting to act under state authority might diverge from the State's considered definition of the public good" and "[t]he resulting asymmetry between a state policy and its implementation can invite private self-dealing," the active-supervision requirement "seeks to avoid this harm by requiring the State to review and approve interstitial policies made by the entity claiming immunity." Id.

As a threshold matter, we first clarify that the active-supervision requirement applies to this case. It is settled law that "active state supervision is not a prerequisite to exemption from the antitrust laws where the actor is a municipality rather than a private party." *Hallie*, 471 U.S. at 47. However, where, as here, "state or municipal regulation by a private party is involved, . . . active state supervision must be shown, even where a clearly articulated state policy exists." Id. at 46n.10 (citing *S. Motor Carriers*, 471 U.S. at 62).

Southern Motor Carriers is illustrative. * * * Likewise here, private parties—for-hire drivers and driver coordinators—are permitted to set rates collectively and submit them to the Director for approval. Accordingly, the active-supervision requirement applies.

The involvement of private parties in municipal regulation renders this case ineligible for the municipality exception outlined in Hallie: "Hallie explained that '[w]here the actor is a municipality, there is little or no danger that it is involved in a private price-fixing arrangement. The only real danger is that it will seek to further purely parochial public interests at the expense of more overriding state goals.'" *Dental Examiners*, 135 S.Ct. at 1112 (alteration in original) (quoting *Hallie*, 471 U.S. at 47). In contrast, this case presents a scenario in which the City authorizes collective price-fixing by private parties, which the Director evaluates and ratifies. The amount of discretion the Ordinance confers upon private actors is far from trivial.

Having decided that the active-supervision requirement applies to this case, we turn to examine whether it is met. Clearly, it is not. It is undisputed that the State of Washington plays no role in supervising or enforcing the terms of the City's Ordinance.

The City cites no controlling authority to support its argument that the Supreme Court uses the word "State" simply "as shorthand for the State and all its agents, including municipalities." The Supreme Court has stated repeatedly that active supervision must be "by the State itself." *Midcal*, 445 U.S. at 105;.

We take it as a given that the Supreme Court means what it states. In *Hallie*, the Supreme Court stated that "[w]here state or municipal regulation by a private party is involved, however, active state supervision must be shown." 471 U.S. at 46 n.10. In the first clause, the Supreme Court used "state or municipal," thus drawing a disjunctive difference between the two words. In the second clause, it used only "state." It is highly improbable that the Supreme Court chose to distinguish between states and municipalities in the beginning of the sentence, only to conflate the two in the latter part of the sentence.

Moreover, the City's interpretation of the Supreme Court's use of "State" collapses the specific distinction the Supreme Court has drawn between cities, which are not sovereign entities, and states, which are. Sovereign capacity matters. Indeed, the very origins of *Parker* immunity stem from respect for the states' sovereign capacity to regulate their economies. *Phoebe Putney*, 568 U.S. at 224. A "substate governmental entity" is simply not equivalent to a state: "Because municipalities and other political subdivisions are not themselves sovereign, state-action immunity under *Parker* does not apply to them directly." *Phoebe Putney*, 568 U.S. at 225. Unlike a state, a municipality may invoke the protective cloak of *Parker* immunity under "the narrow exception *Hallie* identified" not because it is

sovereign, but because there is "little or no danger that it is involved in a private price-fixing arrangement"; the fact that "municipalities are electorally accountable and lack the kind of private incentives characteristic of active participants in the market"; and the "substantially reduc[ed] ... risk that [a municipality] would pursue private interests while regulating any single field." *Dental Examiners*, 135 S.Ct. at 1112-13 (quoting *Hallie*, 471 U.S. at 47). All of the reasons justifying the *Hallie* exception are eviscerated by the involvement of private parties in this case.

In concluding that the active-supervision requirement is not satisfied in this case, we do not disturb *Hallie's* well-settled rule that municipal actors need not meet the active-supervision requirement. See *Hallie*, 471 U.S. at 47. Rather, following *Hallie*, we hold that in this case, in which private actors exercise substantial discretion in setting the terms of municipal regulation, "active state supervision must be shown." Id. at 46 n.10. Because the distinction between states and municipalities is of crucial importance for purposes of state-action immunity, we reject the City's invitation to treat the two entities interchangeably.

II. The Ordinance Is Not Preempted by the National Labor Relations Act.

We next hold that the Ordinance is not preempted by the NLRA under either *Machinists* or *Garmon* preemption. * * *

CONCLUSION

For the foregoing reasons, we reverse the district court's dismissal of the Chamber's federal antitrust claims, and remand the federal antitrust claims to the district court for further proceedings. We also affirm the district court's dismissal of the Chamber's NLRA preemption claims. * * *

NOTES AND QUESTIONS

1. *Understanding Uber and Lyft as a business.* The Third Circuit dismissed the Section 2 claims in the *Philadelphia Taxi Ass'n* case pretty quickly. The court said Uber was an entrant adding new competition to the local transportation market and antitrust law generally favors new entry. That said, Uber and Lyft have both lost substantial amounts of money in building up their new services and of course the pandemic has exacerbated their business problems. What facts would you need to have to make an assessment of whether Uber and Lyft have been engaging in predatory pricing? Is t it enough to show that they lost money for an extended period of time? Should that

fact, if established, be enough to show a predatory intent? And how should we think about recoupment in these markets?

2. *Understanding contracts and corporate form*. Return to the questions that we posed before the three cases that you just read. What explains how Uber and Lyft are organized? Suppose that Uber and Lyft are organized to avoid having drivers characterized as employees? How should all of that matter for how we see the antitrust issues that may be raised in these situations? Should a court rely on the parties' characterization of their relationship in the operative documents, or should it make an independent assessment of the economic substance of the relationship?

3. *Antitrust and localism*. *City of Seattle* puts in play how choices by local governments matter for possible antitrust liability. Why should federal antitrust law play any role here at all? It is easy to see that the home state might not internalize harms to consumers in other states that result from actions by the home state and that we therefore cannot rely on state or local officials to make good decisions when those decisions have effects in other states. But is antitrust law the best tool to address that problem? Moreover, the situation in *City of Seattle* is mainly local. If Seattle doesn't want robust competition in local transportation markets, why is that a federal concern and why should federal antitrust law somehow supply an answer?

Chapter 9.2.1: Labor

[insert after the first full paragraph on p. 1082]

Confederación Hípica de Puerto Rico, Inc. v. Confederación de Jinetes Puertorriqueños, Inc., 30 F.4th 306 (1st Cir. 2022), addresses the scope of the statutory exemption. A group of thirty-seven jockeys refused to race and did so in conjunction with the efforts of a labor Association all as part of an effort to increase the amounts that they were paid. A group of horse owners and a racetrack in Puerto Rico alleged that the action was a group boycott in violation of *Northwest Wholesale Stationers* (U.S. 1985). The First Circuit rejected that analysis. The plaintiffs had argued that the jockeys were independent contractors, and not employees, and thus were not protected by the statutory exemption. The First Circuit rejected that view reasoning that the applicability of the statutory exemption turns on whether there was a labor dispute. Because a labor organization was working with the jockeys and the jockeys were seeking to improve the conditions of their labor, they were engaged in a labor dispute. Thus,

the statutory exemption applied, and the group boycott claim could not be sustained.

Chapter 10.2.C.4: Remedies

[insert at the bottom of page 1164 of the main text]

4. *The new Policy Statement*. The Federal Trade Commission during the Biden Administration has construed its authority under the "unfair methods of competition" prong of Section 5 very broadly. It rescinded the 2015 Statement of Enforcement Principles on July 21, 2021, and replaced that statement on November 10, 2022, with a new Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act. The Policy Statement begins with an extensive summary of the background and legislative history of Section 5, which it describes as culminating in "an intentional balance" established by Congress which "allowed the Commission to proceed against a broader range of anticompetitive conduct than can be reached under the Clayton and Sherman Acts, but . . . did not establish a private right of action under Section 5." The Policy Statement cites several Supreme Court decisions between 1934 and 1986, which the Commission reads as having "affirmed this same broad view of Section 5."

The Policy Statement then describes Section 5 more concretely. According to the Commission, "Congress created the FTC as an expert body charged with elucidating the meaning of Section 5." Section 5 prohibits "unfair methods of competition" and thus prohibits only conduct that "implicates competition" either directly or "indirectly," such as by "misuse of regulatory processes that can create or exploit impediments to competition." Conduct is "unfair" when it "goes beyond competition on the merits."

"There are two key criteria" for determining "whether conduct goes beyond competition on the merits. First, the conduct may be coercive, exploitative, collusive, abusive, deceptive, predatory, or involve the use of economic power of a similar nature." The second is "whether the respondent's conduct has a tendency to generate negative consequences; for instance, raising prices, reducing output, limiting choice, lowering quality, reducing innovation, impairing other market participants, or reducing the likelihood of potential or nascent competition. These consequences may arise when the conduct is examined in the aggregate along with the conduct of others engaging in the same or similar conduct, or when the conduct is examined as

part of the cumulative effect of a variety of different practices by the respondent." Section 5 does not require market definition or proof of market power, and the Section 5 inquiry will "focus on stopping unfair methods of competition in their incipiency based on their tendency to harm competitive conditions."

A number of commenters have criticized the Policy Statement as being excessively ambiguous and reading Section 5 more broadly than Congress intended. To date, no court has evaluated the meaning of the Policy Statement nor the enforceability of its expansive view of the scope of Section 5. The Supreme Court recently granted certiorari, however, in *Loper Bright Enterprises v. Raimondo* (No. 22-451, May 1, 2023), presenting the question whether the so-called *Chevron* doctrine should be overruled. The Court has recently expressed skepticism about permitting administrative agencies to exercise substantial discretion when construing federal statutes, and its decision in *Loper Bright* might at the very least cast doubt on the Commission's statement that it has been charged with determining the scope of Section 5.

5. *Proposed rule-making.* On January 5, 2023, the Federal Trade Commission released a Notice of Proposed Rulemaking (NPRM) to establish a rule that would limit the use of non-compete agreements in employment contracts. The vote to release the NPRM was along party lines, with the 3 Democratic Commissioners supporting the proposal and Christine Wilson, the sole Republican on the Commission, dissenting. The proposed rule would prohibit employers from imposing non-compete clauses on workers in most circumstances. The NPRM invited comments on the proposed rule. The Commission has since received more than twenty-five thousand comments, and the comment period is now closed. The Commission is expected to release a final and perhaps revised version of the new rule in the near future.

The NPRM has provoked substantial controversy for two reasons. First, there is no consensus about the desirability of the NPRM as a policy matter. The Commission explained in the NPRM that non-compete agreements prevent worker from moving to more attractive employment opportunities with competitors of their existing employer and thus can both harm workers and reduce the employer's exposure to competition. In an accompanying statement, the Commission said that there is substantial reason to be concerned about the impact of non-compete clauses on workers, especially workers in low-skill jobs. It estimated that the proposed new rule would increase workers'

earning by nearly $300 billion per year and double the number of companies founded by a former worker in the same industry.[13]

Critics of the NPRM argue, however, that non-compete clauses themselves often promote competition and should thus continue to be assessed under traditional antitrust standards on a case-by-case basis. In her dissenting statement, Commissioner Wilson said the NPRM "represents a radical departure from hundreds of years of legal precedent that employs a fact-specific inquiry into whether a non-compete clause is unreasonable in duration and scope, given the business justification for the restriction" and that the NPRM would prohibit "conduct that 47 state legislators [sic] have chosen to allow." Commissioner Wilson argued, among other things, that non-compete agreements are often necessary to induce procompetitive investment in worker training and customer development and sharing of trade secrets and confidential information with workers because they prevent workers from appropriating the fruits of that investment and sharing for the benefit of competing employers.[14]

Second, and more broadly, there is substantial disagreement as to whether the Commission has the authority to promulgate any substantive rules under the "unfair methods of competition" prong of Section 5. The NPRM says that the proposed rule would be promulgated pursuant to Sections 5 and 6(g) of the FTC Act. Section 6(g) authorizes the Commission to "make rules and regulations for the purpose of carrying out the provisions of the subchapter," but Commissioner Wilson noted in her dissent that FTC leadership has for decades taken the position that Section 6(g) authorizes the promulgation of only procedural rules and not substantive rules governing commercial conduct like the proposed ban on non-compete agreements. More generally, Commissioner Wilson argued, substantive rulemaking goes beyond the Commission's authority after the amendment of the FTC Act by the Magnuson-Moss Act in 1975 and might run afoul of both the new "major question doctrine" adopted by the Supreme Court in *West Virginia v. EPA*, 142 S. Ct. 2587 (2022), and the non-delegation doctrine.

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[13] See U.S. Federal Trade Commission, Fact Sheet: FTC Proposes Rule to Ban Noncompete Clauses, Which Hurt Workers and Harm Competition, January 5, 2023

[14] Dissenting Statement of Commissioner Christine S. Wilson Concerning the Notice of Proposed Rulemaking for the Non-Compete Clause Rule, January 5, 2023

Litigation challenging the new rule banning non-competes is inevitable and thus the fate of the proposed rule prohibiting non-competition agreements is uncertain.

Chapter 10.3.C.2: The Direct Purchaser Doctrine

Apple Inc. v. Pepper

Supreme Court of the United States, 2019.
_ U.S. _, 139 S.Ct. 1514.

[replace *Kansas v. Utilicorp United, Inc.* at pp. 1181-1192]

Justice KAVANAUGH delivered the opinion of the Court: In 2007, Apple started selling iPhones. The next year, Apple launched the retail App Store, an electronic store where iPhone owners can purchase iPhone applications from Apple. Those "apps" enable iPhone owners to send messages, take photos, watch videos, buy clothes, order food, arrange transportation, purchase concert tickets, donate to charities, and the list goes on. "There's an app for that" has become part of the 21st-century American lexicon.

In this case, however, several consumers contend that Apple charges too much for apps. The consumers argue, in particular, that Apple has monopolized the retail market for the sale of apps and has unlawfully used its monopolistic power to charge consumers higher-than-competitive prices.

A claim that a monopolistic retailer (here, Apple) has used its monopoly to overcharge consumers is a classic antitrust claim. But Apple asserts that the consumer-plaintiffs in this case may not sue Apple because they supposedly were not "direct purchasers" from Apple under our decision in *Illinois Brick Co. v. Illinois,*431 U.S. 720, 745-746 (1977). We disagree. The plaintiffs purchased apps directly from Apple and therefore are direct purchasers under *Illinois Brick.* At this early pleadings stage of the litigation, we do not assess the merits of the plaintiffs' antitrust claims against Apple, nor do we consider any other defenses Apple might have. We merely hold that the *Illinois Brick* direct-purchaser rule does not bar these plaintiffs from suing Apple under the antitrust laws. We affirm the judgment of the U.S. Court of Appeals for the Ninth Circuit.

I.

In 2007, Apple began selling iPhones. In July 2008, Apple started the App Store. The App Store now contains about 2 million apps that iPhone owners can download. By contract and through

technological limitations, the App Store is the only place where iPhone owners may lawfully buy apps.

For the most part, Apple does not itself create apps. Rather, independent app developers create apps. Those independent app developers then contract with Apple to make the apps available to iPhone owners in the App Store.

Through the App Store, Apple sells the apps directly to iPhone owners. To sell an app in the App Store, app developers must pay Apple a $ 99 annual membership fee. Apple requires that the retail sales price end in $ 0.99, but otherwise allows the app developers to set the retail price. Apple keeps 30 percent of the sales price, no matter what the sales price might be. In other words, Apple pockets a 30 percent commission on every app sale.

In 2011, four iPhone owners sued Apple. They allege that Apple has unlawfully monopolized "the iPhone apps aftermarket." App. to Pet. for Cert. 53a. The plaintiffs allege that, via the App Store, Apple locks iPhone owners "into buying apps only from Apple and paying Apple's 30% fee, even if" the iPhone owners wish "to buy apps elsewhere or pay less." *Id.,* at 45a. According to the complaint, that 30 percent commission is "pure profit" for Apple and, in a competitive environment with other retailers, "Apple would be under considerable pressure to substantially lower its 30% profit margin." *Id.,* at 54a-55a. The plaintiffs allege that in a competitive market, they would be able to "choose between Apple's high-priced App Store and less costly alternatives." *Id.,* at 55a. And they allege that they have "paid more for their iPhone apps than they would have paid in a competitive market." *Id.,* at 53a.

Apple moved to dismiss the complaint, arguing that the iPhone owners were not direct purchasers from Apple and therefore may not sue. In *Illinois Brick,* this Court held that direct purchasers may sue antitrust violators, but also ruled that indirect purchasers may not sue. The District Court agreed with Apple and dismissed the complaint. According to the District Court, the iPhone owners were not direct purchasers from Apple because the app developers, not Apple, set the consumers' purchase price.

The Ninth Circuit reversed. The Ninth Circuit concluded that the iPhone owners were direct purchasers under *Illinois Brick* because the iPhone owners purchased apps directly from Apple. According to the Ninth Circuit, *Illinois Brick* means that a consumer may not sue an alleged monopolist who is two or more steps removed from the consumer in a vertical distribution chain. See *In re Apple iPhone Antitrust Litig.,* 846 F. 3d 313, 323 (2017). Here, however, the

consumers purchased directly from Apple, the alleged monopolist. Therefore, the Ninth Circuit held that the iPhone owners could sue Apple for allegedly monopolizing the sale of iPhone apps and charging higher-than-competitive prices. *Id.,* at 324. We granted certiorari. 585 U.S. ___ (2018).

II.

A.

The plaintiffs' allegations boil down to one straightforward claim: that Apple exercises monopoly power in the retail market for the sale of apps and has unlawfully used its monopoly power to force iPhone owners to pay Apple higher-than-competitive prices for apps. According to the plaintiffs, when iPhone owners want to purchase an app, they have only two options: (1) buy the app from Apple's App Store at a higher-than-competitive price or (2) do not buy the app at all. Any iPhone owners who are dissatisfied with the selection of apps available in the App Store or with the price of the apps available in the App Store are out of luck, or so the plaintiffs allege.

The sole question presented at this early stage of the case is whether these consumers are proper plaintiffs for this kind of antitrust suit—in particular, our precedents ask, whether the consumers were "direct purchasers" from Apple. *Illinois Brick,* 431 U.S. at 745-746. It is undisputed that the iPhone owners bought the apps directly from Apple. Therefore, under *Illinois Brick,* the iPhone owners were direct purchasers who may sue Apple for alleged monopolization.

That straightforward conclusion follows from the text of the antitrust laws and from our precedents.

First is text: Section 2 of the Sherman Act makes it unlawful for any person to "monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations." 26 Stat. 209, 15 U.S.C. § 2. Section 4 of the Clayton Act in turn provides that "*any person* who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue ... the defendant ... and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee." 38 Stat. 731, 15 U.S.C. § 15(a) (emphasis added). The broad text of § 4—"any person" who has been "injured" by an antitrust violator may sue—readily covers consumers who purchase goods or services at higher-than-competitive prices from an allegedly monopolistic retailer.

Second is precedent: Applying § 4, we have consistently stated that "the immediate buyers from the alleged antitrust violators" may maintain a suit against the antitrust violators. *Kansas v. UtiliCorp United Inc.,* 497 U.S. 199, 207 (1990); see also *Illinois Brick,* 431 U.S. at 745-746. At the same time, incorporating principles of proximate cause into § 4, we have ruled that *indirect* purchasers who are two or more steps removed from the violator in a distribution chain may not sue. Our decision in *Illinois Brick* established a bright-line rule that authorizes suits by *direct* purchasers but bars suits by *indirect* purchasers. *Id.,* at 746.

The facts of *Illinois Brick* illustrate the rule. Illinois Brick Company manufactured and distributed concrete blocks. Illinois Brick sold the blocks primarily to masonry contractors, and those contractors in turn sold masonry structures to general contractors. Those general contractors in turn sold their services for larger construction projects to the State of Illinois, the ultimate consumer of the blocks.

The consumer State of Illinois sued the manufacturer Illinois Brick. The State alleged that Illinois Brick had engaged in a conspiracy to fix the price of concrete blocks. According to the complaint, the State paid more for the concrete blocks than it would have paid absent the pricefixing conspiracy. The monopoly overcharge allegedly flowed all the way down the distribution chain to the ultimate consumer, who was the State of Illinois.

This Court ruled that the State could not bring an antitrust action against Illinois Brick, the alleged violator, because the State had not purchased concrete blocks directly from Illinois Brick. The proper plaintiff to bring that claim against Illinois Brick, the Court stated, would be an entity that had purchased directly from Illinois Brick. *Ibid.*

The bright-line rule of *Illinois Brick,* as articulated in that case and as we reiterated in *UtiliCorp,* means that indirect purchasers who are two or more steps removed from the antitrust violator in a distribution chain may not sue. By contrast, direct purchasers—that is, those who are "the immediate buyers from the alleged antitrust violators"—may sue. *UtiliCorp,* 497 U.S. at 207.

For example, if manufacturer A sells to retailer B, and retailer B sells to consumer C, then C may not sue A. But B may sue A if A is an antitrust violator. And C may sue B if B is an antitrust violator. That is the straightforward rule of *Illinois Brick.* See *Loeb Industries, Inc. v. Sumitomo Corp.,* 306 F.3d 469, 481-482 (C.A.7 2002) (Wood, J.).

In this case, unlike in *Illinois Brick,* the iPhone owners are not consumers at the bottom of a vertical distribution chain who are

attempting to sue manufacturers at the top of the chain. There is no intermediary in the distribution chain between Apple and the consumer. The iPhone owners purchase apps directly from the retailer Apple, who is the alleged antitrust violator. The iPhone owners pay the alleged overcharge directly to Apple. The absence of an intermediary is dispositive. Under *Illinois Brick,* the iPhone owners are direct purchasers from Apple and are proper plaintiffs to maintain this antitrust suit.

B.

All of that seems simple enough. But Apple argues strenuously against that seemingly simple conclusion, and we address its arguments carefully. For this kind of retailer case, Apple's theory is that *Illinois Brick* allows consumers to sue only the party who sets the retail price, whether or not that party sells the good or service directly to the complaining party. Apple says that its theory accords with the economics of the transaction. Here, Apple argues that the app developers, not Apple, set the retail price charged to consumers, which according to Apple means that the consumers may not sue Apple.

We see three main problems with Apple's "who sets the price" theory.

First, Apple's theory contradicts statutory text and precedent. As we explained above, the text of § 4 broadly affords injured parties a right to sue under the antitrust laws. And our precedent in *Illinois Brick* established a bright-line rule where direct purchasers such as the consumers here may sue antitrust violators from whom they purchased a good or service. *Illinois Brick,* as we read the opinion, was not based on an economic theory about who set the price. Rather, *Illinois Brick* sought to ensure an effective and efficient litigation scheme in antitrust cases. To do so, the Court drew a bright line that allowed direct purchasers to sue but barred indirect purchasers from suing. When there is no intermediary between the purchaser and the antitrust violator, the purchaser may sue. * * * Apple's theory would require us to rewrite the rationale of *Illinois Brick* and to gut the longstanding bright-line rule.

To the extent that *Illinois Brick* leaves any ambiguity about whether a direct purchaser may sue an antitrust violator, we should resolve that ambiguity in the direction of the statutory text. And under the text, direct purchasers from monopolistic retailers are proper plaintiffs to sue those retailers.

Second, in addition to deviating from statutory text and precedent, Apple's proposed rule is not persuasive economically or legally. Apple's effort to transform *Illinois Brick* from a direct-

purchaser rule to a "who sets the price" rule would draw an arbitrary and unprincipled line among retailers based on retailers' financial arrangements with their manufacturers or suppliers.

In the retail context, the price charged by a retailer to a consumer is often a result (at least in part) of the price charged by the manufacturer or supplier to the retailer, or of negotiations between the manufacturer or supplier and the retailer. Those agreements between manufacturer or supplier and retailer may take myriad forms, including for example a markup pricing model or a commission pricing model. In a traditional markup pricing model, a hypothetical monopolistic retailer might pay $ 6 to the manufacturer and then sell the product for $ 10, keeping $ 4 for itself. In a commission pricing model, the retailer might pay nothing to the manufacturer; agree with the manufacturer that the retailer will sell the product for $ 10 and keep 40 percent of the sales price; and then sell the product for $ 10, send $ 6 back to the manufacturer, and keep $ 4. In those two different pricing scenarios, everything turns out to be economically the same for the manufacturer, retailer, and consumer.

Yet Apple's proposed rule would allow a consumer to sue the monopolistic retailer in the former situation but not the latter. In other words, under Apple's rule a consumer could sue a monopolistic retailer when the retailer set the retail price by marking up the price it had paid the manufacturer or supplier for the good or service. But a consumer could not sue a monopolistic retailer when the manufacturer or supplier set the retail price and the retailer took a commission on each sale.

Apple's line-drawing does not make a lot of sense, other than as a way to gerrymander Apple out of this and similar lawsuits. In particular, we fail to see why the form of the upstream arrangement between the manufacturer or supplier and the retailer should determine whether a monopolistic retailer can be sued by a downstream consumer who has purchased a good or service directly from the retailer and has paid a higher-than-competitive price because of the retailer's unlawful monopolistic conduct. As the Court of Appeals aptly stated, "the distinction between a markup and a commission is immaterial." 846 F. 3d at 324. * * * If a retailer has engaged in unlawful monopolistic conduct that has caused consumers to pay higher-than-competitive prices, it does not matter how the retailer structured its relationship with an upstream manufacturer or supplier—whether, for example, the retailer employed a markup or kept a commission.

To be sure, if the monopolistic retailer's conduct has not caused the consumer to pay a higher-than-competitive price, then the plaintiff's damages will be zero. Here, for example, if the competitive commission rate were 10 percent rather than 30 percent but Apple could prove that app developers in a 10 percent commission system would always set a higher price such that consumers would pay the same retail price regardless of whether Apple's commission was 10 percent or 30 percent, then the consumers' damages would presumably be zero. But we cannot assume in all cases—as Apple would necessarily have us do—that a monopolistic retailer who keeps a commission does not ever cause the consumer to pay a higher-than-competitive price. We find no persuasive legal or economic basis for such a blanket assertion.

In short, we do not understand the relevance of the upstream market structure in deciding whether a downstream consumer may sue a monopolistic retailer. Apple's rule would elevate form (what is the precise arrangement between manufacturers or suppliers and retailers?) over substance (is the consumer paying a higher price because of the monopolistic retailer's actions?). If the retailer's unlawful monopolistic conduct caused a consumer to pay the retailer a higher-than-competitive price, the consumer is entitled to sue the retailer under the antitrust laws.

Third, if accepted, Apple's theory would provide a roadmap for monopolistic retailers to structure transactions with manufacturers or suppliers so as to evade antitrust claims by consumers and thereby thwart effective antitrust enforcement.

Consider a traditional supplier-retailer relationship, in which the retailer purchases a product from the supplier and sells the product with a markup to consumers. Under Apple's proposed rule, a retailer, instead of buying the product from the supplier, could arrange to sell the product for the supplier without purchasing it from the supplier. In other words, rather than paying the supplier a certain price for the product and then marking up the price to sell the product to consumers, the retailer could collect the price of the product from consumers and remit only a fraction of that price to the supplier.

That restructuring would allow a monopolistic retailer to insulate itself from antitrust suits by consumers, even in situations where a monopolistic retailer is using its monopoly to charge higher-than-competitive prices to consumers. We decline to green-light monopolistic retailers to exploit their market position in that way. We refuse to rubber-stamp such a blatant evasion of statutory text and judicial precedent.

In sum, Apple's theory would disregard statutory text and precedent, create an unprincipled and economically senseless distinction among monopolistic retailers, and furnish monopolistic retailers with a how-to guide for evasion of the antitrust laws.

C.

In arguing that the Court should transform the direct-purchaser rule into a "who sets the price" rule, Apple insists that the three reasons that the Court identified in *Illinois Brick* for adopting the direct-purchaser rule apply to this case—even though the consumers here (unlike in *Illinois Brick*) were direct purchasers from the alleged monopolist. The *Illinois Brick* Court listed three reasons for barring indirect-purchaser suits: (1) facilitating more effective enforcement of antitrust laws; (2) avoiding complicated damages calculations; and (3) eliminating duplicative damages against antitrust defendants.

As we said in *UtiliCorp,* however, the bright-line rule of *Illinois Brick* means that there is no reason to ask whether the rationales of *Illinois Brick* "apply with equal force" in every individual case. 497 U.S. at 216. We should not engage in "an unwarranted and counterproductive exercise to litigate a series of exceptions." *Id.,* at 217.

But even if we engage with this argument, we conclude that the three *Illinois Brick* rationales—whether considered individually or together—cut strongly in the plaintiffs' favor here, not Apple's.

First, Apple argues that barring the iPhone owners from suing Apple will better promote effective enforcement of the antitrust laws. Apple posits that allowing only the upstream app developers—and not the downstream consumers—to sue Apple would mean more effective enforcement of the antitrust laws. We do not agree. Leaving consumers at the mercy of monopolistic retailers simply because upstream suppliers could *also* sue the retailers makes little sense and would directly contradict the longstanding goal of effective private enforcement and consumer protection in antitrust cases.

Second, Apple warns that calculating the damages in successful consumer antitrust suits against monopolistic retailers might be complicated. It is true that it may be hard to determine what the retailer would have charged in a competitive market. Expert testimony will often be necessary. But that is hardly unusual in antitrust cases. *Illinois Brick* is not a get-out-of-court-free card for monopolistic retailers to play any time that a damages calculation might be complicated. *Illinois Brick* surely did not wipe out consumer antitrust suits against monopolistic retailers from whom the

consumers purchased goods or services at higher-than-competitive prices. Moreover, the damages calculation may be just as complicated in a retailer markup case as it is in a retailer commission case. Yet Apple apparently accepts consumers suing monopolistic retailers in a retailer markup case. If Apple accepts that kind of suit, then Apple should also accept consumers suing monopolistic retailers in a retailer commission case.

Third, Apple claims that allowing consumers to sue will result in "conflicting claims to a common fund—the amount of the alleged overcharge." *Illinois Brick,* 431 U.S. at 737. Apple is incorrect. This is not a case where multiple parties at different levels of a distribution chain are trying to all recover the same passed-through overcharge initially levied by the manufacturer at the top of the chain. If the iPhone owners prevail, they will be entitled to the *full amount* of the unlawful overcharge that they paid to Apple. The overcharge has not been passed on by anyone to anyone. Unlike in *Illinois Brick,* there will be no need to "trace the effect of the overcharge through each step in the distribution chain." 431 U.S. at 741.

It is true that Apple's alleged anticompetitive conduct may leave Apple subject to multiple suits by different plaintiffs. But *Illinois Brick* did not purport to bar multiple liability that is unrelated to passing an overcharge down a chain of distribution. * * * Multiple suits are not atypical when the intermediary in a distribution chain is a bottleneck monopolist or monopsonist (or both) between the manufacturer on the one end and the consumer on the other end. A retailer who is both a monopolist and a monopsonist may be liable to different classes of plaintiffs—both to downstream consumers and to upstream suppliers—when the retailer's unlawful conduct affects both the downstream and upstream markets.

Here, some downstream iPhone consumers have sued Apple on a monopoly theory. And it could be that some upstream app developers will also sue Apple on a monopsony theory. In this instance, the two suits would rely on fundamentally different theories of harm and would not assert dueling claims to a "common fund," as that term was used in *Illinois Brick.* The consumers seek damages based on the difference between the price they paid and the competitive price. The app developers would seek lost profits that they could have earned in a competitive retail market. *Illinois Brick* does not bar either category of suit.

In short, the three *Illinois Brick* rationales do not persuade us to remake *Illinois Brick* and to bar direct-purchaser suits against monopolistic retailers who employ commissions rather than markups.

The plaintiffs seek to hold retailers to account if the retailers engage in unlawful anticompetitive conduct that harms consumers who purchase from those retailers. That is why we have antitrust law.

* * *

* * * The consumers here purchased apps directly from Apple, and they allege that Apple used its monopoly power over the retail apps market to charge higher-than-competitive prices. Our decision in *Illinois Brick* does not bar the consumers from suing Apple for Apple's allegedly monopolistic conduct. We affirm the judgment of the U.S. Court of Appeals for the Ninth Circuit.

It is so ordered.

Justice GORSUCH, with whom THE CHIEF JUSTICE, Justice THOMAS, and Justice ALITO join, dissenting: More than 40 years ago, in *Illinois Brick Co. v. Illinois,* 431 U.S. 720 (1977), this Court held that an antitrust plaintiff can't sue a defendant for overcharging *someone else* who might (or might not) have passed on all (or some) of the overcharge to him. *Illinois Brick* held that these convoluted 1526*1526 "pass on" theories of damages violate traditional principles of proximate causation and that the right plaintiff to bring suit is the one on whom the overcharge immediately and surely fell. Yet today the Court lets a pass-on case proceed. It does so by recasting *Illinois Brick* as a rule forbidding only suits where the plaintiff does not contract directly with the defendant. This replaces a rule of proximate cause and economic reality with an easily manipulated and formalistic rule of contractual privity. That's not how antitrust law is supposed to work, and it's an uncharitable way of treating a precedent which—whatever its flaws—is far more sensible than the rule the Court installs in its place.

II.

* * * The lawsuit before us depends on just the sort of pass-on theory that *Illinois Brick* forbids. The plaintiffs bought apps from third-party app developers (or manufacturers) in Apple's retail Internet App Store, at prices set by the developers. The lawsuit alleges that Apple is a monopolist retailer and that the 30% commission it 1528*1528 charges developers for the right to sell through its platform represents an anticompetitive price. The problem is that the 30% commission falls initially on the developers. So if the commission is in fact a monopolistic overcharge, the *developers* are the parties who are directly injured by it. Plaintiffs can be injured *only* if the developers are able and choose to pass on the overcharge to them in the form of higher app prices that the developers alone control. Plaintiffs admitted as much in the district court, where they described their theory of

injury this way: "[I]f Apple tells the developer ... we're going to take this 30 percent commission ... what's the developer going to do? The developer is going to increase its price to cover Apple's... demanded profit." App. 143.

Because this is *exactly* the kind of "pass-on theory" *Illinois Brick* rejected, it should come as no surprise that the concerns animating that decision are also implicated. Like other pass-on theories, plaintiffs' theory will necessitate a complex inquiry into how Apple's conduct affected third-party pricing decisions. And it will raise difficult questions about apportionment of damages between app developers and their customers, along with the risk of duplicative damages awards. If anything, plaintiffs' claims present these difficulties even more starkly than did the claims at issue in *Illinois Brick.*

Consider first the question of causation. To determine if Apple's conduct damaged plaintiffs at all (and if so, the magnitude of their damages), a court will first have to explore whether and to what extent each individual app developer was able—and then opted—to pass on the 30% commission to its consumers in the form of higher app prices. Sorting this out, if it can be done at all, will entail wrestling with "'complicated theories'" about "how the relevant market variables would have behaved had there been no overcharge." *Illinois Brick,* 431 U.S. at 741-743. Will the court hear testimony to determine the market power of each app developer, how each set its prices, and what it might have charged consumers for apps if Apple's commission had been lower? Will the court also consider expert testimony analyzing how market factors might have influenced developers' capacity and willingness to pass on Apple's alleged monopoly overcharge? And will the court then somehow extrapolate its findings to all of the tens of thousands of developers who sold apps through the App Store at different prices and times over the course of years?

This causation inquiry will be complicated further by Apple's requirement that all app prices end in $ 0.99. As plaintiffs acknowledge, this rule has caused prices for the "vast majority" of apps to "cluster" at exactly $ 0.99. Brief for Respondents 44. And a developer charging $ 0.99 for its app can't raise its price by just enough to recover the 30-cent commission. Instead, if the developer wants to pass on the commission to consumers, it has to more than double its price to $ 1.99 (doubling the commission in the process), which could significantly affect its sales. In short, because Apple's 99-cent rule creates a strong disincentive for developers to raise their prices, it makes plaintiffs' pass-on theory of injury even harder to prove. Yet the court will have

to consider all of this when determining what damages, if any, plaintiffs suffered as a result of Apple's allegedly excessive 30% commission.

Plaintiffs' claims will also necessitate "massive efforts to apportion the recovery among all potential plaintiffs that could have absorbed part of the overcharge," including both consumers and app developers. *Illinois Brick,* 431 U.S. at 737. If, as plaintiffs contend, Apple's 30% commission is a monopolistic overcharge, then the app developers have a claim against Apple to recover whatever portion of the commission they did not pass on to consumers. * * * So courts will have to divvy up the commissions Apple collected between the developers and the consumers. To do that, they'll have to figure out which party bore what portion of the overcharge in every purchase. And if the developers bring suit separately from the consumers, Apple might be at risk of duplicative damages awards totaling more than the full amount it collected in commissions. To avoid that possibility, it may turn out that the developers are necessary parties who will have to be joined in the plaintiffs' lawsuit. See Fed. Rule Civ. Proc. 19(a)(1)(B).

III.

The United States and its antitrust regulators agree with all of this, so how does the Court reach such a different conclusion? Seizing on *Illinois Brick*'s use of the shorthand phrase "direct purchasers" to describe the parties immediately injured by the monopoly overcharge in that case, the Court (re)characterizes *Illinois Brick* as a rule that anyone who purchases goods directly from an alleged antitrust violator can sue, while anyone who doesn't, can't. Under this revisionist version of *Illinois Brick,* the dispositive question becomes whether an "intermediary in the distribution chain" stands between the plaintiff and the defendant. And because the plaintiff app purchasers in this case happen to have purchased apps directly from Apple, the Court reasons, they may sue.

This exalts form over substance. Instead of focusing on the traditional proximate cause question where the alleged overcharge is first (and thus surely) felt, the Court's test turns on who happens to be in privity of contract with whom. * * * To evade the Court's test, all Apple must do is amend its contracts. Instead of collecting payments for apps sold in the App Store and remitting the balance (less its commission) to developers, Apple can simply specify that consumers' payments will flow the other way: directly to the developers, who will then remit commissions to Apple. No antitrust reason exists to treat

these contractual arrangements differently, and doing so will only induce firms to abandon their preferred—and presumably more efficient—distribution arrangements in favor of less efficient ones, all so they might avoid an arbitrary legal rule.

Nor does *Illinois Brick* come close to endorsing such a blind formalism. Yes, as the Court notes, the plaintiff in *Illinois Brick* did contract directly with an intermediary rather than with the putative antitrust violator. But *Illinois Brick*'s rejection of pass-on claims, and its explanation of the difficulties those claims present, had nothing to do with privity of contract. Instead and as we have seen, its rule and reasoning grew from the "general tendency of the law ... not to go beyond" the party that first felt the sting of the alleged overcharge, and from the complications that can arise when courts attempt to discern whether and to what degree damages were passed on to others. The Court today risks replacing a cogent rule about proximate cause with a pointless and easily evaded imposter. We do not usually read our own precedents so uncharitably.

Maybe the Court proceeds as it does today because it just disagrees with *Illinois Brick.* After all, the Court not only displaces a sensible rule in favor of a senseless one; it also proceeds to question each of *Illinois Brick*'s rationales—doubting that those directly injured are always the best plaintiffs to bring suit, that calculating damages for pass-on plaintiffs will often be unduly complicated, and that conflicting claims to a common fund justify limiting who may sue. Court even tells us that any "ambiguity" about the permissibility of pass-on damages should be resolved "in the direction of the statutory text," ignoring that *Illinois Brick* followed the well-trodden path of construing the statutory text in light of background common law principles of proximate cause. Last but not least, the Court suggests that the traditional understanding of *Illinois Brick* leads to "arbitrary and unprincipled" results. It asks us to consider two hypothetical scenarios that, it says, prove the point. The first is a "markup" scenario in which a monopolistic retailer buys a product from a manufacturer for $ 6 and then decides to sell the product to a consumer for $ 10, applying a supracompetitive $ 4 markup. The second is a "commission" scenario in which a manufacturer directs a monopolistic retailer to sell the manufacturer's product to a consumer for $ 10 and the retailer keeps a supracompetitive 40% commission, sending $ 6 back to the manufacturer. The two scenarios are economically the same, the Court asserts, and forbidding recovery in the second for lack of proximate cause makes no sense.

But there is nothing arbitrary or unprincipled about *Illinois Brick*'s rule or results. The notion that the causal chain must stop somewhere is an ancient and venerable one. As with most any rule of proximate cause, reasonable people can debate whether *Illinois Brick* drew exactly the right line in cutting off claims where it did. But the line it drew is intelligible, principled, administrable, and far more reasonable than the Court's artificial rule of contractual privity. Nor do the Court's hypotheticals come close to proving otherwise. In the first scenario, the markup falls initially on the consumer, so there's no doubt that the retailer's anticompetitive conduct proximately caused the consumer's injury. Meanwhile, in the second scenario the commission falls initially on the manufacturer, and the consumer won't feel the pain unless the manufacturer can and does recoup some or all of the elevated commission by raising its own prices. In *that* situation, the manufacturer is the directly injured party, and the difficulty of disaggregating damages between those directly and indirectly harmed means that the consumer can't establish proximate cause under traditional principles.

* * * Without any invitation or reason to revisit our precedent, and with so many grounds for caution, I would have thought the proper course today would have been to afford *Illinois Brick* full effect, not to begin whittling it away to a bare formalism. I respectfully dissent.

NOTES AND QUESTIONS

1. *What's the deal?* Be sure to sketch out the differences between how the majority thinks the Apple App Store works and how the dissent sees that. Do consumers buy the apps directly from Apple, or do they buy them from the app developers? Are there sales that all? Is the software licensed rather than sold? How do those arrangements affect how the case should be understood? And does the procedural posture of this case matter for how the Court should understand that?

2. *Where are the platforms?* Always pay attention to what you don't see in an opinion and here what you do not see is any discussion of two-sided markets or platforms. Given that these issues loomed large in the Supreme Court's 2018 decision in *American Express*, what accounts for the absence of those issues here? Would the Court have understood the case differently if it had been much more explicit in thinking about the app store as a two-sided market with Apple acting as an intermediary between iOS developers and iOS users? Does the analysis here meant that the Court is backing away from the aggressive approach it took to two-sided markets in *American Express*? Or are there important differences between *Amex* and *Pepper* such

that it was sensible for direct economic analysis to loom so large in *Amex* and yet be largely absent in *Pepper*?

3. *What is left of* Illinois Brick*?* Justice Gorsuch seems to think that the majority is undercutting *Illinois Brick*. *Illinois Brick* concerned a cartel in the upstream market and the question whether the resale buyers in the downstream market could recover damages. The heart of the case was about the difficulty of calculating damages in situations where we have many layers (say a manufacturer, a retailer and an ultimate consumer). Is the situation in *Pepper* different from that case? Do we think damages calculations are easier in platforms? Harder? Is Justice Gorsuch right to believe that, if the Court is willing to embrace mixed damages calculations in this context, it should be willing to do so more generally and directly overrule *Illinois Brick*? *Pepper* involved a transaction platform that sells distribution services to buyers (app developers and consumers) on both sides of the platform and is accused of illegally monopolizing the distribution market. Is *Illinois Brick* even relevant to *Pepper*?