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## The Firm as Cartel Manager

Herbert Hovenkamp

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# The Firm as Cartel Manager

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Herbert Hovenkamp  
Christopher R. Leslie

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*Antitrust law is the primary legal obstacle to price fixing, which is condemned by Section One of the Sherman Act. Section One condemns only concerted action between separate entities, not unilateral conduct by a single entity. Firms that engage in price fixing may try to reduce the risk of antitrust liability by structuring their actions to appear to be those of a unified single entity that is beyond the reach of Section One.*

*In this Article, Professors Hovenkamp and Leslie examine how price-fixing cartels govern themselves and maximize their profits by cooperating and colluding, instead of competing. They then use this cartel theory to explain the recent American Needle decision, in which the Supreme Court held that the National Football League (“NFL”) is a collaboration among its individual teams rather than a single entity. Much of the argument by those favoring single entity status for an organization such as the NFL confuses the entity question, which is essentially structural, with the question of cooperation, which is functional or behavioral. Many markets require firms to cooperate in the delivery of their product but the need to cooperate does not make the cooperating firms a single entity immune from Section One liability.*

*Despite the fact that antitrust law has condemned price-fixing cartels for over a century and the Supreme Court created the single-entity defense over twenty-five years ago, the link between cartel theory and the single-entity question remains largely unexplored. Many successful cartels function by taking control away from the individual members and giving it to a single organization. A business organization such as a corporation becomes an ideal vehicle for cartel management. Understanding how cartels actually operate can help courts distinguish between a legitimate single entity and a centralized cartel structure subject to Section One liability. This Article uses a series of case studies to illustrate how to make this distinction properly.*

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# The Firm as Cartel Manager

Herbert Hovenkamp\* & Christopher R. Leslie\*\*

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In many markets, competing firms can maximize their profits by colluding to reduce output and increase price. Fortunately, several impediments exist to successful cartelization, some practical and others legal. Practical impediments include the difficulties in getting rival firms to agree to particular price and output limits and to abide by their agreements.

Antitrust law represents the primary legal obstacle to price fixing, which is condemned by Section One of the Sherman Act.<sup>1</sup> Firms that engage in price fixing may try to reduce their probability of antitrust liability in a number of ways. First, members of a price-fixing conspiracy go to great lengths to conceal their illegal activities from antitrust enforcers. Second, because Section One condemns only concerted action, firms may attempt to structure their relationship to appear to be the action of a unified single entity that is beyond the reach of Section One.

Much of the argument for treating an organization such as the National Football League (“NFL”) as a single entity—which is legally incapable of collusion under Section One of the Sherman Act—confuses the entity question, which is essentially structural, with the cooperation question, which is functional or behavioral. Many markets require firms to cooperate in the delivery of their product, in some cases a great deal. This is true of blanket licensing of recorded music,<sup>2</sup> multiple listing services operated by real estate agencies,<sup>3</sup> and standard setting by firms in high tech industries,<sup>4</sup> and sports leagues. But cooperation does not mean these firms are single entities; the need for cooperation, or even for interconnectivity, requires application of antitrust’s more deferential rule of reason.<sup>5</sup> It does not

1. 15 U.S.C. § 1 (2006).

2. *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 15–24 (1979) (applying the rule of reason).

3. *Freeman v. San Diego Ass’n of Realtors*, 322 F.3d 1133, 1152–54 (9th Cir. 2003) (holding it per se unlawful to use the multi-list process to fix commission rates).

4. *Golden Bridge Tech., Inc. v. Motorola, Inc.*, 547 F.3d 266, 270–73 (5th Cir. 2008), *cert. denied*, 129 S. Ct. 2055 (2009) (holding that standard setting by cellular telephone companies did not equate to a restraint of trade).

5. In contrast to the per se rule, pursuant to which restraints that fall in a per se category are conclusively presumed to be unreasonable, *Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 344 (1982), in rule-of-reason cases “the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.” *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977).

require single entity treatment, however, which effectively immunizes the conduct from output reductions and price increases altogether.<sup>6</sup> The Supreme Court's *Copperweld Corp. v. Independence Tube Corp.* decision, which held that a parent and wholly owned subsidiary were a single entity, grew out of a milieu in which agreements between independent actors were often subjected to unreasonably harsh treatment under antitrust's per se rule.<sup>7</sup> For example, in the *Photovest Corp. v. Fotomat Corp.* decision, the Seventh Circuit held that a parent and its wholly owned subsidiary could be guilty of a per se unlawful conspiracy directed at the plaintiff, one of the defendant's independent franchisees.<sup>8</sup> In such a milieu, in which even purely vertical conduct was treated very critically, broad single entity findings made some sense. Today, however, courts are much less likely to apply the per se rule to anything except naked horizontal conduct. Joint ventures and purely vertical arrangements are instead evaluated under the rule of reason, where power and actual anticompetitive effects must be proven.<sup>9</sup>

In *American Needle*, the Supreme Court unanimously held that the NFL was a "combination" of its individual teams rather than a single actor for purposes of an antitrust challenge to a single exclusive licensing arrangement covering all of the teams' individual trademark rights.<sup>10</sup> The Supreme Court's decision cut through formalities of business organization to get directly to the question that is important for antitrust: When is an organization of biological persons, institutions, or other economic actors a single antitrust "person" and

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Under the rule of reason, courts take "into account a variety of factors, including specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint's history, nature, and effect." *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997).

6. See discussion *infra* notes 57, 220 and accompanying text.

7. 467 U.S. 752, 771 (1984).

8. 606 F.2d 704, 725–27 (7th Cir. 1979); *cf.* *Perma Life Mufflers, Inc. v. Int'l Parts Corp.*, 392 U.S. 134 (1968) (holding that parent and wholly owned subsidiaries could conspire to impose per se unlawful ties on dealers); *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211 (1951) (holding that two wholly owned subsidiaries of a common parent could unlawfully conspire to impose resale price maintenance on their dealers).

9. *E.g.*, *Nynex Corp. v. Discon, Inc.*, 525 U.S. 128, 132 (1998) (holding that a purely vertical agreement should be evaluated using the rule of reason); *NCAA v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85, 86 (1984) (using the rule of reason to analyze a horizontal price fixing and output limitation where the industry at issue requires horizontal restraints on competition in order to make their product available).

10. *Am. Needle, Inc. v. NFL*, 130 S. Ct. 2201, 2217 (2010).

when is it a combination? Under the Sherman Act, a “person”<sup>11</sup> acting alone commits a violation only when it “monopolizes” or seriously threatens to do so.<sup>12</sup> However two or more persons joined together into a “contract,” “combination,” or “conspiracy” can violate the statute whenever they unreasonably “restrain trade.”<sup>13</sup>

The *American Needle* decision could conceivably rest on alternative rationales for its separate entity conclusion. These are that (1) the teams are separately owned profit centers capable of competing with each other; (2) the particular agreement challenged in this case restrained the ability of the teams to market their IP rights individually; or (3) the teams themselves acting together actively made decisions about how their IP rights should be packaged and sold.

The Supreme Court’s decision depends on propositions (1) and (2), but not proposition (3). Indeed, the question of the individual teams’ day-to-day control of sales was not all that important. Rather, the relevant question was who *is controlled*. Both lower courts had strongly emphasized control and so did the NFL in its main brief to the Supreme Court. The district court observed that the individual teams had placed their intellectual property rights in trust to NFL Properties (“NFLP”), and that there was no evidence that this organization had ever “dealt with any of the teams as independent organizations.”<sup>14</sup> The Seventh Circuit repeated that point.<sup>15</sup> The NFL’s merits brief to the Supreme Court emphasized that “[v]irtually every significant decision about the production and promotion of NFL Football is controlled by the League” rather than the individual teams.<sup>16</sup>

For the Supreme Court, however, the important question was not who controlled NFL Properties. Rather it was that NFLP was making decisions regarding “the teams’ separately owned intellectual property.”<sup>17</sup> The Court did note that each of the teams owned a share

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11. The statute rather unhelpfully defines a “person” as “includ[ing] corporations and associations existing under or authorized” by law. 15 U.S.C. § 7 (2006).

12. *Id.* § 2 (condemning “every ‘person’ who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize . . .”).

13. *Id.* § 1 (“Every contract, combination . . . or conspiracy, in restraint of trade or commerce . . . is . . . illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty . . .”).

14. *Am. Needle, Inc. v. New Orleans La. Saints*, 496 F. Supp. 2d 941, 944 (N.D. Ill. 2007).

15. *Am. Needle, Inc. v. NFL*, 538 F.3d 736, 740–41 (7th Cir. 2008), *rev’d*, 130 S. Ct. 2201 (2010).

16. Brief for NFL Respondents at 4, *Am. Needle, Inc. v. NFL*, 130 S. Ct. 2201 (2010) (No. 08–661).

17. *Am. Needle*, 130 S. Ct. at 2215.

in NFLP and that they had agreed to cooperate in setting up NFLP in order to exploit their IP rights; however, without that agreement “there would be nothing to prevent each of the teams from making its own market decisions.”<sup>18</sup>

The Supreme Court also quoted the Ninth Circuit’s observation that “ [a]lthough the business interests of the teams ‘will often coincide with those of the’ NFLP ‘as an entity in itself, that commonality of interest exists in every cartel.’ ”<sup>19</sup> The Ninth Circuit’s observation also suggests the importance of who is controlled rather than who does the controlling. A cartel seeks to maximize the profits of the cartel group as a whole. By contrast, individual members of the cartel seek to maximize their own individual profits, which they can do by undercutting the cartel—typically by producing more than its cartel output assignment or by charging less than the cartel price. The question of competitive harm does not depend on who makes the day-to-day price and output decisions, but rather on the cartel manager’s ability to force its price and output decisions upon the individual members.

In sum, the NFL arrangement was potentially anticompetitive, not because the individual teams *had* day-to-day control, but rather because they lacked it. If each team had relevant control it could have deviated from the price or output decisions of the group—that is, it could have cheated on any cartel agreement, something that would tend to make the cartel fall apart. NFLP as an entity became a very effective cartel management device precisely because under the arrangement the individual teams lacked the power to make their own agreements on the side.

A cartel is an organization of two or more separate firms that coordinates output or price, although the cartel may coordinate other aspects of its members’ behavior as well. The cartel reduces competition that might otherwise exist among cartel members.<sup>20</sup> Firms and cartels are both business organizations. Both are characterized by coordination of output and pricing. The creation and boundaries of both are economically motivated. A firm is created when the cost of doing something “internally,” or through a hierarchy such

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18. *Id.* at 2214–15.

19. *Id.* at 2215 (quoting *L.A. Mem’l Coliseum Comm’n v. NFL*, 726 F.2d 1381, 1389 (9th Cir. 1984)).

20. See 2B PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 402, at 4–7 (3d ed. 2006) (discussing the nature and consequences of a perfectly competitive economy); HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE* §§ 4.1–.3, at 146–66 (4th ed. 2011) (discussing cartel price fixing, oligopoly, and collusion).

as an employment relationship, is cheaper in relation to results than is use of the market.<sup>21</sup> A cartel is created when there are gains to be had from coordination of output or sales. We describe a cartel as “naked” when these gains result entirely (or almost entirely) from reduced market-wide output and higher prices. Some agreements among rivals are efficient, however, because they reduce development, production, or distribution costs. Such agreements can be profitable to the firms whether or not they have market power and even if they result in lower prices. We generally characterize these relationships as “joint ventures” and any restraints on price or output that they might contain as “ancillary.”<sup>22</sup>

The lines between firms, cartels, and joint ventures are notoriously indistinct. For example, several farmers might form a partnership, which is a purely contractual relationship, if they consolidate their land, equipment, and operations and produce everything jointly. In that case the legality of their union would be analyzed under the law of mergers, but once the organization is lawfully formed its conduct that does not implicate other firms is treated as unilateral.<sup>23</sup> The farmers would be a cartel, however, if all they did was set a price and reduce output while leaving their operations completely separate. In between is a whole range of possibilities. For example, they might farm separately but share a corn picker, truck, or other costly piece of equipment. They might market jointly through a common sales agent, and this might necessitate a common price.<sup>24</sup> The antitrust law of ancillary restraints deals with these issues, typically by assuming that arrangements that

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21. Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386, 392 (1937); see also Herbert Hovenkamp, *Coasean Markets*, 31 *EUR. J.L. & ECON.* 63 (2010), available at <http://www.springerlink.com.proxy.library.vanderbilt.edu/content/65031035h363g164/fulltext.pdf> (examining the relationship between Coasean firms and Coasean markets).

22. See *United States v. Addyston Pipe & Steel Co.*, 85 Fed. 271 (6th Cir. 1898), *modified and aff'd*, 175 U.S. 211 (1899) (explaining the difference between naked and ancillary restraints and applying the per se rule to the naked restraint at issue); 11 HERBERT HOVENKAMP, *ANTITRUST LAW*, ¶ 1906, at 235–42 (2d ed. 2002) (defining and distinguishing naked and ancillary restraints).

23. See 4A AREEDA & HOVENKAMP, *supra* note 20, ¶ 973c, at 63–66 (discussing transactional alternatives to mergers and joint ventures); 5 *id.* ¶ 1202, at 264–83 (explaining partial asset acquisitions); Gregory H. Werden, *Initial Thoughts on the American Needle Decision*, *ANTITRUST SOURCE*, Aug. 2010, at 1–7, [http://www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/Aug10\\_Werden8\\_2f.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Aug10_Werden8_2f.authcheckdam.pdf) (discussing the implications of the *American Needle* decision); cf. *Texaco Inc. v. Dagher*, 547 U.S. 1, 1 (2006) (holding it is not per se illegal for a lawful joint venture to set the prices at which it sells its products).

24. *E.g.*, *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 375–78 (1933) (upholding exclusive joint marketing scheme for Depression-era coal).

unite only a subset of the individual participants' production and distribution activities are cartels or joint ventures of separate actors rather than the creation of a single firm.<sup>25</sup>

Part I of this Article discusses the *American Needle* decision and how Section One of the Sherman Act does not reach the conduct of single entities. Part II discusses how cartels operate, including the many decisions that price-fixing firms need to make and the operational structures that cartels adopt to make these decisions. Part III shows how the insights from the study of cartel decisionmaking structures should inform the application of *American Needle* to organizations, mainly corporations, that have some structural characteristics of single entities, but also have functional characteristics that threaten price fixing.

### I. AMERICAN NEEDLE AND THE SINGLE ENTITY ISSUE

The Sherman Act evaluates anticompetitive conduct differently depending on whether the challenged restraint is characterized as concerted or unilateral. Section One of the Sherman Act addresses anticompetitive conduct that results from concerted action. Because agreement is required, "unilateral activity by a single firm cannot be reached via this section."<sup>26</sup> Absent an agreement, there is no case under Section One. If an agreement is proven, the resulting conduct can violate Section One if it unreasonably restrains trade.

Section Two of the Sherman Act addresses unilateral conduct to maintain or acquire a monopoly or to attempt monopolization. The Supreme Court has explained that "Section 2 makes the conduct of a single firm unlawful *only* when it actually monopolizes or dangerously threatens to do so."<sup>27</sup> Thus Section Two creates a higher threshold for antitrust liability. The monopolization offense of Section Two of the Sherman Act requires a dominant firm and an "exclusionary" practice, which is a practice that destroys a rival or keeps rivals out of the market, permitting the monopolist to raise its price to monopoly levels.<sup>28</sup> By contrast, an agreement between two or more separate "persons" is unlawful when it violates the restraint of trade formulation of Section One of the Sherman Act, which generally

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25. See 13 HOVENKAMP, *supra* note 22, ¶¶ 2100–04, at 3–46 (providing a broad overview of joint ventures).

26. *Spectrofuge Corp. v. Beckman Instruments, Inc.*, 575 F.2d 256, 286 (5th Cir. 1978).

27. *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 459 (1993) (emphasis added).

28. See 3 AREEDA & HOVENKAMP, *supra* note 20, ¶ 651, at 96–130 (defining monopoly conduct).

means that it is reasonably calculated to result in reduced market output and higher prices.<sup>29</sup> Further, particularly egregious agreements, such as naked price fixing or boycotts, are said to be unlawful "per se," which means that an actual output reduction or price increase need not be proven but will be presumed to result from the behavior itself. A restraint of trade need not exclude anyone in order to be unlawful; it must merely lead to higher prices as a result of reduced output. By contrast, a single firm acting alone may charge as high a price as it pleases and reduce output accordingly.<sup>30</sup> As a result of these differences in statutory treatment, antitrust defendants have a strong incentive to characterize their conduct as unilateral, not concerted.

One difficult question in Section One jurisprudence has been determining whether two entities linked by ownership or contract are legally capable of conspiring for antitrust purposes. For decades, the Supreme Court had held explicitly and implicitly that a parent corporation and its wholly owned subsidiary were legally capable of agreeing and thus satisfying the first element of a Section One cause of action.<sup>31</sup> In *Copperweld Corp. v. Independence Tube Corp.*, the Supreme Court overruled this line of cases and held that a parent corporation and its wholly owned subsidiary were a single entity for antitrust purposes.<sup>32</sup> As a result, agreements between them could not violate Section One.

Lower courts have extended *Copperweld's* holding to a variety of scenarios. For example, courts have held that sibling corporations are incapable of conspiring,<sup>33</sup> as are a parent and its partially owned subsidiary in many cases.<sup>34</sup> The circuit courts had split as to whether the teams in a sports league constituted a single entity or were

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29. See 7 *id.* ¶ 1502, at 387-90; 11 HOVENKAMP, *supra* note 22, ¶ 1912d, at 326-39 (discussing restraint of trade in horizontal trade cases).

30. See 3A AREEDA & HOVENKAMP, *supra* note 20, ¶ 720, at 3-11 (examining why monopolies are allowed to charge a profit-maximizing price).

31. See, e.g., *United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 116-17 (1975) (finding conspiracy between a bank and its partially owned branches); *United States v. Yellow Cab Co.*, 332 U.S. 218, 224-25 (1947) (finding a conspiracy between a taxicab manufacturing company and its wholly- or partially-owned operating company subsidiaries); 7 AREEDA & HOVENKAMP, *supra* note 20, at 205-13 (providing a general overview of Supreme Court cases on antitrust-related conspiracy cases).

32. 467 U.S. 752, 777 (1984).

33. See, e.g., *Eichorn v. AT&T Corp.*, 248 F.3d 131, 139 (3d Cir. 2001) (stating that a "single entity in a parent-subsidiary relationship" is incapable of violating Section One of the Sherman Act).

34. *Bell Atl. Bus. Sys. Servs. v. Hitachi Data Sys. Corp.*, 849 F. Supp. 702, 706 (N.D. Cal. 1994).

capable of agreeing and thus satisfying the first element of a Section One cause of action. Some courts had held that the members of a professional sports league represented a single entity for many purposes and, thus, could not run afoul of Section One.<sup>35</sup> Other courts have declined to extend *Copperweld* to shield teams in sports leagues from Section One liability.<sup>36</sup>

The Supreme Court resolved the split in *American Needle*. The thirty-two teams that belong to the NFL granted individual exclusive licenses to their trademarks and related rights to an NFL-formed company, NFLP. NFLP in turn granted an exclusive license for the manufacture of caps and headgear bearing these logos to Reebok. American Needle, which had previously manufactured NFL-logoed caps, was ousted from this market for ten years by the exclusive contract. It sued the NFL and its team owners for violating Section One by engaging in a concerted refusal to deal. Adhering to its previous decision in *Chicago Professional Sports*,<sup>37</sup> the Seventh Circuit held that the NFL was a single entity, and that *Copperweld* insulated it and the member teams from Section One liability.<sup>38</sup> The Supreme Court reversed.

Under *Copperweld* and its progeny, *American Needle* was an absolutely orthodox antitrust decision and the Seventh Circuit's approach an outlier. The NFL teams were individually owned and had individual profit centers,<sup>39</sup> employment relationships,<sup>40</sup> productive assets, and IP rights. To be sure, their principal activity—playing football for profit—was heavily managed by a central organization, but under standard, traditional antitrust analysis this would not

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35. *E.g.*, *Chi. Prof'l Sports Ltd. P'ship v. NBA*, 95 F.3d 593, 600 (7th Cir. 1996) (finding that professional basketball teams, although separately owned, were more similar to a single entity than multiple entities for purposes of an antitrust challenge to broadcast contracts); *cf.* *Eleven Line, Inc. v. N. Tex. State Soccer Ass'n*, 213 F.3d 198, 205 (5th Cir. 2000) (finding a single entity where amateur soccer teams were not separately owned).

36. *See, e.g.*, *Fraser v. Major League Soccer*, 284 F.3d 47, 57–59 (1st Cir. 2002) (finding that the teams were distinct entities even though they were commonly owned). For a full discussion of all lower court post-*Copperweld* decisions, see 7 AREEDA & HOVENKAMP, *supra* note 20, ¶¶ 1467–69, at 237–58.

37. 95 F.3d at 593.

38. *Am. Needle Inc. v. NFL*, 538 F.3d 736, 741–44 (7th Cir. 2008), *rev'd*, 130 S. Ct. 2201 (2010).

39. The NFL historically prohibited both public ownership of the teams as well as cross-ownership. *But see* *N. Am. Soccer League v. NFL*, 670 F.2d 1249, 1261–62 (2d Cir. 1982) (finding that the NFL cross-ownership ban as applied to non-football teams violated the Sherman Act).

40. While the NFL member teams each hired and competed for players, they engaged in multi-employer collective bargaining as a group. *See* *Brown v. Pro Football*, 518 U.S. 231, 234–35 (1996) (describing one instance of the NFL's collective bargaining process).

change the NFL from a joint venture into a single firm because all of the business relationships among the individual teams were purely contractual.<sup>41</sup> The teams could have created alternative business arrangements. For example, one very large corporation might have owned all of the NFL teams and operated them as a single entity, arranging games among them, collecting the revenue, and paying the players and other staff centrally. In that case there would not be separate profit centers.<sup>42</sup>

In deciding that the NFL was a collaboration rather than a single entity, the Supreme Court focused on two things, one essentially structural and one functional. First, the Court considered whether the organization in question was in fact a union of separate economic decisionmakers who have some residual and potentially competing business interests.<sup>43</sup> This inquiry is structural, in the sense that it asks whether there are multiple profit centers that have ownership interests that are independent of one another. If no such separate ownership interests are found, as was true in *Copperweld*, then we are looking at a single firm.<sup>44</sup>

Given that such separate interests existed, the Supreme Court next considered whether the particular restraint being challenged “deprives the marketplace of independent centers of decisionmaking.”<sup>45</sup> That is, the challenged restraint must be one that

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41. See, e.g., *id.* (assuming that NFL teams were a combination of separate actors for purposes of collective bargaining disputes and finding labor immunity); *NCAA v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85 (1984) (treating NCAA as a combination of its individual teams and applying the rule of reason to output limitations on national television advertising).

42. *E.g. Fraser v. Major League Soccer*, 284 F.3d 47, 57–59 (1st Cir. 2002) (finding that the teams were separate entities notwithstanding common ownership); see also 7 AREEDA & HOVENKAMP, *supra* note 20, ¶ 1478d3, at 368–77 (discussing the impact of *American Needle* on lower courts).

43. *Am. Needle, Inc. v. NFL*, 130 S. Ct. 2201, 2212 (2010) (“The NFL teams do not possess either the unitary decisionmaking quality or the single aggregation of economic power characteristic of independent action. Each of the teams is a substantial, independently owned, and independently managed business. [Further,] ‘their general corporate actions are guided or determined’ by ‘separate corporate consciousnesses,’ and ‘[t]heir objectives are’ not ‘common.’”) (quoting *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 771 (1984)).

44. *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 753 (1984) (holding a parent and wholly owned but separately incorporated subsidiary to be a single actor for antitrust purposes). Justice Stevens, the author of *American Needle*, dissented in *Copperweld*. *Id.* at 778–96.

45. Directly relevant to this case, the teams compete in the market for intellectual property. To a firm making hats, the Saints and the Colts are two potentially competing suppliers of valuable trademarks. When each NFL team licenses its intellectual property, it is not pursuing the “common interests of the whole” league but is instead pursuing interests of each “corporation itself,” teams are acting as “separate economic actors pursuing separate economic interests,” and

limits the market behavior of these independent economic actors in some fashion.<sup>46</sup> For example, the NFL clearly qualifies as a consortium of actors under the structural definition. But suppose that the antitrust challenge was to an exclusive license given by the NFL for reproduction of its own “NFL” logo, or perhaps to the NFL’s decision to fire a staff member who worked for the NFL rather than the member teams. None of the individual teams has an obvious proprietary interest in the NFL logo or most of the NFL’s own employment decisions. With respect to the NFL logo, they have no individual rights to license it, and as a result the license agreement does not limit any right to sell that they would otherwise have. Treating the NFL as a single entity on that issue might be appropriate for purposes of licensing the NFL logo, but not for purposes of licensing the various logos owned by the individual teams.<sup>47</sup> This is consistent with well-established rules for joint ventures, which find

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each team therefore is a potential “independent cente[r] of decisionmaking.” Decisions by NFL teams to license their separately owned trademarks collectively and to only one vendor are decisions that “depriv[e] the marketplace of independent centers of decisionmaking,” and therefore of actual or potential competition. *Am. Needle*, 130 S. Ct. at 2213 (quoting *Copperweld*, 467 U.S. at 769, 770) (alterations in original).

46. *Id.* (“Although NFL teams have common interests such as promoting the NFL brand, they are still separate, profit-maximizing entities, and their interests in licensing team trademarks are not necessarily aligned.”) (citing Herbert Hovenkamp, *Exclusive Joint Ventures and Antitrust Policy*, 1995 COLUM. BUS. L. REV. 1, 52–61, and Zenichi Shishido, *Conflicts of Interest and Fiduciary Duties in the Operation of a Joint Venture*, 39 HASTINGS L.J. 63, 69–81 (1987)).

47. *See id.* at 2214–15 (“[F]or the same reasons the 32 teams’ conduct is covered by § 1, NFLP’s actions also are subject to § 1, at least with regards to its marketing of property owned by the separate teams . . . . For that reason, decisions by NFLP regarding the teams’ separately owned intellectual property constitute concerted action.”). In a footnote the Supreme Court also found it unnecessary to consider the position of the United States:

For the purposes of resolving this case, there is no need to pass upon the Government’s position that entities are incapable of conspiring under § 1 if they “have effectively merged the relevant aspect of their operations, thereby eliminating actual and potential competition . . . in that operational sphere” and “the challenged restraint [does] not significantly affect actual or potential competition . . . outside their merged operations.” Brief for United States as *Amicus Curiae* 17. The Government urges that the choices “to offer only a blanket license” and “to have only a single headwear licensee” might not constitute concerted action under its test. *Id.*, at 32. However, because the teams still own their own trademarks and are free to market those trademarks as they see fit, even those two choices were agreements amongst potential competitors and would constitute concerted action under the Government’s own standard. At any point, the teams could decide to license their own trademarks. It is significant, moreover, that the teams here control NFLP. The two choices that the Government might treat as independent action, although nominally made by NFLP, are for all functional purposes choices made by the 32 entities with potentially competing interests.

*Id.* at 2216 n.9.

their activities to be unilateral in some cases but not in others, depending on the nature of the challenged conduct.<sup>48</sup>

The majority's opinion did not address the actual legality of the collective licensing arrangement. The issue before the Court was solely whether the teams of the NFL were capable of conspiring. While the NFL is a legitimate joint venture, the agreement on collective licensing represents concerted action that falls within the reach of Section One.

Organization into a single firm for state-law purposes is not dispositive of the antitrust issue of single entity status. For example, while partnerships and other unincorporated entities are creatures of the common law, they can be treated as single entities for antitrust purposes.<sup>49</sup> Indeed, even much looser organizations of businesses or individuals bound only by a contract are treated as a single entity for some purposes.<sup>50</sup> On the other side, *American Needle* cited both the *Sealy* and *Topco* cases as correctly decided examples of single incorporated entities that were treated as conspiracies for federal antitrust purposes.<sup>51</sup> Clearly, for example, the members of a cartel could not avoid Section One of the Sherman Act by creating a corporation, placing their individual CEOs on the board of directors, and giving this corporation authority over the individual firm's output and prices. The CEOs are still independent competitors even if they occasionally sit around the same boardroom table. As *American Needle* indicates, distinguishing a firm from a cartel requires looking beyond the form of the business organization to more fundamental issues about how entities make decisions and the economic identities of those

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48. See 7 AREEDA & HOVENKAMP, *supra* note 20, ¶ 1478, at 340–77 (summarizing case law concerning whether joint venture decisions are unilateral or collaborative).

49. *E.g.*, *United Mine Workers of Am. v. Coronado Coal Co.*, 259 U.S. 344, 385–92 (1922) (finding an unincorporated labor union to be a single entity); *United States v. Greater N.Y. Live Poultry Chamber of Commerce*, 30 F.2d 939, 939 (S.D.N.Y. 1928) (holding that an unincorporated association was covered by the Sherman Act).

50. *E.g.*, *Toscano v. PGA*, 258 F.3d 978, 983–85 (9th Cir. 2001) (treating a professional golfers association as a single entity); *Eleven Line, Inc. v. N. Tex. State Soccer Ass'n*, 213 F.3d 198, 205 (5th Cir. 2000) (treating a volunteer association of coaches and players as a single entity); *Am. Council of Podiatric Physicians v. Am. Bd. of Podiatric Surgery*, 185 F.3d 606, 620–22 (6th Cir. 1999) (treating a professional association of podiatrists as a single entity rather than a cartel of podiatrists); *AD/SAT v. Associated Press*, 181 F.3d 216, 233 (2d Cir. 1999) (finding an association of newspapers better treated as a single entity than as a conspiracy of its member newspapers); *Nat'l Camp Ass'n v. Am. Camping Ass'n*, No. 99 Civ. 11853 DLC, 2000 WL 1844764, at \*3–4 (S.D.N.Y. Dec. 15, 2000) (treating an incorporated association of campgrounds as a single entity).

51. *Am. Needle*, 130 S. Ct. at 2215 (citing *United States v. Sealy, Inc.*, 388 U.S. 350 (1967); *United States v. Topco Assocs., Inc.*, 405 U.S. 596 (1972)).

who are controlled. While the question “who is in control” can be important, usually it is not nearly as important as the question “who is controlled.” For example, in *Copperweld* the parent firm was almost certainly in control of the actions of its subsidiary, which was wholly owned. The reason the Supreme Court found a single firm, however, was that there was no separately owned entity whose market behavior was being controlled.

## II. CARTEL DECISIONMAKING STRUCTURES

In order to understand how lower courts should apply *American Needle* to organizations whose constituents have distinct profit centers, one must consider how price-fixing cartels, the primary concern of Section One, operate. This Part reviews the multitude of decisions that firms in a cartel must make and the various decisionmaking structures that cartels have adopted.

### A. Decisions that Cartels Must Make

Price fixing seems straight forward: rival firms agree to fix a price above the competitive level. By colluding instead of competing, the firms in a market can maximize their profits at consumers' expense. Cartelization, in reality, is far more complicated. The difference between successful cartels and failed attempts is often a function of the conspirators' ability to create and implement appropriate decisionmaking structures.<sup>52</sup> This Section examines the multitude of decisions that price-fixing conspirators must make in order to create and stabilize their illegal cartel. The decisions are broken into two categories: coordinating the terms of the cartel agreement and enforcing the agreement once it is made.

#### 1. Coordinating Cartel Terms

Cartels require a great deal of coordination. How explicit the communications and resulting agreements need to be depends on market conditions and the nature of the competitors' relationships with each other.

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52. Margaret C. Levenstein & Valerie Y. Suslow, *What Determines Cartel Success?*, 44 J. ECON. LITERATURE 43, 86 (2006) (“Successful cartels develop mechanisms for sharing information, making decisions, and manipulating incentives through self-imposed carrots and sticks.”).

*a. Price*

In theory, each cartel has a profit-maximizing price that the members of the cartel will agree to set. But the theory often oversimplifies reality for several reasons. First, co-conspirators may not have the same profit-maximizing price. Differences in firm size, efficiency, or product can complicate price-fixing negotiations. For example, firms with lower costs will favor a lower cartel price while firms with higher costs want a higher price.<sup>53</sup> If the market is product differentiated there may not be a single optimum price, but it will have to be a compromise.<sup>54</sup> Because different firms within a cartel may advocate different price targets, the decision on what price to fix requires a deliberative process and a series of compromises.<sup>55</sup>

Second, even if the members of a cartel share similar cost structures, which would indicate the presence of a single profit-maximizing cartel price, the conspirators may disagree about whether to charge it. The fixed price needs to be high enough to maximize profits, but not so high as to induce new competitors into the market. The decisionmaking calculus for single entities and cartels is similar.<sup>56</sup> In both situations, the decisionmaker attempts to calculate the profit-maximizing output and price levels. That level is generally determined by the point at which the firm's marginal cost equals its marginal revenue.<sup>57</sup> For an individual firm, a firm's board of directors is charged

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53. See HOVENKAMP, *supra* note 20, § 4.1, at 148 (examining how cartels fix prices); see also James M. Griffin, *Previous Cartel Experience: Any Lessons For OPEC?*, in *ECONOMICS IN THEORY AND PRACTICE: AN ECLECTIC APPROACH: ESSAYS IN HONOR OF F.G. ADAMS* 179, 179-206 (Lawrence R. Klein & Jaime Marquez eds., 1989) (examining the characteristics of fifty-four different cartels to determine what makes a cartel successful in the long-term).

54. HOVENKAMP, *supra* note 20, § 4.1, at 148.

55. These price negotiations are dangerous for cartel members because they increase the risk of detection and consequent criminal penalties. See *infra* notes 152-53 and accompanying text.

56. See HOVENKAMP, *supra* note 20, § 4.1, at 146-59 (describing the basic economics of price fixing); David E. Mills & Kenneth G. Elzinga, *Cartel Problems: Comment*, 68 *AM. ECON. REV.* 938, 940 (1978) (comparing single joint profit-maximizing points with multiple joint profit-maximizing points); D.K. Osborne, *Cartel Problems*, 66 *AM. ECON. REV.* 835, 841 (1976) (discussing the effect of single, nonmember firms on cartel pricing); see also George A. Hay & Daniel Kelley, *An Empirical Survey of Price Fixing Conspiracies*, 17 *J.L. & ECON.* 13, 26-27 (1974) (suggesting that conspiracies are most likely to arise when "numbers are small, concentration is high, and the product is homogenous").

57. Assuming that all of the individual cartel members have identical costs, the cartel's profit maximizing output and price are the same as that of a single firm monopolist with the same cost function. To the extent that cartel members' individual costs differ from one another, calculation of the optimal output and how it should be assigned is correspondingly more complex. In general, a monopolist would cut its output by closing its least efficient plants first and

with maximizing the firm's value, which generally means selling at the profit-maximizing output and price.<sup>58</sup> For a cartel, the conspirators make a similar calculation, either through a participatory process or a centralized decisionmaker.

Third, in addition to fixing list price, some cartel pricing structures allow for quantity or other discounts.<sup>59</sup> Firms may find agreements on list price relatively easy to reach, but then face heated disagreements about the nature of discounts.<sup>60</sup> Over time, some cartels, such as the copper plumbing tubes cartel, try to simplify the operations by reducing the availability of discounts and rebates.<sup>61</sup> After cartelizing the three-billion dollar worldwide market for graphite electrodes, the members of that cartel eliminated discounts altogether.<sup>62</sup> Additionally, international cartels must make allowances for currency exchange rate issues.<sup>63</sup>

Further complicating the pricing decisions, many cartels have had to negotiate and fix multiple prices. For example, the citric acid and plasterboard cartels had to routinely agree to two sets of prices, one for preferred larger customers and a higher one for other customers.<sup>64</sup> Other cartels—including those in electrical and mechanical carbon and graphite products—have employed far more complicated price schedules that “allowed for many different prices depending on the particular characteristics of the product and the

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producing the residual output only from the lowest cost facilities. As a practical matter, a cartel may not have that option because it could entail that some high-cost members shut down completely.

58. See, e.g., RICHARD A. BREALEY ET AL., *PRINCIPLES OF CORPORATE FINANCE* 20–22 (9th ed. 2007) (discussing present value and the opportunity cost of capital); Herbert Hovenkamp, *Neoclassicism and the Separation of Ownership and Control*, 4 VA. L. & BUS. REV. 373, 386 (2009) (discussing the Coasean vision of the firm as a profit-maximizer); Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function* 9 (Harvard Bus. Sch., Working Paper, Oct. 2001), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=220671](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=220671) (proposing a new system for value maximization called enlightened value maximization).

59. Joseph E. Harrington, *How Do Cartels Operate?*, 2 FOUNDATIONS & TRENDS MACROECONOMICS 1, 12 (2006).

60. *Id.* at 15 (“Though there did not appear to be much disagreement among firms over price, there is a well-documented episode of disagreement with regards to discounts. In the isostatic graphite cartel, members disagreed about the 20% discount to machine shops and distributors; the source of the disagreement appeared to be the different composition of cartel members’ demands.”).

61. *Id.*

62. Robert D. Paul & J. Mark Gidley, *Price Fixing Begins to Hit Bottom Line*, LEGAL TIMES, May 4, 1998, at S44.

63. Harrington, *supra* note 59, at 12.

64. *Id.* at 7, 15.

buyer.”<sup>65</sup> Similar to the international vitamin cartel of the 1990s, the heavy equipment cartel of the 1950s was actually a series of overlapping, multi-faceted cartels involving upwards of forty manufacturers selling expensive equipment in more than twenty product lines.<sup>66</sup>

Many cartels must also coordinate the timing of their announcements of higher prices. Simultaneous price increases could draw the attention of antitrust authorities. Cartels sought to decrease this risk by staggering their price hikes. For example, after fixing the prices for the upcoming year, the corporate officials who ran the international vitamins cartel also agreed on who would announce each price increase and the date of each announcement.<sup>67</sup> Other cartels employed “a clear orchestration of who would move first and when other firms would follow which could be in days, weeks, or even months. This has been documented for cartels in carbonless paper, electrical and mechanical carbon and graphite products, copper plumbing tubes, fine arts auction houses, and sorbates.”<sup>68</sup>

These negotiations could be difficult because no firm wants to be the first to announce a price increase. Being seen as aggressive regarding price hikes can create a public relations problem. In the lag time between price announcements, the later-moving firms can take sales from the price leader.<sup>69</sup> This temporary asymmetry could destabilize a cartel. For example, in the auction house price-fixing conspiracy, Christie’s had agreed to be the first to announce a new nonnegotiable minimum commission and then lost a major consignment to its co-conspirator who had not yet announced the same nonnegotiable term.<sup>70</sup> This led the CEO of Christie’s to fear that his cartel partner at Sotheby’s “was doublecrossing him.”<sup>71</sup>

Because cartels often experience cheating by their members, merely fixing the price of the product is often insufficient on its own to create a stable cartel.<sup>72</sup> Empirically, cartel members frequently cheat

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65. *Id.* at 7.

66. Wayne E. Baker & Robert R. Faulkner, *The Social Organization of Conspiracy: Illegal Networks in the Heavy Electrical Equipment Industry*, 58 AM. SOC. REV. 837, 838 (1993).

67. Harry First, *The Vitamins Case: Cartel Prosecutions and the Coming of International Competition Law*, 68 ANTITRUST L.J. 711, 715 (2001).

68. Harrington, *supra* note 59, at 20–21.

69. *Id.* at 24.

70. CHRISTOPHER MASON, *THE ART OF THE STEAL: INSIDE THE SOTHEBY’S-CHRISTIE’S AUCTION HOUSE SCANDAL* 166 (2004).

71. *Id.*

72. See *infra* notes 96–100 (discussing cartel cheating and common responses).

by honoring the cartel price on the product at issue, but then granting a discount on a complementary good or service. For example, cartel member firms may charge the cartel price but provide delivery service at a loss, thereby effectively selling the cartelized product at a discount.<sup>73</sup> Cartels have responded to this risk by regulating collateral prices or services as well. For example, the sugar cartel “regulated storage rates, freight rates, delivery times, and delivery methods, all to prevent hidden price cuts from being buried in the details.”<sup>74</sup> The cement cartel forbade its members from using trucks, and enlisted cooperative railroad officials to help enforce price fixing in the cement industry.<sup>75</sup> Also, under the cement cartel code, “the cement producers were also barred from competing through different ways of wrapping and shipping their product or through making different charges or allowances for cement bags.”<sup>76</sup> More recently, in the auction house price-fixing conspiracy, in addition to fixing nonnegotiable commissions, the members also sought to prevent waivers of related expenses, including catalog illustrations, shipping, and insurance charges.<sup>77</sup> Similarly, the firms in the industrial and medical gases cartel adopted minimum transport charges and imposed a new drop charge on bulk deliveries in order to prevent circumvention of the cartel price through discounted delivery.<sup>78</sup> In addition to price, the scope of these ancillary agreements had to be negotiated and agreed upon by all cartel members.<sup>79</sup>

In some cases, cartel members developed complicated pricing formulas that cover a range of products and buyers. The electrical and mechanical carbon and graphite products cartel provides an example:

The most important purpose of the cartel was to agree on the prices to be charged to customers in different countries for the many different varieties of electrical and mechanical carbon and graphite products. For this purpose, the cartel members first agreed on a pricing method which calculated the sales price by reference to a number of factors. The basis of the scheme was the calculation of the price for carbon brushes.

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73. Christopher R. Leslie, *Trust, Distrust, and Antitrust*, 82 TEX. L. REV. 515, 624 (2004).

74. *Id.* at 579 (citing David Genesove & Wallace P. Mullin, *Rules, Communication, and Collusion: Narrative Evidence from the Sugar Institute Case*, 91 AM. ECON. REV. 379, 383 (2001)).

75. FRITZ MACHLUP, *THE BASING-POINT SYSTEM: AN ECONOMIC ANALYSIS OF A CONTROVERSIAL PRICING PRACTICE* 201 (1949).

76. *Id.* at 80 (citing Brief in Support of the Complaint at 414–22, Fed. Trade Comm’n v. Cement Inst., 333 U.S. 683 (No. 3,167)) (“It was against the rules of the Compendium, for example, to grant allowances for cloth sacks when they were not returned in good order.”).

77. MASON, *supra* note 70, at 169.

78. Harrington, *supra* note 59, at 12.

79. *See id.* at 6 (“Collusion also extended to prices for ancillary services and non-price dimensions in order to avoid cheating through these avenues.”).

These were divided into three groups: industrial brushes, midget brushes and exceptions. Within each of the first two groups, the volume of the carbon or graphite material in question would be determined in cubic centimetre.<sup>80</sup>

Pricing agreements with several moving parts required more involved negotiation and renegotiation than simple cartels involving a homogenous product in a single market.

In some markets, price fixing takes the form of bid rigging. This is more complicated than fixing a single price. For each contract, the cartel members must decide which cartel will have the lowest bid, what it will be, and what the remaining cartel members will bid in order to lose the contract. The failure to execute this properly can expose the cartel. For example, the heavy equipment cartel of the 1950s and 1960s was discovered when a reporter culled through the purchasing records of the Tennessee Valley Authority and noticed that "at least 47 large and small American manufacturers have taken part in identical bidding on a wide variety of items in the past three years."<sup>81</sup> To prevent exposure, bid riggers assign bids and agree to rotate the winning bids in a manner that does not raise suspicion.

#### *b. Production Limits and Market Allocation*

Many cartels find it preferable to set output or sales limits either instead of or in addition to fixing the price.<sup>82</sup> Some cartels set

80. *Id.* at 9-10 (quoting EMCG-EC2, 91-3).

81. JOHN G. FULLER, *THE GENTLEMAN CONSPIRATORS: THE STORY OF THE PRICE-FIXERS IN THE ELECTRICAL INDUSTRY* 29 (1962). The record in the *Cement Institute* case two decades prior to the heavy equipment cartel had produced the following set of bids on a job sought by the United States Engineer Office, Tucumcari, New Mexico, April 23, 1936, all identical to the one ten-thousandth cent per barrel:

Name of Bidder	Price per Bbl.	Name of Bidder	Price per Bbl.
Monarch	\$3.286854	Oklahoma	\$3.286854
Ash Grove	3.286854	Consolidated	3.286854
Lehigh	3.286854	Trinity	3.286854
Southwestern	3.286854	Lone Star	3.286854
U. S. Portland Cement Co.	3.286854	Universal	3.286854
		Colorado	3.286854

*Fed. Trade Comm'n v. Cement Inst.*, 333 U.S. 683, 713 n.15 (1948). See generally Vernon A. Mund, *Identical Bid Prices*, 68 J. POL. ECON. 150, 150 (1960) (discussing identical bid process).

82. See, e.g., SIMON N. WHITNEY, *TRADE ASSOCIATIONS AND INDUSTRIAL CONTROL* 70 (1934) (discussing the cotton cartel).

limits on output, others on inputs. For example, the Cotton-Textile Institute had its members pledge to limit their day shifts to fifty-five hours per week, and their night shifts to fifty.<sup>83</sup> Depending on the relative efficiency of the various cartel members, firms may advocate very different limits.

Assuming that total production limits are agreed to, price-fixing firms must then decide how to apportion the total quantity produced.<sup>84</sup> Output must be allocated among cartel members, and there may not be a single equilibrium solution that simultaneously maximizes the profits for every cartel member. That is, the size of *total* output is measurable by reference to market demand, but the division of the cartel surplus represents a problem similar to that of a bilateral monopoly.<sup>85</sup> There is no “natural” solution. Intuitively, perfectly identical firms might divide the output equally, but that would not necessarily be the case and, in any event, firms always differ from one another. Smaller firms will tend to want to see output divided evenly; larger ones will want it to be divided in proportion to historical output. When historical output is used, firms may disagree about which years to use as the reference period, some preferring the previous year and others a range of years.<sup>86</sup> Each firm presumably angles to select a time frame that maximizes the firm’s future sales at the cartel price. Finally, newer firms may advocate productive capacity instead of historical sales as the basis for cartel allocations, again because they fare better under such a measure.<sup>87</sup>

Additionally, some cartels allocate specific customers.<sup>88</sup> For example, to stabilize the various vitamin cartels, Roche and Rhone-

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83. *Id.* at 71 (“This plan, proposed in January, 1930, and accepted by practically 75% of the industry within four months, continued in force until July, 1933.”). In one well known antitrust decision, the National Window Glass Manufacturers association reached an agreement under which one group of firms operated for six months of the year while the other group operated for the other six months. Writing for the Court, Justice Holmes approved the agreement as a reasonable way of allocating a shortage of laborers. *Nat’l Ass’n of Window Glass Mfrs. v. United States*, 263 U.S. 403, 413 (1923).

84. See, e.g., *United States v. Andreas*, 216 F.3d 645, 652 (7th Cir. 2000) (discussing volume allocation in the lysine cartel).

85. See ROGER D. BLAIR AND JEFFREY L. HARRISON, *MONOPSONY IN LAW AND ECONOMICS* (forthcoming 2011) (noting that in a bilateral monopoly, the output is typically determinable, but the division of the surplus is indeterminate and must be negotiated); Hovenkamp, *supra* note 21, at 15.

86. Harrington, *supra* note 59, at 28–30 (discussing examples in copper plumbing tubes, organic peroxides, vitamins A and E, folic acid, and citric acid cartels).

87. *Id.* at 31 (discussing lysine cartel).

88. *Id.* at 6, 24.

Poulenc agreed not to pursue certain customers.<sup>89</sup> Such agreements are relatively common in cartels.<sup>90</sup> Customer allocation agreements stabilize a cartel by reducing the ability and the incentive to cheat.<sup>91</sup> In the case of a particularly large customer, cartel members may agree to share a customer, for example by taking turns as to who gets the contract.<sup>92</sup> In such a case, the conspiring firms had to negotiate how to rotate the contract in a manner that did not look too suspicious.<sup>93</sup>

### *c. Coordinating Artificial Standards*

In addition to—or as a prelude to—fixing price, some firms also standardize their product lines with those of other cartel members. In markets with homogeneous products, cartels are more stable.<sup>94</sup> It may be hard to agree upon a single set price when the firms in a cartel sell products of varying quality and sizes. Further, cheating may be harder to detect when firms are selling more diverse products. This reduces the life of a cartel.<sup>95</sup> To address these problems, some cartels attempt to standardize their products.<sup>96</sup> For example, the turn-of-the-century cement cartel standardized the minimum specifications and members declined to “accept[ ] specifications calling for better

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89. DAVID BOIES, *COURTING JUSTICE* 233 (2004).

90. Harrington, *supra* note 59, at 37 (discussing the chlorine and chloride cartel).

91. See BOIES, *supra* note 89, at 233 (“By assigning particular customers to particular suppliers, the conspirators reduce the incentive suppliers have to depart from the agreed price in search of more sales.”).

92. Harrington, *supra* note 59, at 40 (discussing zinc phosphate cartel).

93. *Id.*

94. Andrew R. Dick, *When Are Cartels Stable Contracts?*, 39 J.L. & ECON. 241, 247 (1996) (“As predicted by theory, cartels tended to export relatively homogeneous, less highly processed commodities.”). On product standardization agreements facilitating collusion, see 13 HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 2136, at 231–32 (2d ed. 2005).

95. Dick, *supra* note 94, at 250 (“For example, cartels covering slightly more differentiated products such as textiles and office equipment dissolved after members discovered that ‘foreign market development could be better handled on an individual basis.’”).

96. *E.g.*, *United States v. Am. Radiator & Standard Sanitary Corp.*, 433 F.2d 174, 185 (3d Cir. 1970), *cert. denied*, 401 U.S. 948 (1971) (defendants eliminated lower quality bathroom fixtures that had been subject to heavy discounting); *C-O-Two Fire Equip. Co. v. United States*, 197 F.2d 489, 493 (9th Cir. 1952), *cert. denied*, 344 U.S. 892 (1952) (defendants standardized fire extinguishers in order to facilitate bid rigging); *Milk & Ice Cream Can Inst. v. Fed. Trade Comm’n*, 152 F.2d 478, 482 (7th Cir. 1946) (defendants standardized milk containers in order to facilitate bid rigging, and court stated, “it was easier to reach the goal of uniform prices on a standard product than on one which was not”); see also *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 644–45 (1980) (*per curiam*) (standardization of credit terms); *Plymouth Dealers’ Ass’n of N. Cal. v. United States*, 279 F.2d 128, 134 (9th Cir. 1960) (standardization of trade-in allowances on used cars); see also Harrington, *supra* note 59, at 5–8.

qualities.”<sup>97</sup> Alternatively, cartels may agree to limit the varieties of a product available for sale. For example,

[t]he approach of having standardized products was also taken in the graphite electrodes cartel as the firms: “agreed to charge certain premiums on the price of large-size electrodes, namely a surcharge on the price charged for standard 24-inch electrodes (for example, a 10% premium for 28-inch electrodes and a 40% premium for 30-inch electrodes).”<sup>98</sup>

Such agreements can lead to tension when a cartel member seeks to introduce a slightly different product, as when one firm destabilized the graphite electrodes cartel by introducing a 28.75-inch model at the 28-inch model price.<sup>99</sup> The coordination of the artificial standards helps stabilize the cartel but restricts the ability of member firms to develop new products. Based on their individual research agendas, different firms may advocate different standards. Disagreements over product size and quality can disrupt a cartel.<sup>100</sup>

#### *d. Renegotiation*

Even when rival firms can come to an initial agreement, the need for renegotiation means that coordination issues remain for the life of a cartel. Disagreements within cartels are common.<sup>101</sup> Over time, smaller firms may demand larger allotments.<sup>102</sup> In order to keep a cartel continuing, a firm may agree to sacrifice some of its market share to a cartel partner.<sup>103</sup> The inability to agree on new prices and volume allocations, in light of changing market conditions and cartel firm demands, can result in a cartel dissolving.<sup>104</sup>

Cartel negotiations are perilous because every firm at the table has the same leverage: decline to participate in the conspiracy and nobody reaps cartel profits. Price-fixing conspiracies differ from other

97. MACHLUP, *supra* note 75, at 80 (citing Brief in Support of the Complaint at 414–22, Fed. Trade Comm’n v. Cement Inst., 333 U.S. 683 (No. 3,167)).

98. Harrington, *supra* note 59, at 9 (quoting Graphite electrodes EC, 56).

99. *Id.* at 9.

100. See, e.g., Margaret Levenstein & Valerie Y. Suslow, *Contemporary International Cartels and Developing Countries: Economics Effects and Implications for Competition Policy*, 71 ANTITRUST L.J. 801, 835–36 (2004) (discussing disagreements within the graphic electrodes cartel).

101. *Id.*; Larry R. Stewart, *Canada’s Role in the International Uranium Cartel*, 35 INT’L ORG. 657, 663 (1981) (discussing disagreements within the uranium cartel).

102. See Harrington, *supra* note 59, at 31 (discussing dispute within lysine cartel).

103. See *id.* at 33 (“Though stability of market shares was common, it was not universal. In negotiating in 1992 in the market for vitamin B2, Roche agreed to allow BASF’s market share to rise from 35% in 1990 to 38% by 1994.”).

104. See Dick, *supra* note 94, at 249–50 (discussing potash cartel).

conspiracies in that the market determines the necessary participants. In a traditional conspiracy—say, bankrobbing—if the driver of the getaway vehicle backs out, the remaining conspirators can bring in another driver. In a price-fixing conspiracy, if a firm that supplies a significant market share (or has the productive capacity to do so) departs, then the cartel cannot achieve its aims because when the remaining conspirators reduce output and increase price, the nonmember firm can supply the unmet demand. Because a firm's exit from the cartel means the cartel will dissolve, cartel negotiations take place under mutual threats of withdrawal. Every firm has the dual incentive to make demands in order to maximize its return and to accommodate cartel partners' demands to prevent exit.

## 2. Enforcement of the Agreed-Up Terms

Rival firms agree to fix prices because it increases their expected profits. Another course of conduct increases profits even further: joining a cartel and then cheating by selling more than one's cartel allotment and/or charging less than the cartel-fixed price.<sup>105</sup> When a cartel is reducing its output and raising price to the cartel's maximizing level, each *individual* cartel member's marginal revenue is greater than its marginal cost; that is, each cartel member is earning more per unit sold than the incremental cost of furnishing that unit. While this proposition is readily proven mathematically, it is also quite intuitive.<sup>106</sup> The output and price of a perfectly functioning monopolist and a perfectly functioning cartel are identical. That is, whatever the profit-maximizing price is for the monopolist, the cartel maximizes its aggregate profits by setting output and price to that level, and then dividing up the output among the members. If the monopolist cuts price from the monopoly level, it loses money because the price cut on its entire output is greater than the amount of additional profits it earns by producing more. For example, if the profit-maximizing output and price are one hundred units at ten dollars per unit, a price cut to nine dollars is necessarily unprofitable even though sales rise to 108 units, because the additional profits from the increased sales are more than offset by the lost profits from the price reduction.

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105. Leslie, *supra* note 73, at 526.

106. HOVENKAMP, *supra* note 20, at 149–50; FREDERIC M. SCHERER & DAVID ROSS, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 244–45 (3d ed. 1990).

The individual cartel member is in a different position, however. Suppose that the cartel has ten identical members and each one is producing ten of these one hundred units at the profit-maximizing price. Now one cartel member surreptitiously lowers its price to nine dollars, bringing the eight extra units into the market. For the monopolist, the output increase resulting from the price cut was eight percent, but for the single member of a ten-identical firm cartel it is eighty percent, making it far more likely to be profitable. Further, that is not the entire story. The cheater's price cut will induce some existing customers within the one-hundred units to switch away from their seller and to the cheater, giving the cheater an even larger output increase. Of course, the success of all of this depends on the cheater's ability to cut the price while the other cartel members hold their position. If the cheating is detected, or if other members decide to cheat as well, the cartel is likely to fall apart and competition will break out.<sup>107</sup>

In sum, each individual cartel member has an incentive to "cheat" on the cartel by producing more than its assigned output. Stories of such cartel cheating are common,<sup>108</sup> and this excess of individual firm marginal revenue over marginal cost is one of the principal reasons that cartels become unstable and fall apart, even when they are legal.<sup>109</sup> The absence of effective enforcement mechanisms has led to the demise of many cartels.<sup>110</sup>

Consequently, successful cartels develop mechanisms for detecting and punishing cheating. Common methods for detecting deviations from a cartel agreement include requiring all cartel members to report their sales figures, utilizing auditors, and employing an independent cartel administrator.<sup>111</sup> Once cheating is identified, the cartel must discipline the defecting firm in order to

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107. On cartel cheating and the relationship between the size of the markup and the likelihood of cheating, see GEORGE M. STOCKING & MYRON M. WATKINS, *CARTELS OR COMPETITION?* 94 (1948).

108. See Herbert Hovenkamp, *Regulatory Conflict in the Gilded Age: Federalism and the Railroad Problem*, 97 *YALE L.J.* 1017, 1018 (1988) (noting that, for example, in the railroad industry, both collusion and cheating were widespread during the late nineteenth and early twentieth centuries).

109. See Robert H. Porter, *On the Incidence and Duration of Price Wars*, 33 *J. INDUS. ECON.* 415, 416-18 (1985) (writing on price wars as cartel destabilizers).

110. Dick, *supra* note 94, at 249 ("Webb-Pomerene cartels dissolved under two general sets of circumstances. The first were enforcement failures. Many price-fixing cartels were undermined by their failure to detect and punish members' attempts to undercut the agreed-on price or to exceed quota allocations.").

111. Leslie, *supra* note 73, at 611-15.

make the lapse nonprofitable and to deter future transgressions. Some cartels employ price wars.<sup>112</sup> The more common approach, however, is to have accounting and reimbursement among the affected cartel members. Many cartels employ buyback programs to deal with firms that sell more than their cartel allotment. For example, as part of the agreement by members of the citric acid cartel, to balance the cartel books at the end of 1991, one firm that sold too much, Haarmann & Reimer, was required to buy 7,000 tons of citric acid from ADM, which had sold less than its cartel allotment.<sup>113</sup> While effective, buyback schemes require “‘continuous monitoring’ to assess how sales matched up with quotas.”<sup>114</sup> In short, the cartel’s enforcement mechanism requires constant coordination.

### 3. Summary

In sum, cartels require an extreme amount of coordination about issues beyond the mere fixing of a price. While every cartel faces its own problems in formation and continuity, the international graphite electrodes cartel is fairly typical for successful, profitable cartels:

According to the U.S. Department of Justice’s investigation, cartel members agreed to: (1) increase and maintain prices, (2) eliminate price discounts, (3) allocate volume among conspirators, (4) divide the world market among themselves and designate the price leader in each region, (5) reduce or eliminate exports to members’ home markets, (6) restrict capacity, (7) restrict non-conspirator companies’ access to certain graphite electrode manufacturing technology, (8) exchange sales and customer information in order to monitor and enforce the cartel agreement, and (9) issue price announcements and price quotations in accordance with the agreement.<sup>115</sup>

The amount, difficulty, and variety of coordination issues can speed the demise of the price-fixing cartel. In his empirical study of export cartels, Andrew Dick noted that “cartels . . . dissolved when their coordination costs outweighed their service value to members.”<sup>116</sup>

Consequently, firms must develop cost-effective ways to negotiate, implement, and enforce their cartel agreements. A common

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112. *See id.* at 618–20 (discussing examples); *see also* Harrington, *supra* note 59, at 63 (“In the carbonless paper cartel, cartel member AWA had a market share in Europe of 30–35% and was the largest producer with capacity exceeding twice that of any other firm. It used its dominant position in the market to threaten aggressive pricing if firms did not comply with the collusive agreement.”) (internal citations omitted).

113. Harrington, *supra* note 59, at 57–58.

114. *Id.* at 58 (discussing the citric acid and vitamins A and E cartels).

115. Levenstein & Suslow, *supra* note 100, at 833 (citation omitted).

116. Dick, *supra* note 94, at 250 .

feature of these structures is that they often minimize the role of individual cartel members in making day-to-day output or price decisions, assign it to an entity that has the power to determine the profit-maximizing rate, and impose it on the individual members. The entity may be owned by the cartel members or have cartel members on its acting board, but none of this is essential and it may be counterproductive to the extent that the incentives of individual members diverge from those of the cartel as a whole. As the Supreme Court observed in *American Needle*, the interests of the individual teams are “not necessarily aligned” with those of the NFL as a body.<sup>117</sup>

### *B. The Structures of Cartel Decisionmaking*

In order to coordinate the many aspects of a price-fixing cartel, member firms need to craft a process for making decisions. In a price-fixing conspiracy with only two cartel partners, such as the auction house cartel, the decisionmaking is necessarily democratic to the extent that all decisions must be negotiated and agreed to by every cartel participant.<sup>118</sup> As the number of conspirators rises, however, the fixed price can be reached by consensus, by committee, or by a centralized agent to whom price-setting authority has been delegated. This Section reviews the various decisionmaking schema employed by cartels. Cartels range from relatively democratic to more centralized. On either side of this spectrum, successful cartels construct a sophisticated organizational structure to gather information, to make decisions, and to communicate and enforce their diktats.

#### 1. Democratic Cartels

While economic theory suggests that cartels should be difficult to form and maintain in industries with a large number of competitors, price-fixing cartels do exist in such markets.<sup>119</sup> In the vast majority of these cases, an industry trade association is used to run the conspiracy.<sup>120</sup> At the beginning of the twentieth century, firms

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117. *Am. Needle, Inc. v. NFL*, 130 S. Ct. 2201, 2213 (2010).

118. Following an agreement between the chairmen of Sotheby's and Christie's, the CEOs of the two rival firms met and fixed commissions, among other cooperation. MASON, *supra* note 70, at 122–23, 133–34.

119. See Hay & Kelley, *supra* note 56, at 21 (indicating that there are many cases in which larger groups conspire).

120. *Id.* at 21 (“In seven out of eight [cartel] cases with more than fifteen firms in the conspiracy, a formal industry trade association was involved.”).

in many industries formed trade associations “to avoid ruinous competition” and increase prices.<sup>121</sup> In some cases, firms in trade associations have sought to both increase market price and to cut wages to their workforce.<sup>122</sup>

For many cartels, their illegal summits transpired after a legitimate meeting of their trade association. Examples are cartels in school milk,<sup>123</sup> carbonless paper,<sup>124</sup> citric acid,<sup>125</sup> lysine,<sup>126</sup> choline chloride,<sup>127</sup> copper plumbing tubes,<sup>128</sup> turbines,<sup>129</sup> and other heavy equipment.<sup>130</sup> The presence of a trade association can give the illusion of legitimacy to competitor meetings.<sup>131</sup> The trade association provided

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121. HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW, 1836–1937*, at 321 (Harvard Univ. Press 1991) (citing ARTHUR J. EDDY, *THE NEW COMPETITION* 121, 82 (1914)); see WHITNEY, *supra* note 82, at 40 (“[E]arly trade associations were little more than permanent pools.”).

122. See WHITNEY, *supra* note 82, at 78 (discussing the Institute of Carpet Manufacturers of America).

123. Robert F. Lanzillotti, *The Great School Milk Conspiracies of the 1980s*, 11 REV. INDUS. ORG. 413, 429 n.44 (1996) (“In the Western Kentucky case, according to testimony by industry witnesses, the bid-rigging arrangements were hatched at meetings of the Western Kentucky Dairy Products Association, which were usually held in conjunction with or following meetings of the Kentucky Milk Marketing and Anti-Monopoly Commission.”).

124. Harrington, *supra* note 59, at 75. (“In the carbonless paper cartel, general planning meetings were conducted under the cover of the meetings of the Association of European Manufacturers of Carbonless Paper.”) (internal citation omitted).

125. See JOHN M. CONNOR, *GLOBAL PRICE FIXING* 134–35 (2001) (discussing European Citric Acid Manufacturers’ Association and the citric acid cartel); KURT EICHENWALD, *THE INFORMANT 3* (2000) (discussing how the cartel had “formed bogus industry associations as a cover for [its] illegal meetings”).

126. CONNOR, *supra* note 125, at 220 (discussing the “formation of a formal lysine association to facilitate the conspiracy”).

127. *Id.* at 316 (discussing how a meeting between the manufacturers turned into an agreement “to raise the North American price of choline chloride”); Harrington, *supra* note 59, at 75–76 (“With choline chloride, meetings were generally (though not exclusively) scheduled either before or after the meetings of the European Chemical Industry Council.”) (internal citation omitted).

128. Harrington, *supra* note 59, at 76 (“Coordination with trade association meetings also took place with cartels in copper plumbing tubes.”) (internal citation omitted).

129. Robert R. Faulkner, Eric R. Cheney, Gene A. Fisher & Wayne E. Baker, *Crime by Committee: Conspirators and Company Men in the Illegal Electrical Industry Cartel, 1954–1959*, 41 CRIMINOLOGY 511, 530 (2003).

130. JOHN HERLING, *THE GREAT PRICE CONSPIRACY: THE STORY OF THE ANTITRUST VIOLATIONS IN THE ELECTRICAL INDUSTRY* 315 (1962) (noting that cartel “meetings were incidental to technical gatherings”).

131. CONNOR, *supra* note 125, at 202 (“ADM proposed forming a world lysine association that would meet on a regular basis. The new association would collect and distribute mostly production and market-share information, much like the Corn Refiners Association did for the U.S. corn wet milling products (Tr. 1734–36). Wilson also suggested that, like the European Citric Acid Manufacturers’ Association, the new association would provide a convenient cover for

the cover for the illegal meetings because it explained why competitors were disclosing monthly sales to a common central body<sup>132</sup> and why rival executives and salespeople were gathering together.<sup>133</sup> In sum, the trade association provides the structure for cartel decisionmaking, the cover for why competitors are gathering, and “may also foster a social climate conducive to collusion.”<sup>134</sup> All of this facilitates a relatively democratic decisionmaking process for the cartel.

Of course, not all trade associations are fronts for illegal activity. Most engage in useful activities.<sup>135</sup> Legitimate trade associations generally employ relatively democratic processes. They engage in rulemaking and standard setting in a relatively open fashion.<sup>136</sup> This may in some cases, however, provide a forum for price fixing or market division.

Cartels may assume the democratic decisionmaking structure of their corresponding trade association. In more participatory cartels, the monitoring and enforcement processes are done relatively collectively, with much involvement and discussion among the cartel members. For example, some cartels had twenty-five face-to-face meetings among their conspirators before being discovered and prosecuted.<sup>137</sup> Many cartels had face-to-face meetings every month or

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illegal price-fixing discussions (Tr. 2186). In a year or two, a lysine association in fact emerged that met quarterly and performed the two functions that Wilson proposed.”).

132. EICHENWALD, *supra* note 125, at 205 (“That’s where the scheme came in. No one would question why each company had collected monthly sales data if it was turned over to the association. Then secretly, the companies could swap the numbers among themselves to enforce the volume agreement.”).

133. Harrington, *supra* note 59, at 76 (“Scheduling to convene the cartel at a trade association meeting is obviously convenient—as many of the executives are to be there anyway—but it also serves the purposes of avoiding detection of the cartel. The trade association meeting provides a cover for why executives of competing firms are all at the same venue.”).

134. Arthur G. Fraas & Douglas F. Greer, *Market Structure and Price Collusion: An Empirical Analysis*, 26 J. INDUS. ECON. 21, 39 (1977).

135. See LAWRENCE A. SULLIVAN & WARREN S. GRIMES, *THE LAW OF ANTITRUST* 233–34 (2000) (“Routine activities include publications containing useful general information about the industry and about technological and governmental developments affecting it, lobbying activities, standard setting, safety and other ‘seal of approval’ programs, providing media for arbitration, intra-industry promotion and advertising, and the publication of industry statistics.”).

136. See HERBERT HOVENKAMP, *THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION* 137 (2005) (stating that trade associations “also engage in rule making and standard setting for their industries” and that “the great majority of trade associations’ activities are procompetitive”).

137. See CONNOR, *supra* note 125, at 135 (“There were about 25 face-to-face meetings of the [citric acid cartel] and about a dozen bilateral meetings (Tr. 2614–2801).”); HERLING, *supra* note 130, at 315 (discussing one of the heavy equipment cartels).

quarterly.<sup>138</sup> The members of the Linseed cartel had to attend monthly meetings and were fined if they missed one.<sup>139</sup> Some cartels, such as the district heating pipes cartel, had to increase the frequency of their meetings when the need to allocate new customers and new projects necessitated more group decisions.<sup>140</sup> Similarly, the turbine cartel had to meet more frequently when it had more data to process.<sup>141</sup> Scholars have theorized that economic turbulence could necessitate more cartel meetings because “frequent negotiations among colluders are necessary when market conditions are unstable and uncertain.”<sup>142</sup> In addition to face-to-face meetings, cartels have used weekly phone calls and faxes to exchange information such as sales data.<sup>143</sup> Because cartels make a multitude of decisions that need regular renegotiation and firms must monitor their cartel partners, frequent communication is necessary.<sup>144</sup> In democratic cartels, the member firms discuss price openly and come to agreement following discussion.<sup>145</sup> When done on the heels of a legitimate meeting, the administrative structure of the illegal cartel could take advantage of the previous decisionmaking rules of trade association meeting.

Some cartels develop sophisticated managerial structures that lend themselves to organizational charts. For example, some cartels maintained an all-inclusive, worldwide group while forming regional subgroups.<sup>146</sup> In one case, “[t]he switchgear conspiracy was organized in a decentralized fashion. . . . [The] general managers set price-fixing

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138. See HERLING, *supra* note 130, at 104 (noting one heavy equipment cartel whose working group “met on an average of once every six to eight weeks”); Harrington, *supra* note 59, at 55 (“The lysine, zinc phosphate, and citric acid cartels monitored on a regular monthly basis.”); *id.* (“In the case of the vitamin B5 cartel, firms initially reported sales data on a quarterly basis but later chose to do it on a monthly basis.”).

139. BENJAMIN S. KIRSH, *TRADE ASSOCIATIONS IN LAW AND BUSINESS* 113–14 (1938).

140. See Harrington, *supra* note 59, at 74–75 (discussing how meetings to implement an allocation of sales quotas have “a frequency dictated by the flow of new projects and customers”).

141. Baker & Faulkner, *supra* note 66, at 840–41.

142. *Id.* at 841.

143. Harrington, *supra* note 59, at 75 (“Most cartels exchanged information—generally regarding sales—on a monthly or quarterly basis with some doing it as often as weekly through phone or fax rather than face-to-face meetings.”); *Id.* at 55 (“While the vitamins A and E cartel met monthly for monitoring purposes, they communicated weekly by phone.”).

144. See *id.* at 81 (“To implement such a complex arrangement, some cartels created an impressive organizational structure that entailed frequent communication and face-to-face meetings.”).

145. See, e.g., HERLING, *supra* note 130, at 33 (discussing the heavy electrical manufacturing cartel).

146. See Harrington, *supra* note 59, at 77 (“Other cartels organized themselves into both a general group—comprised of all cartel members—and regional sub-groups.”).

policy and delegated execution of the details to a ‘working-level’ group of subordinates.”<sup>147</sup> Similarly, the graphite electrodes “cartel was organized into a ‘top-level’ group and a ‘working-level’ group. The top-level meetings included primarily company presidents and managing directors and were designed to set policies. Lower-level managers, who met more frequently, worked out the details of the agreement and its implementation.”<sup>148</sup>

## 2. More Centralized Cartel Decisionmaking Structures

On the other end of the spectrum are cartels that are not democratic in the sense that the members have ceded decisionmaking authority on prices, output, and/or customer allocation to another entity. “Democratic” cartels, in which each cartel member has a voice in daily administration, can in fact be quite unwieldy.<sup>149</sup> Cartel stability often requires that the managerial role be given to one or two ringleaders or an organization with centralized decisionmaking authority.<sup>150</sup> Such an organizational form can reduce the agency costs of cartel management by controlling the diverse preferences of individual cartel members.<sup>151</sup>

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147. Baker & Faulkner, *supra* note 66, at 839.

148. Levenstein & Suslow, *supra* note 100, at 833.

149. See HOVENKAMP, *supra* note 20, § 4.1a; W. KIP VISCUSI, JOHN M. VERNON & JOSEPH E. HARRINGTON, JR., *ECONOMICS OF REGULATION AND ANTITRUST* 121–28 (4th ed. 2005) (discussing some of the “real-world complications associated with collusion”); see also Nicolas de Roos, *Examining Models of Collusion: The Market for Lysine*, 24 INT’L J. INDUS. ORG. 1083 (2006); Dick, *supra* note 94; Harrington, *supra* note 59; Hay & Kelley, *supra* note 56; Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power over Price*, 96 YALE L.J. 209, 238–40 (1986) (describing the role of the cartel “ringmaster”); Christopher R. Leslie, *Antitrust Amnesty, Game Theory, and Cartel Stability*, 31 J. CORP. L. 453 (2006) [hereinafter Leslie, *Antitrust Amnesty*]; Christopher R. Leslie, *Cartels, Agency Costs and Finding Virtue in Faithless Agents*, 49 WM. & MARY L. REV. 1621 (2008) [hereinafter Leslie, *Cartels*]; Leslie, *supra* note 73; Margaret C. Levenstein & Valerie Y. Suslow, *Breaking up Is Hard to Do: Determinants of Cartel Duration*, J.L. & ECON. (forthcoming Sept. 2010) (“Cartels respond to imperfect or noisy information by trying to . . . better align individual firm incentives with those of the group” which would reduce agency costs); Levenstein & Suslow, *supra* note 52.

150. See George Baker, Robert Gibbons & Kevin J. Murphy, *Relational Contracts and the Theory of the Firm*, 117 Q.J. ECON. 39, 70 (2002) (concluding that “vertical integration is an efficient response”); Mattias Ganslandt, Lars Persson & Helder Vosconcelos, *Asymmetric Cartels – A Theory of Ring Leaders* 3 (Ctr. for Econ. Pol’y Research, Discussion Paper No. 6829, 2008), available at <http://www.porto.ucp.pt/feg/docentes/hvasconcelos/docs/CEPR-DP6829.pdf> (discussing “why so many cartels have a ringleader and why the leading firm is so frequently substantially larger than other firms in a collusive market”).

151. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) (discussing how “agency costs” arise when a principal cannot fully control his agents); Stewart E.

Another consideration is the problem of detection and prosecution. Day-to-day management of a cartel typically requires ongoing communication among the cartel members. The more such communication is needed, the more the cartel is likely to be detected. Today, communications among members constitute one of the primary types of evidence used to prove agreement in collusion cases.<sup>152</sup> Communications among competitors necessarily involve a certain amount of antitrust scrutiny, even though many of them are competitively beneficial. These facts explain why dealer cartels have often tried to engage a manufacturer in their scheme and have it impose behavior such as resale-price maintenance or territorial division among them. Communications between a manufacturer and its dealers are routine and common, and today are much less likely to invoke antitrust scrutiny. Furthermore, cartels may prefer the centralized model because it reduces the number of witnesses with pertinent information about the details of the cartel's operations.<sup>153</sup>

For all of these reasons, the cartel may function better if it does not permit day-to-day pricing and output decisions to be made by a vote among members, but rather delegates that function to someone else. A corporate board or manager may be an ideal vehicle because, as a matter of corporate function, its goal is to maximize the value of the corporation, which it ordinarily does by maximizing profits. That is, assuming that the profits of the corporation are a good surrogate for the joint profits of the cartel members, maximization of the corporation's value will occur when the cartel maximizes its profits. This does not necessarily require that the cartel manager and the cartel operate in precisely the same market. For example, an exclusive joint selling agency, which is a popular cartel vehicle, might receive as its compensation a percentage of the individual members' profits. In that case, assuming that this formula was properly developed, the agency would maximize its profits by maximizing the aggregate profits of the individual members, which would coincide with the

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Sterk, *Trust Protectors, Agency Costs, and Fiduciary Duty*, 27 CARDOZO L. REV. 2761, 2763 (2006) (discussing how a "trust protector" has "the potential to serve as a monitor of the trustee's performance, reducing agency costs").

152. *E.g.*, William H. Page, *Communication and Concerted Action*, 38 LOY. U. CHI. L.J. 405, 425 (2007) ("What is decisive in these cases is *noneconomic* evidence of the cause, particularly involving communications."); William H. Page, *Twombly and Communication: The Emerging Definition of Concerted Action under the New Pleading Standards*, 5 J. COMPETITION L. & ECON. 439 (2009).

153. *See* Baker & Faulkner, *supra* note 66, at 855 ("In a decentralized network, however, there is no periphery. Many eyewitnesses to activities of numerous conspirators can be obtained, resulting in a much higher conviction rate, as in the switchgear and transformers conspiracies.").

cartel's profit-maximizing price.<sup>154</sup> In that way, corporate management can act as a cartel facilitator in much the same way that a manufacturer can act as a cartel facilitator in some schemes involving vertical restraints, such as resale price maintenance or territorial division, which limit competition among dealers.<sup>155</sup> Importantly, however, once such a structure is in place, daily administration of the cartel may not require the active participation of cartel members at all. Indeed, to the extent that their individual interests in profit maximization differ from those of the cartel, individual participation may serve to hinder rather than further the cartel's goals.

Most cartel structures have not been that extreme. What they share in common, however, is the transfer of daily authority from the cartel's members as a group to some much smaller subset, or else to a third-party organization that has the power to control the cartel members' individual output and prices. This Section discusses the various ways that some cartels centralize decisionmaking. First, a cartel might adopt a ringleader model. A ringleader is a firm that takes the lead in decisionmaking, such as pricing and market allocation, as well as enforcement actions by the cartel. For example, in the lysine cartel, as the largest producers, ADM and Ajinomoto seem to have played a greater role than their Korean counterparts in determining price and market allocation. The ringleader-as-enforcer model is illustrated by OPEC. For some decisions, OPEC is run relatively democratically, but Saudi Arabia clearly plays a dominant role. During major periods of the OPEC cartel, Saudi Arabia has played the role of cartel enforcer, deciding which violations of the cartel agreement to punish through punitive pricing and which deviations to allow by cutting back its own production in order to maintain the cartel price.<sup>156</sup> Similarly, Philip Morris may have played a ringleader role in the tobacco cartel, enforcing agreements through price wars.<sup>157</sup> While enjoying more control, cartel ringleaders also put themselves at risk of being prosecuted because their role in the

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154. A commission based on sales *volume* or amount would not work, for that might induce the manager to charge a competitive price or even a below-cost price.

155. See *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), *overruled by* *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007). For a discussion on the massive retail druggists cartel that occasioned the resale price maintenance scheme in *Dr. Miles*, see HOVENKAMP, *supra* note 136, at 184–91; HOVENKAMP, *supra* note 121, at 331–47.

156. James M. Griffin & Weiwen Xiong, *The Incentive to Cheat: An Empirical Analysis of OPEC*, 40 J.L. & ECON. 289, 306 (1997) (“Historically, Saudi Arabia has played key roles in effectuating OPEC pricing strategies.”).

157. See Christopher R. Leslie, *Rationality Analysis in Antitrust*, 158 U. PA. L. REV. 261, 325–28 (2010).

conspiracy is most clear.<sup>158</sup> Furthermore, although the Department of Justice Antitrust Division grants amnesty from criminal prosecution for the first member of a price-fixing conspiracy to expose the cartel to the government, amnesty is not available to the instigator or ringleader of a cartel.<sup>159</sup>

Second, a cartel may make decisions by a committee composed of a subset of cartel members. For example, one of the earliest cartel cases to reach the Supreme Court<sup>160</sup> involved a cartel by committee. In this cartel, which involved cast iron pipe, the cartel members assigned territories to each other but also created a governing structure for remaining territories "whereby all offers to purchase pipe were submitted to a committee which set the price and awarded the contract to the manufacturer that agreed to pay the largest bonus to be divided among the others."<sup>161</sup> The cartel members relinquished their independent power to set prices to the committee, which sought to maximize the collective revenue of the co-conspirators.

Third, some cartels locate decisionmaking power in a single entity, which is itself typically not a producer in the cartelized market. A common example is a joint sales agent. Under this model, all the members of a cartel agree to have a common sales agency make all sales. Exclusivity is usually critical because otherwise the cartel members would be able to avoid the cartel output limitations by making unlimited numbers of "outside" sales, driving price back down to the competitive level.

Exclusivity is a critical signpost for distinguishing competitive from anticompetitive joint selling. For example, nonexclusivity has saved joint selling ventures from antitrust liability. In *Broadcast Music, Inc.*, the defendant offered a blanket license for recorded music to radio stations and other broadcasters.<sup>162</sup> The blanket license was formed when thousands of individual copyright holders gave BMI nonexclusive licenses to play their music for profit. Cartel output

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158. See Baker & Faulkner, *supra* note 66, at 855 ("[A] lower conviction rate is found in a centralized network because only the core 'ringleaders' can be successfully prosecuted.").

159. U.S. DEP'T OF JUSTICE, CORPORATE LENIENCY PROGRAM pt. A6 (1993), available at <http://www.justice.gov/atr/public/guidelines/0091.htm>; see also Leslie, *Antitrust Amnesty*, *supra* note 149 (advocating making ringleaders eligible for amnesty because this would destabilize cartels by making ringleaders less trustworthy).

160. United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899).

161. Greene v. Gen. Foods Corp., 517 F.2d 635, 647 (5th Cir. 1975) (describing *Addyston Pipe*).

162. *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1 (1979).

reduction was highly unlikely because each individual cartel member had the unlimited power to “cheat” on the cartel by making unlimited numbers of noncartel sales. The Supreme Court rejected per se condemnation, and the Second Circuit upheld the BMI blanket license under the rule of reason. Nonexclusivity is not, however, dispositive. In *Maricopa*, the Court condemned as unlawful per se a nonexclusive agreement among physicians to market their medical services jointly at advertised maximum prices.<sup>163</sup> Nevertheless, courts have frequently cited exclusivity or its absence in determining the legality of joint selling or similar horizontal arrangements.<sup>164</sup>

The most significant aspect of the exclusive joint sales agent is that it “removes individual firm discretion over pricing decisions.”<sup>165</sup> A common sales agent employed by a cartel sets price and other contract terms, allocates customers, and arranges sales.<sup>166</sup> The cartel member may do little more than manufacture and ship the product.

The use of an exclusive joint sales agent by cartels is relatively common.<sup>167</sup> The use of a joint sales agent helped stabilize the Chilean nitrate<sup>168</sup> and international nitrogenous fertilizer cartels.<sup>169</sup> Joint sales agencies were also employed by the cartels in bromine, cement,

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163. *Ariz. v. Maricopa Cnty. Med. Soc'y*, 457 U.S. 332 (1982).

164. *See, e.g., Nat'l Bancard Corp. (NaBanco) v. Visa U.S.A., Inc.*, 779 F.2d 592, 594 (11th Cir. 1986) (refusing to condemn a merchant interchange fee being challenged that applied only when the merchant's bank and the card issuer's bank facilitated their transaction through Visa's own interconnection system, called BASE II; “[s]ignificantly, the parties to the interchange are not required to use BASE II. Merchant and issuer institutions are free to negotiate a different rate and bypass the BASE II system entirely”); *cf. Reyn's Pasta Bella, LLC v. Visa U.S.A., Inc.*, 259 F. Supp. 2d 992 (N.D. Cal. 2003) (condemning an interchange fee found to be exclusive, and distinguishing *NaBanco*). *See generally* 13 HOVENKAMP, *supra* note 22, ¶ 2001 (discussing the requirement of exclusivity for anticompetitive horizontal agreements); *id.* ¶ 2104 (discussing the significance of joint venture exclusivity).

165. Levenstein & Suslow, *supra* note 52, at 69.

166. Dick, *supra* note 94, at 273 (“Cartels that were organized as common sales agencies centralized exporting logistics by negotiating prices and terms of sale, assigning orders to member firms, bargaining with shippers over freight and insurance rates, and collecting remittances.”).

167. *Id.* at 246–47 (“Four-fifths of the cartels set a common price and/or allocated markets, and slightly more than one-half centralized export distribution through a common sales agency.”); *see also* 13 HOVENKAMP, *supra* note 22, ¶ 2132 (discussing how those participating in a market will necessarily have to agree about many things, some of which can be regarded as price-affecting or output-limiting, such as jointly made pricing rules and joint selling).

168. GEORGE W. STOCKING & MYRON W. WATKINS, *CARTELS IN ACTION* 152–53 (1946).

169. *Id.* at 146–47.

diamonds, ocean shipping, oil, potash, and European steel, among others.<sup>170</sup>

Perhaps the most famous example of an exclusive sales agent was *Appalachian Coals*.<sup>171</sup> In that case a group of coal producers created an incorporated selling agency.<sup>172</sup> Each producer then gave this firm the exclusive right to market its coal and to establish standard classifications for coal. The members even gave up individual discretion as to the price, permitting the company to sell it at the "best prices obtainable."<sup>173</sup> The consent of an individual producer on any transaction was required only if the delivery were to occur more than sixty days subsequent to the sale,<sup>174</sup> probably to ensure that the producer would have the coal available. The Court ultimately approved the arrangement under the rule of reason,<sup>175</sup> but it never doubted conspiratorial capacity notwithstanding that the individual producers had entirely taken themselves out of the conduct of daily business.

Cartels pursue the joint exclusive sales agent model for a number of reasons. First, vesting power within a single sales agent eliminates many of the coordination impediments that may otherwise occur. For example, the sales agent sets the price. There is no need to orchestrate price announcements. The price is uniform and moves simultaneously for all cartel participants through the sales agent's decisions.

Second, making all sales through an exclusive sales agent reduces the risk of cartel-destabilizing cheating. Firms in a cartel cannot sell more than their allotment if all sales are made through the central office and cannot offer a lower price if the price is set by the common agent.<sup>176</sup> The exclusive sales agent model solves the problem of distrust that can destabilize cartels because firms do not have to trust their cartel partners.<sup>177</sup> Professors Margaret Levenstein and

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170. See Leslie, *supra* note 73, at 621 (discussing other examples of cartels employing a joint sales agency); Levenstein & Suslow, *supra* note 100, at 825-26 (noting cartel's use of a combination of joint sales agency and joint venture).

171. *Appalachian Coals, Inc. v. United States*, 288 U.S. 344 (1933).

172. On the relevance of the status of *Appalachian Coals* as a corporation independent of its coal producer constituents, see *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 763 & n.7 (1984).

173. *Appalachian Coals*, 288 U.S. at 357-58.

174. *Id.* at 358.

175. See *id.* at 360.

176. Levenstein & Suslow, *supra* note 52, at 69 (noting that the joint sales agency "eliminates the possibility that individual firms will engage in secret cheating").

177. Leslie, *supra* note 73, at 621, 634.

Valerie Suslow conclude that the joint sales agency is “the strongest organizational form used to ‘monitor’ output.”<sup>178</sup> In *American Needle*, the Supreme Court expressly recognized that cartels employ a single management structure in order to reduce the risk of cheating: “Indeed, a joint venture with a single management structure is generally a better way to operate a cartel because it decreases the risks of a party to an illegal agreement defecting from that agreement.”<sup>179</sup> Significantly, the arrangement in *American Needle* was also exclusive. Each team assigned to NFLP the exclusive right to market its intellectual property.<sup>180</sup>

Third, and most importantly, joint sales agencies strongly correlate with cartel success.<sup>181</sup> In his study of export cartels organized under the Webb-Pomerene Act, Andrew Dick found that price-fixing cartels that employed “common sales agencies tended to restrict exports and raise price.”<sup>182</sup> Further, “cartels that organized as common sales agencies were longer-lived on average.”<sup>183</sup> For example, one of the most successful known examples is the international iodine cartel, which used a joint sales agent to conduct all sales to run a cartel for over sixty years.<sup>184</sup> In short, the net effect of the joint sales agency is to stabilize a cartel.<sup>185</sup>

The utility of common sales agents to further cartel interests is not lost on antitrust enforcers. Because the agreement among competitors to utilize a joint sales agent can stabilize a cartel, antitrust law generally prohibits such agreements as an unreasonable restraint of trade.

Some cartels present hybrids of these various mechanisms. For example, the diamond cartel used a joint sales agency—the Central Selling Office (“CSO”)—in London to run the cartel, but DeBeers was

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178. Levenstein & Suslow, *supra* note 52, at 69.

179. *Am. Needle, Inc. v. NFL*, 130 S. Ct. 2201, 2215 (2010).

180. *Id.* at 2207 (noting that prior to 2000 the licenses had been nonexclusive, but in December of 2000 the teams authorized NFLP to grant exclusive licenses).

181. Levenstein & Suslow, *supra* note 52, at 69 (cartels that used joint sales agencies “were among the more successful cartels”).

182. Dick, *supra* note 94, at 256.

183. *Id.* at 275.

184. Robert S. Pindyck, *The Cartelization of World Commodity Markets*, 69 AM. ECON. REV. 154, 157 (1979).

185. Dick, *supra* note 94, at 241 (“Contracts in which the cartel centralized its control through a common sales agency tended to be more stable.”); Levenstein & Suslow, *supra* note 52, at 69 (“Cartels that control the distribution of goods, through a joint sales agency or some other mechanism, appear to be more stable.”).

also clearly the ringleader of the cartel.<sup>186</sup> In addition to the CSO, the diamond cartel set up a network of dealer clubs comprised of sight holders, manufacturers, wholesalers, and brokers.<sup>187</sup> The subdivisions of the diamond cartel developed their own internal private arbitration mechanisms.<sup>188</sup> The diamond cartel's contracts with its members contained price-fixing clauses and quotas.<sup>189</sup> So, it was not a pure joint sales agent structure, but it contained this element. Cartels can fashion their own corporate structures to implement and police a price-fixing conspiracy, but Levenstein and Suslow argue "that the more elaborate these sharing and monitoring mechanisms—or the closer they bring the cartel to a joint sales agency—the more stable the cartel."<sup>190</sup>

### III. CARTEL STRUCTURE AND THE SINGLE ENTITY QUESTION

If the primary purpose of Section One is to deter and punish price-fixing cartels, then the single entity question should be considered in light of how cartels operate. This will assist courts in applying the *Copperweld* doctrine in light of *American Needle*. In other words, why do a parent corporation and its wholly owned subsidiary constitute a single entity for antitrust purposes and the teams within the NFL do not? Studying cartel structure helps answer this question. Part III synthesizes the historical lessons of how cartels operate with the antitrust-agreement analysis of the *American Needle* decision.

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186. See DEBORA L. SPAR, *THE COOPERATIVE EDGE* 53 (1994) ("It is generally understood, however, that DeBeers insists on being both the sole purchaser and the price setter and that the CSO is the sole distributor."); see also Bill Keller, *DeBeers May Be Losing Grip on Diamond Market*, N.Y. TIMES, Sept. 3, 1992, at A1.

187. Lisa Bernstein, *Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115, 119 (1992). One mid-century report explained part of the corporate structure of the diamond cartel as follows:

The diamond industry's marketing system, and DeBeers' dominant position in it, became fully established in the early 1930's with the creation of three new corporate entities—the Diamond Trading Corporation, Ltd., the Diamond Producers Association, Ltd., and the Diamond Trading Company, Ltd.—all controlled by DeBeers. The Diamond Corporation holds exclusive contracts for the purchase of the alluvial diamond production of Western and Central Africa. The Diamond Producers Association functions as the sole purchaser of South African diamonds. Both the Diamond Corporation and Diamond Producers Association sell their diamonds exclusively to the Diamond Trading Company, which is thus the single distributing agency for ninety-seven percent of the African diamond production.

Note, *The Diamond Cartel*, 56 YALE L.J. 1404, 1407 (1947).

188. Bernstein, *supra* note 187, at 121.

189. Note, *supra* note 187, at 1408–09.

190. Levenstein & Suslow, *supra* note 52, at 71.

### A. Touchstones for Determining Single Entity Status

Reading *Copperweld* and *American Needle* in combination leads to several principles on how to distinguish a single entity from a collection of actors who are capable of conspiring.

#### 1. Substance over Form

In *Copperweld*, the Supreme Court established that “substance, not form, should determine whether a[n] . . . entity is capable of conspiring under § 1.”<sup>191</sup> The Court held that in form a parent and its wholly owned subsidiary are legally distinct entities, but in substance, for antitrust purposes, they represent one entity because their unified action does not “deprive[ ] the marketplace of independent centers of decisionmaking.”<sup>192</sup>

The Court in *American Needle* again emphasized that it rejects “formalistic distinctions in favor of a functional consideration of how the parties involved in the alleged anticompetitive conduct actually operate.”<sup>193</sup> This time, however, the Court analyzed the issue from a different perspective. While in *Copperweld*, the Court held that the presence of two legal entities did not necessarily constitute concerted action, in *American Needle*, the Court held that the deposit of decisionmaking power in “a legally ‘single entity’ ” did not necessarily prove the absence of concerted action.<sup>194</sup> Legal descriptions are not determinative; instead, to determine whether an alleged combination constitutes concerted action, the key is “whether it joins together separate decisionmakers.”<sup>195</sup>

Applying these principles to the facts before it, the Court noted that in form, the teams might appear to be a single entity—as the Seventh Circuit had held—because they “organized and own a legally separate entity that centralizes the management of their intellectual property.”<sup>196</sup> In substance, however, the teams were separate and capable of conspiring because “[e]ach of the teams is a substantial, independently owned, and independently managed business.”<sup>197</sup> More

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191. *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 773 n.21 (1984).

192. *Id.* at 769.

193. *Am. Needle, Inc. v. NFL*, 130 S. Ct. 2201, 2209 (2010).

194. *Id.* at 2210 (“We have similarly looked past the form of a legally ‘single entity’ when competitors were part of professional organizations or trade groups.”).

195. *Id.* at 2212.

196. *Id.* at 2213.

197. *Id.* at 2212.

importantly, the teams were in competition with each other for “fans, for gate receipts and for contracts with managerial and playing personnel.”<sup>198</sup>

The emphasis of substance over form is critical when analyzing cartels. When cartels employ a centralized decisionmaking vehicle—whether a trade association, a joint sales agent, or an incorporated management structure—it may appear that a single entity is in control or that all the relevant agreements are vertical rather than horizontal. For example, one could argue that firms employing a joint sales agent are not agreeing on price, because they do not discuss price at all; all price decisions are made by a single entity, the agent. But this argument is too simple. The ringleader model of centralized decisionmaking—in which competitors agree to allow one seller to serve as ringleader—is clearly an agreement (and an illegal one at that). From an antitrust standpoint, there is no difference between agreeing to abide by the ringleader’s decisions and agreeing to cede decisionmaking authority to a separate entity that runs the cartel. Either way, an independent firm has agreed to not compete on price. For example, when DeBeers acts as a ringleader, there is clearly a cartel. When DeBeers sets up the Central Selling Office with a different name to run the cartel, it has the same anticompetitive effect and is not meaningfully distinguishable. Either way, there is an agreement. The more important question is not who controls, but rather how is the business of independent firms controlled by the central organization; that is, do the organization’s operations have an impact on the price and output decisions of otherwise independent decisionmakers?

It is also important not to be sidetracked by the distinction between horizontal and vertical agreements. While horizontal agreements are treated with considerable hostility by the antitrust laws, vertical agreements are nearly always addressed under the rule of reason and most are legal. This includes resale price maintenance, nonprice restraints, exclusive dealing, and vertical boycotts.<sup>199</sup> When each firm in a group gives a sales agent an exclusive right to sell their produce, the form of the arrangement looks like a series of vertical agreements. Of course, there may have been a horizontal agreement to use an exclusive sale agency, but there may not have been an express agreement, or that agreement may be sufficiently surreptitious that it

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198. *Id.*

199. *See, e.g.,* *Nynex Corp. v. Discon, Inc.*, 525 U.S. 128 (1998) (purely vertical boycott to be governed under rule of reason).

cannot be proven. And indeed, not every exclusive sales agency agreement is a cartel. For example, an artist who hangs her painting in a consignment gallery may be giving the gallery an exclusive right to sell her painting for the consignment period. If twenty different artists do the same thing they are certainly agreeing individually with the gallery, but they are not agreeing with each other and may not even be aware of one another's existence.

Price-fixing firms may go to great lengths to make their schemes appear to be the product of a single entity's decisionmaking or of purely vertical agreements. For example, in some historical cases, the member firms structured their cartels so that "the common sales agency actually took title to the product, as would a merchant wholesaler."<sup>200</sup> In that case the form of the agreement would be a set of sales from each cartel member individually to the facilitator, as in a supplier-dealer relationship. Each of the agreements considered individually would be vertical.

It would be foolish for antitrust law to hold that competitors' use of a joint sales agent—or any other single entity—renders them immune from Section One scrutiny. Section One is primarily geared at prohibiting, deterring, and punishing price-fixing cartels. Although cartels are inherently unstable, they can be stabilized through the use of a joint sales agent. That is, being misled by the single entity or purely vertical characterization would effectively remove from antitrust review a class of cartel arrangements that are in fact among the most stable, and thus the most harmful to consumers. As the Seventh Circuit explained in one cartel case, "almost any market can be cartelized if the law permits sellers to establish formal, overt mechanisms for colluding, such as exclusive sales agencies."<sup>201</sup> In short, agreeing to create an exclusionary structure—whether a joint sales agent or ringleader—is an agreement that is subject to antitrust scrutiny.

## 2. The Necessity of Coordination

In concluding that the NFL and its teams were a single entity, the Seventh Circuit in its *American Needle* opinion focused on the presence of "common interests." For example, the court emphasized that "the NFL teams share a vital economic interest in collectively

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200. CONNOR, *supra* note 125, at 27.

201. *In re High Fructose Corn Syrup Antitrust Litig.*, 295 F.3d 651, 655 (7th Cir. 2002).

promoting NFL football.”<sup>202</sup> The Seventh Circuit then stressed the necessity of cooperation in sports leagues, noting that that “the product that the teams produce jointly—NFL football—requires extensive coordination and integration between the teams.”<sup>203</sup>

This presents two related issues—that the actors have common interests and that coordination is necessary for them to achieve these common interests. The Supreme Court rejected the Seventh Circuit’s reasoning on both. First, the Court held that the presence of common interests does not convert a joint effort into a single entity because the NFL teams “are still separate, profit-maximizing entities, and their interests in licensing team trademarks are not necessarily aligned.”<sup>204</sup> Second, the *American Needle* Court held that simply because coordination among team owners is necessary to provide the product,

that does not mean that necessity of cooperation transforms concerted action into independent action; a nut and a bolt can only operate together, but an agreement between nut and bolt manufacturers is still subject to § 1 analysis. Nor does it mean that once a group of firms agree to produce a joint product, cooperation amongst those firms must be treated as independent conduct. The mere fact that the teams operate jointly in some sense does not mean that they are immune.<sup>205</sup>

Ultimately, as the Supreme Court pointed out, the reason why the firms are cooperating does not help answer the question whether the firms are capable of conspiring.<sup>206</sup>

The Court’s holdings are appropriate given the economics of cartelization. The presence of common interests cannot be a basis for finding a collaboration to be a single entity since rival firms form cartels because it is in their common interest to reduce output and increase price. But it is these effects that warrant condemnation of cartels. Moreover, all illegal agreements are likely to be in the common interests of the conspirators; otherwise they would not agree.<sup>207</sup> Furthermore, the need for cooperation cannot be dispositive.

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202. *Am. Needle, Inc. v. NFL*, 538 F.3d 736, 743 (7th Cir. 2008), *rev’d*, 130 S. Ct. 2201 (2010); *see also Int’l Travel Arrangers v. NWA, Inc.*, 991 F.2d 1389, 1397 (8th Cir. 1993) (jury instruction stated: “Where the entities possess an inherent unity of economic interest and purpose, they are not separate entities capable of conspiring”).

203. 538 F.3d at 737, *rev’d*, 130 S. Ct. 2201 (2010).

204. *Am. Needle, Inc. v. NFL*, 130 S. Ct. 2201, 2213 (2010) (citing Herbert Hovenkamp, *Exclusive Joint Ventures and Antitrust Policy*, 1995 COLUM. BUS. L. REV. 1, 52–61; Zenichi Shishido, *Conflicts of Interest and Fiduciary Duties in the Operation of a Joint Venture*, 39 HASTINGS L.J. 63, 69–81 (1987)).

205. *Id.* at 2214.

206. *Id.* (“The justification for cooperation is not relevant to whether that cooperation is concerted or independent action.”).

207. *Id.* at 2213 (“But illegal restraints often are in the common interests of the parties to the restraint, at the expense of those who are not parties.”).

As explained in Part II, price-fixing schemes require an enormous amount of cooperation and coordination to create and maintain a stable cartel. Antitrust law should disrupt these coordination efforts, not reward them through *Copperweld* immunity.

The necessity of cooperation is, nevertheless, important for Section One analysis. If restraints on competition are necessary to produce the product at issue, then the agreement will be evaluated under the rule of reason, instead of condemned under the per se rule.<sup>208</sup> This, however, provides no breathing room for naked price fixing, which is per se illegal. However, the presence of common interests and the need for coordination cannot convert separate actors into a single entity for antitrust purposes.

### 3. The Nature and Direction of Control

The decisions in *Copperweld* and *American Needle* also indicate that the nature and direction of control matters. Where does control reside? Who exercises control over whom? Most importantly, are persons with separate ownership or business interests placed under control? For example, *Copperweld* held that the parent corporation completely controlled its wholly owned subsidiary, which had no separate business. Similarly, sibling corporations that are each wholly owned subsidiaries of the same parent fall within *Copperweld*, and their agreements are generally immune from Section One liability. In *Dagher* the Supreme Court refused to find Section One liability over a joint venture that had taken on all of the production, refining, and marketing activities of its two parent firms.<sup>209</sup> In that case the issue was not whether the joint venture was in “control.” Clearly it was. Rather, the important fact was that, as in *Copperweld*, no independent interests remained to be controlled, since all of the parents’ separate business activities had terminated and been merged into the venture.<sup>210</sup> The *Dagher* Court distinguished a rule of reason application of Section One of the Sherman Act under the ancillary restraints doctrine. That doctrine, it pointed out, “governs the validity of restrictions imposed by a legitimate business collaboration, such as a business association or joint venture, on nonventure activities.”<sup>211</sup>

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208. *Id.* at 2215 n.6 (quoting *NCAA v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 101 (1984)).

209. *Texaco, Inc. v. Dagher*, 547 U.S. 1 (2006).

210. See *infra* notes 262–269 and accompanying text.

211. *Dagher*, 547 U.S. at 7.

That is to say, Section One would be invoked to the extent that the central organization sought to limit the participants' activities outside the venture, but it did not apply when there were no such outside activities to limit.

In thinking of cartel control, it is important to distinguish cartel formation from cartel operation. Cartels are voluntary organizations. By and large firms are not forced to join.<sup>212</sup> At the time a cartel is formed the individual members are clearly in control. Further, as a group they want the same thing: maximization of joint profits. Once the cartel is formed, however, incentives change. At that point each cartel member can profit by cheating, provided that the rest of the cartel hangs together. As a result, control flows in both directions. At the time of formation the members are in control in the sense that they voluntarily join and set up the cartel's structure. Once ongoing operations begin, however, cartel success depends on the ability of the cartel's administration to control the members' day-to-day output and pricing behavior.

*American Needle* is fairly typical. The individual teams participated in creating NFLP and assigned it their IP rights. Thereafter NFLP managed those rights, limiting the individual teams' ability to sell their IP rights separately. The fact that a single incorporated entity such as NFLP served a coordinating function did not make it a single entity for antitrust purposes. NFLP did not govern the teams the way that a parent corporation governs its wholly owned subsidiaries. Instead, the "teams remain separately controlled, potential competitors with economic interests that are distinct from NFLP's financial well-being."<sup>213</sup> In its briefs the NFL argued vehemently that the individual teams had little to no control over their own IP rights. Indeed, for the most part they did not even

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212. Occasionally concerted refusals to deal and similar tactics are used to coerce firms into joining a cartel, but these are themselves actionable under the antitrust laws. *See, e.g., Rossi v. Standard Roofing, Inc.*, 156 F.3d 452, 456 (3d Cir. 1998) (members of roofing cartel conspired to deny price cutter access to materials); *Denny's Marina v. Renfro Prods.*, 8 F.3d 1217, 1219–20 (7th Cir. 1993) (defendant boat sellers conspired to deny price cutting seller access to annual boat show). This was also a fair reading of the claim in *Hartford Fire Insurance Co. v. California*, 509 U.S. 764, 770–78 (1993), namely, that the defendant insurers were involved in a cartel to limit coverage and conspired with the Insurance Services Office to deny loss data and with Lloyds and others to deny reinsurance to insurers who were unwilling to join the cartel. *See generally* 13 HOVENKAMP, *supra* note 22, ¶ 2201 (discussing several cases in which concerted refusal to deal with respect to one transaction in order to get the target to change its behavior with respect to another and unrelated transaction was subject to legal action under antitrust laws).

213. *Am. Needle, Inc. v. NFL*, 130 S. Ct. 2201, 2215 (2010) (citing Herbert Hovenkamp, *Exclusive Joint Ventures and Antitrust Policy*, 1995 COLUM. BUS. L. REV. 1, 52–61).

develop them. Rather, the league itself assigned the teams its official colors and “takes the lead in developing and registering the marks of any new member club.”<sup>214</sup> No team could change its name, marks, or logo without NFLP’s consent.<sup>215</sup> But the Court’s decision turned on the way that the League controlled business activities that the individual member teams could otherwise have engaged in separately.

When one entity absolutely controls all aspects of the business of multiple other entities owned by the parent, as in *Copperweld*, there is one entity for antitrust purposes. When a single entity is set up by the participants in order to control their actual or potentially *separate* business interests, as in *American Needle*, then there are multiple entities capable of conspiring for antitrust purposes. This is true whether that dependent entity is a joint venture, a trade association, or a joint sales agent, and also whether or not the controlling entity is a corporation, as NFLP was. Suppose two separate firms create a joint venture and each owns half. Depending on how it is structured and presented, a joint venture may appear to be single entity with its own name, logo, product, etc. However, for antitrust purposes, the joint venture is a product of concerted action, and actions by the venture management that limit the separate business of each firm are conspiratorial to the extent they limit competition that could otherwise have occurred. Control can certainly be an indicator of conspiratorial capacity. In *American Needle*, the Supreme Court cited *Sealy* and several other decisions as involving situations where “the entity was controlled by a group of competitors and served, in essence, as a vehicle for ongoing concerted activity.”<sup>216</sup> The Supreme Court paid scant attention to questions about how decisionmaking within the NFL is made or the extent to which the individual teams participated in the decision to grant Reebok an exclusive license. Rather, the fact was that the exclusive licensing decision limited the abilities of the individual teams to market their IP rights separately.<sup>217</sup>

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214. Brief for the NFL Respondents at \*7, *Am. Needle, Inc. v. NFL*, 130 S. Ct. 2201 (2010) (No. 08–661), 2009 WL 3865438.

215. *Id.*

216. *Am. Needle*, 130 S. Ct. at 2209 (citing *United States v. Sealy, Inc.*, 388 U.S. 350 (1967)). On *Sealy*, see *infra* the discussion accompanying notes 222–42. See also *Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284 (1985); *NCAA v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85 (1984); *United States v. Topco Assocs.*, 405 U.S. 596 (1972); *Associated Press v. United States*, 326 U.S. 1, 26 (1945) (Frankfurter, J., concurring); *United States v. Terminal R.R. Ass’n of St. Louis*, 224 U.S. 383 (1912).

217. *Am. Needle*, 130 S. Ct. at 2213 (“The NFL respondents may be similar in some sense to a single enterprise that owns several pieces of intellectual property and licenses them jointly, but they are not similar in the relevant functional sense. Although NFL teams have common

#### 4. Ability to Withdraw

The Supreme Court cases also suggest that another metric for determining single entity status is looking at withdrawal status. In other words, can the members of a centralized body withdraw from the structure? If not, it is more likely to be a single entity. If the members can withdraw, however, then that suggests that they are independent decisionmakers capable of conspiring. The Court in *American Needle* noted, after explaining the collective intellectual property licensing arrangement through NFLP, that the individual NFL teams “are able to and have at times sought to withdraw from this arrangement.”<sup>218</sup> The *Copperweld* opinion shows that a parent corporation and its wholly owned subsidiary constitute a single entity for antitrust purposes because the subsidiary is not independent since it cannot, on its own accord, exit the relationship. In contrast, the independence of the teams of a sports league is illustrated in part by their ability to unilaterally withdraw from the enterprise.

A cartel may create a joint sales agency apparently vested with the power to set and impose its will on member firms, who may claim that they are controlled by the central body, not independent decisionmakers, and therefore entitled to *Copperweld* immunity. This argument is weakened by the fact that members can withdraw from the cartel arrangement. All individual firms have the ability to depart the cartel and to compete on the merits. This power to withdraw is what each firm threatens to exercise during the cartel creation and renegotiation process in order to maximize its take of the cartel’s profits.

The presence of a centralized cartel enforcer does not affect the single entity analysis. Even when the agreement creates a single decisionmaker, this entity’s creation is the result of the collective decision of separate decisionmakers. The resulting body does not possess true control; rather the constituent parts have ceded temporary control for limited purposes. We know that the control is not real because each cartel member can withdraw from an arrangement and regain the control that it temporarily relinquished to the cartel. Furthermore, the fact that the cartel members do not directly fix the actual price is beside the point; they agreed to create the structure that controls the price. Each firm could reassert control

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interests such as promoting the NFL brand, they are still separate, profit-maximizing entities, and their interests in licensing team trademarks are not necessarily aligned.”).

218. *Id.* at 2207.

over price by exiting the arrangement. Although it might seem that the firm may be contractually bound to the joint sales agency, any such contract would be void because it violates Section One.<sup>219</sup>

### 5. Relevance of Corporate Form

As the Supreme Court has made clear, corporate form is not decisive of the conspiratorial capacity issue.<sup>220</sup> It may, however, still be relevant. *Copperweld* found a single entity notwithstanding that the challenged “agreement” was between two separate corporations. *American Needle* found conspiratorial capacity even though the licensor was a single corporation. Corporate control is relevant, but the identity of the entities that a corporation controls is also relevant. For example, if a group of rivals organizes a corporation and then manages it so as to limit their independent business interests, conspiratorial capacity is present. The Supreme Court assumed this in *Appalachian Coals* and explicitly recognized it in *Sealy* and *Topco*.

But consider a different structure. A group of independent mattress manufacturers, wishing to produce under a common name, sponsor the launch of an IPO. The resulting company is owned ninety percent by a typical miscellany of investors and ten percent by the manufacturers. The manufacturers do not get a member on the board of directors and have no say in the daily operations of the firm. However, the firm has the power to control the individual business decisions pertaining to sales location, production, and pricing. The directors, as any board, are charged with maximizing the value of the business. They do this by imposing restrictions that limit the output of the individual manufacturers or force them to charge a particular price.

In this case, the firms have organized themselves as a managed cartel. The fact that they have no formal “control” in the day-to-day operations of the corporation and do not even have a presence on the board of directors is no more relevant than the *Copperweld* facts that the parent and subsidiary were separately incorporated. Just as the

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219. See *Citizen Publ'g Co. v. United States*, 394 U.S. 131, 134–36 (1969) (holding that agreement between the only two newspapers in the county to jointly set their subscription and advertising rates, pool their profits, and refrain from engaging in business that competed with the newspapers was illegal for violating Section One); *Spitzer v. St. Francis Hosp.*, 94 F. Supp. 2d 399, 422 (S.D.N.Y. 2000) (holding that agreement between hospitals to fix rates, terms and conditions for services and allocating markets violated Section One); Leslie, *supra* note 73, at 645–46 (discussing how those wishing to withdraw from price-fixing conspiracies should confess so as to avoid antitrust liability still attached to the agreement).

220. See *supra* notes 191–201 and accompanying text.

*Appalachian Coals* corporation was formed for the purpose of selling coal at the best price it could obtain, the directors of our hypothetical corporation are required to maximize their corporation's value, which corporate law obligates them to do. Clearly, decisions about the price and output of plants owned and operated by the corporation itself are unilateral. However, if the corporation acts by imposing restrictions on the separately owned business of the individual manufacturers, the conduct is no longer unilateral. The issue has nothing to do with formal or even informal control of the corporation, but with the fact that the corporation is controlling the separate businesses of these shareholders.

The situation somewhat resembles a manufacturer's control of the business of its independent dealers. For example, a firm such as General Motors ("GM") has franchise relationships with numerous dealers. Many of these dealers may be GM shareholders, and it is conceivable that in GM, or some other franchise, certain individual franchisees or franchisee groups are major or even controlling shareholders. None of these ownership facts changes GM from a single firm to a cartel. However, as soon as GM imposes restrictions on a franchised dealer's separate business, by restricting its location or setting its resale prices, imposing exclusivity or exclusive dealing clauses, or either tying goods sold to the dealer or requiring the dealer to tie in its own sales, the conduct is multilateral and reachable under Section One. Whether or not that particular dealer owns any GM shares is irrelevant. Nor is it relevant whether the dealer whose business is subject to this limitation is in any way in control. The only relevant question is whether GM is controlling the dealer's separate business.

Antitrust law characterizes these restraints as vertical and for the most part subjects them to lenient treatment. However, it uniformly characterizes the conduct as collaborative rather than unilateral, even if the relationship between firms, such as franchisor and franchisee, is so complete that the franchisees are effectively operating as a subsidiary. The Supreme Court has recognized exceptions for certain situations where a cartel of dealers "controls" the parent firm's conduct, but we would not be speaking of corporate control through shareholder voting or director or manager dominance. Rather, we would be speaking of contractual control.<sup>221</sup> Beyond that,

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221. Under the Supreme Court's *Leegin* decision, which adopted a rule of reason for resale price maintenance, a horizontal agreement among dealers in a single brand to fix prices could be treated under the per se rule, while a vertical agreement between a supplier and its dealers

the agreements would be treated under the rule of reason as multilateral activity, just the way the Supreme Court treated the restraint in that case.<sup>222</sup>

### B. Case Studies

Cartels have several options for how to structure their decisionmaking processes. The fact that some cartels choose a centralized cartel model does not convert a cartel into a single entity. A joint venture, cooperative, trade association, or joint sales agent might appear to be a single entity, but it is not for antitrust purposes when it is the instrument of independent actors. Understanding how cartels operate helps apply *American Needle* in a fashion that protects actual single entities from inappropriate antitrust liability while ensuring that concerted action does not escape scrutiny.

In order to show how the factors described above can help courts distinguish between concerted action and conduct by a single entity, this Section applies the factors to joint ventures, past and present, that raise antitrust concerns. Even if antitrust defendants in these cases do not seem to represent a classic price-fixing cartel, antitrust law should not be interpreted to render them a “single entity” for antitrust purposes because this could have implications for later cases involving an actual cartel.

#### 1. *Sealy* and *Topco*

The *American Needle* opinion quoted and cited liberally from two prior Supreme Court cases, *Copperweld* and *Sealy*. The invocations of *Copperweld* are hardly surprising given that *American Needle* was essentially a case about the application and limits of *Copperweld* immunity. In contrast, the reliance on *Sealy* was less

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facilitating such a cartel would be treated under the rule of reason. Both, however, would be treated as collaborative activity. See *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 893 (2007) (“A horizontal cartel among competing manufacturers or competing retailers that decreases output or reduces competition in order to increase price is, and ought to be, *per se* unlawful . . . . To the extent a vertical agreement setting minimum resale prices is entered upon to facilitate either type of cartel, it, too, would need to be held unlawful under the rule of reason.”) (citations omitted); see also *Toledo Mack Sales & Serv., Inc. v. Mack Trucks, Inc.*, 530 F.3d 204, 217, 225 (3d Cir. 2008) (relying on this passage to deny summary judgment on complaint that a truck manufacturer maintained resale prices at the behest of a cartel of its dealers).

222. *Am. Needle*, 130 S. Ct. at 2216–17 (finding conspiratorial capacity and remanding for consideration of the restraint under the rule of reason).

expected. In *Sealy*, the government challenged Sealy's policy of granting exclusive territories to its licensees who manufactured Sealy-brand mattresses.<sup>223</sup> The government argued that, because the licensees controlled the Sealy Board of Directors, the arrangement constituted horizontal market division, which is per se illegal.<sup>224</sup> Sealy argued that it was in a vertical relationship with its licensees and that its policy should be evaluated under the more lenient rule of reason.<sup>225</sup> The Court sided with the government.<sup>226</sup>

On its face, the *Sealy* opinion seems unrelated to the single entity question.<sup>227</sup> Indeed, the *Copperweld* opinion never mentions *Sealy*. Yet the *American Needle* Court found *Sealy* instructive. Because *Sealy* predated *Copperweld*, it was decided at a time when antitrust law permitted findings of conspiracy between a parent and a subsidiary, at least for some purposes.<sup>228</sup> So the single entity question was not explicitly litigated in *Sealy*. Indeed, instead of arguing that Sealy and its licensees constituted a single entity, Sealy argued that "the evidence shows that Sealy has been operated as a separate entity, in its own interest, and not in the private interests of its licensees"<sup>229</sup> and that "evidence showing the scrupulously maintained separation between Sealy's corporate interests and the individual interests of its licensees precludes the conclusion that Sealy and its licensees are not separate entities."<sup>230</sup> The closest that Sealy came to making a single entity argument was its suggestion that Sealy's arrangement should get the same deference as *Simmons*, an integrated firm not subject to Section One scrutiny because it was a single entity.<sup>231</sup>

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223. *United States v. Sealy, Inc.*, 388 U.S. 350 (1967).

224. *Id.*

225. *Id.*

226. See Mark A. Lemley & Christopher R. Leslie, *Categorical Analysis in Antitrust Jurisprudence*, 93 IOWA L. REV. 1207 (2008) (questioning the value of the *Sealy* horizontal versus vertical debate).

227. The primary holdings of *Sealy* are that horizontal territorial allocation schemes are per se illegal and that apparently vertical restraints may, in reality, be horizontal restraints when horizontal actors control the vertical relationship.

228. On such findings prior to *Copperweld*, see 7 AREEDA & HOVENKAMP, *supra* note 20, ¶ 1463 (discussing Supreme Court intraenterprise cases from *Yellow Cab* to *Copperweld*).

229. Brief for Appellee, *Sealy, Inc.* at 6, *United States v. Sealy, Inc.*, 388 U.S. 350 (1967) (No. 9), 1966 WL 100609 [hereinafter *Sealy* Respondent Brief]; see also *id.* at 21 ("Sealy's separate existence as a profitable enterprise operated for its overall best interests, and not as a mere instrumentality or creature of its licensees.").

230. *Id.* at 31.

231. Richard W. McLaren, Transcript of Oral Argument at 45, *United States v. Sealy*, 388 U.S. 350 (1967) (No. 9) [hereinafter *Sealy* Transcript] (arguing that *Simmons* is "an integrated firm; and that's one of the points we argue: Why should a licensee manufacturer under a

The fact that the Supreme Court treated the Sealy organizational structure as concerted action is not controversial. Still, the underlying facts can inform how lower courts should apply *American Needle* and *Copperweld* moving forward. First, the Sealy Court emphasized substance over form with respect to how to classify the restraint at issue.<sup>232</sup> But the Court also touched on the importance of elevating substance over form and the antitrust implications of the structure of joint ventures when it characterized “the use of Sealy, not as a separate entity, but as an instrumentality of the individual manufacturers.”<sup>233</sup>

In substance, the Sealy structure was the result of agreements among independent actors. The Court noted that “Sealy agreed with each licensee not to license any other person to manufacture or sell in the designated area; and the licensee agreed not to manufacture or sell ‘Sealy products’ outside the designated area.”<sup>234</sup> Sales outside of one’s assigned territory were “expressly forbidden by the contract between Sealy and the licensee.”<sup>235</sup> In seeking to avoid the per se rule, the Sealy defendants noted their “*contractual* arrangement” should not be judged more harshly than “*structural* arrangements,” like mergers or joint ventures.<sup>236</sup> In making this argument, the defendants hit on an important point: they noted that they were in a *contractual* relationship. This suggests no single entity, because a single entity does not contract with itself. For example, a parent corporation and a wholly owned subsidiary do not make contracts with each other to carry out their plans. The parent tells the subsidiary what to do. The executives and other employees directly responsible for the subsidiary’s day-to-day operations may make suggestions and provide input, but they have no power to pursue divergent policies in conflict

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trademark have to go out and compete with other people under that trademark when a brand owner, he doesn’t?”); *id.* (“And that’s a basic issue in this case: Does a licensee trademark manufacturer have the same sort of rights as a trademark owner, or is he some sort of second-class citizen where he has to compete against other people manufacturing under the same brand?”).

232. *Sealy, Inc.*, 388 U.S. at 352 (“If we look at substance rather than form, there is little room for debate. These must be classified as horizontal restraints.”).

233. *Id.* at 356.

234. *Id.* at 352.

235. Brief for the United States at 7, *United States v. Sealy, Inc.*, 388 U.S. 350 (1967) (No. 9), 1966 WL 100610 [hereinafter *Sealy* Petitioner Brief].

236. *United States v. Sealy, Inc.*, Motion to Affirm at 29, *available at* 21 ANTITRUST LAW: MAJOR BRIEFS AND ORAL ARGUMENTS OF THE SUPREME COURT OF THE UNITED STATES, 1955 Term – 1975 Term, at 815 (Philip B. Kurland & Gerhard Casper, eds., 1979) (emphasis in original).

with parent's orders. In sum, if parties are contracting with each other, then they are separate entities capable of conspiring.

It is appropriate that Sealy and its licensees were treated as independent entities because, in reality, Sealy employed the structure of a price-fixing cartel. With the competitor-licensees comprising the board of directors, Sealy established minimum prices, below which Sealy manufacturer-licensees could not charge. Following a trial, the district court found that the Sealy manufacturer-licensees had engaged in an illegal conspiracy to fix minimum retail prices on Sealy products and to police the prices so fixed.<sup>237</sup> Sealy did not appeal the finding.<sup>238</sup>

With respect to its territorial exclusivity policies, Sealy operated as a traditional cartel in some ways. For example, there were "numerous instances" in which licensees complained about price cutting by other licensees.<sup>239</sup> Sealy enforced its territorial exclusivity scheme by requiring manufacturers to pay ten dollars for each Sealy item sold in another licensee's territory.<sup>240</sup> The payments were made to Sealy, who forwarded them to the aggrieved licensee.<sup>241</sup> This is reminiscent of the buyback policies employed by illegal price-fixing cartels.<sup>242</sup> Beyond these classic cartel-enforcement devices, in mediating disputes among quarreling licensees, Sealy had no real authority beyond the power of persuasion.<sup>243</sup> This stands in stark contrast to a true single entity structure where the central body controls the constituent parts. For example, a parent corporation does not fine its subsidiary or try to persuade it to take a particular action. The parent controls the subsidiary outright.

Sealy argued that everyone involved in the Sealy structure shared the common interest of building the Sealy brand.<sup>244</sup> It asserted that its licensees had to cooperate by focusing on their own territories and not freeriding on the investments in advertising made by other

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237. *Sealy, Inc.*, 388 U.S. at 351.

238. *Id.*; see also *id.* at 355-56 (1967) ("Appellee has not appealed the order of the District Court enjoining continuation of this price-fixing, but the existence and impact of the practice cannot be ignored in our appraisal of the territorial limitations. In the first place, this flagrant and pervasive price-fixing, in obvious violation of the law, was, as the trial court found, the activity of the 'stockholder representatives' acting through and in collaboration with Sealy mechanisms.").

239. See Daniel Friedman, *Sealy Transcript*, *supra* note 231, at 49.

240. *Sealy* Petitioner Brief, *supra* note 235, at 5.

241. *Id.*

242. See *supra* notes 111-14 and accompanying text.

243. Daniel Friedman, *Sealy Transcript*, *supra* note 231, at 7 (citing specific instances).

244. *Sealy* Respondent Brief, *supra* note 229, at 21.

Sealy licensees in their respective territories.<sup>245</sup> Finally, Sealy argued that it had to coordinate these efforts from the center and impose them on the licensees.<sup>246</sup> The Court found that none of the rationales justified the agreements among Sealy and its licensees.<sup>247</sup> By implication, Sealy's coordination arguments present no reason to suggest that Sealy and its licensees should constitute a single entity for antitrust purposes.

A finding of conspiratorial capacity was obvious in *Sealy* because the individual bedding manufacturers were its only stockholders and completely controlled the corporation itself. About the best argument that the manufacturers could muster was that they wore two "hats," one when they acted in their own individual interests and another when they were acting on behalf of Sealy, Inc.<sup>248</sup> The Court had little difficulty concluding that, even though Sealy assigned the exclusive territories at issue, these should be construed as the product of a horizontal agreement among Sealy's manufacturer directors. The government argued that "the source of the territorial restriction is not an independent third party but the very sellers whom the restriction is designed to shield from competition."<sup>249</sup> When control flows from the members to a central agent, concerted action is involved.

Finally, the licensees' power to withdraw shows the presence of concerted action. The Sealy licensees could abandon their Sealy trademarks and manufacture mattresses under another label. They made long-term decisions about what was best for them, not necessarily what was best for Sealy.<sup>250</sup> This is similar to firms in a cartel, which continually decide whether remaining in the cartel is in their own best interest.<sup>251</sup>

All of the defendants in *Sealy* manufactured and sold products under a common trademark. Yet they were capable of conspiring. In some ways, this presents a stronger case for single entity status than

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245. *Id.* at 21–22.

246. *Id.*

247. *United States v. Sealy, Inc.*, 388 U.S. 350 (1967).

248. *Id.* at 353.

249. *Sealy* Petitioner Brief, *supra* note 235, at 22; *id.* at 24 ("Sealy . . . is not an independent firm responsive to interests other than those of its licensees. It is completely dominated by the licensees.").

250. See Daniel Friedman, *Sealy* Transcript, *supra* note 231, at 4 ("[Licensees are] independent in the sense that they're not controlled by Sealy. And they're also independent in the sense that each one makes its own judgments as to how best exploit his particular market.")

251. See Leslie, *Cartels*, *supra* note 149, at 1638 ("Each firm makes an independent decision as to whether joining or remaining in a cartel is in the firm's own best interest.")

the NFL teams in *American Needle*, each of which possessed its own trademarks. It would be odd to say that firms sharing a single trademark were capable of conspiring while firms aggregating disparate trademarks were not. In terms of organizational structure, NFLP in *American Needle* operated as a centralized administrator in the same manner that Sealy did with its licensees and as the Central Selling Office did for the diamond cartel. In all of these situations, the presence of a central decisionmaking body does not render the overall enterprise a single entity for antitrust purposes.

In addition to discussing *Sealy*, the *American Needle* Court opinion also cited *United States v. Topco Associates, Inc.*<sup>252</sup> In *Topco*, several small- or medium-sized regional supermarket chains created and marketed the Topco brand canned goods.<sup>253</sup> The Topco cooperative allocated exclusive territories to its members.<sup>254</sup> The government challenged the association's exclusive territory policy as a per se illegal horizontal division of markets.<sup>255</sup> The Court sided with the government, rejecting Topco's claim that the policy was a reasonable way to prevent freeriding and to build the Topco brand as a competitor to national store brands.<sup>256</sup> *American Needle* cited *Topco*, along with *Sealy*, for the proposition that "[a]greements made within a firm can constitute concerted action covered by § 1 when the parties to the agreement act on interests separate from those of the firm itself, and the intrafirm agreements may simply be a formalistic shell for ongoing concerted action."<sup>257</sup> It also highlighted *Topco* as an example of a "formally distinct business organization[ ] covered by § 1."<sup>258</sup> As in *Sealy*, Topco's members owned all of its stock and controlled the board of directors.<sup>259</sup>

Both the *Topco* and *Sealy* decisions have been rightfully criticized for applying an overly aggressive per se rule to restraints that were ancillary to legitimate, efficiency-enhancing joint ventures by firms that lacked significant market power.<sup>260</sup> But that is not why

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252. 405 U.S. 596, 609 (1972).

253. *Id.* at 596.

254. *Id.*

255. *Id.*

256. *Id.* at 612.

257. *Am. Needle, Inc. v. NFL*, 130 S. Ct. 2201, 2215 (2010).

258. *Id.* at 2210.

259. *Topco Assoc., Inc.*, 405 U.S. at 598.

260. See 11 HOVENKAMP, ANTITRUST LAW, *supra* note 22, ¶ 1910c2 (criticizing the *Topco* Court's application of a per se rule against horizontal territorial restraints); 12 *id.* ¶ 2033b (criticizing the Court's classification of the restraints in *Sealy* and *Topco* as "vertical"); 13 *id.* ¶

*American Needle* cited them. Both decisions also held that when a corporation imposes market limitations on the separate business of its shareholders who are in a position to compete with one another, the resulting restraints should be considered as a contract or combination rather than a unilateral act insofar as antitrust policy is concerned. The proper analysis in both cases would have been to apply Section One, but then to analyze the restraints at issue as ancillary to the activities of a joint venture. Both the Seventh and D.C. Circuits have taken this approach, and nothing in the *American Needle* opinion suggests that the Supreme Court would treat them any differently.<sup>261</sup>

## 2. *Dagher*

In *Texaco v. Dagher*,<sup>262</sup> a private plaintiff challenged an agreement between Texaco and Shell Oil that created Equilon Enterprises, a joint venture to refine and sell gasoline in the western United States. The joint venture set a single price for gasoline, which continued to be sold under the Texaco and Shell Oil brands. The Court granted certiorari to determine whether this constituted per se illegal price fixing.

While the case was limited to the reach of the per se rule, at times the opinion seemed to implicate the single entity question. For example, the Court framed the question as if *Copperweld* immunity were involved when it said that “the pricing policy challenged here amounts to little more than price setting by a single entity—albeit within the context of a joint venture—and not a pricing agreement between competing entities with respect to their competing products.”<sup>263</sup> In describing the facts of the case and how antitrust law treats joint ventures, the Court explained that

Texaco and Shell Oil shared in the profits of Equilon’s activities in their role as investors, not competitors. When “persons who would otherwise be competitors pool their capital and share the risks of loss as well as the opportunities for profit . . . such

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2134c (criticizing the use of the per se rule in *Sealy* and *Topco*); see also *United States v. Sealy, Inc.*, 388 U.S. 350, 361 n.2 (Harlan J., dissenting) (discussing the lack of market power in *Sealy*); *Topco*, 405 U.S. at 600 (discussing same in *Topco*).

261. *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 224 (D.C. Cir. 1986) (applying this approach to a nationwide moving company, which was owned by local moving companies and that imposed geographic restraints on the latter); *Polk Bros., Inc. v. Forest City Enter., Inc.*, 776 F.2d 185 (7th Cir. 1985) (applying this approach to an ancillary market division agreement in a shopping mall).

262. *Texaco, Inc. v. Dagher*, 547 U.S. 1 (2006).

263. *Id.* at 6.

joint ventures [are] regarded as a single firm competing with other sellers in the market.”<sup>264</sup>

Finally, in its holding the Court concluded that “[a]s a single entity, a joint venture, like any other firm, must have the discretion to determine the prices of the products that it sells, including the discretion to sell a product under two different brands at a single, unified price.”<sup>265</sup> All of these passages seem to suggest that the decisions made through the joint venture were those of a single entity and therefore beyond the reach of Section One.

Despite these careless references to the single entity issue, the opinion ultimately treats Equilon’s activities as the product of concerted action. First, the actual issue before the Court was when “the per se rule against price fixing applies to . . . the joint venture,”<sup>266</sup> not whether Section One applied. Second, the Court held that “Equilon’s price unification policy” could have been challenged pursuant to the rule of reason.<sup>267</sup>

The Court was correct to treat the decisions of a joint venture as concerted action under Section One. Considering substance over form, a joint venture may legally be a distinct entity, but its actions are still subject to Section One scrutiny. The Court in *American Needle* held that it is not “determinative that two legally distinct entities have organized themselves under a single umbrella or into a structured joint venture.”<sup>268</sup> Texaco and Shell Oil’s cooperative conduct through their joint venture must be subject to antitrust review or else illegal cartels could evade antitrust liability.

The fact that a joint venture, like Equilon, serves a coordinating function does not remove its decisions from the reach of Section One. Antitrust legality will turn on what precisely the joint venture is coordinating. The *Dagher* Court presumed that Equilon was “a lawful joint venture,” suggesting that if it were “a sham” then it could have been per se illegal.<sup>269</sup> The legitimacy of Equilon’s role as coordinator removed the joint venture from the per se category; it did not eliminate Section One scrutiny altogether.

Finally, the members of the joint venture were not bound like a parent corporation and its wholly owned subsidiary. The only thing

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264. *Id.* (quoting *Ariz. v. Maricopa Cnty. Med. Soc.*, 457 U.S. 332, 356 (1982)).

265. *Id.* at 7.

266. *Id.* at 5.

267. *Id.* at 7.

268. *Am. Needle, Inc. v. NFL*, 130 S. Ct. 2201, 2212 (2010).

269. *Dagher*, 547 U.S. at 6.

that stopped Texaco and Shell Oil from competing was the agreement, but this does not make them incapable of conspiring.<sup>270</sup> Texaco and Shell Oil could make their own pricing decisions on their branded gasoline; instead they have each decided to make the decisions through Equilon. Each could unilaterally exit the relationship.

### 3. MasterCard and Visa

Historically, the MasterCard and Visa bank credit card associations were organized as joint ventures among issuing banks.<sup>271</sup> For most banks the venture limited only a small portion of their activities, namely those involving the issuance of bank charge cards, and finding a single entity for the venture as a whole would have been absurd.<sup>272</sup> Under this structure both the Visa and MasterCard joint ventures faced antitrust litigation aimed at a variety of practices, including an agreement under which member banks in each venture were forbidden from issuing competitors' cards, but with an exception for one another.<sup>273</sup> Thus, for example, a bank issuing a Visa card was forbidden from issuing a Discover card but it could issue a MasterCard. This restraint on the issuing of others' cards was unsuccessfully challenged by Discover as a concerted refusal to deal.<sup>274</sup> Later litigation by the U.S. government proved more successful, however.<sup>275</sup>

There have also been challenges to card issuer agreements setting the interchange and merchant acceptance fees that finance credit card transactions,<sup>276</sup> and to the "all cards" policy that requires

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270. See *Am. Needle*, 130 S. Ct. at 2214–15 ("Apart from their agreement to cooperate in exploiting those assets, including their decisions as NFLP, there would be nothing to prevent each of the teams from making its own market decisions relating to purchases of apparel and headwear, to the sale of such items, and to the granting of licenses to use its trademarks.").

271. *SCFC ILC, Inc. v. Visa U.S.A., Inc.*, 36 F.3d 958, 960 (10th Cir. 1994).

272. *Id.* at 960–61.

273. See, e.g., *id.* (addressing whether Visa's refusal to admit Sears to its joint venture restrains trade in violation of Section One of the Sherman Act).

274. *Id.* (refusing to condemn exclusivity rules that enabled Visa and MasterCard to be issued by one another's banks but excluded rival cards such as Discover and American Express; to the extent it is relevant, one of the authors was consulted by the plaintiff).

275. *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 238 n.4 (2d Cir. 2003) (condemning governance duality and exclusivity rules under rule of reason; to the extent it is relevant, one of the authors was consulted by the government); see also *Discover Fin. Servs. v. Visa U.S.A., Inc.*, No. 04–CV–7844, 2008 WL 4067445 (S.D.N.Y. Aug. 26, 2008) (denying summary judgment on claim by Discover, issuer of a rival card).

276. See, e.g., *Nat'l Bancard Corp. (NaBanco) v. Visa U.S.A., Inc.*, 779 F.2d 592 (11th Cir. 1986) (applying rule of reason and refusing to condemn the fees).

those accepting Visa or MasterCard credit cards to also take that firm's debit cards.<sup>277</sup> This Article does not consider the "reasonableness," or antitrust legality, of any of these practices, but only whether they should be regarded as unilateral or conspiratorial.<sup>278</sup>

Both MasterCard and Visa have substantially reorganized, changing their structure from a contractual joint venture agreement among independent, issuing member banks to a corporation in which these issuing banks are shareholders with very limited voting rights. For example, in the MasterCard venture, Class A shares, with full voting rights, were issued to the public in an IPO and are publicly traded.<sup>279</sup> Banks that issue MasterCards are not permitted to hold Class A shares, at least for a defined time period.<sup>280</sup> Issuing banks, by

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277. See, e.g., *Wal-Mart Stores, Inc. v. Visa U.S.A., Inc.*, 396 F.3d 96 (2d Cir. 2005) (describing settlement); *In re Visa Check/MasterMoney Antitrust Litig.*, 280 F.3d 124, 130 (2d Cir. 2001) (certifying class action by large retailers).

278. On the legality question, see DAVID S. EVANS & RICHARD SCHMALENSSEE, *PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING* (2d ed. 2005) (discussing the evolution of the credit card industry and defending the position of credit card associations against antitrust claims); Dennis W. Carlton & Alan Frankel, *The Antitrust Economics of Credit Card Networks*, 63 ANTITRUST L.J. 643 (1995) (discussing the potential for anticompetitive harm to result from collective action by members of credit card joint ventures); Adam J. Levitin, *Priceless? The Economic Costs of Credit Card Merchant Restraints*, 55 UCLA L. REV. 1321 (2008) (arguing that merchant restraints should be banned as antitrust violations); Timothy J. Muris, *Payment Card Regulation and the (Mis)Application of the Economics of Two-Sided Markets*, 2005 COLUM. BUS. L. REV. 515, 517–18 (discussing the economics of two-sided markets); Jean-Charles Rochet & Jean Tirole, *Cooperation Among Competitors: Some Economics of Payment Card Associations*, 33 RAND J. ECON. 549 (2002) (analyzing the cooperative determination of the interchange fee by member banks in a payment card association); Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAP. L. REV. 79 (2000) (dismissing the link between credit cards and the bankruptcy crisis); David S. Evans & Richard Schmalensee, *The Economics of Interchange Fees and Their Regulation: An Overview* (MIT Sloan, Working Paper No. 4548–05, 2005), available at <http://ssrn.com/abstract=744705> (analyzing whether policy makers should regulate interchange fees); Todd J. Zywicki, *The Economics of Payment Card Interchange Fees and the Limits of Regulation* (George Mason Law & Econ. Research, Working Paper No. 10–26, 2010), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1624002](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1624002) (arguing against interchange fee regulation); see also U. S. GOV'T ACCOUNTABILITY OFFICE, REPORT ON CREDIT CARDS 44–45 (2009), available at <http://www.gao.gov/new.items/d1045.pdf> (discussing drawbacks of interchange fee regulation).

279. Victor Fleischer, *The MasterCard IPO: Protecting the Priceless Brand*, 12 HARV. NEGOT. L. REV. 137, 145 (2007) (tracing development of MasterCard IPO); see also Adam J. Levitin, *Payment Wars: The Merchant-Bank Struggle for Control of Payment Systems*, 12 STAN. J.L. BUS. & FIN. 425, 463–67 (2007). See generally Robert E. Litan & Alex J. Pollock, *The Future of Charge Card Networks* 6 (AEI-Brookings Joint Ctr. for Regulatory Studies, Working Paper 06–03, 2006) (discussing the reorganization of MasterCard and Visa). MasterCard, Inc. trades on the New York Stock Exchange under the symbol "MA," and Visa, Inc. trades under the symbol "V."

280. Fleischer, *supra* note 279, at 145.

contrast, hold Class B shares, which have no voting rights.<sup>281</sup> A third set of shares, Class M, are also held by member banks and have no voting rights with respect to routine business, although they do have veto power over major transactions that will affect the structure of the firm or its share classes.<sup>282</sup> The Visa structure is roughly similar.<sup>283</sup>

These seemingly odd schemes stand on its head the dual class voting structure found in some corporations. Typically when a corporation has two classes of voting shares the intent is to give insiders a *greater* amount of control than is manifested by their percentage ownership. For example, the Google, Inc. structure was designed to keep control of the corporation among its founders.<sup>284</sup> Ford Motor Company's voting structure gives members of the Ford family approximately forty percent of the company's votes even though they own only six percent of its stock.<sup>285</sup> In MasterCard, Inc. and Visa, Inc., by contrast, the member banks, while having only a minority stake, are also ongoing participants in the credit card business as independent firms, although they have effectively relinquished their voting rights. The likely explanation for this strategy is that the participants were seeking to limit antitrust exposure by ceding "control" to a single firm with diverse, inactive shareholders, as opposed to a joint venture in which decisions were made by active participants. The intended result would be that the IPOs would be treated as single entities for antitrust purposes rather than as collaborations involving agreements among rivals.<sup>286</sup>

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281. *Id.*

282. *Id.*

283. Visa, Inc., Proxy Statement (Form DEF 14A), at 26 (Dec. 1, 2009), available at <http://investor.visa.com/phoenix.zhtml?c=215693&p=proxy> (explaining that class B and C shares have no voting rights). In the Visa, Inc. IPO, Class B shareholders are financial institutions issuing Visa cards in the United States, while Class C shares are similar institutions in Canada. See GOLDMAN SACHS FIN. INST. GROUP, VISA IPO (2008), <http://www.sharpeinvesting.com/2008/01/visa-ipo-goldman-sachs-financial-institutions-group.html> (discussing Visa's organization as an IPO).

284. In the Google, Inc. IPO, Class A shares were entitled to one vote each but class B shares received ten votes. See Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 802–03 (2007) (describing Google structure as leaving outside investors largely powerless).

285. Belen Villalonga & Raphael Amit, *How Are U.S. Family Firms Controlled?*, 22 REV. FIN. STUD. 3047, 3066 (2009) (noting that as of 1998, the Ford family owned six percent of shares but controlled forty percent of votes).

286. Some authors have noted that this was very likely an intended result of the switch from a joint venture to a corporate structure. In addition to Fleischer, *supra* note 279, see Joshua D. Wright, *The MasterCard IPO: MasterCard's Single Entity Strategy*, 12 HARV. NEGOT. L. REV. 225 (2007) (expanding on Fleischer's analysis of the antitrust implications of MasterCard's new governance structure).

Whatever the economics, the legal implications of shifting the analysis from multilateral to unilateral conduct can be significant. Most importantly, the agreements among member banks in the old joint ventures not to permit issuance of rival cards such as Discover would be treated as a concerted refusal to deal, which could be unlawful per se if naked or, more likely, addressed under the rule of reason if found to be an ancillary restraint.<sup>287</sup> By contrast, if a single firm issuing a MasterCard or Visa bank card refused to carry a rival's brands, the conduct would have to be analyzed as a unilateral refusal to sell a rival's goods, which entails virtual per se legality.<sup>288</sup> Under the joint venture analysis, agreements on merchant acceptance and other transfer fees would be price agreements for that portion of the fee that the banks agreed to charge, and would generally be treated as ancillary to the joint venture's business and addressable under the rule of reason.<sup>289</sup> Under single firm analysis, any fee on a transfer from one subsidiary bank to another would be a unilateral act. The agreed upon portion of any fee arrangement with merchants would be collaborative, but that agreement would be vertical rather than horizontal and almost certainly legal. The "all-cards" policy, requiring merchants who wish to take a credit card to take that brand's debit cards as well, would be assessed under the law of tying arrangements, which are ordinarily unilaterally imposed.<sup>290</sup> However, under the joint venture structure, they would have to be regarded as a collusive agreement among the upstream firms to engage in tying, which could invoke harsher antitrust treatment.<sup>291</sup> Finally, within the joint venture structure the business relationship with the shareholder member banks is one of seller or buyer; that is, the IPOs treat the banks as their "customers," to whom they provide card issuance and management services. Formally these would count as purely vertical

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287. See *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 238 n.4 (2d Cir. 2003) (analyzing the government's claim under a rule of reason); *SCFC ILC, Inc. v. Visa U.S.A., Inc.*, 36 F.3d 958 (10th Cir. 1994).

288. *Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398, 410 (2004); see also 3B AREEDA & HOVENKAMP, *supra* note 20, ¶¶ 772–73 (discussing unilateral refusals to deal and "essential facility" doctrine).

289. See, e.g., *Nat'l Bancard Corp. (NaBanco) v. Visa U.S.A., Inc.*, 779 F.2d 592 (11th Cir. 1986) (applying rule of reason analysis instead of per se analysis to Visa's conduct).

290. Christopher R. Leslie, *Unilaterally Imposed Tying Arrangements and Antitrust's Concerted Action Requirement*, 60 OHIO ST. L.J. 1773 (1999) (arguing that most tying arrangements are essentially unilateral).

291. Christopher R. Leslie, *Tying Conspiracies*, 48 WM. & MARY L. REV. 2247 (2007) (advocating per se illegality for tying conspiracies).

relationships between the IPO as seller and each individual bank as purchaser.

The problem can now be viewed this way: suppose a group of banks organize a corporation with two classes of shares. One class is publicly traded and has full voting rights. The other class has no voting rights with respect to day-to-day business, and its ownership is limited to the participating banks. Each of these banks is a separately owned firm, and the relationship between the banks and the central firm is that of shareholder and firm rather than parent and subsidiary. In this regime the directors and managers are answerable to the shareholders and they generally operate under the constraint that they must maximize the value of the firm; however, the value of the firm is largely a function of the aggregate value of the credit card business engaged in by the individual shareholder banks.

This organization effectively uses the corporate form as a cartel or joint venture manager. Management's obligation to maximize firm value can be carried out by actions that increase profits because they are efficient and output expanding—that is, they might reduce costs, produce a superior product, or otherwise attract trade. Alternatively, they might increase profits because they reduce market output in a market where the firm has power, and thus enable higher prices or margins. If this were truly unilateral conduct, antitrust would largely be indifferent to the output reduction effects because a single firm is free to reduce output and raise prices as it pleases.

Even though the banks are not voting decisionmakers in the firm, any rule that limits their *individual* behavior must be regarded as multilateral under the *American Needle* analysis. As a result, anticompetitive collusion would be reachable just as much as anticompetitive exclusion. Of course, the firm might engage in many other activities that have no impact at all on the member banks' separate business. For example, Visa, Inc. might decide to purchase a toaster manufacturer and operate it as a subsidiary, or it might decide to build a new office building for its corporate headquarters. As long as such a decision had no impact on how the individual shareholder banks conduct their business, it would be regarded as unilateral. By contrast, any decision that limited the ability of shareholders to compete in their separate business would be addressable under Section One of the Sherman Act.

In sum, the MasterCard and Visa IPOs have the characteristics of centrally managed cartels. In substance, the central organization has the power to control the independent business of the individual issuing shareholders. The individual members have the ability to withdraw, which they can accomplish by selling their shares and

dropping the card. Further, it is unnecessary that the individual issuing banks coordinate their behavior with one another; the central organization solves that problem. Control runs from the organization to the individual members, limiting their independent business activity with respect to the issuance and management of bank cards.

Legitimate reasons may have existed for the MasterCard and Visa IPOs. For example, a stronger central organization may have enhanced the cards' brand image as a safe and secure brand.<sup>292</sup> However, the unusual "inverted" dual governance structure must have resulted from giving exaggerated importance to formal "control" within collaborative associations. In any event, that decision was based on too subjective a view of control. Once the boards of the MasterCard and Visa IPOs were in place, their goal was to maximize firm profits, and they were as suited to accomplishing this task as any cartel ringleader, whether or not a functioning member of the cartel itself.

#### CONCLUSION

The Supreme Court's opinion in *American Needle* provides an opportunity to examine the connection between cartel theory and the single entity question in antitrust. Many successful cartels function by taking control away from individual members and giving it to a single organization. A business organization such as a corporation becomes an ideal vehicle for cartel management. Understanding how cartels actually operate can help courts distinguish between a legitimate single entity and a centralized cartel structure subject to Section One liability.

It is important not to lose sight of the fact that the rule of reason remains for joint ventures among separate business entities that have significant integrative potential. While both unilateral conduct and ancillary collaborative conduct are treated under the rule of reason, however, the conduct standard differs. Under Section Two of the Sherman Act, a single firm is responsible only for its unreasonably *exclusionary* practices directed against rivals or potential rivals. By contrast, under Section One, a cartel or joint venture is answerable in antitrust when its members unreasonably reduce output and increase price, whether or not there is actionable exclusionary conduct.

As the history of the intraenterprise conspiracy doctrine indicates, that doctrine was developed in a milieu in which per se

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292. See Fleischer, *supra* note 279 (making this argument about the MasterCard IPO).

rules were much more aggressive and of significantly broader scope than they are today. Too broad a finding of “conspiracy” inside a traditional business firm could mean that perfectly benign business behavior might become an antitrust violation. But the last twenty-five years has seen a considerable contraction of per se rules and broad expansion of the rule of reason. In cases such as *American Needle*, *Topco*, and *Seely*, which involve both corporate restraints imposed on independent firms and joint ventures with significant integrative potential, the soundest approach is to view them as involving both collaborative activity and ancillary restraints—situations for which antitrust’s rule of reason is appropriate. Courts should evaluate the anticompetitive effects of resulting restraints, not immunize them from antitrust liability through the intraenterprise conspiracy doctrine.

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