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Vertical Restraints Guidelines: A Step Forward

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VERTICAL RESTRAINTS GUIDELINES : A STEP FORWARD; Analysis and Perspective; Antitrust

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Body

Analysis and Perspective

Antitrust

The Department of Justice's Antitrust Division may not be Sidney Sheldon or John D. McDonald, but it has become almost prolific in its issuance of *guidelines* of various kinds. The 1968 merger *guidelines* were first, but then came the 1977 antitrust guide for international operations, the 1980 antitrust guide concerning research and joint ventures, the 1982 Baxter merger *guidelines*, and the 1984 McGrath revision of the 1982 merger *guidelines*.

Now comes the 1985 *vertical restraints guidelines*.¹ Like its predecessors, this document sets forth the law as the Antitrust Division wishes it were. Of course, all these efforts are couched in terms of statements of enforcement policy, in large part because anything else would be viewed by some as officious meddling. Those who want just cop on the beat antitrust enforcement aren't too thrilled by any type of *guidelines*, but it is difficult to argue with a simple statement of enforcement policy.

The 1985 *vertical restraints guidelines* differ in at least one central respect from all of its predecessors: We doubt that the department has ever analyzed a single *vertical restraint* using the precise methodology set forth in these *guidelines*. Certainly it has never filed a complaint after engaging in this reasoning process. In this respect, the *guidelines* are more a statement of future intentions than a picture of present practice.

This is not necessarily a failing; it is simply a recognition that the Department of Justice has not really been in the *vertical restraints* enforcement business for a decade or so.² There have probably not been enough *vertical restraints* analyzed in the department over the past decade to show even a general pattern of analysis, much less the crisp and precise pattern set forth in these *guidelines*. The Antitrust Division just hasn't been in this business since Tom Kauper's tenure (1972-76).

There is one other difference between these *guidelines* and their predecessors, although it is not so clearly drawn: These *guidelines* do not really set forth the legal analysis as the department **really** believes it should be. Instead, the department pulls its punches in at least two areas--*vertical price restraints* and tying--in which the case law is most clearly inconsistent with its preferred analysis. Other sets of *guidelines* have suffered from this flaw (if that is what it is)--maybe all the others--but it seems more stark here, perhaps because the analytical compromises required are so basic. Again, this is not necessarily a failing; the *guidelines* may ultimately be more influential because of the decision to compromise on principle.

The *guidelines* are, in many respects, direct descendants of three Supreme Court opinions. In **Continental T.V. Inc. v. GTE Sylvania, Inc.**,³ the Court recognized that non-price *vertical restraints* were not universally (and perhaps not generally)

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anti-competitive, and accordingly held that they should be examined under the rule of reason, throwing out the 10-year-old Schwinn per se rule. But the Court also held that vertical price restraints should continue to be per se illegal, without setting forth any plausible analytical reason for the distinction.

In **Monsanto Co. v. Spray-Rite Service Corp.**,⁴ the Court decided-- sort of--that dealer complaints were not sufficient to turn a unilateral vertical decision into a collusive, horizontal violation. While **Monsanto** avoided the opportunity to really clarify the legal rules in this area, it did continue the trend toward a more careful analytical approach to an area that in the past had been best characterized as analysis by anecdote.

Finally, in **Jefferson Parish Hospital District No. 2 v. Hyde**,⁵ the Court refused to discard the per se label for tying arrangements, but held that the per se conclusion is appropriate only under carefully specified circumstances and only if a number of prerequisites are met. In all other cases, tying arrangements will be examined under the rule of reason.

It is this recent Supreme Court attention and the growing economic sophistication that prompted and supported this attention that form the backdrop for the issuance of the guidelines--the excuse, if you will, for an attempt to solidify the gains of the past seven years and perhaps synthesize a set of workable principles from a somewhat ambiguous trio of Supreme Court opinions.

In a press release accompanying the guidelines, Assistant Attorney General J. Paul McGrath stated that the guidelines neither intend to change the law in any way nor represent any change in the enforcement policy of the Antitrust Division. This pronouncement can be taken with the appropriate grain of salt, recognizing the political imperatives at work here. He also said--and this can be taken at face value--that he hoped the guidelines would have the effect of promoting business certainty, especially since they attempt to establish safe harbors for the use of many vertical restraints. Vertical restraints not screened out by the safe harbors would continue to be subject to rule-of-reason analysis, but the articulation of the safe harbors was clearly the primary short-term goal of the guidelines.

What McGrath did not say--but is nevertheless perfectly clear--is that the long-term goal of the guidelines is to direct the analytical process used by lawyers and courts in these situations along a particular line. In this respect, the guidelines are part of a long tradition of the Antitrust Division: to advocate competition as it sees it before all possible fora--the executive branch, the administrative agencies, the Congress, the courts, and the private bar.

The basic plan of the guidelines is (1) to characterize the restraint in question as vertical or horizontal, and as price or non-price; (2) to explain many of the pro-competitive and anti-competitive effects of vertical restraints; (3) to use a market-structure screen to quickly eliminate as sources of antitrust concern many uses of vertical restraints that are unlikely to have anti-competitive consequences (this section screens out firms with less than a 10 percent market share, markets in which less than 60 percent of the sales are by firms using the restraint, and industries scoring low on the newly introduced Vertical Restraints Index (VRI), described infra); (4) to employ a rule-of-reason analysis for the remaining cases, noting in particular that industries in which entry is easy and firms that are new entrants cannot pose significant antitrust problems; and (5) to set forth a similar rule-of-thumb process for analyzing tying arrangements.

Characterization of the Restraints

The guidelines first attempt to characterize the restraints in question as horizontal or vertical. They state that since restraints between a single manufacturer and its dealers--intra-brand restraints--generally lack a significant anti-competitive potential, they should usually be presumed legal. By contrast, restraints involving more than one manufacturer's products--restraints that could have horizontal effects--should be subject to more careful scrutiny.⁶

Although this section seems careful not to take this dichotomy to its logical conclusion, it comes very close to characterizing virtually all non-price vertical restraints as intra-brand and therefore legal, except when there is proof that they involve or facilitate cartelization or monopolization. At a minimum, the guidelines suggest that any vertical restraint not involving cartelization or monopolization should be presumptively lawful, and any attempt to attack such a restraint should carry a high burden of showing likely anticompetitive impact.

The guidelines also note that since all vertical restraints--including those with substantial pro-competitive benefits--may have some effect on price, one should be cautious before describing a restraint as a per se illegal price restraint. Indeed,

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the guidelines state that the department will not characterize a practice as a price restraint unless it finds direct or circumstantial evidence of an explicit agreement between a supplier and its distributors as to the specific prices at which goods or services would be resold. If a manufacturer employs both non-price and price restraints, the Department will analyze the entire program under the rule of reason if the nonprice restraints are plausibly designed to create efficiencies and if the price restraint is merely ancillary to the nonprice restraints.

Since the department has chosen not to directly challenge **Sylvania** and **Monsanto**, it thus attempts to draw the price/non-price distinction in a way that classifies as much as possible as non-price. Of course, the guidelines' rationale applies equally to price restraints, but the department has decided to accept a limited amount of intellectual inconsistency in the hope of increasing the influence of its basic analytical approach. It seems a good trade.

In another area in which there has been great confusion, the guidelines state that situations involving dual distribution--when a manufacturer sells to final customers both directly and through independent dealers--should be characterized as vertical rather than horizontal. They also note that the guidelines do not apply to restrictions on licenses of intellectual property (e.g., patents, copyrights, trade secrets, and know-how). Except under very limited circumstances, such as when the vertical restraints are used to coordinate a cartel among owners of competing intellectual property, such restrictions will not be challenged.

This section of the guidelines concludes by noting that many vertical restraints are always or virtually always legal under the current case law.⁷ The guidelines stress that such practices should continue to be legal and that nothing in the guidelines is intended to cast any doubt on their legality.

This introductory characterization section of the guidelines is potentially its most important. If these guidelines are to have real long-term impact, in large part it will be because of the intellectual influence of this initial discussion of characterization and of the section immediately following, which discusses the pro-competitive and anti-competitive uses of vertical restraints.

Pro-Competitive and Anti-Competitive Effects of Vertical Restraints

The guidelines present a number of possible pro-competitive effects of vertical restraints. For example, vertical restraints that limit the number of outlets can lower distribution costs by enabling each distributor to obtain economies of scale. Vertical restraints can facilitate the entry of a new producer into a market by enabling distributors to recover market development costs. Vertical restraints can be the most efficient method of ensuring the provision of presale demonstration and other informational services that are necessary for the effective marketing of a product.

In the absence of vertical restraints, a dealer may invest too little in such services because other dealers, who do not provide the services, may be able to free ride on the efforts of the full-service dealer. Vertical restraints can reduce the free-riding problem. Similarly, without certain vertical restraints, suppliers may be able to free ride on the promotional and other efforts of their rivals. Finally, vertical restraints may permit firms to optimally allocate risk or costs, or reduce the transaction costs of distributing their products.

The guidelines then go on to concede that vertical restraints could also be used for anti-competitive purposes. Under certain circumstances they can facilitate dealers' cartels⁸ or suppliers' cartels.⁹ Vertical restraints could also have the effect of excluding rivals by prohibitively raising either their cost of a vital input or their costs of distribution.¹⁰

Thus, the department makes clear that its ultimate concern is horizontal effects: It is primarily concerned with cartelization or with practices that would facilitate collusion. To a much lesser extent, it is also concerned that single-firm market power could be used for exclusionary purposes. Although the guidelines on occasion stray from these themes,¹¹ this is the intellectual underpinning of the document. In creating this framework, the department (with valuable help from a number of people)¹² innovatively integrated an impressive amount of new thinking and experience in the area. This is a document that quite simply could not have been written in either 1968 or 1978. We have learned a great deal about these practices (and their economic rationale and impact) in recent years, and a major contribution of the guidelines is the recognition that at a minimum, we are sure that we know enough to screen out certain categories of vertical restraints cases. In this respect,

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the guidelines are but one more nail in the coffin of antitrust as a set of business equal opportunity regulations, in which egalitarian result was more important than economic efficiency.

This cartelization and monopolization notion is slowly permeating the whole of antitrust enforcement theory. Nevertheless, most public figures or institutions--including the department--are not quite ready to boldly state it, at least as a statement of enforcement policy. The guidelines instead suggest it indirectly--not starkly--since to do the latter would be tantamount to saying that all vertical restraints should be per se legal (although we should of course continue to worry about cartelization and monopolization).¹³ Still, while framed in language that seems to fit within the traditional Sherman Act vocabulary, the analytical approach set forth would generate very similar results to a more theoretical, efficiency-based analysis. This is not pragmatism over principle, but rather a lawyer's best judgment of the optimal advocacy approach. Like the Supreme Court in Hyde, the department seems one vote away from wholesale articulation of efficiency considerations as the sole rationale for antitrust.

Structural Prerequisites for Anti-Competitive Effects

While the language is careful, the rules set forth are radical by contrast with antitrust tradition. The guidelines state that anti-competitive uses of vertical restraints are relatively rare, and correctly note that they can occur only under very limited circumstances. The firms and markets in question must have certain characteristics before vertical restraints can be used either to facilitate anti-competitive collusion¹⁴ or exclusion.¹⁵ First, the firm in question should not be unduly small, since it is unlikely that the use of vertical restraints by small firms can be anti-competitive.¹⁶

Second, if a market is relatively unconcentrated, it is unlikely that firms in it can use vertical restraints in an anti-competitive manner. And third, unless most firms in an industry use the restraints, the ones that do use them are unlikely to be able to use them in an anti-competitive manner.¹⁷ After setting forth these characteristics to describe the markets in which the department may or will not have a concern, the guidelines develop structural safe harbors to screen out many of those cases whose anti-competitive potential is minimal.

Step One: The Market Structure Safe Harbors

The department will first take a quick look to eliminate some of those structural situations in which anti-competitive effects are highly unlikely.¹⁸ Uses of vertical restraints not screened out will be examined more closely by the department. The guidelines stress, however, that a restraint is not suspect merely because it is not screened out during this initial examination.¹⁹

Accordingly, the guidelines state that the department will not challenge a non-price, non-tying vertical restraint if:

- (1) the firm employing the restraint has a share of the relevant market of 10 percent or less; or
- (2) the VRI [defined as the sum of the squares of the market shares of each firm at the same level of operations in the market that uses the vertical restraint] is under 1,200²⁰ and the coverage ratio²¹ is below 60 percent in the same (e.g., supplier or dealer) relevant market; or
- (3) the VRI is under 1,200 in both relevant markets; or
- (4) the coverage ratio is below 60 percent in both relevant markets.²²

If any one of these four tests is satisfied, the department will not challenge the use of the restraint in question.²³ As the explanations in 3, supra, demonstrate, only if none of these four possibilities occurs is there any significant probability that the restraint even merits close attention.²⁴ These four tests should allow many (perhaps most) non-price vertical restraints to be characterized as either benign or pro-competitive, and therefore safe from antitrust scrutiny.

The information available to a firm will suggest which safe harbor(s) it should examine to see whether it will be screened out. For example, since firms are most likely to know their own market share, the 10 percent screen will be widely relied

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on. The coverage ratio screen will also prove very useful. The VRI screens, by contrast, seem unnecessary and are likely to cause undue confusion. A VRI of 1,200 is very similar to an HHI of 1,800 and a coverage ratio of 60 percent.

There is no apparent advantage to introducing a confusing new term when the by-now familiar HHI and the coverage ratio would have done just as well. Still, one should not lose sight of the primary effect of the structural safe harbors: If adopted by the courts, they would allow a great many innocuous cases to be eliminated quickly and cheaply, and would provide many businesses with considerable certainty as to the legality of many of their practices. In fact, the safe harbors will probably prove to be the most beneficial portion of the guidelines,²⁵ at least in the short run. If the very rapid acceptance of the 1982 (and now 1984) merger guidelines is any sign, the vertical safe harbors may become standard analysis in short order.

Step Two: A Rule-of-Reason Analysis

For those vertical restraints not eliminated from scrutiny under Step One, the department will employ what it terms a structured rule of reason analysis.²⁶ The guidelines emphasize, however, that the mere fact that a restraint is not screened out in Step One in no way creates a presumption that the restraint is anti-competitive. In fact, very few of the restraints examined in Step Two will be found to be anti-competitive under the standards articulated in the guidelines.

The overriding purpose of Step Two is to determine whether the restraint significantly enhances the possibility of collusion or monopoly through exclusion. Although in this step the department will examine a lengthy list of factors to see whether either of these possibilities is likely, it will employ two relatively discrete tests to screen out additional cases that have little or no anticompetitive potential. The first is an exception for industries with low barriers to entry.²⁷ The second is for firms that have entered a market recently (e.g., within the past two years).²⁸

These two additional exceptions should prove extremely useful. If an industry has low barriers to entry, we should not worry very much about collusion or monopolization with it. And recent research suggests that while new entrants are unlikely to be cartel members or monopolists, they often use vertical restraints to persuade dealers to carry and promote their products--a pro-competitive purpose.²⁹ The use of a clear time period--a firm can use the restraints for at least two years--should substantially increase business certainty.³⁰

Thus, as noted earlier, many vertical restraints will be screened out by the structural safe harbors in Step One. Others will be eliminated by the entry barrier or new entrant safe harbors. The department will, however, conduct an extremely broad rule-of-reason analysis of the remaining vertical restraints.

The inquiry will start by defining the relevant product and geographic market(s), using the principles set forth in the merger guidelines. The department will then ask virtually every potentially relevant question in its study of the remaining non-price, non-tying vertical restraints, including: (1) How high is the VRI and the coverage ratio?³¹ (2) Are conditions in the relevant markets conducive to collusion?³² (3) How exclusionary is the restraint? (4) What is the intent of the parties? (5) Can the firm or firms engaging in the restraint identify credible pro-competitive efficiencies from the practice?³³

As this list suggests, any restraints examined in Step 2 will be the subject of a complete rule-of-reason analysis, with only general guidance as to how that analysis should be resolved.

Like the other vertical restrains,³⁴ tying arrangements³⁵ often have pro-competitive³⁶ or competitively neutral purposes.³⁷ And, although the guidelines state that anti-competitive effects from tying are rare, they can occur.³⁸

Relying heavily on **Jefferson Parish Hospital District No. 2 v. Hyde** and also on the fact that the anti-competitive scenarios described in the guidelines require market power over the tying product, the department sets forth the following enforcement policy:

The use of tying will not be challenged if the party imposing the tie has a market share of thirty percent or less in the market for the tying product. This presumption can be overcome only by a showing that the tying agreement unreasonably restrained competition in the market for the tied product.

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In cases involving market shares of less than 30 percent, the department will rarely find it necessary even to examine the arrangement. If the market share is more than 30 percent, the Department will attempt to determine whether the seller has dominant market power [drawing this term from **Hyde**]. Where the seller has dominant power, and the other factors necessary to find a per se violation are present, a tie will be considered per se illegal.³⁹ Finally, for those situations in which the firm's market share exceeds 30 percent but the firm is nevertheless not dominant (a term the guidelines define as possessing market power that approaches monopoly proportions), the department will employ a rule-of-reason analysis and challenge only those ties that on balance unreasonably restrain competition in the tied product market.

This is the most unsatisfactory portion of the guidelines. Even the specific language is puzzling. The guidelines present a number of pro-competitive uses of tying, show how even monopolies can use tying in ways that benefit consumer welfare, and stress that tying is usually pro-competitive. They then say that it has been posited that tying could be used for one specified anticompetitive purpose, but that even this situation is really an exclusive dealing or vertical integration problem.⁴⁰

The guidelines then point to **Hyde** as requiring the conclusion that when a dominant firm is involved, tying will be considered per se illegal. There is no effort to explain or reject the Hyde majority's analysis--although the former would be difficult given the department's efficiency orientation, and the latter may be thought inappropriate. Certainly the guidelines reflect a philosophy closer to the concurrence in **Hyde**, but until the fifth vote is found for that view, even the Department of Justice seems reconciled to the artificiality of a per se rule that can be applied only after a rule-of-reason analysis.

It is also difficult to understand why the department felt compelled to treat tying separately from other vertical restraints. While the guidelines realistically had to defer to the recent Hyde opinion, the guidelines' overall framework easily could have accommodated the Court's concern with single-firm dominance. The basic theme of the guidelines is that we always have only two possible types of concerns with vertical restraints--cartelization and monopolization. This message could have been presented more clearly if the guidelines had stressed that it made no functional difference into which nonprice vertical restraint pigeonhole the restraint in question was classified--the concern is only cartelization or monopolization.

Now we will often have a very difficult, formalistic, and important characterization problem in order to know whether a given vertical restraint is actually tying--or, for example, exclusive dealing⁴¹--when our actual concerns with these practices are identical.

The past 20 years have witnessed two conflicting antitrust trends--both toward and away from bright lines. Twenty years ago, horizontal mergers were--and we admit to some exaggeration--virtually per se illegal, as were price fixing, tying, resale price maintenance, and (for a while) non-price vertical restraints.

The situation is now very different in each of these areas--nothing is always per se illegal, since **BMI**⁴² tells us that we have to perform some analysis before we place even horizontal price fixing into the per se illegal box.

Running counter to this overall trend has been the very welcome issuance of antitrust guidelines. All of these guidelines are at their best when they carve out pockets of clarity from the rule-of-reason chaos that permeates most of antitrust.

The 1985 vertical restraints guidelines will probably come to be viewed similarly to the 1968 merger guidelines--flawed in some technical respects, too timid in others, crude, and rough, but nevertheless about as good as could be written given the state of knowledge in the area. Notwithstanding the weaknesses described above, they are a very definite step forward.

1. See 48 Antitrust & Trade Regulation Report 1199 (1985) (special supplement).
2. By contrast, the Federal Trade Commission brought numerous vertical restraints cases prior to Chairman James C. Miller III's arrival in 1981.
3. 433 U.S. 36 (1977).
4. 104 S. Ct. 1464 (1984).

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5. 104 S. Ct. 1551 (1984).

6. This distinction appears to have come from Liebler, *Intrabrand Cartels' Under GTE Sylvania*, 30 U.C.L.A. L. Rev. (1982).

7. For example, manufacturers may lawfully select their dealers, and a mere refusal to sell through other dealers is proper. Most arrangements whereby a manufacturer assigns areas of primary responsibility or imposes location clauses establishing or restricting the areas in which dealers can sell and most uses of profit passover arrangements whereby a dealer is required to compensate other dealers for sales made in their territories are also legal. The department's view of the case law in this area is basically correct, although some might say its case citations are a tad selective.

8. For example, the guidelines note that dealers may induce all or almost all suppliers of a product to award exclusive territories. This could facilitate collusion among dealers by limiting the number of dealers that must agree to fix prices . . . and by protecting colluding dealers within a geographic market from the threat of outside competition in response to supracompetitive prices.

9. The guidelines note that suppliers may attempt to facilitate collusion among dealers where (i) direct collusion among suppliers is impractical or more costly than collusion among dealers, and (ii) suppliers can share in the dealers' supracompetitive profits.

10. For example, one or more suppliers may require that their dealers not sell goods of competing suppliers. This would force rival suppliers either to secure alternative independent dealer outlets or to integrate forward into distribution, possibly placing them at a severe cost disadvantage. Similarly, one or more firms might enter into long-term exclusive contracts for the supply of a vital input, leaving little or no existing production of the input for new entrants or fringe firms.

11. For example, some of its language suggests a concern with the use of vertical restraints to facilitate exclusion as an end in itself, rather than as an aid to cartelization or monopolization.

12. The department asked for (and received) comments and suggestions from various public and private sources. The Federal Trade Commission (which historically has brought most of the government vertical restraints enforcement actions) has not, however, issued any statement concerning the extent to which it will follow the guidelines.

13. Thus, although the guidelines appear to all but rule out the possibility of a challenge to a purely vertical vertical restraint, except perhaps by a dominant firm in a tying case, they also seem to keep open the possibility that vertical restraints could be challenged in a facilitating practices case, perhaps under the theory that even if no collusion is present, the vertical restraints make collusion unacceptably easy.

14. The guidelines state that vertical restraints are unlikely to facilitate collusion unless three market conditions are met:

- (1) Concentration is high in the primary market;
- (2) The firms in the secondary market using the restraint account for a large portion of sales in the market; and
- (3) Entry into the primary market is difficult.

15. The guidelines state that for exclusive dealing to facilitate anticompetitive exclusion, the following market conditions normally must be met:

- (1) The nonforeclosed market is concentrated and leading firms in the market use the restraint;
- (2) The firms subject to the restraint control a large share of the foreclosed market; and
- (3) Entry into the foreclosed market is difficult.

16. Even if a relatively small firm is a member of a cartel, it is unlikely to be a major protagonist.

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17. For example, if only 40 percent of the sales in an industry are subject to vertical restraints, it is very unlikely that the restraints are being imposed to facilitate collusion with the industry.

18. This step involves determining provisional, quick-look product and geographic markets. The guidelines emphasize, however, that an in-depth market definition analysis is not necessary in Step One, since this would eliminate some of the time-saving features of this step. The department believes that there are many markets that even at glance can be well-defined, or for which-- no matter how the market is defined--the restraint should raise no question.

19. There is a potential problem, of course, that courts will merely adopt the screen and subject all those who don't escape the initial screen to a presumptively illegal or even a per se illegal type of analysis. This was obviously a matter of concern to the department, which emphasizes several times that the screen takes out only the obvious, not all vertical restraints that are not of concern.

20. (Footnote omitted and added) For example, if only two firms in a dealer market employ a restraint, one with a 5 percent and one with a 20 percent market share, the dealer market VRI equals $5^2 + 20^2 = 25 + 400 = 425$ If all firms in the relevant market use the restraint, the VRI is equal to the HHI used in merger analysis. (See merger guidelines 3). The maximum possible value of the VRI is 10,000, achieved when there is only one firm in a market and that firm employs a vertical restraint.

21. (Footnote omitted) The omitted footnote in part explains: The coverage ratio is the percent of each market involved in a restraint. For example, if 10 suppliers with 5 percent market shares each employ a restraint, the coverage ratio equals 50 percent. In practice, however, it will often be difficult to determine whether different manufacturers' vertical restraints are so similar that the department will consider them to be the same for coverage ratio and VRI purposes.

22. The coverage ratio will be significantly different at the two levels only in unusual circumstances. The VRI, however, will often be very different.

23. The guidelines caution, however, that if there is evidence that a small firm employing restraints is part of an illegal cartel among direct competitors, the Department will not hesitate to investigate its activities.

24. Moreover, the department also recognizes that a national supplier operating in a large number of local markets will be concerned about whether it satisfies the Step One screen in each individual market. If a firm is screened out in most local markets, the department will presume that its use of the restraints in the few remaining markets is likely to be pro-competitive.

25. Of course, the structural screens are bound to eliminate some anti-competitive uses of vertical restraints, and they certainly will not eliminate all of the unmeritorious cases, but this can't be helped. Guidelines, by definition, cannot be universally applicable.

26. For cases examined under Step Two, the department will undertake a complete market definition analysis, using the principles set forth in 2.1-2.3 of the merger guidelines.

27. If entry is easy in both markets, the department will conclude that the anti-competitive potential of any restraints in either market is minimal. Because there is no significant probability of successful collusion or exclusion in such markets, the restraints will not be challenged. If entry is easy at only one level, the department will conclude that the restraint is legal if (1) it is clear that exclusion is the only possible anticompetitive effect of the restraint, and entry is very easy in the foreclosed market; or (2) it is clear that collusion is the only possible anticompetitive effect of the restraint and entry is easy in the primary market.

28. It would have been clearer if the new entrant exception had been placed at the end of Step 1 or at the beginning of Step 2 instead of in the middle of the Other Factors section, since it too is a relatively clear and uncontroversially good screening device.

29. See Lafferty, Lande, and Kirkwood, Impact Evaluations of Federal Trade Commission Vertical Restraints Cases, (FTC publication) (1984). Not only will the department make the presumption that the use of vertical restraints by the new

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entrants themselves is not anti-competitive, but it will also generally assume that other firms in the market also using them are probably attempting to achieve similar efficiencies.

30. It is regrettable that the *guidelines* do not define easy entry with such clarity. Nowhere do they state, for example, that entry that can occur within two years will be considered easy. They do provide one reference to the analogous section of the 1984 merger *guidelines*, and those *guidelines* do state that a two year time period generally will be used (see merger *guidelines*, 3.3 (footnote omitted)), but this section of the *vertical restraints guidelines* can hardly be held up as a model of effective draftsmanship.

31. The higher they are, the greater the likelihood of anti-competitive effects.

32. The factors that make collusion easy or difficult are similar to those examined for the same purpose in 3.4 of the 1984 merger *guidelines*.

33. In what will no doubt be one of the less influential portions of the *guidelines*, the department states that an inability to demonstrate efficiencies will not be interpreted as proof of an anti-competitive explanation since efficiencies may be present even though firms may not know what they are. An ability to demonstrate efficiencies, however, will be taken to indicate that an anti-competitive explanation is less plausible than it would be in the absence of such an efficiency justification. This is the only time that the invisible hand of the Chicago School makes a very visible appearance in what is otherwise a carefully written document.

34. The *guidelines* do not explain how tying arrangements are to be distinguished from other *vertical restraints*. It is often very difficult, for example, to distinguish tying from exclusive dealing.

35. When a seller requires the buyer of one product to purchase a second, distinct product as a condition of purchasing the first, the first product is referred to as the tying product and the second as the tied product.

36. For example, when the manner in which purchasers use a product affects its manufacturer's reputation and future sales, the manufacturer might tie the sale of the product to a maintenance contract or to sales of approved parts, thus reducing the risk of inferior service by distributors. Tying can also redistribute risk in a pro-competitive manner.

37. Tying can be used by manufacturers to price discriminate among purchases. When the volume of purchases of a tied good differs according to the intensity of the use of the tied product (a classic, if somewhat obsolete, example is computers and computer cards), tying the two products together can allow the manufacturer to charge the heavy users more than the light users. The *guidelines* term this result competitively ambiguous or unpredictable.

38. For example, tying arrangements can in certain circumstances be used to eliminate independent suppliers of the tied product and thereby exclude rivals who produce the complementary tying product.

39. Other prerequisites also have to be met. For example, two separate products must be involved. The *guidelines* do not, however, provide a process for making this frequently difficult determination.

40. The *guidelines* explain:

It has been posited that tying arrangements may be used to eliminate independent suppliers of the tied product and thereby exclude rivals who produce the complementary tying product. The exclusionary effect in such cases flows, however, not from tying but from any exclusive dealing or *vertical* integration that accompanies the tying. In the absence of exclusive dealing requirements, the supplier of the tying product cannot deprive its rivals' customers of access to other sellers of the tied product. Thus, rival producers of the tying product will be able to compete effectively for customers with the firm employing the tie.

All this indicates, however, is that tying can be anti-competitive only if it is accompanied by exclusive dealing. It gives us no guidance at all as to when such a combination will be anti-competitive, if ever.

41. The *restraints* discussed in *Hyde* were really exclusive dealing. See also Marvel, *Vertical Restraints* In the Hearing Aids Industry, printed in Lafferty, Lande, Kirkwood, *supra* note 29. The *restraints* discussed therein could have equally well been classified as exclusive dealing or tying.

42. Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1 (1979).

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