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THE ANCILLARY RESTRAINTS DOCTRINE AFTER *DAGHER*

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The common-law concept of an "ancillary restraint" was imported into Sherman Act jurisprudence by Judge Taft's 1898 *Addyston Pipe* opinion,[1] an important early attempt to come to grips with the meaning of section 1 of the Sherman Act.[2] Under the common law[3] Judge Taft concluded, "no conventional restraint of trade can be enforced unless the covenant embodying it is merely ancillary to the main purpose of a lawful contract, and necessary to protect the covenantee in the full enjoyment of the legitimate fruits of the contract, or to protect him from the dangers of an unjust use of those fruits by the other party."[4]

Judge Taft's innovation went largely unnoticed until highlighted and extended in 1959 by Robert Bork,[5] and the most prominent modern statement of the ancillary restraints doctrine may be that in Bork's 1986 opinion for the D.C. Circuit in *Rothery*: "To be ancillary, and hence exempt from the per se rule, an agreement eliminating competition must be subordinate and collateral to a separate, legitimate transaction. The ancillary restraint is subordinate and collateral in the sense that it serves to make the main transaction more effective in accomplishing its purpose."[6]

The Supreme Court touched on the ancillary restraints doctrine several times. Justice Stewart's concurring and dissenting opinion in *Schwinn* noted that the common law permitted restraints "when ancillary to a legitimate business purpose and not unduly anticompetitive" and cited Judge Taft's opinion for the proposition that the "doctrine of ancillary restraints was assimilated into the jurisprudence of this country in the nineteenth century."[7] Justice Stevens' opinion for the Court in *Professional Engineers* cited Judge Taft's opinion for the proposition that the rule of reason is the "standard for testing the enforceability of covenants in restraint of trade which are ancillary to a legitimate transaction."[8] Justice Stevens' dissenting opinion in *Business Electronics* discussed the ancillary restraints doctrine at length, remarking that Judge Taft's "opinion is universally accepted as authoritative."[9] Finally, Justice Thomas' opinion for the Court in *Dagher* explained that the ancillary restraints doctrine "governs the validity of restrictions imposed by a legitimate business collaboration,

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

2 Contemporaneous were Justice Peckham's landmark opinions in *United States v. Joint Traffic Ass'n*, 171 U.S. 505 (1898); *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897). Justice Peckham also authored the opinion affirming of Judge Taft's decision.

3 The "classic 'ancillary' restraint is an agreement by the seller of a business not to compete within the market." *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 729 n.3 (1988) (citing *Mitchel v. Reynolds*, (1711) 24 Eng. Rep. 247 (K.B.)). The classic ancillary restraint has been the subject of some antitrust cases. *E.g., Lektro-Vend Corp. v. Vendo Co.*, 660 F.2d 255, 264-69 (7th Cir. 1981) (rejecting Section 1 challenge to a covenant not to compete associated with an acquisition).

4 *Addyston Pipe*, 85 F. at 282. Judge Taft's opinion is often cited for his colorful rejection of consideration of the reasonableness of non-ancillary restraints. *Id.* at 283-84 ("It is true that there are some cases in which the courts, mistaking, as we conceive, the proper limits of the relaxation of the rules for determining the unreasonableness of restraints of trade, have set sail on a sea of doubt, and have assumed the power to say, in respect to contracts which have no other purpose and no other consideration on either side than the mutual restraint of the parties, how much restraint of competition is in the public interest, and how much is not. The manifest danger in the administration of justice according to so shifting, vague, and indeterminate a standard would seem to be a strong reason against adopting it.").

5 Robert H. Bork, *Ancillary Restraints and the Sherman Act*, 15 A.B.A. ANTITRUST SEC. PROC. 211 (1959). *See also* ROBERT H. BORK, THE ANTITRUST PARADOX 26-30, 270-79 (rev. ed. 1993) (1978); Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 74 YALE L.J. 775, 797-98 (1965).

6 *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 224 (D.C. Cir. 1986).

7 *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 392 (1967).

8 *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 689 (1978).

9 *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 737-39 (1988). Judge Taft's opinion may be considered authoritative because he became Chief Justice and because joining in the opinion were Justice Harlan and future Justice Lorton.

such as a business association or joint venture, on nonventure activities" and that the doctrine "has no application" when "the business practice being challenged involves the core activity of the joint venture itself."[10]

This article addresses the application of the ancillary restraints doctrine to restraints associated with joint ventures formed by competitors.[11] In particular, five specific questions are addressed: First, exactly what is the "ancillary restraints doctrine;" what is at stake in deciding whether a restraint is ancillary? Second, what restraints associated with a joint venture are separate from the venture but collateral to it and thus the subject of the ancillary restraints doctrine, as opposed to what the *Dagher* Court referred to as "core activity of the joint venture itself"? Third, what makes a collateral restraint "ancillary;" what nexus to the venture and the accomplishment of its procompetitive purposes must the restraint have to be deemed "ancillary"? Fourth, precisely what is the "test" for ancillarity, and how are burdens allocated in litigation? Finally, what should we make of *Topco* and *Citizen Publishing*,[12] two cases in which the Supreme Court applied the per se rule to joint venture restraints?

I. What Is the "Ancillary Restraints Doctrine"?

Judge Taft took the view that ancillary restraints were lawful and non-ancillary restraints were unlawful. Were that true today, the ancillary restraints doctrine would be the keystone of Section 1 analysis, but surely that is not the role the doctrine plays. Robert Bork insightfully explained that the "common law doctrine of ancillary restraints offers the Sherman Act not content but form" and that "the sole function of the concept of ancillarity under the Sherman Act should be to point out instances when *per se* illegality should not attach and to confine the exceptions to their proper scope."[13] Citing Professor Bork, the Ninth Circuit held: "The proper function of ancillarity in antitrust analysis 'is to remove [in some instances] the *per se* label from restraints otherwise falling within the category.'"[14]

Professor Hovenkamp indicates that "once a restraint is found to be ancillary, the court pursues its inquiry with a presumption of lawfulness and requires . . . proof of power and effects," and he suggests that an ancillary restraint is unlawful if it has "output-reducing tendencies (anticompetitive effects) that are not offset by reasonable justifications or defense."[15] This treatment presupposes that a restraint is declared ancillary on the basis of a mere potential to facilitate the accomplishment of a joint venture's legitimate objectives.[16] In that event, the "reasonableness" issue is clearly distinct from the "ancillarity" issue, as in Judge Easterbrook's articulation of the ancillary restraints doctrine in *Polk Bros.*:

> A court must ask whether an agreement promoted enterprise and productivity at the time it was adopted. If it arguably did, then the a court must apply the Rule of Reason to make a more discriminating assessment. . . .
>
> If the restraint, viewed at the time it was adopted, may promote the success of the more extensive cooperation, then the court must scrutinize things carefully under the Rule of Reason.[17]

An alternative treatment merges the test for ancillary with the "reasonableness" issue. Although perhaps never explicitly stated, some cases appear to have in mind a concept of ancillarity

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10 *Texaco Inc. v. Dagher*, 547 U.S. 1, 7-8 (2006).

11 In his 1959 article, Bork remarked that "the most fruitful area for the application of the common law of ancillary restraints to the Sherman Act is in the analysis of restraints ancillary to joint ventures." Bork, *Ancillary Restraints, supra* note 5, at 224. Professor Hovenkamp has gone so far as to suggest that "the most frequent application of the rule of reason involves restraints that are 'ancillary' to some underlying productive joint venture." 11 HERBERT HOVENKAMP, ANTITRUST LAW Paragraph 1912c3, at 322 (2d ed. 2005).

12 *United States v. Topco Assocs.*, 405 U.S. 596 (1972); *Citizen Publ'g Co. v. United States*, 394 U.S. 131 (1969).

13 Bork, *Ancillary Restraints, supra* note 5, at 216, 227. *See also id.* at 226 ("It seems best . . . to restrict the concept of ancillarity to those horizontal restraints – agreements to divide markets and to fix prices – which are usually thought of as illegal *per se*.").

14 *Aydin Corp. v. Loral Corp.*, 718 F.2d 897, 901 (9th Cir. 1983) (quoting Bork, *Ancillary Restraints, supra* note 5, at 212). *See also Los Angeles Mem'l Coliseum Comm'n v. NFL*, 726 F.2d 1381, 1395 (9th Cir. 1984) (the practical "effect of a finding of ancillarity is to 'remove the *per se* label from restraints otherwise falling within that category'") (quoting Bork, *Ancillary Restraints, supra* note 5, at 212).

15 11 HOVENKAMP, *supra* note 11, Paragraphs 1904, 1912c4, at 227, 326.

16 Although not entirely clear, that appears to be Professor Hovenkamp's suggested approach. Most notably, in defining an ancillary restraint (*see infra* text at note 49), he uses the phrase "at least upon initial examination." *Id.* Paragraph 1912c, at 320.

17 *Polk Bros. v. Forest City Enters.*, 776 F.2d 185, 189 (7th Cir. 1985).

more like that of Judge Taft, effectively making it coextensive with the application of the rule of reason: Only reasonable restraints are considered ancillary, so all ancillary restraints are lawful.

I favor yet a third treatment in which the ancillarity issue determines whether a joint venture's collateral restraints are assessed separate and apart from the joint venture. Non-ancillary restraints are assessed separately, which may result in per se condemnation. Ancillary restraints are assessed as together with the formation of the joint venture – the whole package being evaluated under the rule of reason if the joint venture itself is legitimate.[18] An ancillary restraint may alter the balance of competitive costs and benefits from the formation of the joint venture and could tip the rule of reason scales against the venture.[19]

Roughly the same idea was expressed by Chief Judge Ginsburg in his *PolyGram* opinion.[20] In analyzing a hypothetical involving the introduction of a new product by a joint venture of major automobile producers, he observed that, "if the only way a new product can be profitably introduced is to restrain the legitimate competition of older products, then one must seriously wonder whether consumers are genuinely benefitted by the new product."[21] Although Judge Ginsburg did not explain his observation in terms of antitrust doctrine, the proper analysis of his hypothetical could be that the restraint is ancillary and causes the formation of the joint venture to be unlawful under the rule of reason.

In sum, the "ancillary restraints doctrine" is understood in this article to hold that restraints collateral to the formation of a joint venture are assessed together with the formation of the joint venture if ancillary, but assessed separately from the formation of the joint venture if non-ancillary. For price or output restraints collateral to a legitimate joint venture, one implication is that ancillary restraints are subject to the rule of reason and non-ancillary restraints may be per se illegal.

II. WHAT IS A "COLLATERAL" RESTRAINT?

As Judge Taft interpreted the common law, "Restrictions in the articles of partnership upon the business activity of the members, with a view of securing their entire effort in the common enterprise, were, of course, only ancillary to the main end of the union, and were to be encouraged."[22] Adopting essential elements of the common law, Judge Bork's *Rothery* opinion states that a restraint can be ancillary only if "subordinate and collateral to a separate, legitimate transaction."[23] Judge Easterbrook similarly remarked in *Polk Bros.* that ancillary restraints "are part of a larger endeavor whose success they promote."[24] Furthermore, the Eleventh Circuit recently held that: "In order for a condition to be ancillary, an agreement limiting competition must be secondary and collateral to an independent and legitimate transaction."[25]

For charge card joint ventures, agreements that members not issue certain competing cards were collateral restraints.[26] In an agreement dissolving a law partnership, a territorial restriction on advertising by the former partners was a collateral restraint.[27] In a joint venture to build and operate a building containing two separate retail stores, a restraint on which products could be sold was

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18 *See* Gregory J. Werden, *Antitrust Analysis of Joint Ventures: An Overview*, 66 ANTITRUST L.J. 701, 706-07, 734 (1998).

19 The 1995 Antitrust Guidelines for the Licensing of Intellectual Property issued jointly by the U.S. Department of Justice and the FTC take a similar approach:

> If the Agencies conclude that the restraint has, or is likely to have, an anticompetitive effect, they will consider whether it is reasonably necessary to achieve procompetitive efficiencies. If the restraint is reasonably necessary, the Agencies will balance the procompetitive efficiencies and the anticompetitive effects to determine the probable net effect on competition in each relevant market.

Section 4.2, *reprinted* in 4 Trade Reg. Rep. (CCH) Paragraph 13,132. Such an analysis also appears to have been suggested by Bork, *Ancillary Restraints, supra* note 5, at 228.

20 *PolyGram Holding, Inc. v. FTC*, 416 F.3d 29 (D.C. Cir. 2005).

21 *Id.* at 38.

22 *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 280 (6th Cir. 1898), *aff'd as modified*, 175 U.S. 211 (1899).

23 *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 224 (D.C. Cir. 1986). In his 1959 article, Bork cited two primary examples of restraints that are collateral and potentially ancillary: "The agreement of the seller of a business not to compete with the business sold; and . . . the agreement of the participant in a joint venture not to compete with that venture." Bork, *Ancillary Restraints, supra* note 5, at 211.

24 *Polk Bros. v. Forest City Enters.*, 776 F.2d 185, 189 (7th Cir. 1985).

25 *Schering-Plough Corp. v. FTC*, 402 F.3d 1056, 1073 (11th Cir. 2005), *cert. denied*, 126 S. Ct. 2929 (2006). *See also* 11 HOVENKAMP, *supra* note 11, Paragraph 1912c2, at 322 ("when a restraint is challenged, one generally looks for some 'underlying' agreement or arrangement among the parties that has at least the potential to reduce costs, provide a new or improved product, or otherwise increase output").

26 *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 237, 243 (2d Cir. 2003), *cert. denied*, 543 U.S. 811 (2004).

27 *Blackburn v. Sweeney*, 53 F.3d 825 (7th Cir. 1995).

collateral.[28] And a territorial restriction was collateral to an arrangement in which truck leasing companies provided service for each others' trucks.[29] Courts also have treated as collateral some restraints on membership in joint ventures.[30]

In *Dagher*, the Ninth Circuit applied the ancillary restraints doctrine to a restraint imposed on the actions of a joint venture.[31] The joint venture combined the domestic petroleum refining and gasoline marketing operations of Texaco and Shell, entirely ending competition between them in the affected markets.[32] The separate Texaco and Shell brands of gasolines were sold by the joint venture subject to the restraint that they be priced the same,[33] and this restraint was challenged as per se illegal price fixing.[34] The district court granted defendants' motion for summary judgment, but the Ninth Circuit reversed.

The Ninth Circuit observed that the issue was "whether the price fixing is 'naked' (in which case the restraint is illegal) or 'ancillary' (in which case it is not)."[35] Invoking the ancillary restraints doctrine, the court held that the key question was whether the restraint was "reasonably necessary to further the legitimate aims of the joint venture."[36] Because the defendants had "failed to offer any explanation of how their unified pricing of the distinct Texaco and Shell brands of gasoline served to further the ventures' legitimate efforts to produce better products or capitalize on efficiencies,"the Ninth Circuit held that the restraint might well be per se unlawful.[37]

The Supreme Court took a quite different view than the Ninth Circuit, holding that, "because Texaco and Shell Oil did not compete with one another in the relevant market," the restraint was not "price fixing in the antitrust sense."[38] The Court further held that the Ninth Circuit erred in invoking the ancillary restraints doctrine, which "has no application" when "the business practice being challenged involves the core activity of the joint venture itself" such as "pricing of the very goods sold by" the venture.[39] Rather, the Court indicated that the ancillary restraints doctrine "governs the validity of restrictions imposed by a legitimate business collaboration, such as a business association or joint venture, on nonventure activities."[40]

The Supreme Court's analysis recognizes that constraints joint venture participants place on the conduct of the venture itself, within the ambit of its operation, are quite different than constraints they place on their own conduct outside the venture. Participants in a manufacturing joint venture almost certainly determine, and hence limit, the products the venture produces, and they may agree to limit the geographic area in which the venture operates, the customers to which the venture sells, or the prices it charges. Such constraints are not collateral restraints; rather, they are integral parts of the joint venture that cannot be separated from it.

Although the Court left participants in a joint venture entirely free to decide what their joint venture does and how it is done, that in no way suggests that joint ventures escape meaningful antitrust scrutiny.[41] The formation of a joint venture may be unlawful because of decisions its

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28 *Polk Bros. v. Forest City Enters.*, 776 F.2d 185 (7th Cir. 1985). Judge Easterbrook specifically rejected the district court's determination that the restraint was not collateral but rather was "an integral part of" the joint venture. *Id.* at 190.
29 *Gen. Leaseways, Inc. v. Nat'l Truck Leasing Ass'n*, 744 F.2d 588 (7th Cir. 1984).
30 *See, e.g., SCFC ILC, Inc. v. Visa USA, Inc.*, 36 F.3d 958 (10th Cir. 1994) (agreement among members of a charge card joint venture to restrict membership); *Sullivan v. NFL*, 34 F.3d 1091 (1st Cir. 1994) (agreement among members of a sports league to ban public ownership of teams).
31 *Dagher v. Saudi Refining Inc.*, 369 F.3d 1108 (9th Cir. 2004), *rev'd*, 547 U.S. 1 (2006).
32 *Id.* at 1111-12.
33 *Id.* at 1112.
34 Plaintiffs also argued that the restraint was unlawful under the "quick look" if not per se illegal. Finding a possible per se violation, the Ninth Circuit did not address the alternative "quick look" argument. *Id.* at 1116 n.7. The Supreme Court rejected liability under the "quick look" "for the same reasons that [it found] *per se* liability is unwarranted." 547 U.S. at 7 n.3.
35 *Dagher*, 369 F.3d at 1118.
36 *Id.* at 1121.
37 *Id.* at 1122. The court found the record "close to establishing that the price-fixing scheme was sufficiently unrelated to accomplishing the legitimate objectives of the joint venture as to justify granting the plaintiffs' motion for summary judgment" but concluded that denying both sides' summary judgment motions was proper under the circumstances. *Id.* at 1122 n.16.
38 547 U.S. at 5-6.
39 *Id.* at 7-8.
40 *Id.* at 7. According to Professor Hovenkamp, "the Court appeared to leave a large area of per se liability for restraints that (1) operate on the participants' intra-venture activity but (2) are not part of the core," and he argues that many such restraints should be viewed as ancillary and therefore not subject to the per se rule. PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW Paragraph 2132, at 509-10 (Supp. 2006). A better reading of the decision, however, is that no constraints on intra-venture activity are assessed separate from the venture itself and hence none are subject to the per se rule if the joint venture is legitimate.
41 Professor Hovenkamp worries that the Court's "core" concept could allow a joint venture to "serve as a front for anticompetitive collusion." *Id.* Paragraph 2132, at 508. But a sham joint venture serving as a front for collusion is per se illegal, and a legitimate joint venture primarily orchestrating a cartel can be found unlawful under a highly abbreviated application of the rule of reason.

participants have made about what it does or how it does it. But if the formation of a venture enhances competition despite the constraints placed upon its operations, the venture is not vulnerable to attack on the grounds that the constraints constitute free-standing violations of Section 1.

Chief Judge Ginsburg's *PolyGram* decision[42] does not mention the ancillary restraints doctrine but has been read to restrict its application. The case concerned a joint venture to produce and market the album of the third Three Tenors concert, and the participants in the venture were the two firms that had separately produced and marketed the albums of the Three Tenors' first two concerts.[43] The FTC held that the firms violated the antitrust laws by agreeing not to promote the first two Three Tenors albums when they introduced the third, and the D.C. Circuit denied the petition for review of the FTC's decision. The agreement was treated by the FTC and the court as a restraint on the actions of the joint venture participants outside the scope of the joint venture, and both rejected as a matter of law the justification that the agreement was a permissible effort to prevent free riding.[44] Commentators have argued that the court thereby precluded treating as ancillary any restraints on competition outside the venture.[45] It is doubtful, however, that Chief Judge Ginsburg overruled *sub silentio* the D.C. Circuit's controlling precedent (*Rothery*), and *Dagher* has now made clear that ancillary restraints doctrine "governs the validity of restrictions . . . on nonventure activities."[46]

In sum, "ancillary restraints doctrine" applies only to "collateral" restraints associated with joint ventures. Such restraints regulate not what the joint venture does or how it is done, but rather the conduct of the joint venture's participants outside the venture.

III. WHAT MAKES A COLLATERAL RESTRAINT "ANCILLARY"?

The Supreme Court has noted that an ancillary restraint in the common law "enhances the value of the contract, or permits the 'enjoyment of [its] fruits.'"[47] Robert Bork explained that, in the context of joint ventures, an "agreement not to compete may be necessary in order that each participant may be safe in contributing his best efforts and his resources to the joint enterprise."[48] And Professor Hovenkamp has indicated that, as a general matter:

> An ancillary restraint is one that is reasonably related to a joint venture or transaction that, at least upon initial examination, promises to increase output, reduce costs, improve product quality, or otherwise benefit consumers. As a result, the profitability of an ancillary restraint depends not on the market power of its participants but on their ability to reduce their costs or increase demand for their product.[49]

A collateral restraint may make a joint venture operate more efficiently: A requirement that participants in a manufacturing joint venture buy exclusively from the venture could facilitate the venture's realization of economies of scale.

A collateral restraint may prevent a joint venture participant from appropriating an undue share of the venture's benefits: Exclusive distribution territories for a brand created and promoted by a joint venture could ensure that each participant in the joint venture reaps only its intended reward.

A collateral restraint may prevent non-participants from appropriating joint venture benefits for which they have not shared the costs: A ban on sub-licensing a research joint venture's intellectual property to non-participants could ensure that firms not sharing in the costs and risks of the venture do not share in its advantages.

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42 *PolyGram Holding, Inc. v. FTC*, 416 F.3d 29, 31-32 (D.C. Cir. 2005).
43 *Id.* at 31-32.
44 *Id.* at 33, 37-38.
45 *See* David L. Meyer & Derek Ludwin, Three Tenors *and the Section 1 Analytical Framework: A Continuum Drawn with Bright Lines*, ANTITRUST, Fall 2005, at 63, 68 (citing 416 F.3d at 38).
46 *Dagher*, 547 U.S. at 7.
47 *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 729 n.3 (1988) (quoting *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 282 (6th Cir. 1898)).
48 Bork, *Ancillary Restraints, supra* note 5, at 217-18; *see also id*. at 228-29 (illustrating the point).
49 11 HOVENKAMP, *supra* note 11, Paragraph 1912c, at 320; *see also id*. Paragraph 1904, at 227 ("To say that a restraint is 'ancillary' is to conclude that it is an essential or at least an important part of some arrangement that has potentially redeeming values.").

A collateral restraint also could prevent unintended competitive consequences that might make the venture uneconomic. Consider a joint venture that supplies its two participants with an industrial commodity each uses to manufacture a product not in competition with the other's product. By lowering their production costs, the formation of the venture could induce each participant to begin making the other's product. This effect could be forestalled by restraints of various sorts.

Whether a collateral restraint is ancillary depends on the particular circumstances faced by the participants in the joint venture. Consider two distribution joint ventures in which participants in joint ventures adopt restraints eliminating price competition. First, suppose joint venture participants sell competing differentiated consumer products marketed primarily through the Internet, and that the venture owns and operates facilities for taking, processing, and fulfilling orders. An agreement between the participants to sell their competing products at the same price is most unlikely to be ancillary because the benefits of sharing on-line sales functions almost certainly do not depend on collective pricing. Second, suppose that a joint venture builds and operates a facility from which its participants dispense a liquid chemical to their customers. An agreement between the participants to sell their competing products at the same price may be ancillary because they may not be able to sustain two different prices.

In *Polk Bros.*, a restraint prohibiting each of the two stores sharing a common site from selling certain products sold by the other was found to be ancillary and lawful.[50] The site was developed to provide premises for two retailers selling complementary lines of products. Polk Bros. sold appliances and home furnishings, and Forest City sold tools and materials for home improvement. At the outset, Forest City agreed not to sell appliances except for built-in models, and Polk Bros. agreed not to sell many enumerated products including Toro and Lawn Boy lawn mowers.[51] Both parties apparently breached their obligations, and when Polk sought an injunction against Forest City, the district court declared the covenant not to compete to be a per se violation of Section 1. The Seventh Circuit reversed, finding that "the restrictive covenant made cooperation possible" which in turn "increased the amount of retail space available and was at least potentially beneficial to consumers."[52] Judge Easterbrook's opinion explained that a "restraint is ancillary when it may contribute to the success of a cooperative venture that promises greater productivity and output" and that the specific question for a court is "whether an agreement promoted enterprise and productivity at the time it was adopted."[53]

It is easy to construct scenarios in which collateral restraints are not ancillary. The Ninth Circuit's *Dagher* opinion offers the example of a research joint venture formed by two soft drink companies to create a new flavor that is accompanied by an agreement between the companies to fix the price of products unrelated to the venture.[54] In this hypothetical, as in many others, "the organic connection between the restraint and the cooperative needs of the enterprise that would allow us to call the restraint a merely ancillary one is missing."[55] A corollary of the necessity of an "organic connection" is that a "restraint cannot be justified solely on the ground that it increases the profitability of the enterprise."[56] In the soft drink example, the price fixing in unrelated products may make the joint venture profitable when it otherwise would not be, but that does not make the price fixing ancillary.

In sum, a restraint collateral to the formation of a legitimate joint venture is "ancillary" only if it has an "organic connection" to the venture's operations and serves to make the venture operate more efficiently or effectively. The effectiveness of a joint venture may be enhanced by restraints that reduce the incentive or opportunity for participants in the venture to expropriate or undermine its value.

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50 *Polk Bros. v. Forest City Enters.*, 776 F.2d 185 (7th Cir. 1985).
51 *Id.* at 187.
52 *Id.* at 190. The district court had found that the stores would not have been built without the restrictive covenant. *Id.*
53 *Id.* at 189.
54 *Dagher v. Saudi Refining Inc.*, 369 F.3d 1108, 1118 (9th Cir. 2004), *rev'd*, 547 U.S. 1 (2006).
55 *Gen. Leaseways, Inc. v. Nat'l Truck Leasing Ass'n*, 744 F.2d 588, 595 (7th Cir. 1984) (Posner, J.) (holding that a territorial allocation was not ancillary to an arrangement by truck leasing companies for cooperative servicing each others' trucks). *See also Freeman v. San Diego Ass'n of Realtors*, 322 F.3d 1133, 1151 (9th Cir. 2003) ("The fixed support fee is not reasonably ancillary to the combined MLS database. Defendants offer no explanation for how it improves the efficiency of the MLS or has any effect at all beyond raising prices.").
56 *PolyGram Holding, Inc. v. FTC,* 416 F.3d 29, 38 (D.C. Cir. 2005).

IV. WHAT IS THE "TEST" FOR ANCILLARITY?

After articulating the definition of an ancillary restraint quoted at the outset of this article,[57] Judge Bork added: "Of course, the restraint imposed must be related to the efficiency sought to be achieved. If it is so broad that part of the restraint suppresses competition without creating efficiency, the restraint is, to that extent, not ancillary."[58] Similarly, Judge Taft indicated that a restraint is ancillary if "commensurate only with the reasonable protection of the coventee" and thus "reasonably necessary . . . to the enjoyment by the buyers of the property, good will, or interest in partnership bought."[59] This "reasonably necessary" test for ancillarity finds much support in the modern case law.

In his dissent from the denial of certiorari in the *NASL* case, Justice Rehnquist asserted that: "The antitrust laws impose a standard of reasonableness, not a standard of absolute necessity."[60] And the Eleventh Circuit recently held that: "Ancillary restraints are generally permitted if they are 'reasonably necessary' toward the contract's objective of utility and efficiency."[61] The "reasonably necessary" test also has been applied in Section 1 cases involving joint ventures but not expressly invoking the ancillary restraints doctrine.[62]

Also without expressly invoking the ancillary restraints doctrine, the *Antitrust Guidelines for Collaborations among Competitors (Guidelines)*, issued by the FTC and Department of Justice, state that the agencies apply the rule of reason to "agreements of a type that otherwise might be considered per se illegal, provided they are reasonably related to, and reasonably necessary to achieve procompetitive benefits from," legitimate joint ventures.[63] The *Guidelines* explain that, in determining whether a restraint is "reasonably necessary," the issue is "whether practical, significantly less restrictive means were reasonably available when the agreement was entered into."[64] Critically, as Judge Easterbrook stressed in *Polk Bros.*, the need for the restraint is evaluated "at the time it was adopted."[65]

Judge Bork provided one of the most thorough applications of the "reasonably necessary" test in *Rothery*, which concerned the activities of Atlas Van Lines, a nationwide interstate mover of household goods.[66] Throughout the country, Atlas employed independent agents for which it provided training, uniforms, and equipment used to supply the Atlas brand of interstate moving services. Unless barred by Atlas from doing so, many of its agents could have used what Atlas provided to supply intrastate moving services. To prevent such free riding, Atlas required its agents either to eschew any independent intrastate operations, or create new corporations to conduct intrastate business and not use any Atlas equipment, facilities, or services.[67] Judge Bork found that Atlas' policy was "a classic attempt to counter the perceived menace that free riding poses," and thus "reasonably necessary" to the joint venture.[68]

A restraint's ancillarity is apt to be a disputed issue for trial. In the *Visa* case,[69] the two charge card joint ventures attempted to show that their rules prohibiting member banks from issuing American Express or Discover cards were reasonably necessary to promote "loyalty" and "cohesion." After trial, the district court held that "defendants [had] not met their burden to come forward with a

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57 *See supra* text accompanying note 6.
58 *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 224 (D.C. Cir. 1986). *See also Schering-Plough Corp. v. FTC*, 402 F.3d 1056, 1073 (11th Cir. 2005) ("Naturally, the restraint imposed must relate to the ultimate objective, and cannot be so broad that some of the restraint extinguishes competition without creating efficiency."), *cert. denied*, 126 S. Ct. 2929 (2006).
59 *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 281, 290-91 (6th Cir. 1898), *aff'd as modified*, 175 U.S. 211 (1899).
60 *NFL v. N. Am. Soccer League*, 459 U.S. 1074, 1079 (1982); *see also id.* at 1080 (arguing that the lower court erred by "ignor[ing] its own holding that the proper standard is that the constraint be 'reasonably necessary'").
61 *Schering-Plough*, 402 F.3d at 1072. *See also Freeman v. San Diego Ass'n of Realtors*, 322 F.3d 1133, 1151 (9th Cir. 2003) (stating that the issue is "reasonably ancillary to the legitimate cooperative aspects of the venture"); 11 HOVENKAMP, *supra* note 11, Paragraph 1912c2, at 332 ("one must consider whether the challenged restraint is necessary or makes and important contribution to" a legitimate arrangement).
62 *See, e.g., Law v. NCAA*, 134 F.3d 1010, 1019 (10th Cir. 1998) (inquiring whether the challenged conduct is "reasonably necessary to achieve the legitimate objectives"); *Orson, Inc. v. Miramax Film Corp.*, 79 F.3d 1358, 1367-68 (3d Cir. 1996) (inquiring whether the restraint is "reasonably necessary to achieve the stated objective"); *Thompson v. Metro. Multi-List, Inc.*, 934 F.2d 1566, 1581 (11th Cir. 1991) (inquiring whether the restraint is "reasonably necessary to the accomplishment of the legitimate goals and narrowly tailored to that end").
63 FTC & U.S. DEP'T OF JUSTICE, ANTITRUST GUIDELLINES FOR COLLABORATIONS AMONG COMPETITORS Section 1.2 (April 2000), *reprinted in* 4 Trade Reg. Rep. (CCH) Paragraph 13,160.
64 *Id.* Section 3.2.
65 *Polk Bros. v. Forest City Enters.*, 776 F.2d 185, 189 (7th Cir. 1985).
66 *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 211 (D.C. Cir. 1986).
67 *Id.* at 211-13, 217, 221-23.
68 *Id.* at 223, 227.
69 *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322 (S.D.N.Y. 2001), *aff'd*, 344 F.3d 229 (2d Cir. 2003), *cert. denied*, 543 U.S. 811 (2004).

valid procompetitive justification" for these rules, which had been shown to have anticompetitive effects.[70] The court found that the rules were not actually motivated by a desire to promote "cohesion" and that there was insufficient evidence that the rules, in fact, promoted "cohesion."[71] Critically, the burden was placed on the defendants to demonstrate that their rules were "reasonably necessary," and they failed to do so.

The rationale for allocating the burden in this manner is essentially that of *NCAA*, which held that a "naked restraint on price and output requires some competitive justification."[72] Of course, ancillary restraints are, by definition, not naked, but restraints may be treated as naked until they are shown to be ancillary. Although never using the word "ancillary," this was precisely Chief Judge Ginsburg's approach in *PolyGram*:

> If, based upon economic learning and the experience of the market, it is obvious that a restraint of trade likely impairs competition, then the restraint is presumed unlawful and, in order to avoid liability, the defendant must either identify some reason the restraint is unlikely to harm consumers or identify some competitive benefit that plausibly offsets the apparent or anticipated harm.[73]

Thus, a collateral restraint is ancillary if, and only if, it was reasonably necessary to make the venture operate more efficiently or effectively at the time the restraint was entered into. Defendants have the burden of demonstrating ancillarity, but that burden is not a heavy one. The more important of the two words in "reasonably necessary" is the first. Defendants are required to show only that the ability of their legitimate joint venture to function efficiently or effectively was compromised in a significant way that was sensibly addressed by the restraint.

V. WHAT SHOULD ONE MAKE OF *TOPCO* AND *CITIZEN PUBLISHING*?

The Supreme Court's 1972 decision in Topco applied the per se rule to a restraint collateral to a plainly procompetitive joint venture.[74] Topco Associates supplied its owners – about twenty-five small and medium-sized supermarket chains – with private label products (store brands). Topco entailed "no pooling of earnings, profits, capital, management, or advertising resources" but rather served only as a purchasing agent for many items the member supermarkets sold under brand names owned by Topco.[75] The Court explained that forming Topco allowed its members "to compete more effectively with larger national and regional chains."[76] The Court also noted that "the profit" derived by the Topco members from its private label brands was "substantial" and selling those brands "improved the competitive potential of Topco members."[77]

The distribution of the Topco brands was subject to complicated territorial licenses featuring some exclusive territories.[78] Topco argued that it "could not exist if territorial divisions were anything but exclusive," so the restraint "actually increase[d] competition."[79] Because it agreed, the district court found the restraints procompetitive and hence lawful.[80] The Supreme Court did not reject, or even consider, whether the territorial restraints were procompetitive, but instead held that they were per se violations of section 1 of the Sherman Act.[81]

Chief Justice Burger dissented,[82] viewing the "principal purpose" of the joint venture –"to make economically feasible" the sale of private label products – as "unquestionably lawful" and

70 *Id.* at 399.
71 *Id.* at 399-405.
72 *NCAA v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85, 110 (1984).
73 *PolyGram Holding, Inc. v. FTC,* 416 F.3d 29, 36 (D.C. Cir. 2005).
74 *United States v. Topco Assocs.*, 405 U.S. 596 (1972). For an extraordinarily in-depth treatment of the case, see Peter Carstensen & Harry First, *Rambling Through Economic Theory: Topco's Closer Look, in* ANTITRUST STORIES 171 (Eleanor M. Fox & Daniel A. Crane, eds. 2007).
75 *Topco*, 405 U.S. at 589-99.
76 *Id.* at 599; *see also id.* at 599 n.3 (detailing the advantages derived from selling private label products).
77 *Id.* at 600.
78 *Id.* at 601-03.
79 *Id.* at 605.
80 *Id.* at 605-06; *United States v. Topco Assocs.*, 319 F. Supp. 1031, 1042-43 (N.D. Ill. 1970).
81 *Topco*, 405 U.S. at 608-12. The Court maintained that it was well established that the per se rule applied to horizontal territorial restraints, *id.* at 608, but Chief Justice Burger in dissent made a strong argument that no prior decision had squarely held that a horizontal territorial restraint by itself constituted a per se violation, *id.* at 615-19.
82 Justice Blackmun concurred in the result, decrying the "anomalous" result of the decision which would be to "stultify" competition. *Id.* at 612-13. Justices Powell and Rehnquist did not take part.

characterizing the territorial restrictions as "minimal ancillary restraints that are fully reasonable in view of the principal purpose."[83] He was inclined to agree with the district court that the restraints tended "positively to promote competition in the supermarket field and to produce lower costs for consumers," and he saw no reason to adopt a rule that would "lead to the likely demise of" competition from the Topco products.[84]

The district court had found that "the cost of developing consumer acceptance for the Topco private brands was born by each member in its own territory."[85] Consequently, the territorial restraints were a reasonable response to a free-rider problem. In his *Rothery* opinion, Judge Bork observed that Topco "was a contractual integration of legally independent businesses designed to achieve efficiencies unavailable to its members separately. . . . Topco had an ancillary horizontal restraint designed to make the integration more effective. . . . This restraint had a clear relationship to marketing effectiveness."[86] In addition, the only competition potentially restrained was that in the sale of Topco private label products,[87] and those products would not have existed absent the joint venture. Per se treatment is not appropriate for a restraint on competition created by a joint venture,[88] so such a restraint should always be *treated* as ancillary, i.e., not analyzed separately from the formation of the joint venture.

Although the Supreme Court has not questioned the wisdom of *Topco*,[89] distinguished judges sitting on the courts of appeals have done so. Judge Bork's *Rothery* opinion concluded that *Topco* had been "effectively overruled" by subsequent Supreme Court decisions involving joint ventures.[90] Judge Boudin opined that: "*Topco* may no longer be good law for its broader proposition that . . . a restraint is condemned *per se* even where it is ancillary to a productive joint venture."[91] And Judge Posner declared that the *Topco* and like decisions "are dead as dodos."[92]

The Supreme Court's 1969 decision in *Citizen Publishing* also applied the per se rule to restraints associated with a joint venture.[93] In 1940 the only two daily newspapers in Tucson, Arizona established a joint venture company to produce and distribute both papers.[94] Although the two papers retained separate ownership as well as separate news and editorial operations, the joint operating agreement (JOA) between them eliminated economic competition. Subscription and advertising rates were set jointly, costs and revenues were pooled with profits distributed in a fixed ratio, and each paper agreed not to engage in any competing publishing activity in the area.[95]

More than twenty years after the formation of the joint venture, the government filed suit, alleging that specific provisions of the JOA were per se violations of Section 1. The district court granted the government's motion for a preliminary injunction, enjoined the challenged provisions of the JOA, and required independent ownership of the two papers.[96] The government did not challenge the joint venture as a whole, however, and the district court found that the sharing of "circulation, advertising, and production departments has resulted in substantial cost savings."[97] The injunction, therefore, permitted the papers to continue sharing these departments.

On direct appeal, the Supreme Court affirmed, holding that the Section 1 violations alleged by the Department and found by the district court were "plain beyond peradventure."[98] The

83 *Id.* at 613-14.
84 *Id.* at 623-24.
85 *Topco*, 319 F. Supp. at 1042.
86 *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 225 (D.C. Cir. 1986). Similar views were expressed by BORK, *supra* note 5, at 274-79; RICHARD A. POSNER & FRANK H. EASTERBROOK, ANTITRUST 248-49 (2d ed. 1981).
87 Chief Justice Burger emphasized this point (*see Topco*, 405 U.S. at 613) but did not take the argument a step further.
88 The 1995 Intellectual Property Guidelines, *supra* note 19, make a similar point. In Section 4.1.2, they explain why a licensing arrangement does not present antitrust concerns by stating that it "does not diminish competition that would occur in its absence."
89 The Court has never suggested that *Topco* is not good law and most recently cited the facts and holding of the case in *Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46, 49 (1990).
90 *Rothery*, 792 F.2d at 229 (citing *Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284 (1985); *NCAA v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85 (1984); *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1 (1979)).
91 *Mass. Food Ass'n v. Mass. Alcoholic Beverages Control Comm'n*, 197 F.3d 560, 564 n.2 (1st Cir. 1999).
92 RICHARD A. POSNER, ANTITRUST LAW 189 n.62 (2d ed. 2001) (referring also to *United States v. Sealy, Inc.*, 388 U.S. 350 (1967)).
93 *Citizen Publ'g Co. v. United States*, 394 U.S. 131 (1969).
94 *Id.* at 133-34.
95 *Id.* at 134.
96 *United States v. Citizen Publ'g Co.*, 280 F. Supp. 978, 993-94 (D. Ariz. 1968).
97 *Id.* at 982.
98 *Id.* at 135.

only issue addressed by the Court at any length was whether the failing company doctrine could justify the arrangement. Sidestepping whether the district court was correct in refusing to consider such a defense because the joint venture was not a merger, the Court held instead that the newspapers could not carry the "burden of proving that the conditions of the failing company doctrine have been satisfied."[99]

Congress prevented *Citizen Publishing* from affecting joint ventures in the newspaper industry by promptly creating an antitrust exemption for newspaper JOAs.[100] And the decision was only occasionally, and only briefly, mentioned by the courts until it was discussed extensively in *Dagher*.[101] Similarities between the two cases naturally led the plaintiffs in *Dagher* to rely heavily on *Citizen Publishing*, and the Supreme Court did not explain why their reliance was misplaced.

The Supreme Court's *Dagher* decision mentions *Citizen Publishing* as case illustrating the proposition that the ancillary restraints doctrine governs "the validity of restrictions imposed by a legitimate business collaboration, such as a business association or joint venture, on nonventure activities."[102] Since the Court found the restraints in *Citizen Publishing* per se illegal, the Court's citation of the case in *Dagher* must imply both that condemned restraints were on non-venture activities and were non-ancillary.[103]

The Court's decision in *Citizen Publishing* provides no indication that the Court considered the possibility that the restraints were ancillary, and petitioners did not invoke the ancillary restraints doctrine their brief.[104] That the restraints were non-ancillary, however, was implicitly argued in the government's brief. The government explained that a JOA permitted "the realization of the benefits of operating economies without requiring the toleration of all anti-competitive effects" and that the asserted justification for the restraints was merely that the papers "needed the increased profits which the elimination of commercial competition between them would make possible."[105] As noted above,[106] merely generating profits does not make a restraint ancillary.

It is more difficult to understand why the restraints in *Citizen Publishing* did not "involve the core activity of the joint venture itself."[107] The Court's decision in that case declared that the "purpose of the JOA was to end any business or commercial competition between the two papers."[108] In this regard, the Court plainly was not viewing the restraints as separate from the JOA, but rather as core elements of it, and that certainly seems an apt characterization.

The proper analysis of *Citizen Publishing* within the framework of *Dagher* may be that restraints relating to "core activity of the joint venture" were sufficiently anticompetitive to render the joint venture as a whole unlawful under the rule of reason.[109] Declaring the joint venture as a whole unlawful, of course, would not imply that the papers could not form a somewhat different joint venture preserving the cost savings they had achieved, so the proper remedy would have been essentially that imposed by the district court and upheld on appeal. Although this analysis leads to the remedy actually applied, it does not involve the application of the per se rule, so this plainly was not

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99 *Id.* at 136-39.
100 Newspaper Preservation Act, Pub. L. No. 91-353, 84 Stat. 466, codified at 15 U.S.C. Sections 1801-04.
101 *Dagher v. Saudi Refining Inc.*, 369 F.3d 1108, 1118-20, 1124 (9th Cir. 2004), *rev'd*, 547 U.S. 1 (2006).
102 *Texaco Inc. v. Dagher*, 547 U.S. 1, 7 (2006).
103 I previously argued that the Court's analysis in *Citizen Publishing* treated the restraints as non-ancillary. *See* Werden, *supra* note 18, at 708 n.26.
104 The ancillary restraints doctrine was invoked by an amicus curiae brief. Brief of American Newspaper Publishers Assoc. as Amicus Curiae 54-58, *Citizen Publ'g Co. v. United States*, 394 U.S. 131 (1969).
105 Brief of the United States 36-37, *Citizen Publ'g Co. v. United States*, 394 U.S. 131 (1969). The district court had found that the cost-reducing joint printing and distribution of the two papers "does not depend upon the continuation" of the challenged restraints. *United States v. Citizen Publ'g Co.*, 280 F. Supp. 978, 992 (D. Ariz. 1968).
106 *See supra* text accompanying note 57.
107 *Dagher*, 547 U.S. at 7.
108 *Citizen Publ'g*, 394 U.S. at 134. In addition, the Department of Justice had argued that the profit pooling "was an integral part of the" JOA. *See* Brief of the United States 23, *supra* note 105.
109 Treating the JOA as a merger might be appropriate in view of the fact that it integrated the operations of the two papers and its purposes was to end commercial competition between them. Many transactions termed joint ventures by their participants have been treated as mergers under the antitrust laws. *E.g., United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 167-72 (1964); *FTC v. Warner Communications Inc.*, 742 F.2d 1156, 1159, 1163-65 (9th Cir. 1984); *United States v. Ivaco, Inc.*, 704 F. Supp. 1409, 1414 (W.D. Mich. 1989). The federal enforcement agencies have stated that a joint venture "ordinarily" should be treated as a horizontal merger if "(a) the participants are competitors in that relevant market; (b) the formation of the collaboration involves an efficiency-enhancing integration of economic activity in the relevant market; (c) the integration eliminates all competition among the participants in the relevant market; and (d) the collaboration does not terminate within a sufficiently limited period by its own specific and express terms." ANTITRUST GUIDELINES, *supra* note 63, at Section 1.3. Treatment as a merger would not affect the analysis or conclusions. *See United States v. Rockford Mem'l Corp.*, 898 F.2d 1278, 1282-83 (7th Cir. 1990).

the Court's analysis in *Citizen Publishing*.[110] Thus, it seems best to conclude that *Citizen Publishing* is no longer good law after Dagher.

VI. CONCLUSION

The ancillary restraints doctrine holds that a restraint collateral to a legitimate joint venture, limiting the ability of participants to compete outside the venture, is assessed as part of a package that includes the formation of the venture, if at the time the restraint was adopted, the restraint had an organic connection to venture and was reasonably necessary to make the venture more efficient or effective in achieving its procompetitive purposes.

110 The application of the per se rule to the joint venture as a whole would be proper only if it was viewed essentially a cartel, but that view was neither suggested by the Department of Justice nor adopted by the Supreme Court, and it is belied by the cost reductions found by the district court. *See supra* note 97 and accompanying text.