MEMORANDUM 2024-34

Expert Report: Concerted Action

Earlier in the course of the Commission's antitrust study,[1] the staff recruited experts to assist the Commission by preparing reports on specific antitrust-related topics. The scope of all the expert working groups' work is described in Memorandum 2023-16. The expert reports are posted on the Commission's study page for Antitrust Law. Each report will be attached to a staff memorandum and circulated in advance of the Commission meeting at which the report will be discussed. The meeting schedule can be found here.

Attached to this memorandum is the expert report from Group 3: Concerted Action. Group 3 is composed of the following members:

Professor Peter Carstensen, University of Wisconsin School of Law (emeritus)
Professor Josh Davis, UC College of the Law San Francisco
Professor Joseph Farrell, UC Berkeley Economics
Professor Christopher Leslie, UC Irvine School of Law
Julie Pollock, Berger Montague
Sarah Van Culin, Zelle LLP
Judith Zahid, Zelle LLP

Professor Carstensen will present the group's report at the Commission's August 15, 2024, meeting.

The staff is extremely grateful for the invaluable assistance that the Group 3 experts have provided. Their expert report will establish a critical foundation for the Commission's deliberations.

Respectfully submitted,

Sharon Reilly
Executive Director

[1] Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting. However, comments that are received less than five business days prior to a Commission meeting may be presented without staff analysis.

Sarah Huchel
Staff Counsel

CALIFORNIA LAW REVISION COMMISSION STUDY OF ANTITRUST LAW

There are five sections to this document which addresses the Cartwright Act's restraint of trade rules. The first provides a brief history of the origins of the Act. The second section provides an overview of its applications to restraints of trade. The third section identifies and describes alternative frameworks that can explain and define the key concepts in restraint of trade law. The fourth section provides in depth analyses of specific topics within restraint of trade law. Finally, the fifth section discusses options for further development of the Cartwright Act's restraint of trade rules.

I. Origins of Cartwright Act and Variations from Federal Antitrust Law

In 1907, the California Legislature passed the Cartwright Act "as part of a wave of turn-of-the-century state and federal legislation intended to stem the power of monopolies and cartels."[1] The legislators enacted the Cartwright Act because cartels were controlling the trade in such important industries as lumber, baking, ice production, and electrical power, and a perception existed that the federal government was not sufficiently enforcing the Sherman Act, especially in California.[2] By outlawing agreements to fix prices or otherwise restrain trade or

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[1] *Clayworth v. Pfizer, Inc.*, 233 P.3d 1066, 1076 (Cal. 2010) (first citing John M. Landry & Kirk A. Hornbeck, *One Hundred Years in the Making: The Cartwright Act in Broad Outline*, COMPETITION, Fall 2008, at 7, 7–8; State *ex rel.* Van de Kamp v. Texaco, Inc., 762 P.2d 385, 388–392 (Cal. 1998) (in bank.), *superseded by statute on other grounds*, 1992 Cal. Stat. 1707, *as recognized in* Stop Youth Addiction, Inc. v. Lucky Stores, Inc., 950 P.2d 1086, 1097 (Cal. 1998); Rush H. Limbaugh, *Historic Origins of Anti-Trust Legislation*, 18 MO. L. REV. 215 (1953)).

[2] John M. Landry & Kirk A. Hornbeck, *One Hundred Years in the Making: The Cartwright Act in Broad Outline*, 17 COMPETITION 7, 7-8 (2008).

competition,[3] the Cartwright Act is designed to promote "the growth of healthy, competitive markets for goods and services and the establishment of prices through market forces."[4]

Early courts believed that the Cartwright Act was based on the Sherman Act.[5] In *Marin County Board of Realtors, Inc. v. Palsson*, for example, the California Supreme Court noted that "[a] long line of California cases has concluded that the Cartwright Act is patterned after the Sherman Act and both statutes have their roots in the common law. Consequently, federal cases interpreting the Sherman Act are applicable to problems arising under the Cartwright Act."[6] Two years later, in 1978, the California Supreme Court repeated that "[s]ince the Cartwright Act is patterned after the Sherman Act, federal cases interpreting the Sherman Act are applicable in construing our state laws."[7]

But doubts began to arise about whether these factual assertions about the origin of the Cartwright Act were accurate. Some sources indicated that California enacted the Cartwright Act

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[3] In re Cipro Cases I & II, 61 Cal. 4th 116, 136, 348 P.3d 845, 855 (2015) (""The [Cartwright] act 'generally outlaws any combinations or agreements which restrain trade or competition or which fix or control prices' [citation], and declares that, with certain exceptions, 'every trust is unlawful, against public policy and void.''"") (quoting *Pacific Gas & Electric Co. v. County of Stanislaus* (1997) 16 Cal.4th 1143, 1147, 69 Cal.Rptr.2d 329, 947 P.2d 291)).

[4] In re Cipro Cases I & II, 61 Cal. 4th 116, 136, 348 P.3d 845, 855 (2015).

[5] G.H.I.I. v. MTS, Inc., 147 Cal. App. 3d 256, 265, 195 Cal. Rptr. 211 (Ct. App. 1983) ("The Cartwright Act is patterned after the federal Sherman Antitrust Act (15 U.S.C. § 1 et seq.) and decisions under the latter act are applicable to the former.") ((*Corwin v. Los Angeles Newspaper Service Bureau, Inc.*, *supra.*, 4 Cal.3d 842, 852; *Saxer v. Philip Morris, Inc*. (1975) 54 Cal.App.3d 7, 19).

[6] 16 Cal. 3d 920, 925, 549 P.2d 833, 835 (1976) (citing Chicago Title Ins. Co. v. Great Western Financial Corp. (1968) 69 Cal.2d 305, 315, 70 Cal.Rptr. 849, 444 P.2d 481; Sherman v. Mertz Enterprises (1974) 42 Cal.App.3d 769, 775, 117 Cal.Rptr. 188; R. E. Spriggs Co. v. Adolph Coors Co. (1974) 37 Cal.App.3d 653, 659, fn. 5, 112 Cal.Rptr. 585; People v. Santa Clara Valley Bowling etc. Assn. (1965) 238 Cal.App.2d 225, 232, 47 Cal.Rptr. 570.)) See also *Mailand v. Burckle*, 572 P.2d 1142, 1147 (1978) (citation omitted) (first citing 15 U.S.C. § 1; then citing *Marin County*, 549 P.2d at 835; and then citing Oakland-Alameda Cnty. Builders' Exch. v. F.P. Lathrop Constr. Co., 482 P.2d 226, 231 n.3 (Cal. 1971) (in bank.) (citing Chi. Title Ins. Co. v. Great W. Fin. Corp., 444 P.2d 481, 487 (Cal. 1968) (in bank.))); Oakland-Alameda Cnty. Builders' Exch. v. F. P. Lathrop Constr. Co., 4 Cal. 3d 354, 362, 482 P.2d 226, 231 (1971) ("Because the Cartwright Act is patterned after the federal Sherman Act and both have their roots in the common law, federal cases interpreting the Sherman Act are applicable in construing the Cartwright Act.").

[7] Mailand v. Burckle, 20 Cal. 3d 367, 376, 572 P.2d 1142, 1147 (1978).

in 1907 "in reaction to the perceived ineffectiveness of the Sherman Act."[8] While observing that "no direct sources for the legislative history of the Cartwright Act exist,"[9] the California Supreme Court in *Cianci v. Superior Court* also noted that "the Cartwright Act is broader in range and deeper in reach than the Sherman Act…"[10] This presaged the Court's upcoming deep dive into legislative history.

In *State* ex rel. *Van de Kamp v. Texaco, Inc.*, the California Supreme Court acknowledged that it had previously "attributed various (and sometimes conflicting) roots to the Cartwright Act. We have (i) asserted that it was patterned after a proposed alternative bill to what became the Sherman Act; (ii) suggested that it was modeled after the Sherman Act itself; and (iii) stated that it codified the common law."[11] The *Texaco* opinion reviewed antitrust history to determine which approach was accurate. The Court explained that broadly speaking, states took one of two different approaches when crafting antitrust laws: (1) the "broadly worded" Kansas-Maine approach or (2) the "more narrowly worded, specific" Texas approach.[12] The Kansas-Maine approach "made illegal 'all arrangements, contracts, agreements, trusts *or combinations*' for various improper purposes."[13] This was probably the majority approach.[14] The

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[8] ABA, State Antitrust Practice and Statutes 6-1 (5th ed. 2014).

[9] *Cianci v. Superior Court*, 40 Cal. 3d 903, 919, 710 P.2d 375 (1985).

[10] *Id*. at 920.

[11] State of California ex rel. Van de Kamp v. Texaco, Inc., 46 Cal. 3d 1147, 1153, 762 P.2d 385 (1988) (citations omitted).

[12] *See Van de Kamp*, 762 P.2d at 388.

[13] *Van de Kamp*, 762 P.2d at 388 (discussing 1889 Kan. Sess. Laws ch. 259).

[14] *Van de Kamp*, 762 P.2d at 388 (first citing 1889 Me. Acts ch. 266; then citing 1889 Kan. Sess. Laws ch. 259; then citing 1889 Neb. Laws ch. 69; then citing 1889 Iowa Acts ch. 28; then citing 1889 Mich. Pub. Acts 225; then citing 1889 Tenn. Pub. Acts ch. 250; then citing 1889 N.C. Sess. Laws ch. 374; then citing 1889 Mo. Laws 96; then citing 1890 N.D. Sess. Laws ch. 174; and then citing 1890 S.D. Sess. Laws ch. 154).

Texaco Court found that a "comparison of selected relevant language (and enforcement provisions) from the various acts… demonstrates that the Cartwright Act, . . . is more similar to the Texas [Act]," and that "the language of the Cartwright Act has very little in common with that of the Sherman Act."[15] Thus, the Cartwright Act "was based in part on other recently enacted state laws aimed at the same problems."[16]

In *Texaco*, the California Supreme Court used this legislative history to hold that the Cartwright Act did not reach mergers because "at the time the Cartwright Act was enacted there was a recognizable body of case law construing the word "combination" (in both Kansas-Maine and Texas-type acts) as not applying to the purchase of one business by another entity engaged in the same business."[17]

More broadly, though, the history review led the Court to conclude that "judicial interpretation of the Sherman Act, while often helpful, is not directly probative of the Cartwright drafters' intent, given the different genesis of the provision under review."[18] More recently, in *In re Cipro Cases I & II*,[19] ("*Cipro*") the California Supreme Court reiterated that "'[i]nterpretations of federal antitrust law are at most instructive, not conclusive, when construing the Cartwright Act, given that the Cartwright Act was modeled not on federal antitrust statutes but instead on statutes enacted by California's sister states around the turn of the 20th century.'"[20]

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[15] *Id.* at 392 n.14.

[16] Clayworth v. Pfizer, Inc., 233 P.3d 1066, 1076 (Cal. 2010) (first citing *Van de Kamp*, 762 P.2d at 392–93 & n.14; and then citing Don T. Hibner, Jr. & Heather M. Cooper, *The Cartwright Act at 100—A History of Complementary Antitrust Enforcement—A Celebration*, COMPETITION, Fall 2008, at 81, 91–92).

[17] State of California ex rel. Van de Kamp v. Texaco, Inc., 46 Cal. 3d 1147, 1159, 762 P.2d 385 (1988).

[18] State of California ex rel. Van de Kamp v. Texaco, Inc., 46 Cal. 3d 1147, 1164, 762 P.2d 385 (1988).

[19] 348 P.3d 845, 858–59 (Cal. 2015).

[20] Id. at 858–59 (quoting Aryeh v. Canon Bus. Sols., Inc., 292 P.3d 871, 877 (Cal. 2013); and then citing *Van de Kamp*, 762 P.2d at 395)).

The U.S. Supreme Court recognized the independent nature of the Cartwright Act when it held that federal antitrust laws do not preempt state antitrust laws, such as the Cartwright Act. In *California v. ARC America Corp.*, the U.S. Supreme Court noted that the reach of the Cartwright Act can be broader than the Sherman Act because "Congress has not pre-empted the field of antitrust law. Congress intended the federal antitrust laws to supplement, not displace, state antitrust remedies."[21] That would seem to prove that the Sherman Act and the Cartwright Act are not identical.

Even after the California Supreme Court's explanation of the Cartwright Act's origins (in *Texaco*) and affirmation that the Cartwright Act is broader than the Sherman Act (in *Cipro*), some courts still treat the latter as binding on or limiting the former. For example, the California appellate court in *Flagship Theatres of Palm Desert, LLC v. Century Theatres, Inc.*,[22] reasoned that the operative section of the Cartwright Act "is analogous to the catchall language of section 1 of the Sherman Act,"[23] and the court quoted a pre-*Texaco* case for the proposition that "'federal cases interpreting the Sherman Act are applicable to problems arising under the Cartwright Act.'"[24]

Even after the California Supreme Court explained the origins of the Cartwright Act, including that it was not based on the Sherman Act, federal courts have continued to conflate the

[21] California v. ARC Am. Corp., 490 U.S. 93, 101–02, 109 S. Ct. 1661, 1665, 104 L. Ed. 2d 86 (1989) (citations omitted).

[22] 55 Cal. App. 5th 381, 399, 269 Cal. Rptr. 3d 446, 461 (2020).

[23] Flagship Theatres of Palm Desert, LLC v. Century Theatres, Inc., 55 Cal. App. 5th 381, 399, 269 Cal. Rptr. 3d 446, 461 (2020).

[24] Id. at 400 (quoting *Palsson,* 16 Cal.3d at p. 925, 130 Cal.Rptr. 1, 549 P.2d 833). The court also quoted *Texaco*'s statement that "Nor can we agree that the Cartwright Act is somehow broader than the Sherman Act and the common law." *Id*. But Texaco was not making a blanket statement here, but was stating that the Cartwright Act did not reach mergers.

two. Most notably, in *County of Tuolumne v. Sonora Community Hospital*, the Ninth Circuit asserted that "analysis under California's antitrust law *mirrors* the analysis under federal law because the Cartwright Act, Cal. Bus. & Prof. Code § 16700 *et seq.*, was modeled after the Sherman Act."[25] Consequently, federal courts held that if challenged conduct did not violate the Sherman Act, then it did not violate the Cartwright Act either.[26] After dismissing federal Section 1 claims, federal courts mechanically dismissed accompanying Cartwright Act claims based on the assumption that the latter are "patterned after section 1 of the Sherman Act."[27]

Today, Ninth Circuit opinions continue to assert that "Cartwright Act analysis mirrors the Sherman Act analysis, so we analyze both claims together."[28] For example, the Ninth Circuit asserted in 2022 that "[b]ecause the analysis of a claim under the Cartwright Act 'mirrors the

[25] 236 F.3d 1148, 1160 (9th Cir. 2001) (first citing Nova Designs, Inc. v. Scuba Retailers Ass'n, 202 F.3d 1088, 1091 (9th Cir. 2000); and then citing Mailand v. Burckle, 572 P.2d 1142, 1147 (Cal. 1978)). See also Fed. Trade Comm'n v. Shkreli, 581 F. Supp. 3d 579, 628 (S.D.N.Y. 2022) ("The analysis of claims brought under California's Cartwright Act 'mirrors the analysis under federal law because the Cartwright Act ... was modeled after the Sherman Act.'") (quoting Cnty. of Tuolumne v. Sonora Cmty. Hosp., 236 F.3d 1148, 1160 (9th Cir. 2001)).

[26] *Cnty. of Tuolumne*, 236 F.3d at 1160 ("Given our analyses and conclusions regarding the federal claims, the district court properly granted summary judgment on the state antitrust claims, as well.").

[27] Kelsey K. v. NFL Enterprises, LLC, 757 F. App'x 524, 527 (9th Cir. 2018) (holding plaintiff's "claim under California's Cartwright Act fails for the same reasons because the requirements to plead a claim under California's Cartwright Act are 'patterned after section 1 of the Sherman Act.'" Accordingly, we affirm the district court's ruling that the complaint fails to plausibly allege conspiracy under the Cartwright Act.") (quoting Dimidowich v. Bell & Howell, 803 F.2d 1473, 1476–77 (9th Cir. 1986)); Insulate SB, Inc. v. Advanced Finishing Sys., Inc., 797 F.3d 538, 547 (8th Cir. 2015) ("Because Insulate has not sufficiently pled a claim under federal antitrust law, Insulate also has not stated a claim under the Cartwright Act.").

[28] PLS.Com, LLC v. Nat'l Ass'n of Realtors, 32 F.4th 824, 831–32 (9th Cir. 2022). See Name.Space, Inc. v. Internet Corp. for Assigned Names & Numbers, 795 F.3d 1124, 1131 n.5 (9th Cir. 2015) ("Because the analysis under the Cartwright Act, Cal. Bus. & Prof.Code §§ 16700–16770, is identical to that under the Sherman Act, *see Cnty. of Tuolumne v. Sonora Cmty. Hosp.,* 236 F.3d 1148, 1160 (9th Cir.2001), we also affirm the district court's dismissal of the Cartwright Act claim."); Rick-Mik Enterprises, Inc. v. Equilon Enterprises LLC, 532 F.3d 963, 976 (9th Cir. 2008) ("The state law antitrust claims are derivative of the federal law claims. Because the federal claims fail, the state law claims fail.") (citing *County of Tuolumne v. Sonora Cmty. Hosp.,* 236 F.3d 1148, 1160 (9th Cir.2001)). *See also In re* Cal. Bail Bond Antitrust Litig., 511 F. Supp. 3d 1031, 1040 n.2 (N.D. Cal. 2021) ("Because the Cartwright Act was modeled after the Sherman Act, the Court's analysis addresses both statutes together pursuant to federal antitrust law." (citing *Sonora Cmty. Hosp.*, 236 F.3d at 1160)); Jain Irrigation, Inc. v. Netafim Irrigation, Inc., 386 F. Supp. 3d 1308, 1314 (E.D. Cal. 2019) (asserting that "the Cartwright Act . . . was modeled after the Sherman Act") (quoting County of Tuolumne v. Sonora Cmty. Hosp., 236 F.3d 1148, 1160 (9th Cir. 2001).

analysis under federal [antitrust] law,' we do not consider the Cartwright Act claims separately from the federal antitrust claims."[29]

Some federal courts, however, have recognized the independent reach of the Cartwright Act. For example, the Ninth Circuit in *Knevelbaard Dairies v. Kraft Foods, Inc*., noted that "federal antitrust precedents are properly included in a Cartwright Act analysis, but their role is limited: they are 'often helpful' but not necessarily decisive."[30] More recently, the court in *Samsung Electronics. Co. v. Panasonic Corp*. cited California Supreme Court precedent to acknowledge that it "is no longer the law in California" that the Cartwright Act is "coextensive with the Sherman Act."[31] One federal district court in California noted that because "the Cartwright Act is 'broader and deeper' than the Sherman Act,"[32] "a claim dismissed under the Sherman Act can still survive under the Cartwright Act."[33]

Properly understood, federal cases interpreting Section One of the Sherman Act are persuasive authority for interpreting the Cartwright Act, not binding authority.[34] One California appellate court explained "the appropriate use of federal cases interpreting the Sherman Act is as

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[29] Olean Wholesale Grocery Coop., Inc. v. Bumble Bee Foods LLC, 31 F.4th 651, 665 n.8 (9th Cir. 2022) (quoting *Sonora Cmty. Hosp.*, 236 F.3d at 1160)). See also Calabasas Luxury Motorcars, Inc. v. Gen. Motors LLC, No. CV2109566TJHPDX, 2022 WL 17348983, at *1 (C.D. Cal. Aug. 25, 2022) ("Because the Cartwright Act is modeled after the Sherman Act, 15 U.S.C. § 1, *et seq.*, California courts regularly apply Sherman Act cases to Cartwright Act claims.") (citing *Marin Cnty. Bd. of Realtors, Inc. v. Palsson*, 16 Cal. 3d 920, 925 (1976)).

[30] Knevelbaard Dairies v. Kraft Foods, Inc., 232 F.3d 979, 985 (9th Cir. 2000).

[31] Samsung Electronics. Co. v. Panasonic Corp., 747 F.3d 1199, 1205 n.4 (9th Cir. 2014) (citing *Aryeh v. Canon Business Solutions, Inc.,* 55 Cal.4th 1185, 1195, 151 Cal.Rptr.3d 827, 292 P.3d 871 (2013)).

[32] In re Qualcomm Antitrust Litig., No. 17-MD-02773-JSC, 2023 WL 121983, at *15 (N.D. Cal. Jan. 6, 2023) (quoting Cipro, 61 Cal. 4th at 160–161).

[33] In re Qualcomm Antitrust Litig., No. 17-MD-02773-JSC, 2023 WL 121983, at *15 (N.D. Cal. Jan. 6, 2023) (citing Samsung Elecs. Co. v. Panasonic Corp., 747 F.3d 1199, 1205 n.4 (9th Cir. 2014)).

[34] Morrison v. Viacom, Inc., 66 Cal. App. 4th 534, 541, 78 Cal. Rptr. 2d 133 (1998) ("Though not always directly probative of the Cartwright Act drafters' intent, judicial interpretations of the Sherman Act are, nevertheless, often helpful because of the similarity in language and purpose between the federal and state statutes.").

an aid in interpreting our own Cartwright Act, not as controlling precedent…"[35] The California Supreme Court in *Aryeh v. Canon Business Solutions, Inc*., stated that "[i]nterpretations of federal antitrust law are at most instructive, not conclusive, when construing the Cartwright Act, given that the Cartwright Act was modeled not on federal antitrust statutes but instead on statutes enacted by California's sister states around the turn of the 20th century."[36]

To the extent that federal courts continue to assert that the Cartwright Act mirrors federal antitrust law, the California legislature could eliminate this confusion by clarifying that the Cartwright Act is broader than federal antitrust law and has its own common law.

II. Basic Framework

The California Supreme Court has held that the text of the Cartwright Act should not be interpreted literally. The *Cipro* Court noted that "[t]hough the Cartwright Act is written in absolute terms, in practice not every agreement within the four corners of its prohibitions has been deemed illegal."[37] Like the Sherman Act, courts interpret the Cartwright Act to prohibit only *unreasonable* restraints of trade.[38]

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[35] Cellular Plus, Inc. v. Superior Ct., 14 Cal. App. 4th 1224, 1240, 18 Cal. Rptr. 2d 308 (1993). See also *In re Auto. Antitrust Cases I & II*, 1 Cal.App.5th 127, 204 Cal. Rptr. 3d 330, 351 n.15 (2016) ("In antitrust actions brought under the Cartwright Act, we look to interpretations of its federal law counterpart, the Sherman Antitrust Act....").

[36] Aryeh v. Canon Bus. Sols., Inc., 55 Cal. 4th 1185, 1195, 292 P.3d 871, 877 (2013).

[37] In re Cipro Cases I & II, 61 Cal. 4th 116, 136, 348 P.3d 845, 855 (2015) (citing *Morrison v. Viacom, Inc.* (1998) 66 Cal.App.4th 534, 540, 78 Cal.Rptr.2d 133).

[38] Ben-E-Lect v. Anthem Blue Cross Life & Health Ins. Co., 51 Cal. App. 5th 867, 872, 265 Cal. Rptr. 3d 495, 501 (2020), as modified on denial of reh'g (July 22, 2020) ("The Cartwright Act prohibits all combinations created for or carrying out unreasonable restrictions in trade or commerce."). See Flagship Theatres of Palm Desert, LLC v. Century Theatres, Inc., 55 Cal. App. 5th 381, 398–99, 269 Cal. Rptr. 3d 446, 461 (2020) ("The distinction between per se and rule of reason analysis stems from the fact that the Cartwright Act, like its federal counterpart the Sherman Act, prohibits not *all* agreements restraining trade, but rather agreements that *unreasonably* restrain trade.").

The issue for courts is where to draw the line between reasonable and unreasonable restraints.[39] Case law interpreting the Cartwright Act follows the federal approach of using two primary tests for evaluating whether a challenged agreement unreasonably restrains trade: the per se rule and the rule of reason.[40] When a restraint falls in a per se category, "[t]he law conclusively presumes manifestly anticompetitive restraints of trade to be unreasonable and unlawful, and evaluates other restraints under the rule of reason."[41] If a challenged restraint does not fall in a per se category, courts evaluate it under the rule of reason.[42]

A. Per Se Rule

The per se rule is categorical. The California Supreme Court in *Cipro* noted that – similar to federal antitrust jurisprudence – California courts interpreting the Cartwright Act have "identif[ied] categories of agreements or practices that can be said to always lack redeeming value and thus qualify as per se illegal."[43] California courts apply the per se rule "where the conduct involved is manifestly anticompetitive and has no clearly discernible benefits to competition."[44] Once a restraint is deemed to be in a per se category, it creates "an irrebuttable presumption that, if the court were to subject the conduct in question to a full-blown inquiry, a

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[39] In re Cipro Cases I & II, 61 Cal. 4th 116, 136–37, 348 P.3d 845, 855 (2015) ("What was true under the common law, however, is true today: 'the difficulty lies in determining what are reasonable and what unreasonable restrictions.'") (quoting Wright v. Ryder (1868) 36 Cal. 342, 358).

[40] Flagship Theatres of Palm Desert, LLC v. Century Theatres, Inc., 198 Cal. App. 4th 1366, 1374, 131 Cal. Rptr. 3d 519, 525 (2011), as modified on denial of reh'g (Sept. 29, 2011) ("Under both Cartwright Act and Sherman Act case law, some restraints of trade are treated as per se unlawful, while others are analyzed under the 'rule of reason.'").

[41] Fisherman's Wharf Bay Cruise Corp. v. Superior Ct. of San Francisco, 114 Cal. App. 4th 309, 334–35, 7 Cal. Rptr. 3d 628, 649 (2003) (quoting *Chavez v. Whirlpool Corp., supra,* 93 Cal.App.4th at p. 369, 113 Cal.Rptr.2d 175)).

[42] See also Reynolds v. California Dental Serv., 200 Cal. App. 3d 590, 596, 246 Cal. Rptr. 331 (Ct. App. 1988) ("The United States Supreme Court has evaluated allegedly anticompetitive practices by two standards. The basic test is the rule of reason. This test is intended to allow courts to strike down only those restraints on trade which are unreasonable.").

[43] In re Cipro Cases I & II, 61 Cal. 4th 116, 146, 348 P.3d 845, 861–62 (2015) (citations omitted).

[44] Guild Wineries & Distilleries v. J. Sosnick & Son, 102 Cal. App. 3d 627, 634, 162 Cal. Rptr. 87 (Ct. App. 1980)

violation would be found under the traditional rule of reason."[45] Thus, the plaintiff need not define the relevant market or prove anticompetitive harm.[46] The anticompetitive effect is presumed and no actual anticompetitive effect needs to be proven.[47]

B. Rule of Reason

The rule-of-reason "inquiry asks 'whether an agreement harms competition more than it helps' by considering 'the facts peculiar to the business in which the restraint is applied, the nature of the restraint and its effects, and the history of the restraint and the reasons for its adoption.'"[48] Under the rule of reason, "the appropriate focus was on the effects of [the defendants'] practices rather than the[ir] intention…"[49] The challenged restraint's anticompetitive effects are weighed against its procompetitive effects. If the former outweigh the latter, the restraint is unlawful.[50] Rule of reason analysis, however, should not be overly deferential because "[p]ractices scrutinized under the rule of reason may hold tremendous potential to harm competition and violate the antitrust laws."[51] California courts have stated the

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[45] In re Cipro Cases I & II, 61 Cal. 4th 116, 146, 348 P.3d 845, 861–62 (2015) (quoting *Fisher v. City of Berkeley,* 37 Cal.3d at p. 666, 209 Cal.Rptr. 682, 693 P.2d 261).

[46] See Flagship Theatres of Palm Desert, LLC v. Century Theatres, Inc., 55 Cal. App. 5th 381, 398, 269 Cal. Rptr. 3d 446, 461 (2020) ("Flagship first responds to Century's arguments regarding the sufficiency of the evidence by contending that Century's multi-theater licensing agreements are per se illegal under the Cartwright Act, rather than subject to the rule of reason, and thus that Flagship was not *required* to prove anticompetitive harm in a properly defined market in order to prevail.").

[47] Mailand v. Burckle, 20 Cal. 3d 367, 380, 572 P.2d 1142, 1150 (1978) ("Under the authorities cited above, the agreement between plaintiffs and defendants and between defendants and Powerine were unlawful per se. It is, therefore, not necessary to inquire whether these arrangements had an actual anticompetitive effect.").

[48] Ixchel Pharma, LLC v. Biogen, Inc., 9 Cal. 5th 1130, 1150, 470 P.3d 571, 581 (2020) (quoting *In re Cipro Cases I & II* (2015) 61 Cal.4th 116, 146, 187 Cal.Rptr.3d 632, 348 P.3d 845).

[49] Reynolds v. California Dental Serv., 200 Cal. App. 3d 590, 596, 246 Cal. Rptr. 331 (Ct. App. 1988).

[50] Flagship Theatres of Palm Desert, LLC v. Century Theatres, Inc., 198 Cal. App. 4th 1366, 1374, 131 Cal. Rptr. 3d 519, 525 (2011), as modified on denial of reh'g (Sept. 29, 2011) ("Under the rule of reason, the challenged conduct is unlawful only if its anticompetitive effects outweigh its procompetitive effects.").

[51] Flagship Theatres of Palm Desert, LLC v. Century Theatres, Inc., 55 Cal. App. 5th 381, 400, 269 Cal. Rptr. 3d 446, 462 (2020) (citing *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* (2007) 551 U.S. 877, 894). See also Flagship

rule of reason is "consumer focused" and "any such focus on competition more broadly is merely a means to protect the consumer."[52]

C. Quick Look

Beginning in the 1980s, federal courts began to recognize a third intermediate category between the per se rule and the rule of reason, generally called quick-look analysis. The Supreme Court officially recognized quick look in 1999's *California Dental Association v. Federal Trade Commission* ("*CalDental*").[53] Quoting *CalDental*, the California Supreme Court in *Cipro* has noted that "[u]nder the quick look approach, applicable to cases where 'an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets,' a defendant may be asked to come forward with procompetitive justifications for a challenged restraint without the plaintiff having to introduce elaborate market analysis first."[54] The *Cipro* court noted "[t]he emergence of quick look rule of reason analysis did not signal the supplanting of the traditional per se/rule of reason dichotomy with a new trichotomy, but rather a shift to "something of a sliding scale" in antitrust analysis. This more nuanced approach makes equal sense for claims under the Cartwright Act."[55] Although the California Supreme Court has seemingly endorsed the use of quick-look analysis under the Cartwright Act, it has not yet condemned challenged restraints

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Theatres of Palm Desert, LLC v. Century Theatres, Inc., 55 Cal. App. 5th 381, 400, 269 Cal. Rptr. 3d 446, 462 (2020) ("Subjecting conduct to rule-of-reason scrutiny thus does not reflect a conclusion that the conduct is somehow innocuous or likely to be legal.").

[52] Flagship Theatres of Palm Desert, LLC v. Century Theatres, Inc., 55 Cal. App. 5th 381, 416, 269 Cal. Rptr. 3d 446, 475–76 (2020).

[53] 526 U.S. 756 (1999).

[54] In re Cipro Cases I & II, 61 Cal. 4th 116, 146–47, 348 P.3d 845, 862 (2015) (quoting *CalDental,* 526 U.S. at 770).

[55] In re Cipro Cases I & II, 61 Cal. 4th 116, 146–47, 348 P.3d 845, 862 (2015) (cleaned up; citations omitted).

under the quick-look rule. How California courts will apply a quick-look analysis to Cartwright Act claims remains to be seen.

III. Statutory Comparison and General Frameworks for Analysis

A. Introduction

Although the Cartwright Act and the Sherman Act's Section 1 both address and prohibit many restraints of trade, the wording of the two statutes differs in key respects. Despite those differences, the results that California courts have reached in applying the Cartwright Act are similar in many cases to what the federal courts have done in applying the Sherman Act to agreements in restraint of trade. This section will first compare the statutory language of the Sherman Act's Section 1 with the Cartwright Act's provisions governing restraints of trade. It will identify areas where there are differences based on California's statutory language. Second, it will examine the application of these statutes in the federal and California courts in terms of alternative frameworks for determining the legality of restraints.

B. Comparison of the Statutes

1. The Sherman Act's Ambiguous Language

The Sherman Act's Section 1 on its face categorically condemns all agreements that restrain trade: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce . . . is declared to be illegal . . .[and] [e]very person who shall make any contract or engage in any combination or conspiracy . . . shall be deemed guilty of a felony. . .."[56] There is no basis to believe that Congress in 1890 meant to prohibit all contracts that involved restraints as almost all contracts do. As a result, the courts have never interpreted Section 1 in that way. Even the earliest decisions recognized that absolute condemnation applied

[56] 15 U.S.C. §1.

in only some circumstances while in others a different standard based on some determination of the reasonableness of the restraint would govern (see Part III C for a discussion of this issue). At no time, however, has Congress seriously considered revising this language or the implicit grant of broad powers of interpretation assumed by the courts. As a result, interpretations of this section have varied considerably over time as the views of justices on the Supreme Court have shifted.

The lack of statutory direction with respect to restraints of trade is a positive feature in the view of some observers. It allows courts to adjust their interpretation of the statutory command in light of developing economic theories, empirical analyses of markets, and emerging business conduct. Other observers are concerned that it allows the courts too much latitude to decided which kinds of competitive conduct are lawful or unlawful. This is a greater concern if courts are seen as being influenced in their interpretation of the statute by ideological perspectives that may lack strong empirical or theoretical support. One part of this critical concern is that judges are neither economists nor legislators.

Although Congress has not modified the wording of Section 1, it has at various times adopted statutes that modify or eliminate the application of this provision. For example, standard setting organizations which would appear to be "per se" illegal restraints (see discussion of the case law infra), if found to violate the law in a private damage action can only be assessed single damages and their conduct must be evaluated under the "rule of reason."[57] Similarly, Congress has created modifications to protect local governments from financial liability,[58] authorized for 30 years agreements among competing colleges to share information about financial aid

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[57] See, 15 U.S.C. §4301 et seq.

[58] See, 15 U.S.C. §34 et seq.

analysis,[59] and authorized medical resident programs to allocate applicants through a national system in which programs select the resident applicants.[60] In some instances, Congress has limited exemptions that the Court created. The best-known example is the Curt Flood Act[61] that limited the scope of the Supreme Court's decision that professional baseball was not subject to antitrust law.[62] It has also granted and then removed exceptions.[63] Nevertheless, the interpretation of Section 1, has remained primarily a matter of judicial decisions. [64]

2. The California Statutory System

The California statutory system has substantially more structure than the federal system. This can impose constraints on enforcement.[65] In contrast to federal antitrust law, California's

[59] Emma Whitford, *Financial Aid Blues: Elite Colleges See Federal Antitrust Exemption Expire As Price-Fixing Lawsuit Advances,* FORBES, Oct. 5, 2022 available at https://www.forbes.com/sites/emmawhitford/2022/10/05/financial-aid-blues-elite-colleges-see-federal-antitrust-exemption-expire-as-price-fixing-lawsuit-advances/?sh=7b738ea43176 (exemption for coordination among colleges on financial aid allowed to expire).

[60] 15 U.S.C. §37b.

[61] Public Law 105-297 (1998) codified at 15 U.S.C. §26b.

[62] Federal Baseball Club v. National League, 259 U.S. 200 (1922) (holding professional baseball was not subject to antitrust law). The Court has refused to apply the same standard to other professional sports. See, e.g., Radovich v. NFL, 352 U.S. 445 (1957).

[63] At one point, via the Mil1er-Tydings Act of 1937, Pub. L. No. 314, 75th Cong. 1st Sess., Congress authorized states to adopt and enforce resale price maintenance laws at a time when such agreements were illegal under federal law. That exemption was repealed in 1976 by the Consumer Goods Pricing Act, Public Law 94-145.

[64] The evolution of antitrust standards for resale price maintenance is a good example. Doctor Miles v. John D. Park & Son, 220 U.S. 373 (1911) condemned resale price maintenance and was understood to make it "per se" illegal. But in 1937, Congress authorized such restraints under limited conditions but then in 1975, repealed that authorization. However, the Supreme Court subsequently reversed its own precedent and determined that the Sherman Act only barred resale price maintenance schemes that violated the rule of reason. See Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

[65] For example, the California Supreme Court determined that the wording of §16720 precluded its use to challenge anticompetitive mergers resulting in a gap in the coverage of state law. State of California ex rel. Van de Kamp v. Texaco, Inc., 46 Cal. 3d 1147 (1988). The Clayton Act's prohibition on mergers that can result in harm to competition still applies to mergers affecting California as long as they are in or affect interstate commerce. See, e.g., California v. American Stores, 495 U.S. 271 (1990).

law condemns certain type of restraints completely or provides specific standards that both authorize and constrain the scope of such restraints.

a) Specific Statutory Rules for Covenants Not to Compete

Many states use contract law to provide guidance on the permissible scope of covenants (contracts) not to compete although such agreements are also subject generally to antitrust law as well. California has instead chosen to establish standards for such contracts in its antitrust law: §16600 categorically condemns all covenants not to compete. But following that command there are series of statutory exceptions: §16601 (sale of a business), §16602 (exit from partnership), and §16602.5 (exit from an LLC). The exceptions require the covenants be limited to a reasonable territory related to the transaction but provide that they can last as long as another party continues to operate that business. This is a more protective standard in terms of duration than overall contract law would seem to allow. The usual standard is that duration should last only sufficiently long to allow the buyer or surviving firm to establish itself in the market.

Effectively, §16600's absolute prohibition applies only to post-employment agreements. Even here the legislature has made accommodations to protect what it deemed legitimate interests of former employers: §16606 allows a restraint on customer lists used in telephone answering services and §16607 bars a former employee from using lists of those using an employment service in the 180 days prior to departing such a job. This restriction lasts for a year. The ban on covenants also does not foreclose other agreements restricting post-employment use of confidential information or customer lists if those restraints are reasonable. What is forbidden is any restraint on actual employment by a competitor.

Thus, in this area, California's statutory plan is more clearly defined than the generalized command of the Sherman Act. It is worth noting here that the FTC is currently considering a rule

that would ban such employee covenants under its authority.[66] This proposal has generated a very large number of responses including a number from businesses that assert that such a rule would significantly and adversely affect their operation. However, other states have followed or are following California in adopting statutes that ban post-employment covenants not to compete entirely or as applied to classes of employees. In addition, some scholars have asserted that California's general prohibition on post-employment covenants contributed importantly to its emergence as a leading location for technological innovation because its law allowed former employees more easily to establish their own enterprises.[67]

b) General Rules on Agreements in Restraint of Trade

§16720 defines a "trust" as "a combination" involving "two or more persons" that engages in any of a list of acts. The list has a general prohibition in (a) of any "restrictions in trade or commerce" and then has four sections that identify more specific restraints involving commodities including (e) (3) which prohibits agreements that control prices including resale prices. Sub-section (c) explicitly prohibits exercise of buyer power to harm competition in supply markets. Although subsections (b) to (e) are limited to restraints involving commodities, subsection (a) applies to goods and services.[68] Engaging in any of these restraints is then explicitly forbidden by §16722 ("Any contract or agreement in violation of this chapter is absolutely void . . ..") and §16726 ("Except as provided in this chapter, every trust is unlawful, against public policy and void").

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[66] See, https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-proposes-rule-ban-noncompete-clauses-which-hurt-workers-harm-competition.

[67] See, Ronald J. Gilson, *The Legal infrastructure of High Technology Industrial Districts: Silicon Vale, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575 (1999).

[68] Marin County Bd. of Realtors, Inc. v. Palsson, 16 Cal. 3d 920, 927-928 (1976) (Cartwright Act applies to services).

But unlike the Sherman Act, but similar to the structure of the covenants not to compete sections, §16725 provides that it is "not unlawful to enter into agreements or form associations or combination, the purpose and effect of which is to promote, encourage or increase competition in any trade or industry, or which are in furtherance of trade."

Like the Sherman Act, there are also statutory exceptions. One is for motor carriers to use agreed forms and rates. See, §16728. Another provision, §16770 is directed at buying groups for health care services and rejects use of a per se standard for such buying groups based on the legislature's interpretation of *Maricopa v. Arizona*, 457 U.S. 332 (1982).[69] It declares such groups to be creating a "new product" and so subject to the rule of reason. Other provisions declare specifically defined conduct to be unlawful. §16721 and §16721.5 (forbid discrimination in business relationships);[70] and §§16800 to 16804 (added in 1953) provide specific prohibitions on interfering with the sale of livestock.

The Sherman Act is on its face absolute and the use of the rule of reason is a judicial interpretation.[71] California, in contrast, has employed a statutory structure both for covenants not to compete and for restraints generally that starts with a general prohibition and then recognizes exceptions that apply to a large number of cases. Thus, §16725 provides a broad basis to defend restraints which is consistent with an ancillary restraint model (discussed infra), but the language arguably goes beyond that and may authorize naked restraints that "promote, encourage or

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[69] Apparently, the legislature believed that the *Maricopa* decision implied that any buying group was engaged in an unlawful price fixing arrangement. The case involved a venture that coordinated and combined the collection of fees from many health insurers by doctors. It also included an agreement among those doctors that fixed the prices that doctors would charge. In the view of many the question in the case was whether that price fixing element was necessary for the joint venture to provide the collection services for the doctors.

[70] This is qualified by §16721.6 to avoid a conflict with federal export laws.

[71] See discussion infra of the judicial application of these statutory standards.

increase competition. . ..” This provides a potential standard for allowing reasonable standard setting agreements that are necessary for efficient market operation. In contrast, the Sherman Act was supplemented by a statute that only indirectly and only to a limited extent provides a standard for excusing such organizations from liability as long as their conduct is reasonable.[72]

3. Conclusion

Overall, the Cartwright Act arguably has a framework in §16720, §16722, §17625 and §16726 that provides relatively more guidance than does the Sherman Act as to those restraints which are “per se” illegal and those which are subject to a “rule of reason.”

C. Judicial Frameworks for Analysis of the Merits of Agreements in Restraint of Trade

Given the ambiguity of any statutory language when applied to actual business transactions and agreements, there is substantial scope for courts to interpret that language in a variety of ways. This Part will provide background on the evolution of federal law and compare that with the results of California courts application of the Cartwright Act. In order to provide structure to this comparison, the part identifies alternative conceptual frameworks for determining the criteria that should apply to determine both whether a per se rule or a test of reasonableness should apply and what factors will determine the specific analysis.

1. The Problematic Evolution of the Per Se Rule and the Rule of Reason in Federal Law

The Sherman Act declares that: “Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce . . . is declared to be illegal.”[73] The manifest problem with this statement is that literally it would condemn almost all contracts

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[72] Standard Setting Organizations Section, 15 U.S.C. §4301 et seq.

[73] 16 USC §1.

because inherently contracts impose restraints on one or more of the parties. Hence, from the outset of Supreme Court interpretation of this provision, the decisions have imposed some kind of a distinction among restraints. Some restraints were condemned on their face.[74] Other restraints were upheld.[75] Unfortunately, the Supreme Court' early explanations for the distinctions between the cases were not very informative.

William Howard Taft's opinion in the *Addyston Pipe* case for the Sixth Circuit provided one potential organizing principle based on the common law treatment of covenants not to compete.[76] That decision focused on the function of the restraint. If it functioned to resolve some legitimate need or control some risk arising from a productive transaction or venture, then the restraint was "ancillary" to that primary transaction and its reasonableness could be assessed in light of the reasonable needs of the venture or transaction. On the other hand, "naked" restraints of competition, ones that only functioned to create, allocate, and or exploit market power, were condemned absolutely because there was no metric by which such direct interference with the market process could be measured as to its reasonableness.[77] The Supreme Court, however, did

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[74] United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897); United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898).

[75] Anderson v. United States, 171 U.S. 604 (1898); Hopkins v. United States, 171 U.S. 578 (1898). These two decisions upholding restraint ancillary to joint ventures were decided the same day as *Joint Traffic* and the opinions were written by Justice Peckham who was also the author of both *Joint Traffic* and the earlier *Trans-Missouri* decisions.

[76] Addyston Pipe & Steel v. United States, 85 Fed. 271 (6th Cir. 1898).

[77] Id. at 282-283 (". . .[W]here the sole object of both parties in making the contract as expressed therein is merely to restrain competition, and enhance or maintain prices, it would seem that there was nothing to justify or excuse the restraint, that it would necessarily have a tendency to monopoly, and therefore would be void. In such a case there is no measure of what is necessary to the protection of either party, except the vague and varying opinion of judges as to how much, on principles of political economy, men ought to be allowed to restrain competition. There is in such contracts no main lawful purpose, to subserve which partial restraint is permitted, and by which its reasonableness is measured, but the sole object is to restrain trade in order to avoid the competition which it has always been the policy of the common law to foster.").

not directly ratify this framework in its subsequent affirmation of the decision.[78]

In 1912, the Supreme Court explicitly adopted a "rule of reason" for determining the legality of monopolies in the *Standard Oil* and *American Tobacco* decisions.[79] Again, the exact meaning of the standard is at best illusive in the opinions. Moreover, Chief Justice White, the author of those decisions, had, as a justice, dissented from the *Joint Traffic* and *Trans-Missouri* decisions on the ground that the courts should consider the reasonableness of all restraints.[80] However, the *Standard Oil* and *American Tobacco* decisions explicitly declared that those earlier decisions were correctly decided.[81]

Justice Brandeis's opinion for the Court in the *Chicago Board of Trade* case further confused the situation.[82] That decision declared:

> The true test of legality is whether the restraint imposed is such as *merely regulates*, and perhaps thereby promotes competition, or whether it is such as *may suppress or even destroy competition*. To determine that question, the court must ordinarily consider the facts peculiar to the business to which the restraint is applied, its condition before and after the restraint was imposed, the nature of the restraint, and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation, or the reverse, but because knowledge of intent may help the court to interpret facts and to predict consequences.[83]

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[78] 175 U.S. 211 (1899).

[79] Standard Oil Co. of New Jersey v. United States, 221 U.S. 1 (1911); United States v. American Tobacco Company, 221 U.S. 106 (1911).

[80] See, *Trans-Missouri*, 166 U.S. at 343; *Joint Traffic*, 171 U.S. at 578.

[81] *Standard Oil*, 221 U.S. at 66-69; *American Tobacco*, 221 U.S. at 179

[82] Chicago Board of Trade v. United States, 246 U.S. 231 (1918).

[83] Id. at 238 (emphasis added); see generally, Peter C. Carstensen, *The Content of the Hollow Core of Antitrust: The Chicago Board of Trade Case and the Meaning of the "Rule of Reason" in Restraint of Trade Analysis,* 15 RES. L. & ECON 1 (1992) (historical study of the *Board of Trade* case arguing that the restraints were ancillary to the joint venture that constituted the Board of Trade).

When this open-ended standard would apply was not explained and, in a subsequent case, the Court rejected Brandeis's effort to impose a reasonableness test on a conspiracy to share sales and output information that had restrained price competition in the affected industry.[84] But it later upheld a conspiracy among glass makers to allocate labor and other inputs[85] and in *Appalachian Coals* rejected a challenge to an agreement among competing coal producers to allocate markets and set prices.[86] Both cases are generally regarded as involving cartelistic conduct.[87]

In 1940, the Supreme Court in the *Socony* case used the term "per se" in its condemnation of an agreement among major oil refiners to buy up surplus gasoline from independent refiners in order to keep up the market price for gasoline.[88] Thereafter the Court invoked "per se" illegality in a variety of contexts including condemnation of cartels, resale price maintenance, and tying.[89] The Court has changed some of those earlier classifications.[90]

Thus, there is a core problem with the interpretation of the Sherman Act's alternative bases for evaluating agreements in restraint of trade. The next section provides descriptions of

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[84] American Column & Lumber v. United States, 257 US. 377, 415 (1921) (Brandeis dissenting on the basis that the result was inconsistent with the *Board of Trade* decision).

[85] Window Glass Mfrs. v. United States, 263 U.S. 403 (1923).

[86] Appalachian Coals v United States. 288 U.S. 344 (1933).

[87] It is at least arguable that the defendants in *Appalachian Coals* presented their agreement as ancillary to a legitimate joint venture to market coal. In that case, as in *Chicago Board of Trade*, the government had not challenged the ancillary defense but rather had simply pointed to the agreement restraining competition and argued it was illegal of its face. See, Peter C. Carstensen, *The Content of the Hollow Core,* supra note 83.

[88] United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

[89] United States v. Parke, Davis & Co, 362 U.S. 29 (1960) (resale price maintenance is per se illegal); United States v. General Motors, 384 U.S. 127 (1966) (cartel of car dealers enjoined); Northern Pacific R. Co. v. United States, 356 U.S. 1 (1958) (tying per se illegal)

[90] See, e.g., Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007) (reversing the "per se" condemnation of resale price maintenance).

two frameworks that might explain the standards. The final part turns to California's law to examine its relationship to these standards.

2. Substantive Frameworks for Assessing the Legality of Restraints of Trade

It is useful to recognize at the outset substantive standards are only relevant if the jurisdictional elements already exist: 1) a "contract, combination . . .or conspiracy" in 2) restraint of trade. Many cases in fact turn on those issues, especially the first because the parties agree that if the elements exist, then the restraint would be unlawful.

Given that a "rule of reason" applies to at least many restraints while a "per se" rule applies to some others, it is essential to define when each standard is applicable. Arguably there are two contending frameworks that can provide a structure for determining what standard would apply. One might be called a formal category approach that rests on a determination that a particular type of restraint is absolutely illegal or that it is illegal only if "unreasonable." The contrasting framework draws on Taft's *Addyston Pipe* distinction to provide a functional basis for determining which standard would apply.

a) The Formal Category Framework

(1) Essential Elements

One can describe the formal categories as resting on the distinction between horizontal and vertical agreements which are then subdivided into specific types of restraints. The conventional categories are price fixing, territorial or customer allocation, and refusals to deal (also called boycotts). These categories are on both the vertical and horizontal lines producing a two by three matrix with each cell having a specific rule either "per se" or "rule of reason." In addition, tying, which is a distinct type of vertical contract, is a separate cell. In this system, the horizontal cells were subject to the "per se" standard, while, today, the vertical cells except for

tying are subject to a rule of reason requirement. However, each horizontal cell has at least one exceptional case which upholds a restraint which would otherwise be per se illegal. The most striking example is *Topco* in which the Court first condemned the territorial allocation among the members of Topco as per se illegal but then upheld the lower court's decision on remand to allow a less restrictive form of the same territorial allocation.[91] The criteria for making these exceptions are not clearly articulated in the decisions.

(2) Classification Challenges

As the preceding paragraph suggests, there are a number of challenges in applying these conventional formal categories. The first challenge is to distinguish between vertical and horizontal restraints. In theory, horizontal restraints involve agreements among competitors with respect to some aspect of their competition. Vertical restraints in contrast involve agreements among producers and suppliers or distributors.

But in reality, the distinction is often less clear.[92] For example, many "vertical" restraints restrict competition among distributors or control competition among upstream suppliers. In either case, there is a horizontal element to the restraint even if it is mediated through a buyer or seller at a different level. Moreover, some cases in fact condemn as illegal some such agreements when the horizontal element of the agreement is perceived to dominate.[93]

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[91] Compare, United States v. Topco, 405 U.S. 596 (1972) (territorial restraints among competitors are per se illegal); with Id., 414 U.S. 801 (1973) (per curium affirming lower court order that allowed Topco to continue to employ territorial restraints of a less restrictive nature); see generally, Peter C. Carstensen & Harry First, *Rambling Through Economic Theory: Topco's Closer Look*, in ANTITRUST STORIES (Elanor Fox & Dan Crane eds., 2007).

[92] Mark A. Lemley & Christopher R. Leslie, *Categorical Analysis in Antitrust Jurisprudence*, 93 IOWA L. REV. 1207 (2008).

[93] See, e.g., United States v. Apple, 791 F.3d 290 (2015) (Apple entered into contracts with book publishers to act as their "agent" in selling eBooks which the courts found to be a cartel among book publishers to restrain price competition).

Horizontal agreements may entail vertical elements when the participants are engaging in a joint venture to produce inputs or outputs for the enterprise. Thus, in *Topco*, the joint venture supplied house-brand groceries to its retailer members. In *BMI*, the joint venture of music copyright owners combined to create a pooled license under which the licensee could make use of an inventory of musical compositions.[94] Marketing this product required its participants to agree on the prices that would be charged and how the resulting revenue would be allocated. Thus, there was both price fixing and a kind of market allocation that were elements of the venture. But those were upheld in the circumstances. In contrast, the Court condemned the effort by doctors in Arizona to set maximum prices for the services they provided in connection with a venture that would provide health insurers with a method of pooling charges and some quality controls.[95]

The most frequent explanation of the rule of reason is that it is a three or four step process in which the challenger has the initial burden of showing that there is a restraint which has an adverse competitive effect.[96] This step often requires market definition based on the assumption that unless the parties to the restraint have market power, there is no prospect of an adverse competitive effect.

If the challenger prevails on this initial step, according to the empirical data a relatively rare occurrence,[97] then the second step requires that the defendants establish that there is a "pro-competitive" justification for the restraint. The meaning of this concept is itself arguably unclear

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

[95] Arizona v. Maricopa County Medical Society, 457 U.S. 332 (1982).

[96] See, e.g., Ohio v. American Express, 585 U.S. __, 138 S. Ct 2274 (2018).

[97] See, Michael Carrier, *The Rule of Reason: Am Empirical Update for the 21st Century*, 16 GEO. MASON L. REV. 827 (2009).

because a restraint is inherently anti-competitive. The focus is on what positive claims (consequences) with respect to consumer preferences, efficiency, or other goals are advanced by the restraint. Hence, the implication is that the restraint can only be justified when it serves some other, legitimate interest. The mere elimination of competition in itself is generally not accepted as legitimate even if the claim is that competition has adverse effects on consumers.[98] On the other hand, the needs of joint ventures to deal with risks of opportunism as well as define the basic tasks each party is to carry out have provided justifications.[99] Harder to explain are the occasional cases in which the only explicit function of the restraint is to restrain the freedom of the parties, but the restraint is still subject to a "reasonableness" test.[100] There are also explicit or implied statutory exemptions for some such conduct.[101]

If the justification is accepted as plausible, the next, third, step allows the challenger to show that the justification is pretextual or that there is a less restrictive alternative that can achieve the legitimate function. The pretextual response focuses on showing that the restraint is unnecessary or irrelevant to the purported justification. The less restrictive alternative argument accepts the validity of the excuse and attempts to show that another restraint would have provided approximately the same protection for the legitimate objective but would have produced less harm to the competitive process.[102]

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[98] See, e.g., Nat. Soc. Prof. Eng. v. United States, 435 U.S. 679 (1978).

[99] See, e.g., Broadcast Music Inc. v. Columbia Broadcasting System Inc., 441 U.S. 1 (1979); Texaco Inc. v. Dagher, 547 U.S. 1 (2006).

[100] See, e.g., NCAA v. Board of Regents of the University of Oklahoma, 468 U.S. 85 (1984); National Collegiate Athletic Association v. Alston, 594 U.S. ___ (2021); California Dental Ass. v. FTC, 526 U.S. 756 (1999).

[101] See, e.g., Credit Suisse Securities (USA) LLC v. Billing, 551 U.S. 264 (2007).

[102] See, e.g., United States v. VISA, 344 F.3d 229 (2nd Cir. 2003).

Finally, step four, courts have suggested that even if the restraint has both a legitimate objective and is no more restrictive than reasonably necessary, the overall gains to the economy from the restraint should be weighed against the harms that it causes. If, on that ultimate balancing, the costs exceed the benefits, the restraint should be condemned. Otherwise, it should be permitted. It is hard to find any actual case that goes as far as applying this fourth step.

This formal framework emphasizes the significance of the vertical- horizontal distinction. Vertical cases almost without exception are examined under the rule of reason framework and rarely result in findings of liability.[103] The outcomes with respect to "horizontal" restraints are more heterogeneous with reasonableness being more likely when the parties are involved in a joint venture or other similar transactions.

Tying as discussed earlier is also a distinct category in this approach. It is nominally "per se" illegal, but only if market power is present. Moreover, some cases suggest that some tying can be lawful when it serves an essential business need and there are no alternatives.[104] Thus, it would seem that at the federal level when substantial market power is present, there is a strong presumption of illegality that can be rebutted only in limited circumstances.

b) The Function Framework

(1) Essential Elements

Taft's *Addyston Pipe* decision applied the well-established, common law rules governing contracts not to compete to restraints of trade generally.[105] The common law doctrine required

[103] See, Carrier, supra note 97.

[104] See, e.g., Pick Manufacturing v. General Motors, 299 U.S. 3 (per curium 1936) (upholding a tying agreement governing repair parts in cars); Jerrold Electronics v. United States, 365 U.S. 567 (per curium 1961) (upholding a decree that found that new entrant could engage in tying its equipment to its engineering services until it had established itself in the market); See also, Dehydrating Process v. A. O. Smith, 292 F.2d 653 (1st Cir. 1961) (silo maker could tie unloading equipment to sale of silo because of need to ensure good performance for most buyers).

[105] See, text at note 76-77 supra.

that there be a legitimate transaction, usually a sale, which in turn faced risks of opportunistic behavior. The classic example was the sale of a business in which consumer goodwill was a significant part of the value. If the seller could reopen a competing business shortly after the sale, it would substantially diminish the value of the business sold. Therefore, to permit the seller to realize the full value of the goodwill, it was necessary to give the buyer an assurance that the seller would not reenter the business and compete. Such restraints were "ancillary" to the primary transaction and reasonable so long as they were limited in duration and territory to address the need of the buyer to protect its investment and have reasonable opportunity to establish its own goodwill.

Taft applied that framework to distinguish between cartelistic conduct which had no function other than restraining competition from those restraints that were ancillary to the legitimate needs of the venture and so could be lawful if reasonable. In this expanded formulation, the ancillary restraint would include all restraints that are necessary in any contractual relationship including those that define the venture or transaction, prices, etc.

This framework in its basic form would condemn categorically all naked, i.e., non-ancillary restraints, while subjecting all other restraints to a reasonableness test. Lawful contracts inherently include a variety of restraints. "To bind, to restrain, is of their very essence."[106] But that would over burden the courts and potentially inhibit many legitimate contracts. A second problem with this framework is that except where there is an express exemption it condemns all naked restraints even when there is a plausible argument that they serve an important market facilitating function.

[106] Chicago Bd. of Trade, 246 U.S. at 238.

(2) Fitting the Functional Framework to the Caselaw

If the courts are employing this functional analysis, at least implicitly, then it would appear that there are presumptions of legality and illegality with respect to arguably ancillary restraints. This could explain much of the case law dealing with applications of the rule of reason. Basically, if there is a plausible ancillary explanation for a restraint it is likely to be presumed to be legal. This is most obvious in the vertical restraint categories where, by definition, the parties engaged in some kind of a transaction or venture. This presumption is rebuttable. The most common test is to look at the substantiality of the market power of the firm imposing the restraint combined with some inquiry into the likely competitive effect on the market as a whole. In those cases where such evidence exists, the restraint is subject to critical review as to its necessity and whether there is a less restrictive way to achieve whatever legitimate interest justifies the restraint.[107] It is also likely that if the challenger were to show that the justification was pretextual that would also rebut the presumption.[108] The limited scope of these rebuttals would predictably lead to relatively few cases in which potentially ancillary restraints would be found unreasonable.[109]

The so-called "quick look" standard is consistent with a limited presumption of illegality in horizontal restraint cases involving potentially ancillary restraints which manifestly interfere with the freedom of action of the parties.[110] Indeed, it is possible that all horizontal restraints are

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[107] See, e.g., United States v. VISA U.S.A., 344 F.3d 229 (2nd Cir. 2003). The case suggests that a lack of justification alone would rebut the presumption, but it also suggested that there were less restrictive ways for the joint venture to protect any legitimate interests it might have.

[108] See, Toys R Us v. FTC, 221 F. 3d 928 (7th Cir. 2000) (claimed justification for restraint found to lack justification).

[109] See, Carrier, supra note 97.

[110] Polygram v. FTC, 416 F.3d 29 (D.C. Cir. 2005).

subject to this presumption, but in many cases, it is rebutted prima facie by the existence of the joint venture or transaction to which the restraint is probably ancillary.

There are a group of cases that involve restraints that lack any ancillary justification, but which arguably served some public interest.[111] Most such cases applied express or implied exemptions from antitrust law based on federal or state statutory authorization for the restraints.[112] In such exemption cases, the focus is on statutory interpretation to ensure that the restraint is within the scope of the exemption and, in the case of state authorization, that appropriate process and procedure has been employed.[113] From a functional approach, such exemptions can be expanded to include cases where the authorization is implied from the necessity to have some kind of market regulation.[114] If some regulation appears necessary, then the specific regulation would have to fall within the ambit of that justification and be established as well as enforced with appropriate process including avoidance of conflicts of interest. No courts have explicitly accepted this framework for reviewing such restraints; hence the claim is that this framework may better explain what courts are doing even if they employ other terms.

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[111] NCAA v. Bd. of Regents, 4687 U.S. 85 (1984); NCAA v. Alston, 519 U.S. __ (2021) (both NCAA cases involve the scope of regulation of college athletics); Am. Soc. Mech. Eng'ers v HydroLevel, 456 U.S. 556 (1982); Allied Tube v. Indian Head, 486 U.S. 492 (1988) (both of these cases involved standard setting organizations which had abused their power).

[112] See, e.g., Credit Suisse Securities (USA) LLC v. Billing, 551 U.S. 264 (2007) (federal securities law precluded antitrust suit); New Motor Vehicle Bd. Cal. v. Orrin W. Fox, 439 U.S. 96 (1978) (upholding state regulation of auto dealer competition).

[113] FTC v. North Carolina Dental Board, 573 U.S. 494 (2015).

[114] See Peter C. Carstensen & Bette Roth, *The Per Se Legality of Some Naked Restraints: A (Re)Conceptualization of the Antitrust Analysis of Cartelistic Organizations*, 45 ANTITRUST BULL 349 (2000).

(3) Tentative Conclusions

Either of these alternatives can predict and explain most results in Sherman Act restraint of trade cases. The functional approach, arguably, provides somewhat more restrictive standards by limiting the discretion of judges to approve pure restraints. On the other hand, the strength of the presumptions of legality and illegality under the functional framework can confirm substantial scope for courts to elect to review more or less strictly restraints. It is the rare case that actually focuses on an articulation of the standard being employed. This leaves a large area of judicial ambiguity in interpreting the Sherman Act.

3. California Restraint of Trade Caselaw and the Alternative Frameworks

§16720 provides a list of agreements in restraint of trade that are prohibited absolutely by §16722 and §16726. The descriptions in §16720 are consistent with prohibitions on naked restraints in the *Addyston Pipe* (naked/ancillary) framework. §16725 then provides that it is "not unlawful to enter into agreements or form associations or combination, the purpose and effect of which is to promote, encourage or increase competition in any trade or industry, or which are in furtherance of trade." This combined with the language in §16770 (authorizing buying groups for health care)[115] is consistent with an ancillary restraint model, but the language of §17625 arguably goes beyond that and seems to authorize naked restraints that "promote, encourage or increase competition. . .." As discussed earlier this provides a basis for allowing reasonable standard setting types of agreements that are necessary for efficient market operation.[116]

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[115] The section rejects use of a per se standard for such buying groups based on an interpretation of *Maricopa v. Arizona*, 457 U.S. 332 (1982) and declares such groups to be creating a "new product" and so subject to the rule of reason.

[116] §16728 allows motor carriers to agree to use uniform contracts under specific conditions including at least some public agency oversight.

Overall, the California courts seem to have followed a largely functional analysis of restraints of trade and declined to adopt interpretations that would have opened the door to protecting unauthorized cartels. *People v. Building Maintenance Etc. Assn.*, 41 Cal.2d 719, 264 P.2d 31 (Cal. 1953) rejected an effort to revive a statutory provision that would have allowed reasonable cartelistic conduct: "No agreement, combination or association is unlawful or within the provisions of this chapter, the object and purpose of which are to conduct operations at a reasonable profit or to market at a reasonable profit those products which can not otherwise be so marketed."[117] The Court had declared it unconstitutional in *Speegle v. Board of Fire Underwriters*, 29 Cal.2d 34 (Cal. 1946).

The *Building Maintenance* decision also reviewed application of §16725 to the agreement. It rejected that claim because the agreement only sought to protect existing contractors from competition.[118] The opinion also distinguished between the prices agreed to for services, and price restraints imposed on competitors with respect to the prices they charged.[119] This is consistent with using the naked-ancillary distinction as the basis for determining when per se and rule of reason might apply.

State of California ex rel. Van de Kamp v. Texaco, Inc., rejected use of §16720 to challenge a merger.[120] The primary analysis of §16720 was that the term "combination" required that there be more than one entity participating in the restraint. The Court acknowledged that

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[117] This was §16723.

[118] 41 Cal.2d. at 727.

[119] Id. at 728-729.

[120] State of California ex rel. Van de Kamp v. Texaco, Inc., 46 Cal. 3d 1147 (1988). The topic of merger law is addressed elsewhere in this report.

Sherman Act's §1 did apply to mergers,[121] but it distinguished that standard based on the difference between the California law and the Sherman Act as well as asserting that a violation of the Sherman Act required actual harm to competition which was not alleged in this case.[122]

In re Cipro involved the standard for determining when a settlement (agreement) involving a patent dispute was reasonable.[123] Hence, the issue was the scope of the rights of the patent holder relative to the public interest in competitive markets. The Court recognized that federal law determined the scope of patent rights, but then the question was how would California competition law deal with the issues that resulted. The court relied on the Supreme Court's decision in FTC v. Actavis, Inc., 570 U.S. 136 (2013).

> This more nuanced approach [in *Actavis*] makes equal sense for claims under the Cartwright Act. Like the federal antitrust statutes, nothing in the text of the Cartwright Act dictates the precise details of the per se and rule of reason approaches; these are but useful tools the courts have developed over time to carry out the broad purposes and give meaning to the general phrases of the antitrust statutes. (See *National Soc. of Professional Engineers v. United States, supra,* 435 U.S. at p. 688, 98 S.Ct. 1355.) It is consistent with the common law tradition at the root of our antitrust laws to describe, as the United States Supreme Court now has, the analytic approach as involving a continuum, with the "the circumstances, details, and logic" of a particular restraint (*California Dental Assn. v. FTC, supra,* 526 U.S. at p. 781, 119 S.Ct. 1604) dictating how the courts that confront the restraint should analyze it. In lieu of an undifferentiated one-size-fits-all rule of reason, courts may "devise rules ... for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones." (*Leegin Creative Leather Products, Inc. v. PSKS, Inc.* (2007) 551 U.S. 877, 898–899, 127 S. Ct. 2705, 168 L.Ed.2d 623; see *Fisher v. City of Berkeley, supra,* 37 Cal.3d at pp. 671–677, 209 Cal. Rptr. 682, 693 P.2d 261 [tailoring the rule of reason to account for differences between private and municipal government actions].) [124]

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[121] Section 1 of the Sherman Act explicitly condemns "combinations in the form of trust or otherwise" which in context seems explicitly to refer to such trusts as the Standard Oil trust.

[122] 46 Cal. 3d. at 1165-1166.

[123] 61 Cal.4th 116 (Cal. 2015)

[124] Id at 147

While this articulation would seem to undercut any structured method of analysis, the decision then gave a series of examples of per se type offenses as unlawful conspiracies to monopolize.[125] Thus, it is arguable that the open-ended nature of the Court's exposition was tied closely to the nature of the case before it which required a balancing of patent rights with the public interest in competition.

Two much earlier decisions involving joint ventures suggest that the rule of reason was applicable to such cases. In *Corwin v. Los Angeles Newspaper Service Bureau*,[126] the Court considered a joint venture to solicit and place certain kinds of legal advertisements:

> Since the agreements between the Bureau and its member newspapers constitute a restraint upon trade, they violate the Cartwright Act unless they are shown to be reasonable. To determine whether the restrictions are reasonable, "the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be obtained, are all relevant facts." (Chicago Board of Trade v. United States (1918) 246 U.S. 231, 238. The court should consider "the percentage of business controlled, the strength of the remaining competition [and] whether the action springs from business requirements or purpose to monopolize...." (United States v. Steel Co. (1948) 334 U.S. 495, 527 [92 L. Ed. 1533, 1554 68 S. Ct. 1107]; quoted with approval in Times-Picayune v. United States (1953) 345 U.S. 594, 615. Whether a restraint of trade is reasonable is a question of fact to be determined at trial. [127]

The second case is *Fisherman's Wharf Bay Cruise v. Superior Ct.*, that primarily focused on predatory pricing under the unfair competition law. (§17200).[128] One element of the case considered the legality of exclusive dealing contracts that only covered 20% of the relevant

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[125] Id at 148

[126] 4 Cal. 3d 842 (1971):

[127] Id. 853-854; see also, Marin County Bd. of Realtors, Inc. v. Palsson, 16 Cal. 3d 920, 932 (distinguishing between direct and indirect refusal to deal which is again consistent with the naked-ancillary dichotomy).

[128] 114 Cal.App.4th 309, 326 (Cal. Ct. App. 2003)

market which itself was a subpart of the overall tour boat business.[129] The court upheld the claim in the context of a motion to dismiss based on the pleadings:

> ". . . we conclude that market foreclosure from 20 percent of the relevant market resulting only from written exclusive dealing contracts, under the facts of this case, was substantial enough . . .. Furthermore, . . the court also had before it the full panoply of Blue Gold's alleged exclusionary conduct, including both written exclusive dealing arrangements, tying agreements and below-cost pricing claims. When Blue Gold's exclusive dealing contracts are viewed in context with its other alleged anticompetitive behavior, a triable issue of fact exists whether the market foreclosure reached as much as two-thirds of the wholesale bay cruise tour market."[130]

Thus, the general focus on the decisions is to focus on the function of restraints, but as in the federal cases, the California courts are reluctant to articulate any overall structure of the analysis of restraints of trade.

The vertical case law in California is dispersed but with the notable exception of the RPM cases seems largely similar to the federal law. As a result, it is consistent with either the functional or categoric approach to defining and judging restraints of trade.

California's tying law as discussed earlier seems to employ a stricter version of the "per se" standard in that no cases seem to allow justification if the market power and/or effect on commerce criteria are met. However, it is not clear from the relatively few decisions whether defendants in these cases sought to present justifications.

In sum, the California case law seems somewhat more consistent with the functional approach, but the relative paucity of decisions makes any firm conclusion impossible. Further, as with the federal case law, there is no articulated recognition that there might be alternative frameworks for applying the per se and rule of reason concepts.

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[129] Overall defendant had 2/3 and plaintiff had 1/3 of the broader market. Id. at 339.

[130] Id.

D. Continuum: obviously procompetitive to obviously anticompetitive

In economic terms, it is helpful to parallel the per se versus rule of reason treatment described above.

Broadly speaking there is a mix of two modes of analysis. One can start by asking *what one would expect the effects of an agreement to be*, based on the interests of each party and the economic relationship between them and not based on the actual details of the agreement. One can expect that an agreement between two parties will tend to maximize their *joint* interests, and the nature of their joint interests depends on their economic or competitive relationship. Then, or alternatively, one can consider a typically more detailed analysis based on what the agreement says. One might expect that a more detailed analysis that delves more into the facts of what has actually been agreed would be more reliable, but that is not generally the case.

When *horizontal rivals* negotiate an agreement between/among one another, they have an obvious and robust joint incentive to soften competition. Competitor A would like to nudge competitor B away from competing hard, efficiently, or directly; and competitor B would like to do the same to A. This simple economic point justifies a deeply suspicious approach to agreements among horizontal competitors, which is reflected in legal terms in per se treatment or adverse presumptions.

Turning to the more specific mode of analysis, such a weakening of competition between A and B is not the only thing that A and B might attempt or achieve by an agreement. Sometimes, for instance, they can cooperate in ways that make them more potent as competitors against C. An agreement can achieve some of the same effects as a merger, and this potential pro-competitive effect shows up in the category of pro-competitive merger efficiencies.[131]

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[131] Many suspect that antitrust has gradually erred by giving too much credence to alleged or imagined efficiencies of horizontal mergers. At the same time, however, the robust habit of counting "significant competitors" with some sort

A different economic logic applies to the "underlying incentives" analysis when the parties to an agreement are vertically related.[132] It is useful to subdivide this into simple and deep cases. In the simple case where the agreement only affects transactions between the two parties, their joint incentive is to eliminate double marginalization and resolve the "vertical externality," which applies to a range of non-price conduct such as product quality, service, warranties, innovation, etc., and is pro-competitive. This procedurally creates a zone in which agreements could reasonably be treated as per se legal. The deep or more complex case is that in which the vertical agreement (perhaps in addition) hinders some or all rivals to one or both of the agreeing parties: this is a "contract that references rivals." For example, an exclusive dealing agreement, or discounts based on market share. This creates a rule-of-reason zone for the deep case.
This is not the place to attempt an extensive analysis of such a rule of reason, but it is an appropriate place to note that some courts have announced narrow understandings of how a contract that references rivals can be anticompetitive. For example, it is well established in the economics literature that a pattern of exclusive dealing agreements can deny viable scale to a potential rival and thereby cement a monopoly. But that does not suggest that scale is the only way for exclusionary conduct to be anticompetitive. More broadly exclusive dealing, market-share discounts, and other practices that raise rivals' costs can be anticompetitive.

IV. Types of Restraints (Kinds of Agreements)

Like federal antitrust law, cases interpreting the Cartwright Act distinguish between horizontal and vertical restraints. Horizontal restraints are agreements between competitors,

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of scale threshold for being "significant" does imply, probably correctly, that some scale-expanding horizontal mergers can make a potent competitor out of two impotent ones.

[132] As a matter of economics this would cover both the case where one party's output is an input to the other party, and the case where each party's product is more valuable to customers in combination with the other's product.

while vertical agreements are between entities at different levels of the distribution chain, such as between wholesaler and a retailer.[133] In general, horizontal restraints are more likely to be condemned as per se illegal than are vertical restraints.[134]

We next discuss a variety of classic horizontal and vertical restraints, and we compare their treatment under federal antitrust law and the Cartwright Act.

A. Horizontal

1. Price Fixing

Unlike the Sherman Act, which never explicitly mentions price or price fixing, the Cartwright Act defines trusts, in part, by their price-fixing activities. The Act states: "A trust is a combination of capital, skill or acts by two or more persons for any of the following purposes: …(b) To limit or reduce the production, or increase the price of merchandise or of any commodity. …"[135]

Through the common law process, however, both federal and California antitrust law have evolved to condemn horizontal price-fixing agreements as per se illegal.[136] Under both

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[133] G.H.I.I. v. MTS, Inc., 147 Cal. App. 3d 256, 267, 195 Cal. Rptr. 211 (Ct. App. 1983) (citations omitted) ("Two forms of conspiracy may be used to establish a violation of the antitrust laws: a *horizontal* restraint, consisting of a collaboration among competitors; or a *vertical* restraint, based upon an agreement between business entities occupying different levels of the marketing chain.").

[134] Bert G. Gianelli Distrib. Co. v. Beck & Co., 172 Cal. App. 3d 1020, 1044, 219 Cal. Rptr. 203 (Ct. App. 1985) ("In recent years the courts have applied a per se rule to horizontal restraints with considerably greater alacrity than has been true with respect to apparently vertical restraints of the sort with which we are here concerned."), disapproved of on other grounds by Dore v. Arnold Worldwide, Inc., 39 Cal. 4th 384, 139 P.3d 56 (2006).

[135] Cal. Bus. & Prof. Code § 16720 (West); Knevelbaard Dairies v. Kraft Foods, Inc., 232 F.3d 979, 986 (9th Cir. 2000) ("The California statute explicitly makes price fixing by buyers unlawful. *See* Cal. Bus. & Prof.Code § 16720(c) (prohibiting any combination to prevent competition in the 'sale *or purchase* of any commodity.'")

[136] Oakland-Alameda Cnty. Builders' Exch. v. F. P. Lathrop Constr. Co., 4 Cal. 3d 354, 363, 482 P.2d 226, 232 (1971) ("Under both California and federal law, agreements fixing or tampering with prices are illegal per se."). See also Knevelbaard Dairies v. Kraft Foods, Inc., 232 F.3d 979, 986 (9th Cir. 2000) ("The same rule applies in California: 'Under both California and federal law, agreements fixing or tampering with prices are illegal per se.'") (quoting *Oakland–Alameda County Builders Exch. v. F.P. Lathrop Constr. Co.,* 4 Cal.3d 354, 363, 93 Cal.Rptr. 602, 482 P.2d 226 (1971).

bodies of law, per se illegal price fixing includes "*any* combination which tampers with price structures constitutes an unlawful activity."[137] The plaintiff need not prove that the horizontal price-fixing agreement had actual anticompetitive effects, such as increasing prices.[138] Consequently, the plaintiff does not have to define the relevant market or prove that the defendants possess market power.[139] The defendants cannot argue a defense or justification for their naked price fixing.[140] For example, as with federal law, Cartwright Act defendants cannot argue that the price they fixed was "reasonable."[141] Because bid rigging is a form of horizontal price fixing, it is also per se illegal.[142]

Both federal law and the Cartwright Act similarly condemn horizontal price fixing as per se illegal. This is not controversial.

2. Market Allocation and Customer Allocation

Horizontal market division describes agreements in which competitors assign each other designated geographic markets or allocate particular customers. These agreements have a similar

[137] Kolling v. Dow Jones & Co., 137 Cal. App. 3d 709, 721, 187 Cal. Rptr. 797, 806 (Ct. App. 1982); Cellular Plus, Inc. v. Superior Ct., 14 Cal. App. 4th 1224, 1244, 18 Cal. Rptr. 2d 308, 319 (1993) ("Price fixing between competitors is illegal per se under the Cartwright Act.").

[138] Aguilar v. Atl. Richfield Co., 25 Cal. 4th 826, 851–52, 24 P.3d 493 (2001), as modified (July 11, 2001) ("[T]he Cartwright Act…, like its Sherman Act analogue, makes a conspiracy among competitors to restrict output and/or raise prices unlawful per se without regard to any of its effects.") (citing *Oakland-Alameda County Builders' Exchange v. F. P. Lathrop Constr. Co.* (1971) 4 Cal.3d 354, 360-362 [93 Cal.Rptr. 602, 482 P.2d 226]))

[139] *Mailand v. Burckle,* 20 Cal.3d 367, 376, 143 Cal.Rptr. 1, 572 P.2d 1142 (1978); Knevelbaard Dairies v. Kraft Foods, Inc., 232 F.3d 979, 986 (9th Cir. 2000).

[140] Rosack v. Volvo of Am. Corp., 131 Cal. App. 3d 741, 751, 182 Cal. Rptr. 800 (Ct. App. 1982) ("Proof of a violation requires only evidence of a conspiracy among defendants to fix prices; no defense or justification is recognized.").

[141] Rosack v. Volvo of Am. Corp., 131 Cal. App. 3d 741, 751, 182 Cal. Rptr. 800 (Ct. App. 1982) ("It is no defense that the price fixed was a "reasonable price.") (citing *United States v. Trenton Potteries* (1927) 273 U.S. 392, 397-398).

[142] See Oakland-Alameda Cnty. Builders' Exch. v. F. P. Lathrop Constr. Co., 4 Cal. 3d 354, 360, 482 P.2d 226, 230 (1971) (condemning as per se illegal "a combination of participating subcontractors and general contractors to restrain open price competition among subcontractors").

effect to horizontal price fixing—namely, they reduce output and raise prices.[143] Under federal law, horizontal market division is per se illegal.[144] Similarly, the California Supreme Court has held that "businesses may not engage in a horizontal allocation of markets, with would-be competitors dividing up territories or customers."[145] Such agreements are per se illegal violations of the Cartwright Act.[146]

Both federal law and the Cartwright Act condemn horizontal market division as per se illegal. This is not controversial.

3. Refusals to Deal (Group Boycotts)

California law – like federal law – recognizes group boycotts as a *per se* violation of the antitrust laws when they present in a hallmark conspiratorial setting – horizontal competitors concertedly refuse to deal with a competitive rival to cause harm to that competitor.[147] However, from this relatively straightforward starting point, the application of group boycott law has been characterized by highly fact-specific analyses and confusion.

In recognizing group boycotts as a per se violation of the Cartwright Act, the California

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[143] John M. Landry & Kirk A. Hornbeck, *One Hundred Years in the Making: The Cartwright Act in Broad Outline*, 17 Competition 7, 14 (2008) ("Horizontal Market Division[:] This type of restraint suppresses all vectors of competition, not just price, and thus has at least the same anticompetitive impact as price fixing. Although few courts have addressed the question under the Cartwright Act, this restraint would undoubtedly be treated as illegal per se.").

[144] *United States v. Topco Associates* (1972) 405 U.S. 596.

[145] In re Cipro Cases I & II, 61 Cal. 4th 116, 148, 348 P.3d 845, 863 (2015) (citing *United States v. Topco Associates, Inc., supra,* 405 U.S. at pp. 608, 612, 92 S.Ct. 1126; *Vulcan Powder Co. v. Hercules Powder Co., supra,* 96 Cal. at pp. 514–515, 31 P. 581; *Guild Wineries & Distilleries v. J. Sosnick & Son* (1980) 102 Cal.App.3d 627, 633–635, 162 Cal.Rptr. 87).

[146] See Oakland-Alameda Cnty. Builders' Exch. v. F. P. Lathrop Constr. Co., 4 Cal. 3d 354, 361, 482 P.2d 226, 230 (1971) ("Among the practices which the courts have heretofore deemed to be unlawful in and of themselves are … division of markets…").

[147] *Oakland-Alameda Cty Builders Exch. v. F.P. Lathrop Constr. Co.*, 4 Cal. 3d 354, 365 (1971) (considering it "obvious" that "group boycotts are illegal per se under traditional antitrust principles."); *Marin County Bd. Of Realtors, Inc. v. Palsson*, 16 Cal. 3d 920, 932 (1976); Cal. Bus. & Prof. Code § 16720(a) & (c); *Klor's Inc. v. Broadway-Hales Stores*, 359 U.S. 207 (1959); *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 135-36 (1998).

Supreme Court explained that the policies underlying the Cartwright Act require free competition so that prices are dependent "upon the interplay of the economic forces of supply and demand."[148] And, for example, in the case of the bid depository at issue, "[i]t should be apparent that the 'economic forces of supply and demand' can have little impact on a bidding system which is conducted in secrecy and which leaves general contractors no alternative but to accept the lowest bids submitted through the Depository or withdraw from the bidding."[149] Indeed, it was "obvious" that "group boycotts are illegal per se under traditional antitrust principles."[150] Thus these per se group boycotts cannot be saved from antitrust scrutiny by a showing of reasonableness or by showing that the boycotts lowered prices or stimulated competition.[151]

Determining which group boycotts qualify as per se violations, however, is a continuing source of confusion for litigants and the courts.[152] Heeding the Supreme Court's warning that "the

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[148] *Oakland-Alameda Cty Builders Exch. v. F.P. Lathrop Constr. Co.*, 4 Cal. 3d 354, 363 (1971).

[149] *Oakland-Alameda Cty Builders Exch. v. F.P. Lathrop Constr. Co.*, 4 Cal. 3d 354, 363-64 (1971).

[150] *Oakland-Alameda Cty Builders Exch. v. F.P. Lathrop Constr. Co.*, 4 Cal. 3d 354, 365 (1971) (citing *Klor's Inc. v. Broadway-Hale Stores*, 359 U.S. 207, 212 (1959)). The Court also found the reasoning of other courts persuasive, including *Christiansen v. Mechanical Contractors Bid Depository*, 230 F. Supp. 186 (D. Utah 1964) (Invalidating three bid depository rules as per se antitrust violations). And cited *People v. Inland Bid Depository*, 233 Cal. App. 2d 851 (1965) and *Carl N. Swenson Co. v. E. C. Braun Co.*, 272 Cal. App. 2d 366 (1969) as further California support for the lower courts' holding. *Oakland-Alameda County Builders' Exchange*, 4 Cal. 3d at 367-68.

[151] *Oakland-Alameda Cty Builders Exch. v. F.P. Lathrop Constr. Co.*, 4 Cal. 3d 354, 365 (1971); *Klor's Inc.*, 359 U.S. at 212; *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 290 (1985) (This Court has long held that certain concerted refusals to deal or group boycotts are so likely to restrict competition without any offsetting efficiency gains that they should be condemned as *per se* violations of § 1 of the Sherman Act." (collecting cases)); *F.T.C. v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 424 (1990) ("The statutory policy underlying the Sherman Act 'precludes inquiry into the question whether competition is good or bad.' . . . Respondents' argument . . . ultimately asks us to find that their boycott is permissible because the price it seeks to set is reasonable. But it was settled shortly after the Sherman Act was passed that it is no excuse that the prices fixed are themselves reasonable." (*quoting Nat'l Soc. of Professional Engineers v. U.S.*, 435 U.S. 679, 695 (1978)).

[152] *Honey Bum LLC v. Fashion Nova Inc.*, 63 F.4th 813, 820 (9th Cir. 2023); *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 293-94 (1985) ("Exactly what types of activity fall within the forbidden category is, however, far from certain. '[T]here is more confusion about the scope and operation of the *per se* rule against group boycotts than in reference to any other aspect of the per se doctrine.'"); *PLS.com, LLC v. National Ass'n of Realtors*, 32 F.4th 824, 835 (9th Cir. 2022) ("Precisely which group boycotts qualify as *per se* violations of the Sherman Act has been a source of confusion for decades.").

category of restraints classed as group boycotts is not to be expanded indiscriminately,"[153] the courts have been wary of assigning per se status to alleged boycotts.[154]

In analyzing whether to treat a boycott as a per se violation, courts applying the Sherman Act look for certain indicia including "whether the group of competitors 'cut[s] off access to a supply, facility, or market necessary to enable the boycotted firm to compete,' whether the group 'possesse[s] a dominant position in the relevant market,' and whether the criticized practice is 'not justified by plausible arguments that [it is] intended to enhance overall efficiency and make markets more competitive.'"[155] This required pre-analysis under *Northwest Wholesale Stationers* has led the lower federal courts to struggle with how to apply the analysis, particularly where the *Northwest Wholesale Stationers* court ultimately analyzed the challenged boycott there under the rule of reason.[156]

In applying the Sherman Act, the United States Supreme Court has expressly limited the per se rule to cases involving horizontal agreements between direct competitors.[157] California law hasn't reached the same bright line rule, however, under either federal or California law, even when dealing with a horizontal agreement between direct competitors, the courts do not automatically apply the per se rule. Where the boycott is indirect, that is the refusal to deal is a

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[153] *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 458 (1986).

[154] See, e.g., where the courts are faced with rules for admission to trade associations and professional organizations, the courts are wary of applying the *per se* rule. *See, e.g., Flaa v. Hollywood Foreign Press Ass'n*, 55 F. 4th 680 (9th Cir. 2022); *Phil Tolkan Datsun, Inc. v. Greater Milwaukee Datsun Dealers' Advert. Ass'n*, 672 F. 2d 1280 (7th Cir. 1982); *National Ass'n of Rev. Appraisers & Mortg. Underwriters, Inc. v. Appraisal Found.*, 64 F.3d 1130 (8th Cir. 1995).

[155] *Flaa v. Hollywood Foreign Press Ass'n*, 55 F. 4th 680, 689 (9th Cir. 2022) (*quoting Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 298 (1985).

[156] *Northwest Wholesale Stationers*, 472 U.S .at 297-98. *See also, In re Tableware Antitrust Litig.*, 484 F. Supp. 2d 1059, 1069-70 (N.D. Cal. 2007).

[157] *NYNEX Corp v. Discon, Inc.*, 525 U.S. 128, 135 (1998).

byproduct of an otherwise legal agreement, courts apply the rule of reason.[158] And, the analysis is highly fact specific with no guarantee that the type of boycott found to merit per se treatment in one case will be found to merit per se treatment in a similar case.[159] Or indeed, the type of boycott found anticompetitive in one setting may be found legal in another setting.[160]

Under the Sherman Act, vertical boycotts are analyzed under the rule of reason.[161] California courts generally apply the rule of reason but have not adopted such a bright line rule.[162] And when faced with a boycott that appears both horizontal and vertical in nature, the courts again are left to grapple with what standard to apply.[163]

And each of the analyses discussed above presuppose that you do in fact have a group boycott. The courts must also grapple with a fact-intensive inquiry to determine whether the case before them even constitutes a group boycott.[164]

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[158] *Marin County Board of Realtors, Inc. v. Palsson*, 16 Cal. 3d 920, 934 (1976) ("Since the primary object is not the destruction of particular brokers or of nonmember brokers as a class, the *Klor's* principle, that a group boycott designed to coerce directly is per se unlawful, should not apply."); *Nw. Wholesale Stationers v. Pac. Stationery & Printing Co.*, 472 U.S. 284, 293-97 (1985).

[159] *Compare, e.g., Associated Press v. U.S.*, 326 U.S. 1 (1945) (bylaws of the Associated Press held to be a per se violation) *with Flaa v. Hollywood Foreign Press Ass'n*, 55 F. 4th 680, 691 (9th Cir. 2022) (applying Rule of Reason to Hollywood Foreign Press Association admissions practices).

[160] *Marin County Board of Realtors, Inc. v. Palsson*, 16 Cal. 3d 920, 931-934 (1976) (finding access rules to be an illegal group boycott but refusing to "mechanically appl[y] a per se rule" and instead applying the rule of reason as "the primary object is not the destruction of particular brokers or of nonmember brokers as a class."); *Freeman v. San Diego Ass'n of Realtors*, 77 Cal. App. 4th 171, 197-98 (1999) (describing "exclusion from an MLS only superficially resembles other forms of group boycotts" and distinguishing *Palsson* as the plaintiff had failed to allege that being appointed a service center was so essential to her business that she couldn't compete without being appointed.) See also, *PLS.com., LLC v. Nat'l Ass'n of Realtors*, 32 F.4th 824, 835 (9th Cir. 2022).

[161] *See, e.g. Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 893 (2007) (vertical agreement analyzed under the rule of reason, even where horizontal agreement would be a per se analysis).

[162] *Bert G. Gianelli Distribution Co. v. Beck & Co.,* 172 Cal. App. 3d 1020 (1985).

[163] *See, e.g. Dinosaur Financial Group LLC v. S&P Global, Inc.*, 2023 WL 4562031, at *17 (S.D.N.Y. July 14, 2023) (Rejecting application of the *per se* rule in an alleged combined horizontal and vertical boycott where "regardless of the existence of a vertical component, the putative boycott *must* have a horizontal component, which is lacking here.").

[164] Compare *PLS.com, LLC v. National Ass'n of Realtors*, 32 F.4th 824, 834-35 (9th Cir. 2022) (Ninth Circuit found PLS adequately alleged a per se group boycott under the Sherman Act where Defendants coerced suppliers not to supply the plaintiff business with real estate listings or to do so on "highly unfavorable terms" with the express purpose

4. Confidential Information Exchanges among Competitors

There appears to be a difference between the standards for judging the legality of exchanges of confidential business information among competitors under the Sherman Act and under the Cartwright Act. Under federal law, exchanges of competitively sensitive information among competitors can constitute an antitrust violation in itself.[165] It appears that the California Supreme Court's decision in *Aguilar v. Atlantic Richfield*, 24 P.3d 493, 518-519 (2001) holds that such exchanges are neither unlawful nor in themselves probative of an underlying conspiracy to restrain competition under the Cartwright Act.

The *Aguilar* case involved the claim that the nine major oil refiners serving California colluded to decrease production of the specialized gasoline required in California. Lacking direct proof of such a conspiracy, the complaint focused on information exchanges among the refiners, their use of the same consultants, and exchange agreements in which they transferred to each other refined gasoline. The refiners exchanged information about "capacity, production, and pricing information through the independently owned and operated Oil Price Information Service, or OPIS. . . ." [166] The plaintiffs' theory was that these exchanges supported the inference

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of preventing a new entrant to the market) with *City of Oakland v. Oakland Raiders*, 20 F.4th 441, 454 (9th Cir. 2021) (Ninth Circuit found no group boycott under the Sherman Act where "the other NFL teams simply supported the Raiders' refusal to deal with the City, but did not themselves refuse to do business with the City."); David Haddock, Tonga Jacobi & Matthew Sag, *League Structure & Stadium Rent-Seeking-the Role of Antitrust Revisited*, 65 Fla. L. Rev. 1, 50-51 (2013) (analyzing potential for antitrust violation in similar setting). *Freeman v. San Diego Ass'n of Realtors*, 77 Cal. App. 4th 171, 197-98 (1999) (describing "exclusion from an MLS only superficially resembles other forms of group boycotts" and distinguishing *Palsson* as the plaintiff had failed to allege that being appointed a service center was so essential to her business that she couldn't compete without being appointed.). *Compare F.T.C. v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 424 (1990) (finding lawyer boycott in pay dispute violated antitrust laws) *with Confederacion Hipica de Puerto Rico, Inc. v. Confederacion de Jinetes Puertorriquenos*, 30 F.4th 306, 312-13 (1st Cir. 2022) ("Congress exempted labor disputes from antitrust law."). *See also, id.* at 315 and n.4 noting labor exemption was not argued in *San Juan Racing Ass'n Inc v. Asociacion de Jinetes de Puerto Rico, Inc.*, 590 F.2d 31 (1st Cir. 1979) nor *FTC v. Superior Court Trial Lawyers Ass'n*. where collective refusals to deal were considered antitrust violations.

[165] *See, e.g., United States v. Container Corp*. 393 U.S. 33 (1969); United States v. U.S. Gypsum, 438 U.S. 422 (1978).

[166] *Aguilar v. Atlantic Richfield*, 24 P.3d 493, 503 (2001).

that the refiners had agreed on prices and/or output.[167] The Court, however, rejected categorically the plaintiffs' theory that such exchanges could support an inference of a price fixing conspiracy:

> . .. Aguilar's evidence concerning the gathering and dissemination of capacity, production, and pricing information by the petroleum companies, through OPIS or otherwise, with respect to CARB gasoline does not even imply collusive, rather than independent, action. What the United States Supreme Court stated three-quarters of a century ago in Maple Flooring Mfrs. Ass'n v. U.S. (1925) 268 U.S. 563, 45 S.Ct. 578, 69 L.Ed. 1093, remains true today: ''It is the consensus of opinion of economists and of many of the most important agencies of Government that the public interest is served by the gathering and dissemination, in the widest possible manner, of information'' of the sort identified above ''because the making available of such information tends to stabilize trade and industry, to produce fairer price levels and to avoid the waste which inevitably attends the unintelligent conduct of economic enterprise. Free competition means a free and open market among both buyers and sellers for the sale and distribution of commodities. Competition does not become less free merely because the conduct of commercial operations becomes more intelligent through the free distribution of knowledge of all the essential factors entering into the commercial transaction.'' (Id. at pp. 582–583, 45 S.Ct. 578, 69 L.Ed. 1093.) To be sure, such information can be misused as a ''basis'' for an unlawful conspiracy. (Id. at p. 585, 45 S.Ct. 578, 69 L.Ed. 1093.) The evidence here, however, does not suggest such misuse. [168]

The *Aguilar* decision relies on the Supreme Court's 1925 decision in *Maple Flooring Mf'gs' Assn. v. United States*, 268 U.S. 563 (1925). That case involved the exchange of detailed production and cost information among a large number of flooring manufacturers who also used a common freight rate book in formulating delivered prices for their products. Before *Maple Flooring* and after it, the Supreme Court has recognized that information exchange in itself could result in a restraint on competition.[169] The more recent cases, however, also assert that such exchanges may have "pro-competitive" effects by making market participants better informed

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[167] This kind of conduct is often called a "facilitating device."

[168] 24 P.3d at 518-519 (footnote omitted).

[169] See, American Column Co. v. United States, 257 U. S. 377 (1921); United States v. American Linseed Oil Co., 262 U.S. 371 (1923); Sugar Institute v. United States, 297 U.S. 553 (1936); United States v. Container Corp., 393 U. S. 333 (1969); United States v. U. S. Gypsum Co., 438 U.S. 422 (1978).

about supply and demand.[170] Hence, such agreements are not "per se" illegal but require more focused analysis to determine whether they result in a restraint on competition of the participants. This is generally understood to include some market definition and evidence of an actual effect on prices or output.[171]

In *Aguilar*, the plaintiff had claimed that there was a conspiracy to limit the production of the specialized gasoline required in California. The defendants participated in the exchange of information about capacity, production, and pricing. Thus, there was an agreement to exchange competitively sensitive information.[172] But the plaintiffs did not challenge the exchanges as themselves unlawful and a source of harm. Instead, the plaintiffs limited their claim to the assertion that these exchanges facilitated an underlying conspiracy which would itself be per se illegal. It is often the case that private plaintiffs seek to avoid any claims that might involve issues of "reasonableness" because of the great difficulty of convincing courts that such agreements are unreasonable.

In *Aguilar*, the Court observed that in an oligopolistic industry there is a natural inclination among firms to engage in parallel conduct that is mutually beneficial.[173] Only a tacit understanding is required to facilitate this conduct. Exchanging information, the Court inferred, did not prove that there was an underlying agreement to restrict production. Thus, the plaintiffs had not challenged the information exchange as itself unlawful and so that issue was not directly

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[170] Id at 441, n. 16.

[171] See, e.g., Todd v. Exxon, 275 F. 3d 191 (2nd Cir. 2001).

[172] A plausible theory, given the significant number of firms in the market, would be that without the exchange of detailed, competitively sensitive information, the refiners would have behaved much more competitively. Hence, the tacit control of output, see *Aguilar* at 520, was possible only because each of the nine refiners could tell very quickly if any other party was "cheating" on the tacit understanding and increasing production or cutting prices.

[173] Id. at 520.

before the Court. However, the Court's analysis and its explicit praise of information as improving market transactions suggests that it would have rejected any such claim. Since the *Aguilar* decision, courts applying the Cartwright Act seem to reject any negative inference arising from sharing sensitive information among competitors.[174]

In contrast, at the federal level, the case law has with substantial consistency recognized that information exchanges can be unlawful because they make possible otherwise lawful tacit collusion.[175] In the 1990s in connection with providing guidance on antitrust enforcement in health care, the DOJ and FTC addressed information exchange in ways that were tolerant of such exchanges although that guidance also recognized that such exchanges could be anticompetitive.[176] In 2016, as concerns with collusion among employers increased, the agencies offered guidance to human services officials that emphasized the risks of exchanging confidential information about employment conditions.[177] Then, in 2022, the DOJ withdrew the

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[174] See, In re Automotive Antitrust Cases I and II, 1 Cal.App.5th 127 153-154, 204 Cal. Rep. 3ard 330, 353 (CA 1st District, Div. 4, 2016) ("In attempting to prove unlawful conspiracy, one type of evidence antitrust plaintiffs often present—as plaintiffs do here—is evidence that the alleged co-conspirators met and shared industry information at conferences or trade association meetings. The law is clear, however, that "[i]n general, trade association activities tend to promote competition and are lawful. Gathering and compiling industry information and disseminating it among members does not offend antitrust policy, even though to do so naturally 'tends to stabilize that trade or business and to produce uniformity of price and trade practice.'" (*Biljac, supra,* 218 Cal.App.3d at p. 1430, 267 Cal.Rptr. 819, quoting *Maple Flooring Assn. v. United States* (1925) 268 U.S. 563, 582, 45 S.Ct. 578, 69 L.Ed. 1093 (*Maple Flooring).*) Moreover, trade association members do not "'become ... conspirators merely because they gather and disseminate information ... bearing on the business in which they are engaged *and make use of it in the management and control of their individual businesses....*'" (*Biljac,* at p. 1430, 267 Cal.Rptr. 819, quoting *Maple Flooring,* at p. 584.) "Only when they take *concerted action to restrain trade* based on such information do they act illegally." (*Ibid.*)"); see also, Eddins v. Sumner Redstone, 134 Cal.App.4th 290, 307-308 (Cal. Ct. App. 2005) (rejecting evidence of shared confidential pricing information as probative of any conspiracy).

[175] See, cases cited at note 178 supra; see also, e.g., Todd v. Exxon, 275 F.3d. 191 (2d Cir, 2001); Cason-Merenda v. Detroit Medical Center, 862 F. Supp. 2nd 603 (E.D. Mich. 2012) (dismissed claim of wage fixing conspiracy, but refused to dismiss claim of unlawful information exchange)

[176] U.S. Department of Justice and the Federal Trade Commission, Statements of Antitrust Enforcement Policy in Health Care (1996) available at https://www.justice.gov/atr/page/file/1197731/download.

[177] Dept. of Justice & FTC, Antitrust Guidance for Human Resource Professionals, 4 (2016) available at https://www.justice.gov/atr/file/903511/download.

health care guidance on information exchange because experience had shown that such exchanges were likely to result in restraints of competition beyond what had been postulated in the 1990s.[178] At the same time, the DOJ settled a major case involving only information exchange among poultry processors with respect to wages and working conditions. [179] The complaint asserted that the conspiracy had been ongoing for at least 20 years and had allowed the companies to restrict wages not only for lower-level employees but also for more senior employees. [180]

Some scholars have contended that some types of information exchange ought to be per se illegal.[181] The basic characteristic of such exchanges is that they relate to very sensitive, forward-looking information such as new list prices. These scholars contend that there are no real justifications in terms of facilitating competitive market behavior in sharing such information. An alternative approach would impose a presumption of illegality, akin to the "quick look" employed to reject some restraints, to any exchange among competitors of competitive sensitive information, but allow the parties to rebut that presumption by a showing of legitimate reason to exchange such information.[182]

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[178] Doha Mekki, Remarks, Feb. 2, 2023, available at https://www.justice.gov/opa/speech/principal-deputy-assistant-attorney-general-doha-mekki-antitrust-division-delivers-0

[179] See, Proposed Final Judgment, United States v. Cargill Meat Solutions, Case 1:22-cv-01821-ELH, D. Md., available at https://www.justice.gov/atr/case-document/file/1528346/download.

[180] See, Complaint, United States v. Cargill Meat Solutions, Case 1:22-cv-01821-DLH (D. Md. 2022) available at https://www.justice.gov/atr/case/usv-cargill-meat-solutions-corp-et-al

[181] Joseph E. Harrington Jr, & Christopher R. Leslie, *Horizontal Price Exchanges* 44 CARDOZO L. REV. 2301 (2023) (arguing for per se treatment for exchanges of prospective list prices even if those prices are not ones that will actually be charged but recognizing that courts at most are like to adopt a presumption of illegality).

[182]Peter C. Carstensen and Annkathrin Marschall, *Pooling and Exchanging Competitively Sensitive Information Among Rivals: Absolutely Illegal Not Just Unreasonable*, forthcoming U. CIN. L. REV. (2023) (arguing that agreements involving exchanges of competitive sensitive information among competitors are usually naked restraints which would be per se illegal but in a few cases might not have any adverse effect on competition; hence, all such exchanges should be at least presumptively illegal). An example of a potentially permissible exchange would be a plan to establish some comparative benchmarks by which firms could judge their relative efficiency in various aspects of their business. Even

Although current federal antitrust law still uses the "rule of reason" framework for reviewing information exchanges, cases such as *Cargill Meat Solutions* suggest that the standard is closer to a "quick look" in which the exchange among competitors of competitively sensitive information is likely to be presumed illegal. This puts the burden of justification on the parties exchanging information to demonstrate that it does not in fact affect their competitive freedom.

Because the treatment of information exchanges is part of the broader context of the standards and criteria by which agreements among competitors will be assessed, it is likely to be very challenging to identify a statutory path to change the California standard with respect to information exchange. If such a change were deemed desirable, it might be possible to include language that creates a presumption of anticompetitive effect if competitors exchange competitively sensitive information.

5. Pay-for-Delay

a) Background

"Pay-for-delay" settlements arise when a brand drug manufacturer pays a generic manufacturer to refrain from entering the market. Typically, the brand and generic manufacturers engage in patent litigation under the Hatch-Waxman Act. The brand drug patentee sues or countersues the generic for patent infringement, and the parties reach a settlement in which the patentee *compensates* the alleged infringer, in exchange for a commitment to keep its generic equivalent off the market until a future date. The payment thus flows in reverse in these types of settlements: a patentee plaintiff pays a large sum of money to an alleged infringer in exchange for *dismissing its own lawsuit*. On one end of the continuum, these settlements arguably amount

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there, the risk of abuse of such a process is real which requires the parties to develop good procedures and limits on the kinds of information actually shared. See, id.

to an agreement between two rivals not to compete and could be treated as a *per se* violation of the antitrust laws. On the other end of the continuum, they arguably fall within the potential patent rights of the brand drug manufacturer and could be treated as virtually always legal.

The Supreme Court found a middle ground in *FTC v. Actavis, Inc.* 570 U.S. 136, 159 (2013), and held that these types of settlements can violate federal antitrust laws under a rule of reason analysis. In *Actavis*, Solvay Pharmaceuticals settled patent litigation with several manufacturers that sought to market a generic version of Androgel, Solvay's brand drug.[183] Solvay agreed to pay hundreds millions of dollars in combined settlements to the generic manufacturers in exchange for commitments to refrain from marketing their products until approximately five years before the patent expired.[184] The Supreme Court held that such settlements were not immune from antitrust liability simply because the agreements did not extend beyond the scope of the exclusionary potential of the patent.[185]

While the Court did not set forth the precise structure for a rule of reason analysis in the reverse payment setting,[186] it did offer a conceptual framework based on five considerations to justify the application of antitrust scrutiny to reverse payments. First, reverse payments have the potential for genuine adverse effects on competition.[187] Second, the anticompetitive effects of reverse payments will not always be justified by procompetitive effects.[188] Third, because reverse payments pose a real risk of anticompetitive harm, the patentee likely possesses the

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[183] *Id.* at 140-41.

[184] *Id.* at 145.

[185] *Id.* at 148-49.

[186] *Id.* at 160.

[187] *Id.* at 153

[188] *Id.* at 156.

power to bring about that harm.[189] Fourth, it is administratively feasible to subject reverse payments to antitrust scrutiny,[190] because it is "normally not necessary to litigate patent validity" to determine whether a reverse payment violates the antitrust laws.[191] An unexplained large reverse payment itself "suggests that the payment's objective is to maintain supracompetitive prices."[192] Fifth, the Court rejected the notion that reverse payments are necessary to settle patent disputes among drug manufacturers.[193]

b) Reverse Payment Claims under the Cartwright Act

Following the *Actavis* decision, the California Supreme Court left its own detailed blueprint for treatment of reverse payments under the Cartwright Act in *In re Cipro Cases I & II*, 61 Cal. 4th 116 (2015) ("*Cipro*"). The *Cipro* case arose out of a settlement between Bayer Corporation, the patentee for the active ingredient in the antibiotic Cipro, and Barr Laboratories, a generic manufacturer.[194] Barr agreed not to market its generic until after Bayer's patent expired, and Bayer agreed to make payments to Barr and to supply it with Cipro for licensed resale six months before the expiration.[195] Under the settlement, Bayer paid Barr almost $400 million over six years.[196] In several coordinated cases, indirect purchasers alleged that the

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[189] *Id.* at 157.

[190] *Id.*

[191] *Id.*

[192] *Id.*

[193] *Id.* at 158.

[194] *Id.* at 131-32.

[195] *Id.*

[196] *Id.* at 133.

reverse payment settlement violated the Cartwright Act, California's unfair competition law, and the common law prohibition against monopolies.[197]

In *Cipro,* the California Supreme Court noted, "Interpretations of federal antitrust law are at most instructive, not conclusive, when construing the Cartwright Act."[198] It then set out its own structured approach to apply a rule of reason analysis to the Cartwright Act in the reverse payment setting. To establish a prima facie case, a plaintiff must show that the settlement: 1) limits the generic's entry into the market; 2) includes cash or equivalent financial consideration flowing from the brand to the generic; and 3) the consideration exceeds the value of a) goods and services *other* than any delay in market entry plus b) the brand's anticipated costs to litigate the patent suit.[199] Once plaintiff has shown this, the defendant has the burden to come forward with its own evidence of litigation costs and collateral benefits from the agreement.[200] If the defendant fails to do so, the plaintiff has satisfied its initial burden.[201] The defendant then has the burden to present evidence of procompetitive effects.[202]

c) *Cipro* and *Actavis*: Key Distinctions under California and Federal Law

(1) Payments That Do Not Take the Form of Cash

While the Supreme Court in *Actavis* was silent on reverse payments that do not take the form of cash settlements, the California Supreme Court in *Cipro* condemned non-cash

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[197] *Id.*

[198] *Id.* at 142.

[199] *Id.* at 151.

[200] *Id.* at 154.

[201] *Id.*

[202] *Id.* at 157-58.

consideration, stating that "courts considering Cartwright Act claims should not let creative variations in the form of consideration result in the purchase of freedom from competition escaping detection."[203] The California Supreme Court was perhaps addressing an increasingly significant issue in reverse payment settlements, in which pharmaceutical manufacturers adopt creative means to settle patent infringement lawsuits that involve wealth transfers of intellectual property or other assets, but are hard to value and in particular may not include cash. Today, settlements between branded and generic manufacturers frequently include nonmonetary "no-AG" agreements, under which the branded firm agrees not to introduce, market, or advertise an authorized generic that might compete with the generic manufacturer's product.

(2) Value of a Lost Risk

In *Actavis,* the Supreme Court explained that it is not normally necessary to litigate underlying patent validity to determine if a reverse payment violates antitrust law because "the size of the unexplained reverse payment can provide a workable surrogate for a patent's weakness, all without forcing a court to conduct a detailed exploration of the patent itself."[204] In other words, when a generic manufacturer agrees not to enter the market and receives in exchange something of value that cannot otherwise be explained, courts may infer potential patent weakness. Moreover, a patentee who makes a payment to avoid *the risk of patent invalidity* – even a small risk – has violated antitrust law.[205] A "payment (if otherwise

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[203] *Cipro*, 61 Cal. 4th at 151 n. 11.

[204] *Actavis,* 570 U.S at 158.

[205] *Id.* at 157.

unexplained) likely seeks to prevent the risk of competition. And, as we have said, that consequence constitutes the relevant anticompetitive harm."[206]

In *Cipro,* the California Supreme Court also articulated this inference, stating that a court can resolve an antitrust challenge to a reverse payment without adjudicating the patent's underlying validity.[207] Moreover, the Court indicated that a payment to reduce *any risk of competition* violates the Cartwright Act – even if a plaintiff cannot show that the patent more likely than not would have been upheld if tested in court.[208]

(3) AB 824: The California Reverse Payment Statute

In October 2019, California enacted first-of-its-kind reverse payment legislation through Assembly Bill 824, modifying by statute the burden of proof requirements for reverse payment claims under California law. The bill amended Cal. Health & Safety Code § 134000 *et. seq.*[209] to provide that reverse payment agreements in the pharmaceutical drug marketplace are *presumed to have anticompetitive effects* if: i) the generic manufacturer obtains "anything of value" from the agreement and ii) the generic manufacturer agrees to limit or forego research, development, manufacturing, marketing, or sales of the generic.[210] AB 824 shifts the burden to pharmaceutical companies to rebut a presumption of an anticompetitive agreement, by showing that the value of

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[206] *Id.* at 158.

[207] *Cipro*, 61 Cal. 4th at 162 n. 21.

[208] *Id.* at 149.

[209] https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200AB824

[210] Cal. Health & Safety Code §134002(a)(1)(A)-(B).

compensation received by the generic drug company was fair market value for goods or services provided, or that the settlement generated procompetitive benefits.

(a) Judicial Treatment of AB 824

In 2021, a district court in the Ninth Circuit issued a preliminary injunction blocking enforcement of AB 824 on constitutional grounds in *Ass'n for Accessible Medicines v. Bonta*, 562 F.Supp.3d 973, 989 (E.D. Cal. 2021). An association of generic pharmaceutical companies filed an action for declaratory and injunctive relief against the California Attorney General, challenging AB 824.[211] The court held that plaintiff was likely to succeed on the merits on its claim that AB 824 violates the dormant Commerce Clause by regulating out-of-state conduct – i.e., regulating reverse payment agreements made outside of California.[212] The California Attorney General subsequently asked the court to modify the injunction to permit enforcement of AB 824 on in-state settlements only. The district court held that California may "enforce the provisions of AB 824 with respect to settlements negotiated, completed, or entered into within California's borders."[213]

6. Product Hopping

a) Federal Law

Pharmaceutical "product hopping" typically involves a brand manufacturer switching to a reformulated version of a drug prior to the expiration of the drug's patent. The manufacturer persuades doctors to write prescriptions for the reformulated drug, which is often therapeutically similar or equivalent to the original. A successful "product hop" extends the manufacturer's

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[211] *Id.* at 978.

[212] *Id.* at 987.

[213] *Ass'n for Accessible Meds v. Bonta*, 2022 WL 463313, at *24 (E.D. Cal. Feb 14, 2022).

monopoly by inhibiting competition from generic equivalents to the original drug. Several federal courts have evaluated the anticompetitive effects of product hopping under the Sherman Act. In *New York ex rel. Schneiderman v. Actavis*, *PLC* ("*Namenda"*), 787 F.3d 638, 642 (2d 2015), the State of New York brought an antitrust action against Actavis for introducing a once-daily Alzheimer's treatment, just as the patent exclusivity period for the twice-daily version neared its end. New York alleged that defendants' forced switch would impede generic competition.[214] The Second Circuit affirmed a preliminary injunction requiring Actavis to continue selling the original formulation until one month after generics were permitted to enter the market, holding that plaintiff demonstrated a substantial likelihood of success on its claim that defendant violated Section 2 of the Sherman Act for monopolization and attempted monopolization.[215]

In *Mylan Pharm. Inc. v. Warner Chilcott Pub. Ltd. Co.* ("*Doryx*"), 838 F.3d 421, 426 (3d Cir. 2016), a generic manufacturer alleged that brand manufacturers of the acne drug "Doryx" conspired to protect their position in the market through "product hopping," making various insignificant reformulations to Doryx to make it difficult for generic competitors to enter the market. The Third Circuit upheld an order granting summary judgment for defendants, concluding that Mylan established neither monopoly power nor anticompetitive conduct under Section 2 of the Sherman Act.[216] The Court distinguished *Namenda* on both procedural and factual grounds, noting that *Namenda* was decided at the preliminary injunction phase, whereas

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[214] *Id.* at 642.

[215] *Id.* at 652.

[216] *Id.* at 441.

this case had "proceeded through full discovery and resulted in a robust record void of any evidence of anticompetitive conduct."[217]

b) Product Hopping and California Law

California's Cartwright Act prohibits concerted conduct in restraint of trade, but is silent on single-firm conduct.[218] Because "product hopping" claims often depend on claims of monopolization or attempted monopolization in violation of Section 2 of the Sherman Act, there has been limited judicial treatment of product hopping claims under the Cartwright Act.

B. Vertical.

1. Price Fixing (Resale Price Maintenance)

The federal antitrust standards for resale price maintenance (RPM) have changed dramatically over the last century. The Supreme Court in 1911 condemned RPM and was understood to make it "per se" illegal.[219] But in 1937, Congress authorized the states to permit such restraints and strengthened that authority in 1952.[220] But in 1976, it repealed those statutes.[221] The congressional goal was to restore the original general prohibition on RPM. However, the Supreme Court, having generally taken an increasingly tolerant view of restraints

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[217] *Id.* at 440.

[218] *Asahi Kasei Pharma Corp. v. CoTherix, Inc.* 204 Cal.App.4th 1, 9 (1st Dist. 2012)

[219] Doctor Miles v. John D. Park & Son, 220 U.S. 373 (1911). This case was argued at the same time as the *Standard Oil* and *American Tobacco* cases that announced the rule of reason. Hence, it is probable that the Court understood the specific agreement to be nothing more than a cartel implemented at the behest of retailers, but it came to be understood as an absolute prohibition on RPM. See, James May, *Antitrust in the Formative Era: Political and Economic Theory in Constitutional and Antitrust Analysis*, 1880-1918, 50 OHIO ST. L.J. 257 (1989); see also, Lester G. Telser, *Why Should Manufacturers Want Fair Trade*, 3 J. L. & ECON. 86 (1960).

[220] Miller-Tydings Act of 1937, Pub. L. No. 314, 75th Cong. 1st Sess. Congress subsequently strengthened this grant of authority in the McQuire Act, Pub. L. No 542, 66 Stat. 362 (1952).

[221] Consumer Goods Pricing Act, Public Law 94-145

on distribution, in 2007 reversed its own precedent and determined that the Sherman Act only barred RPM schemes that violated the rule of reason.[222]

In California, §16720 (e) (3) of the Cartwright Act prohibits agreements that control prices including resale prices, and the California Supreme Court has held that such restraints are "per se" illegal.[223] That holding preceded the United States Supreme Court's decision in *Leegin* that reversed its earlier standard of illegality. No subsequent California decision has addressed the continued validity of the per se standard for RPM.

The merits of RPM have long been contested. For example, Robert Bork supported RPM based on his belief in the validity of the theories that showed it only made economic sense when it supported enhanced competition at the retail level.[224] In contrast, Justice Louis Brandeis advocated for RPM as a means for small businesses to maintain higher prices when faced with competition from larger and more efficient retailers.[225] Tom McCraw, a business historian, has shown that General Electric employed RPM in collaboration with larger retailers to restrict entry into retailing by discounters and in return the retailers favored GE products thereby excluding potential competitors of GE.[226] Eventually entry at both levels resulted in GE abandoning RPM.

"Per se" statutory rules in such areas as RPM can be explained as a legislative judgment balancing the potential gains from allowing such restraints at all and their harms resulting in a

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[222] See, Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

[223] Mailand v. Burckle, 20 Cal. 3d. 371 (1978).

[224] See, Robert H. Bork, *Resale Price Maintenance and Consumer Welfare*, 77 YALE L. J. 950 (1968).

[225] See, Louis D. Brandeis, *Cutthroat Prices--Competition that Kills*, HARPER'S WEEKLY, Nov. 15, 1913, reprinted in LOUIS D. BRANDEIS, BUSINESS-A PROFESSION, Chapter 15 (1914).

[226] Tom McCraw, *Competition and "Fair Trade": History and Theory*, 16 RES. ECON. HIST. 185 (1996).

judgement that the gains are unlikely and rare while harms are frequent and significant.[227] Such an interpretation would also recognize that there are other ways to protect legitimate interests in distribution of goods such as creating territorial assignments or imposing express requirements with respect to product promotion and servicing. Alternatively, the prohibition on RPM could be a "presumption of illegality" of the sort associated with the "quick look" standard in some Sherman Act cases.[228] Such an approach could reconcile this provision with §16725 that allows restraints that promote competition.[229]

Since the Supreme Court reversed itself on RPM, empirical economic studies have found that allowing this practice has generally resulted in higher prices while improvements in services or increased value of the resulting product appear to be rare or non-existent.[230] On the other hand, the theory that eliminating price competition can result in increased competition by retailers in other dimensions is plausible.[231] Some scholars have shown that in some cases, the likely effect is that consumers seeking less service will subsidize those who demand or value

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[227] The California absolute prohibition of post-employment covenants not to compete imposed by §16660 is an illustration of such a legislative judgement.

[228] See, Polygram v. FTC, 416 f,.3d 29 (D.C. Cir. 2005) (an agreement not to discount recordings that competed with that being produced by the joint venture was unreasonable after only a quick look). It is arguable that the Sherman Act prohibition on RPM when it existed was similarly a quick look presumption of illegality. See, Peter C. Carstensen, *Lost in (Doctrinal) Translation: The Misleading Retelling of the Supreme Court's Antitrust Decisions on Restraints of Trade*, 62 SMU LAW REV. 525 (2009).

[229] The existing caselaw in California has not related the prohibition on RPM to the defense authorized by §16725. If RPM is indeed per se illegal, then this defense would be inapplicable. It is also possible that given the specific statutory command, that RPM is presumptively illegal and only a strong justification could possibly excuse it.

[230] See, e.g., Alexander MacKay & David Smith, *The Empirical Effects of Minimum Resale Price Maintenance* (June 16, 2014). Kilts Center for Marketing at Chicago Booth – Nielsen Dataset Paper Series 2-006, Available at SSRN: https://ssrn.com/abstract=2513533 or http://dx.doi.org/10.2139/ssrn.2513533 (comparison of prices and services in states that enforced the per se rule against RPM with those that adhered to the rule of reason showed that the rule of reason states had higher consumer prices and no increased services); others?

[231] See, Kenneth G. Elzinga & Dav1d E. Mills, *The Economics of Resale Price Maintenance*, in in 3 ISSUES IN COMPETITION LAW AND POLICY 1841 (ABA Section of Antitrust Law 2008); cf. Lester G. Telser, *Why Should Manufacturers Want Fair Trade*, 3 J. L. & ECON. 86 (1960).

increased services.[232] In addition, it is not disputed that RPM can be a cartelistic device by which retailers can avoid price competition.[233]

2. Exclusive Dealing

Exclusive dealing refers to situations where a contract between a manufacturer/seller and a buyer "forbids the buyer from purchasing the contracted good from any other seller or that requires the buyer to take all of its needs in the contract good from that manufacturer."[234] The contract need not specifically require the buyer to avoid other suppliers if the practical effect is the same.[235] While not a per se violation of the antitrust laws, the courts recognize that such agreements take away a buyer's freedom to choose to purchase from the seller's competitors and may allow a monopolist to strengthen its position in the market.[236] Both California and federal law recognize the potential for procompetitive effects of exclusive dealing agreements and thus analyze such agreements under the Rule of Reason.[237]

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[232] See, William Comanor, *Vertical Price Fixing, Market Restrictions, and the New Antitrust Policy,* 98 HARV. L. REV. 983 (1985); F. M. Scherer, *The Economics of Vertical Restraints*, 52 ANTITRUST L. J. 687 (1983).

[233] See, Telser, supra note 219.

[234] *In re EpiPen (Epinephrine Injection, USP) Marketing, Sales Practices & Antitrust Litig.*, 545 F. Supp. 3d 922, 1002 (D. Kan. 2021) (quoting Areeda & Hovenkamp, *Antitrust Law* ¶ 1800a, at 3 (4th ed. 2018).

[235] *In re EpiPen (Epinephrine Injection, USP) Marketing, Sales Practices & Antitrust Litig.*, 545 F. Supp. 3d 922, 1002 (D. Kan. 2021) (quoting *Perington Wholesale, Inc. v. Burger King Corp.*, 631 F. 2d 1369, 1374 (10th Cir. 1979)

[236] *In re EpiPen (Epinephrine Injection, USP) Marketing, Sales Practices & Antitrust Litig.*, 545 F. Supp. 3d 922, 1002 (D. Kan. 2021); *Perington Wholesale, Inc. v. Burger King Corp.*, 631 F. 2d 1369, 1374 (10th Cir. 1979); *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254, 270-71 (3d Cir. 2012) ("Exclusive dealing arrangements are of special concern when imposed by a monopolist.").

[237] *Fisherman's Wharf Bay Cruise Corp. v. Superior Court of San Francisco*, 114 Cal.App.4th 309, 334-35 (2003) ("In California, exclusive dealing arrangements are not deemed illegal per se. 'They may provide an incentive for the marketing of new products and a guarantee of quality-control distribution. They are proscribed when it is probable that performance of the contract will foreclose competition in a substantial share of the affected line of commerce.'"); *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 333 (1961). *In re Mylan N.V. Securities Litig., 2023 WL 2711552*, at *7 (S.D.N.Y. March 30, 2023) ("To assess exclusive dealing contracts, courts apply the rule of reason."); *In re EpiPen (Epinephrine Injection, USP) Marketing, Sales Practices & Antitrust Litig.*, 545 F. Supp. 3d 922, 1003 (D. Kan. 2021) (So, because exclusive dealing arrangements 'may actually enhance competition, . . . they are not deemed per se illegal.' . . . Instead, courts apply the rule of reason to determine the legality of exclusive dealing arrangements." (citations omitted).)

Under Federal law, exclusive dealing claims may be brought under Sections 1 or 2 of the Sherman Act or Section 3 of the Clayton Act.[238] However, not all exclusive dealing arrangements are unlawful; a contract will only violate the antitrust laws if "the court believes it probable that performance of the contract will foreclose competition in a substantial share of the line of commerce affected."[239] In application, this means that the court must consider (1) the line of commerce; (2) the area of effective competition; and (3) the share of competition foreclosed.

The line of commerce is a fact-based inquiry specific to the case.[240] The area of effective competition is another fact-based inquiry bounded by where the seller operates and "to which the purchaser can practicably turn for supplies."[241] The line of commerce may only affect a certain region and need not be nationwide.[242] As the *Standard Oil* court explained, "the narrower the area of competition, the greater the comparative effect on the area's competitors. Since it is the

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[238] 15 U.S.C.A. § 14 ("It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce."). Claims may also be brought under the Sherman Act for the same conduct. *See, e.g., Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 335 (1961); *In re Mylan N.V. Securities Litig.*, 2023 WL 2711552, at *7 (S.D.N.Y. March 30, 2023) (analyzing exclusive dealing contracts under Section 2 of the Sherman Act).

[239] *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961).

[240] *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961) ("First, the line of commerce, i.e., the type of goods, wares, or merchandise, etc., involved must be determined, where it is in controversy, on the basis of the facts peculiar to the case.").

[241] *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961)

[242] *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961) (*quoting Standard Oil Co. v. U.S.*, 337 U.S. 293, 299 (1949). See, also, *Standard Oil Co. v. U.S.*, 337 U.S. 293, 299 (1949) (area of competition was where the seller and 75 of its competitors sold petroleum products – Arizona, California, Idaho, Nevada, Oregon, Utah, and Washington.); *U.S. v. Columbia Steel Co.*, 334 U.S. 495 (1948) (relevant market was the 11 Western States were Consolidated marketed its products); *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 331-32 (1961) (describing the relevant competitive market as "the area in which respondents and the other 700 producers effectively compete.")

preservation of competition which is at stake, the significant proportion of coverage is that within the area of effective competition."[243]

In determining substantiality, the United State Supreme Court has directed courts to take into account the "relative strength of the parties," the "proportionate volume of commerce involved in relation to the total volume of commerce in the relevant market area," and the "probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein."[244] The fact a contract involves a lot of money is generally irrelevant to the analysis.[245]

To succeed under California law, like the federal standard described above, a plaintiff must show "knowledge and analysis of the line of commerce, the market area, and the affected share of the relevant market."[246] While California courts had looked for more than 20 percent of the market to be foreclosed to establish a substantial effect on competition, the Court of Appeal in *Fisherman's Wharf Bay Cruise Corp. v. Superior Court of San Francisco* rejected this benchmark, noting that courts must consider "any other existing unique market factors which

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[243] *Standard Oil Co. v. U.S.*, 337 U.S. 293, 299 (1949); *In re Mylan N.V. Securities Litig.*, 2023 WL 2711552, at *7 (S.D.N.Y. March 30, 2023) ("Under either Section 1 or Section 2, it is required that plaintiffs 'present strong evidence' not just of effect but, specifically of substantial market foreclosure."). *Compare, e.g. Standard Oil Co. v. U.S.*, 337 U.S. 293, 299 (1949) (requirements contracts covered a large number of gas stations, a large number of contracts, and a large number of products supported finding that the contracts violated Section 3.) *with U.S. v. Columbia Steel Co.*, 334 U.S. 495 (1948) (No violation where Consolidated's share of the national market for rolled steel products was less than 1/2 of 1% and its share of the relevant market was only 3%). *In re Mylan N.V. Securities Litig.*, 2023 WL 2711552, at *8 (S.D.N.Y. March 30, 2023) (Finding no substantial foreclosure where the product at issue had access to 80% of the commercial market within two years of coming to market, thus "[t]his is not substantial foreclosure under any standard.")

[244] *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 329 (1961). *See, also, id.* at 333-334 (Recognizing the 20-year supply contract as one which 'may well be of economic advantage to buyers as well as to sellers' in allowing the buyer to assure supply and giving the seller the possibility of a predictable market.);

[245] *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 334 (1961) ("While $128,000,000 is a considerable sum of money, even in these days, the dollar volume, by itself, is not the test, as we have already pointed out").

[246] *Fisherman's Wharf Bay Cruise Corp. v. Superior Court of San Francisco*, 114 Cal.App.4th 309, 335 (2003) (*quoting Dayton Time Lock Service, Inc. v. Silent Watchman Corp.*, 52 Cal.App.3d 1, 6 (1975)).

bear on the degree of residual competition between the parties remaining after the exclusive arrangements."[247]

V. Potential Areas of Statutory Change

There are several ways in which the statutory language in California's provisions governing restraints of trade might be modified and improved.

A. Eliminate the Distinction Between Commodities and Services in §16720 (b) to (e) and §16727.

Although §16720 (a) applies generally to any restraint, the following subsections (b) to (e) apply only to "commodities." In addition, §16727 that condemns tying applies only to commodities. Hence, tying contracts that involve services or real property are not subject to this stricter standard although they can still be condemned under §16720(a). From an economic and market perspective there is no rational basis for distinguishing between commodities and other goods or services in the market. As a result, it would make sense to revise these provisions to include all goods, services, and real property.

With respect to tying, federal case law refers to such contracts as "per se" illegal but applies only when a number of pre-conditions are satisfied including significant market power.[248] California law distinguishes between ties that violate §16720(a) which require proof of market power and an effect on a significant amount of commerce and those that violate §16727 which require only an effect on a substantial amount of commerce.[249] Federal law also allows tying when there is a legitimate business justification.[250] The current state California's tying law is

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[247] *Fisherman's Wharf Bay Cruise Corp. v. Superior Court of San Francisco*, 114 Cal.App.4th 309, 336 (2003)

[248] Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2 (1984)

[249] See, Morrison v. Viacom, 66 Cal. App. 4th 534, 542, 546 (1998).

[250] See, e.g., Pick Manufacturing v. General Motors, 299 U.S. 3 (per curium 1936) (upholding a tying agreement governing repair parts in cars); Jerrold Electronics v. United States, 365 U.S. 567 (1961) (upholding a decree that found that new entrant could engage in tying its equipment to its engineering services until it had established itself in

unclear on whether such a defense exists. If, as discussed below, the statutes make clear that §16725 provides a route for the justification of an otherwise objectionable tying contract that would resolve concern that the stricter standard of §17627 would cause any adverse effect.

B. Revising or Deleting Subsections §16720 (b) to (e)

It is arguable that these subsections (§16720 (b) to (e)) do not add significantly to the general condemnation provided in §16720(a). However, §16720(e)(3) provides an express condemnation of resale price maintenance (RPM) and the California Supreme Court has held that such restraints are "per se" illegal.[251] That holding preceded the United States Supreme Court's decision in *Leegin* that reversed its earlier standard of illegality for minimum RPM.[252] No subsequent California decision has addressed the continued validity of the per se standard for RPM. Moreover, apparently, no California court has considered the relationship between that section and §16725 (see following discussion of §16725 and its relationship to overall restraint of trade analysis). This is significant in light of the change in federal law that now treats RPM as presumptively lawful unless the party imposing the RPM has substantial market power. As discussed at section V. A, there is little empirical support for broad claims that RPM restraints are necessary for success in the market. Retaining §16720(e)(3) would, therefore, ensure that any effort to impose RPM in California would be subject at least to strict scrutiny.

A second important inclusion in the subsections of §16720 is the explicit condemnation of restraints affecting the buying side of the market (§16720(c)). While federal law has

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the market); see also, Dehydrating Process v. A. O. Smith, 292 F.2d 653 (First Cir. 1961) (silo maker could tie unloading equipment to sale of silo because of need to ensure good performance for most buyers).

[251] Mailand v. Burckle, 20 Cal. 3d. 371 (1978).

[252] See, Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007); the Court had earlier reversed its per se rule governing maximum RPM, see, State Oil Co. v. Khan, 522 U.S. 3 (1997).

consistently recognized that such restraints are within the scope of the Sherman Act's coverage,[253] the emphasis on "consumer welfare" as the central goal of antitrust law tends to weaken the focus and scope of concern related to exploitation of buyer power in various markets including employment and agricultural commodities.[254] Hence, if the subsections of §16720 are consolidated this provision should also be retained.

C. Declaring That §16725 Provides the Standard for Upholding Restraints

As shown in Parts II-IV, California courts have not focused their analysis on the statutory language of the Act. In particular, there has been little or no reliance on §16725 or explanation of when and how it applies to restraints of trade. Rather California courts have followed the pattern of the federal courts and used the vertical/horizontal distinction with each level subdivided by price, non-price, and refusal to deal categories. As discussed in Part III C 2 this formal system makes explanation of decisions as well as prediction of outcomes challenging. This is particularly true of the horizontal-vertical distinction because some restraints that are vertical in form can be (at least partly) horizontal in effect, e.g., RPM and exclusive dealing.[255] These examples illustrate the limits of the current formal system of analysis. But, as discussed in Part III C 2, a number of leading California decisions are also consistent with the functional approach suggested as an alternative explanation of federal case law.

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[253] The Sherman Act does not explicitly include the buying side of the market, but the case law has consistently held that it applies to buyers and much as to sellers. See, e.g., Mandeville Island Farms v. American Crystal Sugar, 334 U.S. 219 (1948).

[254] The latest federal merger guidelines reinforce the importance of recognizing the potential competitive harms from buyer power. See, U.S. DEPARTMENT OF JUSTICE, FEDERAL TRADE COMMISSION, [2023] MERGER GUIDELINES, 26-27, available at https://www.justice.gov/atr/2023-merger-guidelines.

[255]. This conclusion strongly reinforced in the focused discussions of refusals to deal both vertical and horizontal. See, Part IV A. 3. & B.2.).

California's statutory scheme provides an alternative method of analysis with an explicit functional focus. The statutes impose a general condemnation of all restraints in §16720, §16722, and §16726, but §16725 provides an affirmative defense if the party defending a restraint demonstrates that it functions ". . . to promote, encourage or increase competition in any trade or industry, or . . .[is] in furtherance of trade." Applying these criteria would allow courts to condemn conventional cartelistic restraints because by definition they do not promote competition. The courts could in all other cases focus on the functional merits of the justifications offered for a restraint. While the relationship of the parties to the restraint as rivals (horizontal) or customers/suppliers (vertical) could be relevant in many situations, the core focus of analysis would be on the function of the restraint in the market context in which it operates.[256]

To achieve such a reform, the wording of §16725 should make it explicit that California law requires that any non-exempt restraint must satisfy this section. For example, the addition could read: "no restraint can be upheld unless it satisfies this section [§16725] or any other applicable statutory provision." This would require California courts to focus their analysis on the function of the restraint at issue and determine whether it "promote[s], encourage[s], or increase[s] competition."

By directing California courts to apply §16725, it is also possible to have a distinct approach to RPM, especially if it remains explicitly condemned in §16720(e)(3). Unlike federal law that presumes the legality of all "vertical" restraints, §16725 requires express justification.

[256] In doing so, the courts can employ presumptions to limit the necessity of detailed review of some classes of restraints. For example, federal courts generally presume restraints in distribution to be lawful, see, e.g., Continental Television v. GTE Sylvania, 433 U.S. 36 (1977) and presume after only a "quick look" that some restraints among competitors even when engaged in a joint venture are anticompetitive. See, e.g., Polygram Holding v. FTC, 416 F. 3d 29 (D.C. Cir. 2005).

Hence, a defendant that had imposed RPM on its dealers would have to provide an affirmative justification for that action.

D. Specific Condemnation of RPM

As discussed in Part V A, there is in fact little empirical support for the claim that RPM results in economically desirable outcomes. Moreover, other less anticompetitive restraints can achieve almost all the positive results claimed for RPM. This would suggest that the legislature could decide that the potential benefits of RPM, even if subject to a strict §16725 review, are not worth the potential costs and so it should be categorically condemned.[257] Hence, the condemnation in §16720(b)(3) could be revised either explicitly to condemn RPM as illegal or to exclude it from inclusion in those restraints that are reviewable under §16725.

[257] This would be consistent with the legislature's treatment of employee covenants not to compete.