The Section of Antitrust Law of the American Bar Association\(^1\) believes that a single purchaser should be able to terminate one supplier in favor of another without facing potential *per se* liability under the antitrust laws. In *Discon v. NYNEX*,\(^2\) the Second Circuit adopted a rule that could subject a purchaser’s decision to replace one supplier with another to scrutiny as a “two-firm group boycott” that might be considered illegal *per se*. Such a rule exposes businesses to litigation risk over normal, procompetitive business decisions, confuses clear and well established precedent, and may discourage purchasers from finding better suppliers while encouraging incumbent suppliers to become complacent.

*Discon* sued NYNEX for violations of Sections 1 and 2 of the Sherman Act\(^3\) and other statutes.\(^4\) *Discon* alleged that, as part of a scheme to evade regulation, NYNEX had conspired with AT&T Technologies to terminate *Discon* as NYNEX’s supplier of removal services, *i.e.*, the salvaging of obsolete telephone central office equipment, and replace it with AT&T Technologies. *Discon* alleged, among other things, “that the intent and effect of choosing AT&T Technologies over *Discon* was entirely anti-competitive.”\(^5\) The District Court dismissed the complaint for failure to state a claim.

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\(^1\)These views are presented on behalf of the Section of Antitrust Law of the American Bar Association. They have not been approved by the Board of Governors or House of Delegates of the American Bar Association and, accordingly, should not be construed as representing the position of the Association.


\(^4\)*Discon*, 93 F.3d at 1060. The Second Circuit’s opinion summarizes the factual and procedural background; the opinion of the District Court is unreported.

\(^5\)*Discon*, 93 F.3d at 1061.
Plaintiff appealed and the Second Circuit reversed. The appellate court noted that a vertical agreement, such as the one between NYNEX and AT&T Technologies, “may be characterized as a horizontal restraint of trade if the agreement seeks to disadvantage the direct competitor (e.g., Discon) of one of the conspiring firms.” Applying the Supreme Court’s decision in *Klor’s Inc. v. Broadway-Hale Stores, Inc.* to “two-firm group boycotts,” the Second Circuit held that “Discon has alleged a cause of action under, at least, the rule of reason, and possibly under the *per se* rule applied to group boycotts in *Klor’s*, if the restraint of trade has no purpose except stifling competition.”

The Supreme Court granted NYNEX’s petition for writ of certiorari. Without expressing an opinion with respect to the propriety of the result in the Second Circuit’s opinion or to the ultimate outcome of the case, the Section of Antitrust Law is publishing this statement to present its views on the dangers of allowing the rule announced by the Second Circuit to stand: the conduct that Discon alleged, *i.e.*, NYNEX’s agreement with AT&T Technologies to terminate Discon in favor of AT&T Technologies, should not be actionable as a two-firm vertical boycott under *Klor’s*, nor judged *per se* unlawful.

I.

The Second Circuit’s first error was applying *Klor’s*, a case involving a horizontal group boycott, to the vertical arrangement alleged here. Antitrust jurisprudence draws an important distinction between horizontal and vertical agreements restraining trade.

Although “[t]here may be occasional problems in differentiating vertical restrictions from horizontal restrictions,” “[f] restrictions imposed by agreement between competitors have

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Discon*, 93 F.3d at 1061 (internal quotation marks and citations omitted).


traditionally been denominated as horizontal restraints, and those imposed by agreement between firms at different levels of distribution as vertical restraints."¹¹ The distinction is important because horizontal restraints “are more likely than vertical agreements to be viewed as per se unlawful.”¹²

In *Klor’s*, the Supreme Court considered whether it was appropriate for the trial court to have dismissed a complaint in which a retailer (Klor’s) alleged that a competitor (Broadway-Hale) and at least 10 of its suppliers had conspired to refuse to deal with the plaintiff retailer.¹³ The Court labeled the activity alleged a group boycott or concerted refusal to deal and deemed it per se illegal.¹⁴ The Court noted that the case was not one “of a single trader refusing to deal with another, nor even of a manufacturer and a dealer agreeing to an exclusive distributorship.”¹⁵ Not only does the reasoning in *Klor’s* depend on the horizontal nature of the agreement among the plaintiff’s many former suppliers, the clear language of the opinion excludes from the rule in *Klor’s* antitrust claims that allege a single firm refused to deal with the plaintiff or that an exclusive distributorship injured a plaintiff.¹⁶

The Second Circuit mistakenly applied *Klor’s* to Discon’s allegations by characterizing the conduct as a vertical agreement with a horizontal effect.¹⁷ Thus, that


¹³*Klor’s*, 359 U.S. at 209–10 & n.2.

¹⁴*Klor’s*, 359 U.S. at 210 (the alleged boycott was not an agreement “whose validity depended on the surrounding circumstances” but was one whose “nature or character” was so “unduly restrictive” that “it was not for the courts to decide whether in an individual case injury had actually occurred”).

¹⁵*Klor’s*, 359 U.S. at 211 (footnote omitted).

¹⁶See, e.g., Products Liability Ins. Agency, Inc. v. Crum & Forster Ins. Cos., 682 F.2d 660, 685 (7th Cir. 1982) (distinguishing *Klor’s* from a case involving only a vertical agreement).

¹⁷*Discon*, 93 F.3d at 1060–61.
court concluded, Discon had stated a cause of action under Section 1 of the Sherman Act because the alleged purpose of the exclusive deal between NYNEX and AT&T Technologies was to disadvantage and discriminate against Discon, a competitor of AT&T Technologies. But this application of Klor’s blurs the important distinction between horizontal and vertical restraints because virtually every vertical agreement has such an effect. In cases from Colgate to Business Electronics, the Supreme Court has considered vertical arrangements to be vertical even though, as the Court described the facts in those cases, the arrangements may have had horizontal effects. Characterizing a vertical agreement as horizontal because it has horizontal effects, therefore, contradicts at least eighty years of antitrust jurisprudence and deprives courts and businesses of a clear rule that has long assisted the adjudication of antitrust cases and the determination of what conduct runs afoul of the antitrust laws.

The Second Circuit was also incorrect to describe NYNEX’s conduct as a boycott. Even if terminating one supplier in favor of another were characterized as concerted action, courts have recognized that, as Professor Areeda put it, “not everything that can be called a concerted refusal to deal is in fact illegal.” What makes boycotts subject to the antitrust laws is collective action by competitors: “the core reason for intense antitrust concern about ‘boycotts’ is the aggregation of the power of several competitors — a reason that does not apply to distribution restraints involving a single

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20Colgate, 250 U.S. at 306–07 (retailer who refused to abide by manufacturer’s condition would incur the displeasure of the manufacturer while retailers who agreed to the condition would presumably be favored); Business Elecs., 485 U.S. at 721 (manufacturer terminated discounting dealer at request of other dealer).

manufacturer’s product.”22 Because the only actors involved here are a competing seller and its customer, the customer’s decision to buy from the competing supplier does not boycott the former supplier. Inappropriate labels should not be allowed to lead to inappropriate answers.23 Klor’s is properly limited to horizontal group boycotts and simply should not apply to Discon’s complaint.

II.

Even if Discon has stated a claim for relief under the Second Circuit’s two-firm boycott theory, the alleged conduct should not be analyzed as a per se violation of the Sherman Act. The Second Circuit muddied the distinction between per se analysis and analysis under the rule of reason when it suggested that if the restraint were found to have no purpose but stifling competition it would be deemed per se illegal. Agreements either are so unduly restrictive because of their nature and character that courts need not inquire whether competitive injury actually occurred (per se analysis),24 or they are not. If not, a court must decide whether the conduct is unreasonable by weighing its procompetitive benefits against its anticompetitive effects (rule of reason analysis). A restraint may be found unlawful under the rule of reason, but that does not make the restraint per se illegal.

There is no basis for the suggestion by the Second Circuit that this alleged arrangement falls in the category of per se illegal agreements. A vertical arrangement that does not set minimum price or price levels cannot be found per se unlawful under Business Electronics and Khan,25 among others. This is because, since at least


24 See, e.g., Klor’s, 359 U.S. at 211.

Continental T.V., the Supreme Court has recognized that non-price vertical restraints can have procompetitive effects. As the Court has recognized, for example, vertical restraints may promote interbrand competition by ensuring that retailers provide the level of service and promotional activities that a distributor deems necessary to market a product successfully while limiting other retailers’ free-riding on the investment of full-service retailers. Vertical restraints may also help enforce safety standards. Even a vertical agreement on price is not illegal *per se* if it involves agreement on only maximum (as opposed to minimum) resale prices.

In *Discon*, the alleged conduct did not involve fixing prices but selecting suppliers. The Second Circuit’s conclusion that such conduct could give rise to a *per se* violation of the Sherman Act is inconsistent with recent decisions of the Supreme Court. Beyond sowing confusion in the law, this expansion of the *per se* rule will encourage litigation by terminated suppliers who claim their rivals conspired with buyers, and deny defendants the ability to defend their actions by demonstrating the procompetitive benefits of their actions.

Regardless of the resolution of the defendants' motion to dismiss or the ultimate outcome of the case, the Section of Antitrust Law believes that the rationale for the Second Circuit’s conclusion in *Discon* should not stand. The Supreme Court should reject the reasoning of the Second Circuit as inconsistent with well established precedent and should confirm that vertical agreements, even exclusive agreements between

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28 *Continental T.V.*, 433 U.S. at 55 n.23.

29 *Khan*, 118 S. Ct. 275.

30 *Discon.*, 93 F.3d at 1060 n.5.
customers and suppliers, should be judged under the rule of reason and not as group boycotts subject to per se liability under a Klor’s analysis.