Ancillary Restraints in a Competitive Global Economy: Does the Possibility Exist for an Ancillary Restriction to Be Reasonable in Light of Section 1 of the Sherman Act?

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Ancillary Restraints in a Competitive Global Economy: Does the Possibility Exist for an Ancillary Restriction to be Reasonable in Light of Section 1 of the Sherman Act?

When a practitioner is approached by potential clients seeking to form a joint research and development project, the parties will oftentimes express a desire to restrict the agreement in some manner in order to recoup their initial investments. The attorney must somehow formulate an agreement which will meet the needs of the clients, while also staying within the limits of the law. Ancillary restrictions to the cooperative agreement embodying the parties' desires are frequently employed by attorneys to enable the parties to recover the fruits of their labors.

This comment serves as a guide for the practitioner faced with the dilemma of creating a restraint, ancillary to a legitimate joint research and development agreement, which the courts will not consider to be an unreasonable restraint of trade. At the outset, this comment reviews the status of the law for analyzing the reasonableness of ancillary restrictions, while also discussing the most recent relevant decisions to determine which restraints pass muster under the antitrust laws. In addition, conclusions are drawn as to whether or not certain restrictions will withstand antitrust scrutiny, and suggestions are offered for avoiding antitrust litigation when using ancillary restrictions.

Oftentimes, cooperation is necessary to allocate the costs associated with large-scale research and development projects and to enable parties to share technology peculiar to each industry. Economies of scale and start-up costs of creating new businesses and developing new technology force competitors to join forces so as to allow American firms to compete with international industrial and
Throughout history, much concern has arisen over such cooperation among firms classified as competitors. The reason being that free market proponents are fearful that joint efforts may suppress competition, the backbone of a free market society, even though innovation is a product of cooperation.

The concern regarding cooperation has resulted in antitrust legislation being enacted to prevent joint research efforts which may reduce, or threaten to reduce, competition at the expense of technological advancement. Businesspersons and scholars alike are fearful that this legislation is stifling the incentive to develop new technology by those parties unable to undertake the research and development alone. Unfortunately, this fear may cripple the ability of U.S. firms to compete in a global economy.

Section 1 of the Sherman Act condemns “every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations. . . .” The Supreme Court interpreted this Act to ban all concerted arrangements which are adopted for the purpose of reducing competition, or which significantly tend to reduce competition. Commercial agreements which are adopted for and tend to achieve legitimate purposes, however, are not violative of the Act merely because of some consequential restraining effect on competition. Thus, uncertainty exists as to whether joint research agreements with ancillary restrictions, which may have some restraining effect on competition, are in violation of Section 1 of the Sherman Act, even though the agreement fosters competition for the most part.

A restraint is ancillary when it “contributes to the success of a cooperative venture that promises greater productivity and output.” An ancillary restraint should be subordinate to the agreement, while making the main transaction more effective in accom-

1. See for example, Sherman Antitrust Act, 15 USC § 1 et seq (West 1890); Clayton Act, 15 USC § 18 (1914); Federal Trade Commission Act, 15 USC § 41-46, 47-58 (West 1914).

2. 15 USC § 1.

3. Board of Trade of the City of Chicago v United States, 246 US 231 (1918).


plishing the objectives of the cooperation. However, a restraint that is not related to the goals of the main transaction, or is so broad that it suppresses competition without creating any procompetitive effects, is not ancillary.

The courts have encountered various forms of ancillary restrictions. Ancillary restraints are usually either horizontal (agreements among competitors restricting the way in which they will compete with each other) or vertical (agreements between firms in different stages of the chain of distribution that restrict conditions under which the parties may purchase, sell, or resell goods). Occasionally, the restraint is a combination of the two. Vertical nonprice restraints are often used by a manufacturer to protect its investment in the service and promotion of its brands from others who do not make such investments, but cut their prices in order to take advantage of the manufacturer's investment (the so-called "free-rider" problem). Covensants not to compete, i.e., covenants restricting what products may be sold and in what areas, are frequently included so as to preserve the quality of the specific bargain. Similarly, territorial restrictions are often used to protect parties' interests in an area to which they have a legitimate claim. Secrecy agreements are considered to be reasonable ancillary restrictions when used to protect a party's technological knowledge or goodwill contributed in joint development programs. Other examples of ancillary restrictions include boycotts, bans on competitive bidding, and blanket licenses.

I. REASONABleness OF RESTRAINTS

A. Illegal Per Se

Generally, section 1 of the Sherman Act condemns all arrange-

9. A boycott is defined as a concerted refusal to deal on particular terms with other competitors. Black's Law Dictionary 169 (West, 6th ed 1990).
10. Blanket licenses are agreements by which individuals grant a single person or entity the right to license their products or technology to others. Broadcast Music, Inc. v CBS, 441 US 1 (1979).
ments that have a significant tendency to reduce competition. Those agreements which are plainly anticompetitive and "lack any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused."\(^\text{11}\) These naked restraints are said to be illegal per se since they deny customers the opportunity to choose freely in a competitive economy.\(^\text{12}\)

The inquiry as to whether a restriction is a per se violation of the Sherman Act depends on whether the practice facially appears to be one that would always, or almost always, tend to restrict competition and decrease output.\(^\text{13}\) Price-fixing is the foremost example of a restriction which is illegal per se, regardless of whether the arrangement is structured as horizontal or vertical;\(^\text{14}\) however, not all arrangements among actual or potential competitors that have an impact on price are per se violations of the Sherman Act.\(^\text{15}\)

B. Rule of Reason

1. Overview of Section 1

Although section 1 of the Sherman Act prohibits every contract in restraint of trade, only those restrictions which unreasonably restrain trade are struck down.\(^\text{16}\) Since the early years of this century, courts have considered this "Rule of Reason" to be the prevailing standard of analysis for determining the reasonableness of a restraint.\(^\text{17}\) Essentially, the inquiry under the Rule of Reason is to determine "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."\(^\text{18}\) This analysis

\(^\text{13}\) Sewell Plastics, Inc. v Coca-Cola Co., 720 F Supp 1196, 1217 (W D NC 1989). A tying agreement (where the sale of one product is made on the condition that another product is also purchased) is an example of a restriction usually considered to be illegal per se. Broadcast Music, Inc. v CBS, 441 US 1 (1979); Northern Pacific Railway Co. v United States, 356 US 1 (1958).
\(^\text{14}\) See Standard Oil Co. of New Jersey v United States, 221 US 1 (1911).
\(^\text{15}\) Broadcast Music, 441 US at 23 (restriction with an impact on price was necessary to economize the procedures for licensing musical scores).
\(^\text{16}\) Standard Oil, 221 US at 60.
\(^\text{17}\) Id.
is employed to form a judgment about the competitive side of the restraint. The conclusion that the restraint is unreasonable may be based either on

1) the nature or character of the contracts or
2) surrounding circumstances giving rise to the inference that they were intended to restrain trade and enhance prices.19

Thus, the fundamental inquiry is whether the challenged restraint suppresses or enhances competition.20

2. Application of the Rule of Reason to Ancillary Restraints

As early as 1899, the courts recognized the need for ancillary restraints to legitimate agreements in order to promote such agreements or to protect business interests. A Sixth Circuit Court articulated what is known today as the doctrine of ancillary restraints:

[n]o 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 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.21

Much ado has been made as to whether ancillary restrictions are per se unlawful. In 1972, in United States v Topco Associates, Inc.,22 the Supreme Court condemned all horizontal ancillary restraints as illegal per se, without considering whether they were reasonable or ancillary to a legitimate purpose.23 In rejecting the argument that the horizontal territorial restrictions used in Topco were necessary to foster competition among private label brands, the Court stressed its inability to weigh a decrease in competition in one sector against the procompetitive consequences achieved in another sector.24 The Court would rather have seen competitors "cut each other's throats" than allow any limitation on the free market, even though significant procompetitive effects were likely

22. 405 US 596 (1972).
24. Id at 607.
to result from the use of the restraint.\textsuperscript{26} This decision was probably due in part to the view that the benefit of doing a case-by-case analysis of the reasonableness of each restraint would not outweigh the tremendous expense of such an endeavor.

More recently, the Court rejected the broad application of the per se rule to horizontal ancillary restraints and stated that the reasonableness of the restraint is determinative.\textsuperscript{27} The modern trend is towards such an analysis for all forms of ancillary restraints in order to consider the economic impact, which may not be immediately obvious in certain arrangements.\textsuperscript{27} Notably, in \textit{Rothery Storage & Van Co. v Atlas Van Lines, Inc.},\textsuperscript{28} the United States Court of Appeals for the District of Columbia stated that, in \textit{Broadcast Music}\textsuperscript{29} and \textit{NCAA},\textsuperscript{30} the Supreme Court had effectively overruled \textit{Topco} as to the per se illegality of all horizontal restraints and had returned to the ancillary restraint doctrine formulated in \textit{Addyston Pipe}.

In \textit{United States v Arnold, Schwinn & Co.},\textsuperscript{33} the Supreme Court reinvigorated the per se rule of illegality for vertical non-price restraints by applying the per se rule to intrabrand competition which was viewed as harmful, while concluding that interbrand competition was conducive to a free economy and, therefore, should be judged under the Rule of Reason.\textsuperscript{33} In 1977, the Supreme Court overruled \textit{Schwinn} and its distinction between forms of competition in \textit{Continental T.V. v G.T.E. Sylvania},\textsuperscript{34} and stated that new manufacturers may need vertical restrictions in order to induce retailers to make necessary capital and labor investments.\textsuperscript{35}

\begin{itemize}
\item \textsuperscript{25} Id at 611.
\item \textsuperscript{26} See \textit{Broadcast Music}, 441 US at 23-25.
\item \textsuperscript{27} See \textit{NCAA}, 468 US at 100; \textit{McDonnell Douglas}, 705 F2d at 1052; \textit{VISA U.S.A.}, 596 F Supp at 1252; \textit{Lektro-Vend Corp. v Vendo Co.}, 660 F2d 255, 265 (7th Cir 1981), cert denied, 455 US 921 (1982); \textit{Polk Bros.}, 776 F2d at 190; \textit{Sewell Plastics, Inc. v Coca-Cola Co.}, 720 F Supp 1196, 1217 (W D NC 1989).
\item \textsuperscript{28} 792 F2d 210 (D C Cir 1986), cert denied, 479 US 1033 (1987) (the court determined that carrier agents which agreed to use pooling agreements to govern business relationships between a van line and a carrier agent were not group boycotts and, therefore, were not unreasonable restraints of trade).
\item \textsuperscript{29} 441 US 1 (1979).
\item \textsuperscript{30} 468 US 85 (1984). See note 93 and accompanying text for discussion of \textit{NCAA}.
\item \textsuperscript{31} \textit{Rothery Storage}, 792 F2d at 229. See note 21 and accompanying text for text of the doctrine of ancillary restraints.
\item \textsuperscript{33} \textit{Schwinn}, 388 US 365.
\item \textsuperscript{34} 433 US 36 (1977).
\item \textsuperscript{35} \textit{Sylvania}, 433 US at 55.
\end{itemize}
Thus, the Court reverted to the standard articulated in *North. Pacific R. Co.* to determine whether vertical restrictions should be conclusively presumed to be illegal and concluded that the Rule of Reason should definitely govern vertical restrictions.

Courts have also hesitated to classify a restraint as illegal per se when the courts have no considerable experience with the business relationships associated with the restriction. In addition, the Department of Justice has recognized that restraints ancillary to a legitimate joint venture hold significant potential for creating procompetitive consequences and, therefore, analyzes them under the Rule of Reason. Moreover, the courts have recently stated that there is today a presumption in favor of applying the Rule of Reason. Although the Supreme Court has managed to skirt the issue as to whether the Rule of Reason always applies when examining ancillary restrictions, the general consensus of the courts and the modern trend is toward its application to all types of ancillary restrictions.

3. Rule of Reason Test

In order to resolve whether the restraint is reasonable, the Rule of Reason basically requires the factfinder to determine whether, under the circumstances, the anticompetitive consequences of a particular action or arrangement are outweighed by its procompetitive effects. Thus, even though a restriction may suppress competition or restrain trade to some degree, it may be necessary to protect a legitimate business purpose.

36. The standard set forth by the Court in *North. Pacific R. Co.* is whether the restraint has a "pernicious effect on competition" or lacks any "redeeming virtue." *North Pacific*, 356 US at 5. See also note 11 and accompanying text.
40. See *Sharp*, 485 US at 726 (the Supreme Court recognized that the scope of per se illegality should be narrow in the context of vertical restrictions and stated that its decision to find such a restraint not to be a per se violation was guided by the presumption).
41. *Sewell Plastics*, 720 F Supp at 1217; *NCAA*, 468 US at 103; *Society of Professional Engineers*, 435 US at 691; *Lektro-Vend*, 660 F2d at 268. Relevant circumstances may include a number of various factors such as "the parties' intentions and purposes in adopting the restriction, the structure of and competitive conditions within the affected industry, the relative competitive positions of the parties, and the presence of economic barriers inhibiting the ability of competitors to respond and offset the challenged practices." William C. Holmes, 1990 *Antitrust Law Handbook* at 135 (Clark Boardman Co., 1990).
The elements of the Rule of Reason analysis are anything but clear. What is clear, however, is that the old rules of per se illegality, which strike down restrictions without considering their reasonableness, are arbitrary and should only be applied after a view of the facts reveals a naked restraint on competition. While some clarity exists for vertical restraints, some uncertainty exists in analyzing horizontal restrictions on cooperative efforts under the antitrust laws today.42

The Department of Justice issues guidelines to advise the business and legal communities of the general legal and economic analysis it implements in making prosecutorial decisions under the antitrust laws. The basic test for collateral restrictions on joint ventures have been set forth as follows:

1) Is the restraint ancillary to a lawful main purpose?
2) Is the restraint's scope and duration no greater than is necessary to achieve that purpose?
3) Is the restraint otherwise reasonable alone or in conjunction with other circumstances?43

Since vertical nonprice restraints on joint ventures hold the potential for generating procompetitive consequences, the Department of Justice has specifically stated that these restraints could only facilitate prohibited collusion when each of the following three necessary market conditions exists:

1) the market where collusion may occur is highly concentrated at the time the restriction becomes effective;
2) the parties imposing the restraint must account for most sales in that market; and
3) entry into the market is difficult.44

The first two conditions require an examination into the market power of the parties. Unless the parties are able to control the market, it is unlikely they will be able to exclude new entrants from the market and gain a noteworthy return from use of the restriction. If entry into the market is not foreclosed or made significantly more difficult and costly, new entrants could easily enter and undercut prices of any attempted collusion. The Department of Justice considers a firm with a small market share (e.g., ten per-

43. See Anti Div, Joint Ventures (cited in note 19); Anti Div, International Operations (cited in note 8).
44. Anti Div, International Operations at 56-7 (cited in note 8).
cent or less) to be unable to construct barriers to entry significant enough to create anticompetitive effects, and so normally does not challenge the small firm's use of a vertical nonprice restraint.⁴５

If a showing is made of the existence of all three conditions that indicate collusion, the Department will consider certain other factors which would tend to create greater anticompetitive consequences. These factors include the following: the duration and restrictiveness of the restraint; any direct evidence of anticompetitive intent; whether the restraint actually has had an exclusionary effect; and whether market conditions are conducive to collusion or anticompetitive exclusion.⁴⁶ Any anticompetitive effects are weighed against procompetitive consequences in order to determine the validity of the restriction under the Rule of Reason.

4. Application of the Rule of Reason

a. Relevant Market and Market Power

The starting point for any Rule of Reason inquiry is usually the identification of the relevant market, which involves an assessment of both the relevant product and geographical markets. The next step is to determine whether the parties to the agreement have market power sufficient to have a real adverse effect on competition. Market power is the ability to raise prices above those that would be charged in a competitive market.⁴⁷ However, those agreements involving parties with little or no market power are rarely found to be anticompetitive. "Unless [the parties to the agreement] have the power to raise prices by curtailing output, their agreement is unlikely to harm consumers, and it makes sense to understand their cooperation as benign or beneficial."⁴⁸ If reasonable substitutes for the product or service at issue are available in the market, the market power may be severely undercut. In comparison, a unique commodity provides correspondingly higher market power.

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⁴⁷. *NCAA*, 468 US at 109, n.38; *Sewell Plastics*, 720 F Supp at 1218 (citing *NCAA*).
⁴⁸. *Polk Bros.*, 776 F2d at 191. See also, *Bi-Rite Oil Co. v Indiana Farm Bureau Assoc.*, 720 F Supp 1363 (S D Ind 1989) (since evidence indicated that defendants did not have the ability to control output and prices, and, therefore, did not have market power to adversely affect competition, no genuine issue existed as to the reasonableness of the restraint).
b. Anticompetitive Effects

If the possessed market power is sufficient to invite inquiry, other anticompetitive factors are given significant consideration under a Rule of Reason analysis. One such anticompetitive effect is the elimination of a potentially significant new market entrant with the capability, incentive and actual intention to enter the market when creating a joint venture. Any agreement which attempts to suppress or destroy competition, or whereby the parties attempt to control prices, is said to have significant anticompetitive effects.

c. Procompetitive Effects

The next step in a Rule of Reason analysis is for a court to consider whether any procompetitive justifications exist for the use of the restrictions at issue, assuming a showing of actual adverse effect on competition has been made. Courts often assess, among other factors, the facts peculiar to the business to which the restraint is applied, the nature of the restraint and its effect, the history of the restraint, and the reasons for adopting it.

Oftentimes, circumstances may indicate that, but for the use of such a restriction, neither party acting alone could have developed the product. This suggests potential procompetitive effects. Where the evidence indicates that the parties had not intended to use a restriction to thwart competition, but instead, to attract research and development participants into a project where pooling of resources and technology was essential, courts are inclined to allow such a restriction. In many cases, the alternative to joint development would be no development at all.
5. Other Considerations

a. Standing

A consideration for parties entertaining the thought of including an ancillary restriction in their agreement is whether a party exists who may seek to have the restriction struck down as violative of section 1 of the Sherman Act. While persons may claim that the restraint suppresses competition, only parties with standing may lawfully bring an antitrust claim.

In order for the complaining party to be sufficiently aggrieved to have standing to bring an antitrust claim, the party must have suffered an "antitrust injury" from another party's use of a restriction, which injury entitles the complaining party to relief. When the injury is to competition and of the type the antitrust laws were designed to prevent, a party has suffered an "antitrust injury." 65

b. Reasonably Necessary Test

Courts evaluate ancillary restraints on the basis of whether they are "reasonably necessary" to achievement of legitimate business purposes. 66 When using a Rule of Reason analysis, the "least restrictive alternative" test is not determinative. 67 In order to prevail under the more difficult "least restrictive alternative" test, the parties to the agreement are required to show that the restraint used was the least restrictive, there being no other restriction available that would have a lesser adverse impact on competition. 68 Most courts agree that the "[a]pplication of the rigid 'no less restrictive alternative' test would place an undue burden on the ordinary conduct of business," and instead apply the "reasonably necessary" test. 69

c. National Cooperative Research Act

In 1984, in an effort to promote joint research and development projects, Congress formulated its desire to allow these projects, some of which may have anticompetitive consequences, to go for-
ward without the fear of antitrust litigation by enacting the National Cooperative Research Act ("NCRA"). The threat of antitrust claims against a joint research cooperative and the resulting treble damages imposed when found in violation of section 1 of the Sherman Act often create a significant barrier to such research. For this reason, a wasteful duplication of effort has hindered the ability of United States firms to compete in a global economy, an economy which thrives on technological advances.

Under NCRA, innovative joint efforts which fall within the definition "joint research and development ventures" are assured to be analyzed under the Rule of Reason if suit is later brought, thereby avoiding being struck down as illegal per se. For example, should a research and development program that was registered with the Department of Justice pursuant to this Act be found to violate the antitrust laws, the recoverable damages are limited to actual damages, no treble damages being imposed. Through the use of this Act, Congress intends to improve the quality and amount of research and development being performed in the United States by lessening the likelihood of an antitrust claim prevailing.

Congress has made a step in the right direction by enacting NCRA, but unfortunately, has not sufficiently assured innovators that the United States is a hospitable environment for strategic alliances and cooperative arrangements. NCRA has been criticized for not being permissive enough to entice joint manufacturing and production of innovative products and processes, as these neces-

61. "Joint research and development venture" includes, in relevant part:  
any group of activities . . . by two or more persons for the purpose of . . .  
(B) the development or testing of basic engineering techniques,  
(C) the extension of investigative findings . . . into practical application for  
experimental and demonstration purposes, including the experimental produc-  
(D) the collection, exchange, and analysis of research information, or  
(E) any combination of [the above]  
but does not include:  
(1) exchanging information . . . that is not reasonably required to conduct the re-  
search and development . . .  
(2) entering into an agreement . . . restricting, requiring or otherwise involving the  
production or marketing . . . of any product, process, or service . . . that is not rea-  
sonably required to prevent misappropriation of proprietary information contributed.  

15 USC § 4301.  
62. 15 USC § 4302.  
63. 15 USC § 4303.
ecessary cooperatives are not covered by the Act. Moreover, no guidance is given as to how to apply the Rule of Reason test, which is replete with ambiguities. In addition, while treble damages are not imposed upon a joint effort registered under the Act, this does not guarantee that no litigation will result. The costs of defending an antitrust claim are often substantial enough to be a deterrent, even without the threat of treble damages.

II. Case Law History of Ancillary Restraints

Recently, courts have consistently been applying the Rule of Reason to determine whether ancillary restrictions to joint research and development programs are reasonable under section 1 of the Sherman Act. Since some confusion exists as to whether the Rule of Reason is to be applied to all ancillary restrictions, courts have been careful to first dismiss the possibility that application of the per se rule is required before determining whether the restraint is reasonable.

Even though in two decisions, Berkey Photo, Inc. v Eastman Kodak Co. and Yamaha Motor Co., Ltd. v FTC, ancillary restrictions to legitimate business purposes were struck down as violative of section 1 of the Sherman Act, the courts were applying the Rule of Reason in reaching their conclusions that the restraints were unreasonable. In Eastman Kodak, the United States Court of Appeals for the Second Circuit found that a secrecy agreement ancillary to a project to jointly develop camera devices violated section 1 of the Sherman Act. At first glance it appears that the court may still have been inclined to find all ancillary restrictions unreasonable even after the overturning of Schwinn. A closer reading of the case, however, reveals that, by requiring nondisclosure, Kodak had kept a desirable innovation off the market for two years solely for its own benefit. Also, Kodak's market power, a

66. Id.
67. 603 F2d 263 (2d Cir 1979).
68. 657 F2d 971 (8th Cir 1981).
69. Eastman Kodak, 603 F2d 263 (2d Cir 1986).
70. See notes 32 and 33 and accompanying text for the discussion concerning Schwinn.
71. Eastman Kodak, 603 F2d at 302. The parties to the agreement had not actually jointly invested in this project, another party having separated researched and developed the product, which was the basis of the secrecy agreement, before approaching Kodak. Id.
significant factor as viewed by the court, was being used to prevent other camera makers from competing with Kodak. 72 Thus, the court concluded that the ancillary secrecy agreement requested by Kodak was merely intended to suppress competition. 73 At the same time, the court stressed that it was not holding this joint development restriction to be a per se violation of section 1. 74 Although this restriction was found to be an unreasonable restraint of trade, the court noted the realistic need of contributors to restrict to themselves the rewards of innovation. 75

In Yamaha, restrictions as to sales markets used by the parties were found to be collateral to the legitimate joint venture to produce outboard motors and, therefore, illegal under section 5 of the Federal Trade Commission Act. 76 A thorough examination of the facts revealed that the market restrictions on the research and development joint venture were extended to non-joint venture motors and consequently, these restraints were not “reasonably necessary” to the purpose of the joint venture. 77 Instead, the parties were attempting to carve up the market for their own benefit. 78 Such an agreement unreasonably foreclosed competition and served only to eliminate possible competition between the parties. 79

An exclusivity provision raised antitrust issues in National Bank of Canada v Interbank Card Ass’n. 80 This vertical restriction was a result of negotiations between two parties seeking to develop and establish an organization for extending credit in order to create a Canadian credit card market. 81 In order to protect and recover the major investment necessary to allow them to compete with the

72. Id at 301-02.
73. Id.
74. Id at 302.
75. Id at 301.
76. 657 F2d 971 (8th Cir 1981). Notably, although this claim was brought under section 5 (Federal Trade Commission Act, § 5(c), 15 USC § 45(e)), the court applied the same reasoning as is used in a section 1 analysis. Yamaha, 657 F2d 971.
77. Id at 981.
78. Id.
79. Id.
80. 507 F Supp 1113 (S D NY 1980). The exclusivity provision was divided into three periods, the first period being that time during which both parties’ consent was required to grant a license to any Canadian entity so that it could become a member of the credit system. United States entities were allowed to enter the system without such consent during the second period. During the final period, consent by the parties could not be denied to a Canadian entity which agreed to expend a reasonable share of start-up costs. National Bank of Canada, 507 F Supp at 1116.
81. Id.
VISA system, the parties agreed to exclude entry into their Canadian credit system for an eight-year period, the time period calculated to recover start-up costs. The court stated that in light of its purpose to enhance competition and the moderate duration of the restriction which was necessary to recover expenses, the ancillary restraint was reasonable and not violative of section 1 of the Sherman Act.

Using an analysis similar to that employed in National Bank of Canada, the Seventh Circuit Court of Appeals concluded that a covenant not to compete in an employment contract was reasonable under the Rule of Reason. The court rejected an argument that the covenants were executed primarily to eliminate the new hire as a competitor. Instead, the court found the restriction to be justified since the party seeking to enforce the covenant had a substantial interest in protecting its goodwill and trade secrets. Also stressed by the court was the fact that the covenant occurred within a reasonable geographic area and time period, with limitations as to what products were restricted.

A case illustrative of the courts' interest in propagating the incentive of parties to pool resources in joint research and development projects in order to attract venture participants is Northrop Corp. v McDonnell Douglas Corp. This case involved a teaming agreement to build a new type of jet. The agreement included a restriction that was subjected to antitrust scrutiny. This restriction limited Northrop to marketing land-based aircraft and McDonnell to marketing those aircraft suitable for aircraft carrier operations. While the court did not actually apply the Rule of Reason, the tone of the court suggested that the restriction was reasonable. This is evident from the court's emphasis on the fact

82. See note 80 for the terms of the exclusivity provision.
83. Id.
84. Id at 1122, 1123.
86. Lektro-Vend, 660 F2d at 266.
87. Id at 267. The employment contract prohibited the new hire from entering into the vending machine business, the trade of the employer, within the employer's territories for a period of five years from the termination of employment. Id at 258, 259.
88. 705 F2d 1030 (9th Cir 1982).
89. McDonnell Douglas, 705 F2d at 1037, 1038.
90. Id at 1038. The use of such restrictions is common in the defense industry and "serves the purposes of spreading financial risk, pooling technological know-how, and raising sufficient resources to complete costly developmental research." Holmes, 1990 Handbook at 370 (cited in note 41).
91. McDonnell Douglas, 705 F2d at 1053. On appeal, the court was restricted to de-
that this teaming agreement allowed both parties to compete in a market from which they would have otherwise been foreclosed.\textsuperscript{82}

By the time \textit{McDonnell Douglas} was decided in 1982, courts throughout the United States were consistently applying the Rule of Reason to ancillary restraints. Yet, numerous courts still felt compelled to discuss and subsequently reject the application of the per se rule of illegality to certain types of restrictions before examining a restraint under the Rule of Reason. In 1984, the Supreme Court examined an ancillary restraint to collegiate activities in \textit{NCAA v Board of Regents},\textsuperscript{93} but no general holding as to the applicability of the Rule of Reason was set forth by the Court.\textsuperscript{94} The restriction at issue was a horizontal agreement regulating televised athletic events in hopes of preserving attendance at football games and the overall collegiate athletic system.\textsuperscript{95}

Rejecting an argument to apply the per se rule, the Court analyzed the ancillary restraint implemented by the NCAA under the Rule of Reason. In striking down the agreement, the Court found that the anticompetitive limitation on price and output was not sufficiently offset by any procompetitive effects.\textsuperscript{96} However, the Court did not broadly declare that the Rule of Reason was always to be applied to ancillary restraints. Instead, the Court stated that an application of a per se rule to this situation would be inappropriate because the NCAA is an industry in which horizontal restraints on competition are essential if the product is to be available at all.\textsuperscript{97} The Court conceded that some type of restraint may be necessary to preserve and encourage intercollegiate amateur athletics and may actually enhance market-wide competition.\textsuperscript{98} But here, the Court stated, the NCAA was merely insulating collegiate football with this particular restraint so that it would not have to compete in the free market.\textsuperscript{99}

The Court also determined that the restraints on football telecasts were significantly different from other justifiable means of fostering competition.\textsuperscript{100} The television plan was found not to be

\begin{itemize}
\item \textsuperscript{92} Id.
\item \textsuperscript{93} 468 US 85 (1984).
\item \textsuperscript{94} \textit{NCAA}, 468 US at 85.
\item \textsuperscript{95} Id at 99.
\item \textsuperscript{96} Id at 114.
\item \textsuperscript{97} Id at 101.
\item \textsuperscript{98} Id at 102-03.
\item \textsuperscript{99} Id at 105-06.
\item \textsuperscript{100} Id at 117. The Court suggested a number of justifiable means of fostering compe-
an effective attempt to equalize competition throughout the NCAA.\textsuperscript{101} Also considered was the fact that no similar restriction was required to promote another analogous sport, college basketball.\textsuperscript{102} In striking down this agreement, the Court concluded that intercollegiate football was unnecessarily restricted and not enhanced by the television restraint.\textsuperscript{108}

Shortly after \textit{NCAA} was decided, the United States District Court for the Southern District of Florida considered the findings of the Supreme Court in \textit{NCAA} and the necessity of certain restraints in joint ventures to conclude that the Rule of Reason should govern the determination of validity of the interchange fee used by VISA in \textit{National Bancard Corp. v VISA U.S.A.}\textsuperscript{104} Upon review, the court decided that the interchange fee was a reasonable charge by the parties to transfer credit card transactions throughout the credit system network and that the network yielded efficiencies beneficial to the economy.\textsuperscript{106} The court stressed the fact that the fee was negotiable and discretionary, customers being free to make alternate arrangements. In weighing the procompetitive effects against the anticompetitive consequences, the court considered the nonexistent market power of the parties, the lack of barriers to entry in the credit market and the investment of the parties into the joint venture, thereby concluding that the balance clearly tipped in favor of reasonableness.\textsuperscript{108}

Oftentimes, a party to an agreement with an ancillary restriction will refuse to honor the agreement, asserting as a defense in breaching the agreement that the covenant is invalid under section 1 of the Sherman Act. In \textit{Polk Bros. Inc. v Forest City Enterprises, Inc.},\textsuperscript{107} two appliance retailers agreed to combine resources to construct a building to house both businesses so that the two stores could offer a full line of home furnishings.\textsuperscript{108} The parties included in the agreement a covenant which restricted the products each

\textsuperscript{101} Id at 119.
\textsuperscript{102} Id.
\textsuperscript{103} Id.
\textsuperscript{104} 596 F Supp at 1231. VISA, a for-profit non-stock-membership corporation, accepted eligible financial institutions as members and exchanged their transactional papers for credit purposes. A fee charged by VISA for this service was set by a cost analysis system. VISA members, however, were free to interchange paper through other credit services. Id.
\textsuperscript{105} Id at 1263.
\textsuperscript{106} Id at 1259.
\textsuperscript{107} 776 F2d 185 (7th Cir 1985).
\textsuperscript{108} \textit{Polk Bros.}, 776 F2d at 187.
could sell. Years later, one party, concerned about declining profits, notified the other party of its intent not to honor the covenant, arguing that the covenant was invalid. The court distinguished this ancillary restriction as part of a larger endeavor which actually promoted efficiency and productivity from a naked restraint designed to suppress competition. The court discussed how cooperation, common to joint ventures, mergers, and systems of distribution, often facilitates market efficiencies and concluded that a Rule of Reason focus was appropriate.

Finding that one party "would not have entered into this arrangement, however, unless it had received assurances that [the other party] would not compete with it in the sale of products that are the 'foundation of [its] business,'" and recognizing the benefits of cooperation, the court set forth the analytical framework for the factfinder to follow upon remand under the Rule of Reason.

In yet another noteworthy decision, Sewell Plastics, Inc. v Coca-Cola Co., the District Court for the Western District of North Carolina stressed the need to examine market power when weighing competitive effects in order to determine the reasonableness of vertical supply contracts used to economize the plastic bottle production and distribution process. In order to reduce packaging costs and better compete with other bottlers, a manufacturing cooperative of bottlers was formed so the parties could produce bottles for themselves. The manufacturer who had previously sold the bottles to the parties claimed that these contracts were unreasonable restraints of trade.

In deciding that the supply contracts were reasonable, the court found that, not only had bottle prices decreased and production of bottles increased, but that market concentration had decreased since the cooperative was formed. Also, the court found that the cooperative probably could not have increased its market share

109. Id.
110. Id.
111. Id at 189-90.
112. Id at 189.
113. Id at 190. The discussion of the court suggested that the restraint was reasonable.
116. Id at 1208. To justify the investment in plant and equipment, the bottlers executed supply contracts to purchase 80% of their bottle requirements for five years, with a price being set by the cooperation for the first year of production. Id.
117. Id.
118. Id at 1210-12.
materially in the future, and therefore could not have had sufficient market power to control prices so as to have an actual adverse impact on competition.\textsuperscript{119}

In dicta, the court went on to consider whether any procompetitive effects actually existed in the event that the complaining party made a showing of anticompetitive consequences.\textsuperscript{120} In doing so, the court merely examined whether the contracts were a reasonably justified means of achieving legitimate ends (as opposed to the least restrictive means).\textsuperscript{121} The court dismissed the claims, however, under section 1 of the Sherman Act, but only for failure to establish anticompetitive effects resulting from the cooperative's supply contracts.\textsuperscript{122}

\section*{III. SUGGESTIONS FOR AVOIDING ANTITRUST LITIGATION}

In light of the above review of applicable decisions, any investigation into the validity of a particular ancillary restriction would most certainly be performed under the Rule of Reason. Should the complaining party allege that the restriction is illegal per se, the parties to the agreement should refer to the discussion above in support of the application of the Rule of Reason.

Under the Rule of Reason, in order for the ancillary restriction included in the joint development agreement to withstand antitrust inquiry it must either have no anticompetitive effects or, if such effects exist, they must be outweighed by the procompetitive effects of the agreement. In arguing that the restriction is not anticompetitive and does not violate section 1 of the Sherman Act, the parties to the agreement should rely primarily on those cases in which two or more parties worked jointly to develop a technological innovation where pooling of technology and resources was required.\textsuperscript{123} Those cases suggest that, in general, courts are willing to allow parties to restrain trade to a certain extent in order to

\begin{itemize}
\item \textsuperscript{119} Id at 1213. The cooperative's 3.6\% share of the market could grow, at most, to 40\% of the market, that share of the soft drink market possessed by the bottlers. The court concluded that the complaining party had failed to show that the bottlers, with this percentage market share, possessed sufficient market power to control prices. Id.
\item \textsuperscript{120} Id at 1219.
\item \textsuperscript{121} Id. See notes 56-9 and accompanying text for discussion of the "reasonably necessary" and "least restrictive alternative" tests.
\item \textsuperscript{122} \textit{Sewell Plastics}, 720 F Supp at 1222.
\item \textsuperscript{123} See for example \textit{McDonnell Douglas}, 705 F2d 1030 (9th Cir 1982); \textit{VISA U.S.A}, 596 F Supp 1231 (S D Fla. 1984); \textit{National Bank of Canada}, 507 F Supp 1113 (S D NY 1980); \textit{Polk Bros.}, 776 F2d 185 (7th Cir 1985); \textit{Sewell Plastics}, 720 F Supp 1196 (W D NC 1989).
\end{itemize}
provide the necessary incentive for parties to undertake costly developmental projects. Looking to the principal purpose for imposing the restrictions, the courts concluded that the restrictions were not naked restraints of trade, but were intended to enable the parties to successfully launch a new venture while protecting the fruits of their labors.

Another concern of the courts is the market power possessed by the parties imposing the restrictions. The courts agree, for the most part, that without market power, parties are unable to adversely impact the economy by the use of ancillary restrictions. Therefore, careful consideration should be given when parties with great market power are desirous of including an ancillary restriction in the joint agreement.

In addition, the parties should avoid making the same mistakes as those parties whose restrictions, ancillary to a joint project, were struck down as unreasonable.124 Eastman Kodak and Yamaha are two premiere examples of what types of restrictions should not be adopted by contracting parties. Where the parties do not limit the agreement to the subject of the research project, but instead extend the restrictions to other anticompetitive purposes (as was the case in Yamaha), the courts will not hesitate to find the restraints to be violative of section 1 of the Sherman Act.

In Eastman Kodak, the parties attempted to keep an innovative product off the market merely to allow Kodak to realize profits on another newly introduced product. The court emphasized its disapproval with the resulting loss to consumers created solely by Kodak. Those courts also made clear that labeling an agreement as a joint venture is not enough to ensure that any restraints of trade imposed by parties to the agreement will be considered reasonable. Therefore, an analysis of these two cases indicates that restraints, which on their face may appear to be necessary to a legitimate business purpose, still may be found to be unreasonable if a closer examination of the facts reveals that the restrictions were intended to merely suppress competition or if other significantly less anticompetitive means were available to achieve the goals of the project.

Where a necessary incentive to induce the parties to undertake such a large scale development project is required, so long as the restriction is of a reasonable time duration and geographical area,

124. In Eastman Kodak and Yamaha, discussed at notes 67 and 68, respectively, the court struck down ancillary restrictions as unreasonable.
the ancillary restraint will probably be considered reasonable. A further consideration is the barrier to entry. Where no barrier exists, competition is great and ancillary restraints are more likely to be seen as reasonable than if no other parties could enter the market and compete.

In conclusion, in today's fast-paced, hi-tech environment, the ability of the United States to compete in a global economy hinges on American businesses taking the risks and investing the capital necessary to undertake research and development projects. Parties will not commit themselves to agreements to develop innovative products if the benefits of such projects are lost in defending against antitrust claims. In light of the legislature's response in enacting research and development incentives and the courts' trend towards considering the reasonableness of restraints on the parties' agreements, the necessary backdrop is set for parties to reap the benefits of such an investment. Therefore, so long as parties are careful to ensure that ancillary restriction incorporated into the agreements are reasonable, the fear of antitrust litigation and potential penalties should not erect too formidable a barrier to joint research and development.

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