A PEEK AT ANCILLARY RESTRAINTS DOCTRINE THROUGH THE NEW DEFENCE IN THE AMENDED COMPETITION ACT

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The Canadian Bar Association
2010 Competition Law Spring Conference

May 17, 2010
Toronto, Ontario
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INTRODUCTION

On March 12, 2009, Bill C-10, otherwise known as the Budget Implementation Act (“Bill C-10”), received Royal Assent. Bill C-10 consists of numerous amendments that, taken together, arguably represent a significant paradigm shift in how the Competition Bureau (the “Bureau”) and the Director of Public Prosecutions (“DPP”) in Canada challenge agreements between competitors. Notably, for purposes of this paper, the revisions to the Competition Act (the "Act") found in Bill C-10 expressly adopt an “ancillary restraints defence” (“ARD”) to what are otherwise widely considered the province of hard core cartel conduct – agreements to fix price, allocate markets and/or restrict output. To U.S. practitioners the codification of the ancillary restraints doctrine, a staple part of U.S. joint conduct analysis, as a “defence” to criminal antitrust charges appears at first a peculiar way of approaching ancillary restraints. But with a closer look at our own antitrust statute, which provides absolutely no clarity as to what can be prosecuted criminally versus civilly, the peculiarity reverses direction. It makes good sense as a matter of law to provide that clarity, particularly as to the circumstances that might result in punishment as severe as incarceration. Nevertheless, it is still striking to see the doctrine articulated as a “defence” against criminal challenge because it is a broad and deep concept that in the U.S. profoundly shapes the assessment of joint ventures and other forms of joint conduct, and has both civil and criminal enforcement ramifications. With over a hundred and ten years of judicial decisions interpreting the doctrine since then, ancillary restraints is one of the richest and most informed areas of U.S. antitrust law.1

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1 The U.S. Supreme Court’s first discussion of the ancillary restraints doctrine dates back to 1899, only ten years after Canada’s first competition legislation. Addyson Pipe and Steel Co. v. United States, 85 F. 271 (6th Cir. 1898), aff’d as modified 175 U.S. 211 (1899).
The defence, as articulated in the revised Act, surely captures the major thresholds that have been distilled over so many years in the US – ancillarity and reasonable necessity – and the Competition Bureau’s Competitor Collaboration Guidelines (the “Guidelines”) likewise capture many of the same points of assessment that have been developed in the US. The one thing that appears to be missing, however, in both the Act and the Guidelines is a threshold requirement of integrative economic efficiencies in the joint conduct that support ancillary restraints. This may be much to do about nothing since the ARD, as used in the Act, is a defence to criminal prosecution whereas in the United States the doctrine arguably represents so much more – it permits a wholesale shift from an unyielding per se standard to a defense-friendly rule of reason standard in civil damage actions. Using a lower threshold for escaping criminal prosecution may make good sense; the U.S. Department of Justice after all has behaved consistently with its enforcement intention to only pursue “naked” agreements to fix price, allocate markets or restrict output criminally.2

The gap, intended or not, nevertheless exists. The Guidelines say very little about integrative efficiencies – they recognize efficiencies as a factor behind collaborative activity that may inform the ARD, and generally as a pro-competitive benefit to be weighed against anticompetitive effects in the analysis applied to civil challenges of competitor agreements in Section 90.1, but neither the Act nor the Guidelines appears to require the presence of integrative efficiencies in the first place. This presents an ideal area of focus as we share here the U.S. experience with applying the ancillary restraints doctrine.3 The remainder of this paper first introduces as background the relevant amendments to the Act that contain the new ARD, then discusses the current state of the ancillary restraints doctrine in the U.S. and walks through a sampling of its application in both well-known and less well-known cases, and concludes with some practical observations about the ARD that fall out of the U.S. experience.

2 U.S. Department of Justice Antitrust Division Manual 4th ed., Chapter III Section c5 (“In general, current Division policy is to proceed by criminal investigation and prosecution in cases involving horizontal, per se unlawful agreements such as price fixing, bid rigging, and customer and territorial allocations”).

3 There is no telling whether this observation is meaningful or not since these revisions and the ARD have only come into force two months ago. Experts have stated that there is no choice but to “wait and see” how tribunals will rule based on the language of the act. See, e.g., Barry Zalmanowitz, “New Rules in Canada – What a Cross-Border Business Needs to Know” (April 21, 2010), ABA Antitrust Section Annual Spring Meeting Session. There is no jurisprudence in the Canadian court system on major terms like “reasonably necessary” so there are no signals that indicate what courts will do.
I. BRIEF BACKGROUND

One of the most significant changes in the Act is the adoption of a dual track approach to agreements between competitors, one for criminal enforcement and another for civil enforcement. Section 45 of the revised Act, which essentially adopts a per se standard for “hard core” antitrust violations, delineates the “ancillary restraints defence.”

Conspiracies, agreements or arrangements between competitors

45. (1) Every person commits an offence who, with a competitor of that person with respect to a product, conspires, agrees or arranges

(a) to fix, maintain, increase or control the price for the supply of the product;
(b) to allocate sales, territories, customers or markets for the production or supply of the product; or
(c) to fix, maintain, control, prevent, lessen or eliminate the production or supply of the product.

(2) Every person who commits an offence under subsection (1) is guilty of an indictable offence and liable on conviction to imprisonment for a term not exceeding 14 years or to a fine not exceeding $25 million, or to both.

(4) No person shall be convicted of an offence under subsection (1) in respect of a conspiracy, agreement or arrangement that would otherwise contravene that subsection if

(a) that person establishes, on a balance of probabilities, that

(i) it is ancillary to a broader or separate agreement or arrangement that includes the same parties, and

(ii) it is directly related to, and reasonably necessary for giving effect to, the objective of that broader or separate agreement or arrangement; and

(b) the broader or separate agreement or arrangement, considered alone, does not contravene that subsection.

Agreements between competitors can alternatively be challenged by the Bureau before the Competition Tribunal under the new Civil Agreements provision at Section 90.1, which provides in relevant part as follows:

Agreements or Arrangements that Prevent or Lessen Competition Substantially

Order

90.1 (1) If, on application by the Commissioner, the Tribunal finds that an agreement or arrangement — whether existing or proposed — between persons two or more of
whom are competitors prevents or lessens, or is likely to prevent or lessen, competition substantially in a market, the Tribunal may make an order

(a) prohibiting any person — whether or not a party to the agreement or arrangement — from doing anything under the agreement or arrangement; or

(b) requiring any person — whether or not a party to the agreement or arrangement — with the consent of that person and the Commissioner, to take any other action.

(2) In deciding whether to make the finding referred to in subsection (1), the Tribunal may have regard to the following factors:

(a) the extent to which foreign products or foreign competitors provide or are likely to provide effective competition to the businesses of the parties to the agreement or arrangement;
(b) the extent to which acceptable substitutes for products supplied by the parties to the agreement or arrangement are or are likely to be available;
(c) any barriers to entry into the market, including...
(d) any effect of the agreement or arrangement on the barriers referred to in paragraph (c);
(e) the extent to which effective competition remains or would remain in the market;
(f) any removal of a vigorous and effective competitor that resulted from the agreement or arrangement, or any likelihood that the agreement or arrangement will or would result in the removal of such a competitor;
(g) the nature and extent of change and innovation in any relevant market; and
(h) any other factor that is relevant to competition in the market that is or would be affected by the agreement or arrangement.

(3) For the purpose of subsections (1) and (2), the Tribunal shall not make the finding solely on the basis of evidence of concentration or market share.

(4) The Tribunal shall not make an order under subsection (1) if it finds that the agreement or arrangement has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the agreement or arrangement, and that the gains in efficiency would not have been attained if the order had been made or would not likely be attained if the order were made.

On March 12, 2010, these sections came into effect.

Both Sections contain subparagraphs that make clear that the same conduct cannot be challenged under both provisions – in effect, the Bureau has to decide whether to challenge under either Section 45 or Section 90.1 of the Act. To aid in counseling firms about the risks of
competitor collaborations, the Bureau issued the Guidelines that inform the analysis the Bureau will undertake in deciding whether to challenge competitor agreements under either Section 45 or Section 90.1. In those Guidelines, the Bureau adopts a policy stance for criminal enforcement that is much like the U.S. Department of Justice – it reserves for criminal enforcement “naked restraints” on competition between competitors. Naked restraints is, as in the U.S., shorthand for saying the restraint is not ancillary to legitimate conduct and thus not subject to the ARD. The Bureau in its Guidelines repeats the maxim that naked restraints on competition “are not implemented in furtherance of a legitimate collaboration, strategic alliance or joint venture.”

Neither the Act nor the Bureau in its Guidelines, however, describe what makes a collaboration, strategic alliance or joint venture legitimate or not for purposes of applying the ARD (other than the Act’s requirement that the broader, separate joint conduct not itself be a price fixing, output or market allocation agreement in contravention of Section 45(1)), making it difficult to counsel when a restraint is implemented in furtherance of a legitimate collaboration. In comparison, the Antitrust Guidelines for Collaborations Among Competitors Issued by the Federal Trade Commission and the U.S. Department of Justice (April 2000) require “an efficiency enhancing integration of economic activity” as a threshold for application of the ancillary restraints doctrine. As a matter of practice the Bureau of course very well might apply the same screen, which suggests it may recommend challenge of agreements that may still be ancillary to a broader agreement that is neither an agreement in contravention of Section 45 nor an agreement that yields integrative efficiencies. The difficult issue then is what a court will do given that Section 45(4) itself does not require integrative efficiencies.

II. U.S. JOINT VENTURE LAW

The backbone of the ancillary restraints doctrine in the U.S. is the treatment of collaborative activity between competitors, or, broadly speaking, joint ventures. U.S. courts typically analyze joint ventures under a rule of reason because it is widely believed that joint ventures foster or facilitate certain integrative efficiencies that are pro-competitive. Not all joint ventures, however, command such treatment. In order to qualify as a joint venture subject to rule of reason analysis, there must be some form of economic integration, i.e., the pooling of the
participating parties’ resources and the sharing of risks,\(^4\) or the creation of a new product that would otherwise not be available absent collaboration of some form.\(^5\) U.S. courts have been careful not to raise form over substance in determining whether joint activity rises to the level of a joint venture whose competitive constraints are deserving of rule of reason treatment. They have applied per se treatment to arrangements that were called joint ventures,\(^6\) and, conversely, have applied rule of reason treatment to joint activity even where the existence of a joint venture was not readily apparent.\(^7\)

The identification of an economic integrative efficiency thus pulls joint collaborative activity, and the restraints on competition ancillary to it, out of an unyielding per se analysis to a far more hospitable place – a more exacting inquiry into competitive effects. It is rather remarkable that U.S. antitrust law, which treated as per se illegal maximum and minimum resale price maintenance until 1997 and 2007, respectively,\(^8\) has for so long acknowledged the benefits of collaboration between horizontal competitors and provided a construct that gave competitors ample running room to pursue integrative efficiencies. That construct is the ancillary restraints doctrine, which simply provides that in the presence of legitimate joint conduct, competitors can agree to restraints that otherwise would be regarded as per se illegal as long as they are (i) ancillary or supportive of broader, legitimate joint conduct and (ii) reasonably necessary to

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\(^4\) Arizona v. Maricopa County Medical Society, 457 U.S. 332 (1982) (fact that doctors participating in setting maximum fees were in business individually and did not pool their capital and share the risks of loss decisive in court’s refusal to afford rule of reason treatment to joint activity)


\(^6\) COMPACT v. Metropolitan Government of Nashville & Davidson County, 594 F. Supp. 1567, 1574 (M.D. Tenn. 1984) (finding lack of any integrative efficiency, in this case an increase in new productive capacity, condemned competitive restraints in “joint venture” to per se treatment); Engine Specialties, Inc. v. Bombardier Limited, 605 F.2d 1, 8 (1st Cir. 1979) (joint activity pursuant to contract which contemplated a joint venture that never materialized analyzed under per se rule)

\(^7\) Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210 (D.C. Cir. 1986); National Bancard Corp. v. VISA USA, Inc., 779 F.2d 592 (11th Cir. 1986)

achieve the purpose of that venture.9

U.S. courts regard a restraint as ancillary if it is “subordinate and collateral to a separate, legitimate transaction” and “serv[es] to make the transaction more effective in accomplishing its purpose.”10 In the case of price fixing, for example, the restraint would be ancillary if it “achieved purposes unrelated to price formation.”11 Reasonable necessity spans a rather broad array of factors. One of them is what restraints are necessary to induce output-enhancing cooperation and risk-sharing, and, relatedly, prevention of free riding and economic feasibility.12 Others include the scope of the restraint and the existence of available less restrictive alternatives. A restraint must be no broader than necessary in terms of product, time and territory, to accomplish the purpose of the larger agreement.13 “If [the restraint] is so broad that part of the restraint suppresses competition without creating efficiency, the restraint is, to that extent, not ancillary.”14

III. ILLUSTRATIVE U.S. CASE PROFILES

What follows is a series of cases that illustrate the emphasis on integrative efficiencies and a general willingness to defer to business judgment on what will best facilitate such efficiencies. Each case thoughtfully discusses the ancillary restraints doctrine. These cases are

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10 Rothery, 792 F. 2d at 224.
12 See Polk Bros. Inc. v. Forest City Enterprises, Inc., 776 F.2d 185 (7th Cir. 1985) (In upholding the covenant not to compete as an ancillary restraint, the court emphasized the important role of the covenant played inducing cooperation between the parties because the parties would not have agreed to pursue the joint venture without the covenant.); Business Review Letter from William F. Baxter, Assistant Attorney General, Antitrust Division, Department of Justice, to Irving B. Yoskowitz, United Technologies Corporation (October 27, 1983) (In stating intention not to challenge the scope of a right of first refusal in a jet engine development agreement between competitors, DOJ recognized “economic feasibility” as a legitimate basis to approve an expanded scope of restraint as reasonably necessary); Van Dyk Research Corp. v. Xerox Corp., 478 F. Supp. 1286 (D. N.J. 1979) (world wide market divisions in license agreements were reasonable and ancillary “to the formation of speculative business venture.”) aff’d, 631 F.2d 251 (3d Cir. ‘90), cert. denied, 452 U.S. 905 (1981).
14 Rothery, 792 F. 2d at 224. See also 7 P. Areeda, Antitrust Law ¶ 1505 at 383-84 (“the restraint must not only promote the legitimate objective but must do so significantly better than the available less restrictive alternatives.”)
not the leading cases used by most to define the U.S. ancillary restraints doctrine but rather a mix of rather pedestrian, run-of-the-mill decisions and more well known, higher profile decisions you may recognize either by name or fact pattern. The common thread in all of these cases is the identification of a bona fide integrative efficiency as a threshold requirement to eliminate the possibility of a naked restraint and apply a more rigid analysis of competitive effects.

A. **In Re ATM Fee Antitrust Litigation**

*In Re ATM* relates to a challenge to the setting of fees paid by debit card-issuing banks to ATM owners. Debit card holders alleged that the banks, who were ATM network members, were guilty of price fixing for pre-arranging the amount of these fees in lieu of allowing each ATM owner and bank to work out a fee individually. The court rejected the plaintiff’s complaint and held that the restraint was necessary to ensure the viability and development of the ATM network.

To understand the case, one must understand what happens when a customer uses their debit card at a foreign ATM machine (one that is not owned by their bank). There are four parties typically involved in such a transaction: (i) the customer, (ii) the card issuing bank, (iii) the ATM owner and (iv) the “ATM network,” an entity that coordinates agreements between banks and ATM owners so that customers can access their account and secure funds from any member in the network. The bank must pay two fees when a customer withdraws funds from a foreign ATM: a switch fee to the network and an interchange fee to the ATM owner. Plaintiff debit card holders brought suit against banks who were members of the ATM network, arguing that the setting of network-wide interchange fees constituted illegal price fixing.\(^\text{15}\)

Plaintiffs also attempted to preempt an ancillary restraints defense by further alleging that the interchange fee agreement was a “naked” attempt to fix prices, and thus not ancillary to a legitimate, pro-competitive venture.\(^\text{16}\) They argued that it was not necessary to set such fees to sustain the network. Defendants responded that the fee was necessary to compensate the ATM owner for making their ATM available and taking on the costs and risks associated with that

\(^{15}\) *In re ATM Fee Antitrust Litig.*, 554 F. Supp. 2d 1003, 1007-8 (N.D. Cal. 2008).

\(^{16}\) *Id.* at 1008.
decision. The defendants argued that without such fees, the owner would not participate in the network because there would be no guarantee of reimbursement.17

The court agreed with the defendants and discussed a separate set of reasons why the fees were both ancillary and necessary to the network’s existence. The ATM network needed a uniform set of rules to operate properly.18 If every individual ATM owner had to negotiate separate arrangements with every card-issuing bank, the efficiencies of the system would be lost.19 The fees supported the venture because they created an incentive for the introduction of additional ATMs, thereby increasing competition.20 Having found the fee-setting was both ancillary and reasonably necessary to achieve the efficiency-enhancing purpose of the venture – widespread access to funds from foreign ATMs and the proliferation of ATMs generally, the court ruled the agreement could fall under rule of reason review.21

This ruling is instructive in two ways. First, it exhibits the respect that the U.S. judicial system has for the potential of these agreements to lead to greater efficiencies and pro-competitive benefits in the market place. The opinion states, “the network here is a legitimate integrated venture, not a sham cartel, and thus the assumption is that it is creating efficiencies that would not be possible otherwise.”22 Second, and arguably more compelling, is that the opinion demonstrates a certain humility towards the business judgment of defendants in effectuating desired efficiencies.

17 Id. at 1008-9.
18 Id. at 1015 (citing Regents of the University of California v. American Broadcasting Companies, 747 F.2d 511, 517 (9th Cir. 1984).
19 Id. at 1016.
20 Id. at 1015.
21 If restraints are “necessary if the product is to be marketed ‘at all,’ restraints that are reasonably ancillary to the legitimate cooperative functions of the venture qualify for rule of reason treatment.” Id. at 1013-14 (citing Law v. NCAA, 134 F.3d 1010, 18-19 (10th Cir. 1998)).
22 Id. at 1012 (citing Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 768 (1984).
**Integrative efficiency:** The court ruled that the pricing agreements between members of the ATM network allowed the network to exist. Without them, the inefficiencies of each individual negotiation between banks and ATM owners would be so burdensome that the network would collapse, consumers would no longer be able to use foreign ATMs and they would suffer as a result.

**B. Perceptron, Inc. v. Sensor Adaptive Machs., Inc.**

One of the most common types of ancillary restraints cases relates to agreements between actual or potential competitors not to compete with one another in the context of the sale of a line of business. While the sale of a business does not necessarily involve much in the way of joint conduct other than the transfer of assets and goodwill from one competitor to another, courts generally recognize that the transfer of assets and goodwill to parties for value can achieve allocative and integrative efficiencies that enhance output and thus benefit competition.23

In July of 1990, two laser beam technology competitors, Perceptron and Diffracto Ltd., entered into a contract through which Perceptron purchased some of Diffracto’s intangible assets. These assets related to Diffracto’s “Fit business,” which encompassed the creation, production and marketing of laser devices for measurement and location purposes. Among these assets was Diffracto’s “Z-sensor” technology, which was used by car manufacturers to measure sheet metal. Part of the agreement entailed a broad five year non-compete provision that included a Diffracto sister company or “spin-off”, Sensor Adaptive Machs., Inc. (“SAMI”). SAMI abided by the terms of the non-compete provision for three years and then introduced a laser sensor technology to the market that could “gauge automobile assemblies” and thus could compete with Perceptron’s measuring devices. When Perceptron sued SAMI for breach of contract, SAMI counterclaimed that the non-compete agreement violated antitrust law. SAMI argued the restraint was not ancillary because it was too broad given that Perceptron purchased a narrow form of technology from Diffracto that SAMI did not use in its new laser sensor product.24 SAMI also alleged the duration of the non-compete was unreasonable.

In upholding an expansive view of the covenant not to compete, the court focused on the

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23 *Cf. Town of Norwood v. New England Power Co.*, 202 F.3d 408, 422 (1st Cir. Mass. 2000) (recognizing that a transfer of assets to a new entrant would likely increase competition because it adds a competitor to the market while reducing the market power of the seller).

intended transfer of goodwill from Diffracto to Perceptron. The court recognized that a valid non-compete agreement can cover competitive sales some measure beyond the product at the core of the agreement, particularly where the seller’s goodwill and customer base are part of the deal.25 The court held that “reasonable minds” could conclude that Perceptron also purchased the right to serve Diffracto’s customers and secure their goodwill.26 SAMI’s new technological product endangered that goodwill, so the non-compete was regarded as a valid ancillary restraint the breach of which gave Perceptron a credible contract claim.

Turning to the duration of the non-compete, the court readily recognized that deciding the appropriate temporal scope is necessarily a difficult exercise and it decided to adopt a relatively low “where reasonable minds can differ” standard. SAMI argued that the duration of the non-compete had to be “reasonably calculated” to protect the purchaser’s interest.27 SAMI then submitted evidence that it would take only two years to develop a product from scratch to compete with Perceptron’s sensors and thus the five year period was unnecessarily broad. Perceptron in turn presented testimony that the five year period of coverage was reasonable given selling cycles in the industry.28 The court held that as long as reasonable minds could disagree, then it would not interfere with the companies’ judgments.29 The evidence that the defense presented raised enough of a question that reasonable minds could differ. Moreover, the court recognized not only that the benefits of the venture were speculative, but that market conditions were unknown as well. In effect, given risks of the transaction, restraints that attempt to hedge risk by taking these unknowns into account were found to be reasonable.

**Integrative efficiency:** The court recognized that the non-compete was necessary to preserve the goodwill Perceptron purchased from Diffracto. Perceptron had already made investments in Diffracto’s new laser beam technology (which itself is presumptively pro-competitive) but it needed to also secure Diffracto’s goodwill as well to maximize its chances to succeed. If closely related products from the affiliates of a seller were permitted to challenge Perceptron in the marketplace before it had a chance to establish its own good footing with

25 *Perceptron*, 221 F.3d at 919-20.
26 *Id.* at 919-20.
27 *Id.* at 920.
28 *Id.*
29 *Id.*
customers, competition could be diminished, not enhanced.

C. **Polk Bros., Inc. v. Forest City Enters., Inc.**

Agreements not to compete also commonly arise where ongoing competitor collaboration is anticipated. In *Polk Bros.*, an appliance dealer, Polk Bros., and a building material dealer, Forest City, agreed to a joint venture whereby they sold their distinct but complimentary products out of adjacent stores at the same site. As part of the joint venture, each party agreed not to sell any products sold by the other. When Forest City changed management, the company requested that it be relieved from the covenant so it could sell appliances. Polk Bros. refused and Forest City responded that it considered the non-compete covenant invalid. Forest City argued, and the District Court agreed, that the covenant was a per se violation of antitrust law.30

The Seventh Circuit Court of Appeals reversed. In upholding the covenant not to compete, the court emphasized the important role that the covenant played in inducing cooperation between the parties because neither would have agreed to pursue the joint venture without the covenant. The court pointed out that cooperation, just like competition, can contribute to productivity and efficiency under the right circumstances.31 In this case, the joint venture permitted each of the companies to increase their output by opening a new facility and enticing consumers with the convenience of purchasing complementary products in one location. If the covenant was not in place, the possibility of investing in promotional activity only to lose a customer to a neighbor store would have prevented the agreement from happening at all, to consumers’ detriment.32 For example, a party to the agreement would not be willing to spend a significant amount of money to attract customers to buy an appliance if it was possible that the other party could lure them away at the last minute with a cheaper price.33 The venture required a restraint to make the business opportunity viable and thus the non-compete was ancillary to that pursuit.

**Integrative efficiency:** Because of the opportunity to “free-ride” on the advertisement costs and other efforts of the other party, the parties would not have

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30 *Polk Bros.*, 776 F.2d at 187.
31 *Id.* at 188.
32 *Id.* at 188-89.
33 *Id.* at 190.
considered the project viable from a business standpoint unless the covenant not to compete was in place. The court permitted the restraint to exist, thereby preserving the venture, the companies’ expanded output and each of the parties’ incentives to continue promoting and developing their suite of products.

D. Major League Baseball Props., Inc. v. Salvino, Inc.34

The sports realm offers plaintiffs an abundance of opportunities to challenge restraints in the context of a joint venture. In this case, a sports collectible manufacturer challenged the activities of Major League Baseball Properties (“MLBP”) alleging that their exclusive agreement to license the intellectual property (“IP”) of each club violated Sections 1 and 2 of the Sherman Act as well as Section 7 of the Clayton Act. The majority opinion reviewed the case under a rule of reason analysis and, finding that the plaintiff offered no evidence of an anticompetitive effect, affirmed the district court’s opinion in favor of the defendants. Supreme Court Justice Sonia Maria Sotomayor, at the time a judge on the Second Circuit, agreed with the outcome of the majority but wrote a concurrence because she believed, in contrast to the majority, that indeed there was evidence of a potential anticompetitive effect and that an ancillary restraints analysis was more appropriate.

MLBP is a wholly owned subsidiary of Major League Baseball Enterprises, Inc. (“MLBE”) and serves as the exclusive agent for licensing of all IP that belongs to the Major League Baseball (“MLB”) clubs. Prior to MLBP’s formation in 1966, each club handled its own licensing. The decentralized nature of the licensing process foreclosed baseball from certain marketing programs, including that of the Coca-Cola Company, because the programs found the prospect of licensing with each individual club to be “too cumbersome.”35 MLBE’s incorporation of MLBP allowed the sport to start taking advantage of these marketing opportunities.36

Salvino, a corporation that produced and sold sports collectibles, marketed bean filled teddy-bears called “Bammers” with the Arizona Diamondbacks logo on them. While Salvino

35 Id. at 297.
36 Id. at 297. See also Am. Needle Inc. v. NFL 538 F.3d 736, 737 (7th Cir. Ill. 2008) (formation of similar entity, National Football League (“NFL”) Properties, to act as sole licensing agent for NFL teams and to promote the league as a whole).
had a license to produce these Bammers for other clubs, the company did not have a license from MLBP to represent the Arizona Diamondbacks on its products. Upon learning of the transgression, MLBP sent a cease and desist letter to the company. Salvino responded with a suit alleging that MLBP’s restraints were anticompetitive and that they amounted to “naked horizontal price and output restrictions [that] traditionally [fell] within the per se proscriptions.”

Salvino explained that the presence of a single licensing body removed the incentive of teams to compete with each other and it resulted in lower investment in promotional activity and a negative impact on output and product quality. Moreover Salvino alleged that widespread control over every club’s IP led to higher prices and reduced market efficiency.

Sotomayor in her concurrence recognized Salvino’s argument that the license agreement effectively eliminated the possibility of price competition between ball clubs, which she described as the “essence of price fixing.” Justice Sotomayor was quick, however, to identify efficiencies in the licensing arrangements with MLBP that MLB clubs could not have achieved on their own, and applied ancillary restraint doctrine principles.

First, Justice Sotomayor credited MLBP’s argument that their agreement allowed the clubs to achieve lower transaction costs for licensing and lower costs for monitoring and enforcement, which enabled them to compete more effectively. Second, as a response to Salvino’s contention that the license agreement was not necessary because clubs could achieve the same efficiencies by simply retaining an option to choose MLBP or license on their own, Sotomayor identified the risk of free riding. In this case, the exclusivity provisions were necessary to the claimed efficiencies of the joint venture because they removed any incentives that could benefit one club to the detriment of another or to the detriment of the league as a whole. For example, if a club and the MLBP each signed a license agreement with separate competing vendors and only one of the entities invested in the promotion of that product, then the other party would benefit without any extra expenditure. Or if a club performed better during

37 Major League Baseball Props., 542 F.3d at 309.
38 Id. at 294-95.
39 Id. at 355 (citing United States v. Container Corp. of Am., 393 U.S. 333, 337 (1969)).
40 Id. at 338.
41 Id. at 337.
the season, it could gain more from its merchandise than competitors because of its popularity, despite its success coming from all of the clubs’ involvement in the league. This, in turn, could decrease the incentive of any club to invest in promotional and development efforts. Eliminating this possibility was enough to justify the exclusivity restraint as ancillary to the venture.\textsuperscript{42} Thus Sotomayor shed light on the ability of a restraint to not only enable pro-competitive effects, but also prohibit marketplace conduct that would discourage these potential efficiencies.

The opinion did not dismiss the possibility that per se violations could arise in joint ventures however. Per se review \textit{may} still be appropriate if (i) the venture is a sham with no reasonable benefit to society or (ii) the particular restraint is not reasonably necessary \textit{and acts} only as a naked restraint against competition.\textsuperscript{43} (emphasis added).

\textbf{Integrative efficiency:} Sotomayor realized the exclusive license agreement protected the clubs’ ability to market themselves without fear of competing teams benefitting from their expenditures. If each club and the MLBP could license directly, net promotional investment would likely fall because of free-riding risks. Since there is currently no method to ensure that each team’s investment will benefit that team alone, only the presence of a centralized licensing body provides clubs with the security to continue spending on development. This enables merchandise to reach the widest population possible and motivates continued marketing innovation, thereby benefiting consumers.

E. \textit{Schering-Plough Corp. v. FTC}

In \textit{Schering-Plough}, the FTC alleged that a drug manufacturer and two generic companies violated Section 1 of the Sherman Act and Section 5 of the FTC Act by settling patent infringement suits and delaying potential generic market entry. The court held that it would analyze the restrictions under a rule of reason standard because there was a reasonable possibility that the settlement agreements could be pro-competitive.

\textit{Schering-Plough} (“Schering”), a major pharmaceutical manufacturer sued a generic competitor, Upsher-Smith Labs (“Upsher”), for patent infringement relating to Schering’s product K-Dur 20, a supplement for the treatment of high blood pressure and congestive heart disease. Upsher-Smith had sought FDA approval for their generic version of the K-Dur product.

\footnotesize{\textsuperscript{42} Id. at 340.}

\footnotesize{\textsuperscript{43} Id. at 338.}
Both parties entered settlement discussions and agreed on the generic’s entry date as well as a separate deal where Schering would license some of Upsher’s products. Two years later, Schering entered into a settlement agreement with another manufacturer, ESI Lederle, Inc. (“ESI”), who also intended to produce a generic version of K Dur 20. In this case, the parties agreed that ESI would forgo its patent suit and enter the market at an agreed upon time, later than when ESI would have come in if it had won the suit, but earlier than the patent expiration date.\(^{44}\) The FTC filed an administrative complaint a few years after these settlements alleging that Schering and the generic companies had entered into illegal agreements in violation of Section 1 of the Sherman Act and Section 5 of the FTC Act.\(^{45}\)

The court in *Schering-Plough*, like the court in *In Re ATM*, held the *per se* rule should only apply to restraints lacking “…any redeeming virtue.”\(^{46}\) Settlements in patent infringements suits, according to the court, did not fall into this category. Among the potential “redeeming virtues” of these agreements were the savings that the parties could realize by avoiding litigation\(^{47}\) and the incentive for companies to continue challenging patents. The court explained that prohibiting these settlements would lower the likelihood of legitimate patent challenges, to the detriment of the public.\(^{48}\) Companies with legitimate claims would be reluctant to deal with the high litigation costs and risks involved with pursuing such claims.

The opinion went on to support a manufacturer’s decision to enter into one of these settlement agreements because of the uncertainty involved. It was “uncontested” that parties had the right to settle a case based on their perception of risk involved with engaging and losing in litigation.\(^{49}\) The court emphasized that generic companies had a lot of leverage because the litigation costs paled in comparison to what they could gain in sales and profits should they enter

\(^{44}\) *Schering-Plough Corp. v. FTC*, 402 F.3d 1056, 1058-61 (11th Cir. 2005).

\(^{45}\) *Id.* at 1061.

\(^{46}\) *Id.* at 1064 (citing *Continental T.V. Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 50 (1977)).

\(^{47}\) *Id.* at 1073 (citing *Aro Corp. v. Allied Witan Co.*, 531 F.2d 1368, 1372 (6th Cir. 1976)).

\(^{48}\) *Id.* at 1075.

\(^{49}\) *Id.* at 1073
It was reasonable for patent-holders to take this leverage into account when deciding whether they wanted to settle or not.

**Integrative Efficiency:** The court observed that patent settlements on generic entry help prevent (i) the “litany of costs” associated with litigation, as well as (ii) the diminished product innovation that would result if companies no longer felt the research and development was worth the risk. Without these settlements, manufacturers and generic companies alike might not have the same incentive to innovate because the prospect of expensive and lengthy litigation could make their efforts worthless. In addition, protecting Schering’s license of Upsher’s products enabled a new marketplace entrant and thus the prospect of greater competition.

IV. **PRACTICAL OBSERVATIONS ON IMPLEMENTATION OF THE ARD**

There really cannot be much debate that the new Section 45 makes cartel enforcement easier. The removal of the undue lessening of competition requirement and implementation of a *per se* rule for what is clearly intended to reach hard core cartel conduct reduces the prosecution’s burden and thus should allow for more effective enforcement. The Bureau has made clear through its Guidelines that it intends to use Section 45 in much the same way that the U.S. Department of Justice does today in the exercise of its prosecutorial discretion. It is evident that the Bureau will reserve criminal action for hard core price fixing, market allocation or output setting agreements that stand alone or are “naked” insofar as they are not ancillary to a legitimate broader agreement and reasonably necessary for effectuating the broader agreement. Beyond that, we are hardly qualified to predict how Section 45 and the ARD will play out in practice. Based on the U.S. experience with the ancillary restraints doctrine, however, we offer the following observations:

1. **As in the U.S., don’t be surprised if the ARD gets litigated more in civil rather than criminal antitrust cases.**

As reflected in the above sampling of cases, the ancillary restraints doctrine is primarily litigated in civil rather than criminal settings in the U.S. There are several reasons the ARD typically is raised in defense to civil challenges. First, as mentioned at the start of this
article, civil challenges of agreements between horizontal competitors in the U.S. can invoke a per se standard. Second, the enforcement practice and tradition of the U.S. Department of Justice is well known and understood to limit criminal enforcement to naked, hard core cartel agreements (i.e., bid rigging, market allocation, and price fixing). Third, the U.S. offers prospective plaintiffs tremendous incentives to challenge agreements between competitors as per se violations. Treble damages, joint and several liability, and attorneys fees are the handsome rewards offered for victory, and like any profit-maximizing enterprise plaintiffs in the U.S., plaintiffs in these cases fight hard to invoke the per se standard and avoid having to establish a net anticompetitive effect in an expensive rule of reason contest.

It appears plausible that most of these conditions attach to Canada now as well. First, and perhaps most importantly, while Section 45 on its face adopts a per se standard for criminal enforcement purposes, it would also permit a per se standard for civil enforcement purposes as well. Section 36 of the Act provides that “Any person who has suffered loss or damage as a result of (a) conduct that is contrary to any provision of Part VI . . . may, in any court of competent jurisdiction, sue for and recover from the person who engaged in the conduct . . . an amount equal to the loss or damage proved to have been suffered by him, together with any additional amount that the court may allow not exceeding the full cost to him of any investigation in connection with the matter and of proceedings under this section.” Section 45 is part of Part VI so violations of it qualify for purposes of civil damage actions authorized by Section 36, regardless of whether the Bureau determined to act against the conduct under Section 45. Second, the Bureau’s criminal enforcement intentions reflected in the Guidelines and its criminal referral practices to date seem closely in line with that of the U.S. Department of Justice.\footnote{See infra n. 2} Finally, the prospect of single damages and costs may be more than a sufficient incentive for plaintiffs to sue, particularly in collective actions by direct customers.

Further, for reasons discussed below, the ARD, at least as drafted in the Act, is considerably stronger and more attractive than in the United States, increasing the odds that the Bureau will be less inclined to refer cases to the DPP that have a plausible ARD. That further reduces the likelihood that the ARD will be tested in a criminal setting more often than it is in a

\footnote{See infra n. 2}
civil setting. This is not a bad thing of course. U.S. courts have developed a strong body of jurisprudence in this area; arguably stronger than other areas of antitrust law.

2. **Does the lack of an integrative efficiencies threshold make ARD more liberal?**

As reflected above, U.S. courts routinely require integrative efficiencies to justify rule of reason treatment for ancillary restraints that would otherwise be considered *per se* illegal. Not surprisingly that threshold is adopted by the U.S. Department of Justice and the U.S. Federal Trade Commission in their competitor collaboration guidelines:

> “If, however, participants in an efficiency-enhancing integration of economic activity enter into an agreement that is reasonably related to the integration and reasonably necessary to achieve its precompetitive benefits, the Agencies analyze the agreement under the rule of reason, even if it a type that would otherwise be considered per se illegal.”

The absence of this threshold in Section 45(4) arguably makes the ARD considerably more liberal than in the United States. Potential or actual defendants will naturally seek to capitalize on this breadth. What will a court do when agreements to restrict output between competitors are (at least allegedly) justified as ancillary to a broader private effort to address industry environmental or safety concerns, for example? Courts would appear to get no guidance from the Act on the legitimacy of the broader agreement other than the narrow requirement that the broader agreement not itself violate Section 45. To the extent that this increases risk to the Bureau in situations that it otherwise would refer a case to the DPP, then there is a possibility of chilling otherwise desirable enforcement. For reasons discussed above, the greater risk, however, is that all this gets sorted out in the context of civil damage actions that present nowhere near as strong a case for *per se* treatment as hard core cartel conduct and courts facing a more liberal standard fail to take up a reasoned approach to ARD based on economics.

3. Relatedly, will the lack of an integrative efficiencies threshold make ancillary restraints analysis in judicial decisions less robust?

The statute arguably makes this a risk, but, at the end of the day, we would venture a guess that the answer is no. An integrative efficiencies threshold is simply too compelling to not find its place in Canadian court decisions. As the Bureau readily acknowledges in the preface to its Guidelines, competitor collaborations can “permit firms to combine capabilities and resources so as to lower the costs of production, enhance product quality, and reduce the time required to bring new products to market. Such pro-competitive collaborations, even when they involve competitors, can often benefit Canadians by allowing firms to make more efficient use of resources and accelerate the pace of innovation.” Requiring a showing of a broader agreement’s integrative efficiencies is completely in line with this acknowledgement and provides a powerful buttress for an ARD. As reflected above it has become an important guidepost to courts, counselors and clients alike in the U.S. Moreover it complements economics-based tests of competitive effects. From a counseling standpoint, it is the first thing we look for in assessing a competitor collaboration – what is its purpose and what restraints are necessary to accomplish it. If there are no cognizable integrative efficiencies, the risk meter goes way up; on the other hand, if they exist and are compelling, the field of options becomes larger and more exciting as counselors focus on more complex issues of business viability, necessity, and scope. The odds are strong courts considering the ARD will likewise focus on integrative efficiencies fairly quickly and use it as an anchor in assessing ancillary restraints, either out of convenience or simply logical necessity.