Harmful Remedies: Optimal Reformation of Anti-Competitive Contracts

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ABSTRACT

Current law and economics literature identifies two main types of errors courts can make in applying antitrust law. Courts may erroneously label conduct as anticompetitive even though competition is not harmed. Alternatively, courts may fail to identify, and thus fail to attack, anticompetitive conduct. This Article focuses on a third possible error—where a court correctly identifies anticompetitive conduct, but its mode of interference, i.e., its prescribed remedy, harms competition. It analyzes this error in the context of anticompetitive contract reformation. Such error occurs, for example, where a court has chosen one reformation option that is less efficient and effective than an alternative reformation option. Accordingly, this Article identifies a set of clear and coherent principles for contract reformation in order to eliminate, or at least reduce, the occurrence of the third type of error. The analysis moves beyond the prevailing wisdom that contract reformation should simply sever the anticompetitive parts of a contract if doing so does not alter the nature of the contract, and suggests instead that in most cases courts should invalidate the contractual relationship in its entirety.

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INTRODUCTION

Current law and economics literature identifies two main types of errors that courts sometimes make in applying antitrust law. Courts may erroneously label conduct as anticompetitive and consequently enjoin what is actually procompetitive conduct ("false-negative errors"). Alternatively, courts may fail to identify anticompetitive conduct and thus fail to attack it ("false-positive errors"). This Article focuses on a third possible error where a court correctly identifies anticompetitive conduct, but its mode of interference—its prescribed remedy—harms competition. The Article then analyzes such error in the context of anticompetitive contract reformation in civil suits.

Contract reformation arises when an antitrust court deals with an anticompetitive contract that has not reached its term at the time of the decision. In such cases, a court is faced with several options in fashioning its remedies.\(^1\) It can invalidate, or in extreme cases, vitiate, the contract in its entirety. Alternatively, it can partially invalidate the contract by severing the objectionable provisions. It may also impose on the parties contractual obligations that were not included in the original contract or mandate restitution of part performances. These options may broadly be termed "contract reformation." In extreme cases courts can use more drastic measures such as divestiture.\(^2\) The choice of relief—given its possible economic effects on market participants and market conditions—is highly significant to achieving the goals of antitrust law.

The reformation of anticompetitive contracts in the antitrust context is largely unexplored. There is no serious debate with regard to the optimal contract reformation regime courts should adopt.\(^3\) Yet the contract reformation remedy plays an important role in antitrust decisions. To illustrate, recent allegations of anticompetitive conduct against the Microsoft corporation have brought to the forefront issues regarding anticompetitive contracts.\(^4\) Some of the allegations against Microsoft, which also served as a basis for the 1995 suit filed against the company,\(^5\) involve exclusionary contracts signed by Microsoft and some of its

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\(^1\) These options stem from two basic assumptions that are elaborated below. Namely, (1) the court is empowered by law to grant a civil remedy interfering with the contractual relationship; and (2) the main remedial goal is to restore competition in the market.

\(^2\) In such cases the court may divest some or all of the parties to the contract of certain assets if such measures are necessary in order to restore competition in the market.

\(^3\) In fact, no academic studies on the subject are known to the author.


customers and developers. Contract reformation was one of the remedies prescribed by the United States District Court for the District of Columbia. Contract reformation issues also arose in the recent antitrust inquiries of Intel, which involved allegations of exclusionary contracts. Nonetheless, contract reformation is limited to cases in which the parties have contracted to achieve an anticompetitive end and where the law empowers the court to grant remedies that interfere with the parties' contractual arrangements.

One main problem with contract reformation is the potential unbalancing of the market equilibrium that enables competition to take place. A contract is an economic tool that presumably balances the economic interests of the contracting parties (at least at the time of contract formation). By invalidating only particular contractual provisions, or by adding provisions to the contract that were not agreed upon by the parties, the court may create an internal imbalance in the contract in favor of one or more of the contracting parties. This remedy might go beyond eradicating the consequences of the anticompetitive contract. Apart from the fact that such reformation creates a benefit to one contracting party over another for which the parties did not contract, it may significantly affect a competitor to the point of exiting the market. This, in turn, may have significant anticompetitive effects on the market, contravening the underlying purpose of antitrust law. This may be the outcome, for example, where a small number of competitors operate in a market characterized by high barriers to entry and one competitor is significantly disadvantaged as a result of the judicial reformation of its anticompetitive contract. The competitor may then be compelled to exit the market, thereby creating, at least for the short-run (and possibly for a longer period), a highly concentrated market structure prone to monopolistic or oligopolistic exploitation. Thus, in the antitrust law setting, where the ultimate goal is to promote competition in the market, there is a need for increased caution in fashioning contract reformation remedies. It is important for courts to adopt remedies that reduce the likelihood of outcomes that are

7 While this Article mainly deals with contracts that serve as a tool for achieving an anticompetitive goal, it also explores the application of the proposed analysis to anticompetitive contracts in which the anticompetitive terms are a manifestation of prior anticompetitive conduct of one or more of the contracting parties. See discussion infra Part I.A.
8 For an analysis of the conditions necessary for such an outcome, see infra Part II.C.1.a.
counterproductive to competition.

Fashioning an effective and efficient contract reformation remedy, however, can be a formidable task. Reformation rules that are effective in restoring the internal balance of the contract suffer from several drawbacks, including the reduction of deterrence and detection effects. Other reformation rules do not successfully restore competition in the market in all cases. This Article provides a theory of how efficiency-minded courts and legislatures should fashion contract reformation remedies. The analysis moves beyond the received wisdom that contract reformation should simply sever the anticompetitive parts of a contract when doing so does not alter the nature of the contract. It suggests that courts should generally invalidate anticompetitive contracts in their entirety. In rare cases, however, where the contract is severely thrown off balance and such an imbalance is likely to impede the restoration of competition in the market, courts should also mandate restitution of part performances. Courts should also adopt such a remedy where indeterminate legal standards are clarified by case law for the first time.

Part I of this Article introduces contract reformation through its scope of application. Part II analyzes alternative reformation rules that may be applied in cases involving anticompetitive contracts. Part III proposes a set of principles and considerations that should guide courts in exercising their reformation powers.

I. INTRODUCING CONTRACT REFORMATION

A. The Factual Scenario

When market participants contract to engage in anticompetitive conduct, their contract conflicts with public policy as reflected in antitrust law, which is designed to promote the freedom of trade and the prevention of monopolistic control.

Anticompetitive contracts can be divided into two groups. In the first group, the contract provisions themselves serve as the tool for achieving an anticompetitive goal ("tool contracts"). Tool contracts have a negative externality effect on the market. For example, exclusive contracts between producers and monopolistic input sellers may be used as a strategic mechanism to deter entry into the market by competitors and to enhance monopoly power. When parties sign such a contract, they can jointly determine the

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9 See infra Part II.C.2.a.
10 See infra Part I.
11 See infra Part II.
fee an entrant producer must pay in order to trade with the seller by including a contractual damages clause.\textsuperscript{12} The entrant must either wait until the contract expires, or induce the seller to breach its contract with the incumbent producer and pay the liquidated damages. The net economic consequences of such a contract might be reduced output, diminished return to innovation and new entry, and enhanced profits for the monopolist.\textsuperscript{13} In such a contract, the principle that private orderings maximize total welfare does not apply. Accordingly, the law limits the freedom to enter into such contracts.

Several scenarios may lead to the signing of an anticompetitive tool contract. In the first scenario, all contracting parties share a common incentive to engage in anticompetitive behavior at the time the contract is signed. This may be the case, for example, where potential competitors agree to collude in order to raise market prices,\textsuperscript{14} or where all parties to the contract share incentives to exclude potential or existing participants from the market.

In the second scenario, only some parties have prior incentives to engage in anticompetitive conduct. The other parties to the contract agree to take part in such conduct either because they are compensated for their willingness to participate in the anticompetitive act,\textsuperscript{15} or due to a collective action problem.\textsuperscript{16} The incentives of the contracting parties may, of course, change during the contract term, due to changes in market

\textsuperscript{12} See generally Philippe Aghion & Patrick Bolton, \textit{Contracts as a Barrier to Entry}, 77 \textit{AM. ECON. REV.} 388 (1987). The Aghion-Bolton model, however, makes no allowance for the fact that under contract law a liquidated damages clause is enforceable only if it is reasonable, inter alia, in the light of the anticipated or actual harm caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large damages is void as a penalty. Thus, the applications of this model are limited in any jurisdiction that limits liquidated damages. See Oliver E. Williamson, \textit{Delimiting Antitrust}, 76 GEO. L.J. 271, 283 (1987).


\textsuperscript{14} The most interesting cases arise when the parties agree to divide their profits from the collusive agreement amongst themselves. See, e.g., United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898) (dealing with manufacturers and vendors of cast-iron pipe entering into a collusive agreement to fix prices of cast-iron pipes throughout a number of states), aff'd, 175 U.S. 211 (1899). Defendants, who sold pipes in areas assigned to them by the association, paid a fixed "bonus" to the association that was divided amongst association members. See id.

\textsuperscript{15} The incentives of such parties to engage in anticompetitive contracting arise from the benefits they are offered by the other contracting party, rather than by the anticompetitive external effects of the contract on third parties.

conditions. For instance, consider the case where a supplier and a distributor have signed an exclusive dealing agreement, which was mutually beneficial at the time the contract was signed. During the contract term, however, a third party offered to pay the supplier a high price for carrying its products, such that it is in the supplier's interest to contract with both distributors. The supplier will have a strong interest in the invalidation by a court of either the entire existing contract or, even better, only the exclusive dealing provisions of the existing contract while validating the remaining provisions, including the consideration provision. If the initial distributor does not pay the consideration stipulated in the contract, he will be in breach of contract. As will be elaborated below, it is easy to imagine how market participants might manipulate antitrust law to void clauses that would no longer be favorable to them were such relief to be granted.\textsuperscript{17}

In the second group of anticompetitive contracts one party is forced to accept the conditions\textsuperscript{18} set by another party as a result of its prior anticompetitive conduct ("fruit contracts").\textsuperscript{19} In other words, some contracting parties have a stronger bargaining position and thus can demand the inclusion of anticompetitive provisions in the contract. In fruit contracts, all or some of the contractual terms are in themselves manifestations of the anticompetitive conduct or result from prior anticompetitive conduct. While this Article deals mainly with tool contracts, the possible application of the theory to fruit contracts is also analyzed.\textsuperscript{20}

For purposes of the analysis it is assumed that the contract has not yet reached its term and that all or some of the parties have acted in reliance on the contract's provisions. It is also assumed that the contract was found to be anticompetitive in a government-initiated civil suit. For illustrative purposes, the following example shall be used: Two parties, a monopolistic supplier (S) and a dealer (D), have signed a long-term anticompetitive contract under which S has agreed to sell its widgets for ten years only to D, provided that D pay S an excessive price (E) for each widget. E is five times the price (P) that D would have been willing to pay if S had not granted D exclusivity. D paid S an advance sum in the amount of E times L (a large number of widgets). The parties did not specify P in the contract. The government brought the parties to court, alleging exclusive dealing, before S had supplied any

\textsuperscript{17} See infra Part II.C.1.a.ii.(b).
\textsuperscript{18} For instance, monopolistic pricing or high fixed prices.
\textsuperscript{19} For instance, price fixing or abuse of monopolistic power.
\textsuperscript{20} See infra Part II.D.
widgets to D. The court held that the contract's exclusivity provisions are anticompetitive. It is now prepared to issue its remedial decree.

B. The Remedial Powers of the Court: Contract Reformation

Contract reformation is one of the general remedial powers of courts dealing with antitrust violations. Contract reformation may be used in government-initiated civil litigation. It is also used in injunctive orders or consent decrees in private suits and even in criminal antitrust proceedings. Reformation remedies include revision of the terms on which defendants buy and sell, and cancellation or modification of outstanding agreements with competitors, suppliers or customers.

U.S. antitrust courts have most commonly remodeled anticompetitive contracts by excising the anticompetitive provision(s) and leaving the remainder intact and enforceable, where such judicial surgery did not alter the nature of the contract. In one of the best known cases, United States v. United Shoe Machinery Corp., the United States District Court for the District of Massachusetts pointed to a number of practices that, in its view, prevented competition with United Shoe on a basis other than superior economic performance. These included ten-year leases, the requirement in the leases that the lessee use the machine to full capacity when work was available, and the provision of repair services without charge. The court ordered United Shoe to eliminate these provisions from its leases. In particular, the lease was shortened, the full capacity clause was eliminated, the discriminatory charges were removed, and United Shoe was required to separate its charges for machines from its charges for repair services.

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23 Areeda and Hovenkamp suggest that when merely forbidding the consummation or continuation of the restraint suffices, the court need not go any further. See 2 PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW—AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION 162 (rev. ed., 1995). In illegal merger or joint venture cases the court typically invalidates the contractual arrangement in its entirety. However, since in merger cases the contractual arrangement, as a whole, is considered to be anticompetitive, such cases also conform to the general rule stated above. The court may, nonetheless, require restitution of part performances among the parties.
25 See id. at 315-19.
26 See id. at 352-53. Additional remedies issued by the court are not relevant to this discussion.
27 See id.; see also Rose v. Vulcan Materials Co., 194 S.E.2d 521 (1973) (holding that a provision that violated state antitrust law did not make entire contract for sale of stone
were left intact, including the consideration provision included in the original contracts.

Contract reformation was also used in the 1995 suit against Microsoft,28 which involved alleged exclusionary contracts between Microsoft and its software developers.29 Under the contracts, programmers who were granted access to prerelease editions of a new version of the Windows operating system could not work for competing firms for a period of three years.30 The case ended in a consent decree.31 The settlement limited the duration of Microsoft's agreements to twelve months and prohibited Microsoft from imposing contractual terms preventing software developers from creating products to run on competing applications. Yet the original consideration provisions were left intact.32 Although Microsoft arguably would not have consented to such a decree had the company believed that it would create a contractual imbalance in favor of its developers thereby bestowing a comparative advantage on its competitors,33 it may also be the case that Microsoft assumed such a decree to be the least harmful option. Microsoft likely accepted the terms of the consent decree only because it feared the possible outcome and detrimental effects of a full-fledged lawsuit.

II. ANALYSIS OF THE REFORMATION REMEDY

This part analyzes contract reformation and presents the basic principles that should guide courts in its application. The effectiveness of a remedy is evaluated against the ends it seeks to achieve. Accordingly, the first section reviews, briefly, the goals of contract reformation. The second section introduces alternative reformation rules that balance such goals, and the third section

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30 See Microsoft, 56 F.3d at 1451.
31 See id. at 1462.
33 Comparative advantages bestowed on competitors might take one of two forms. First, Microsoft must continue its current level of payments to its developers, without receiving the benefits of exclusivity the payments were intended to secure, while its competitors may make payments at a lower level. Second, if Microsoft's contractual arrangements with its suppliers enhanced efficiency (although not necessarily net consumer welfare), Microsoft is prevented from making such arrangements while its rivals may be permitted to do so. This Article is concerned, mainly, with the first type of comparative advantage.
analyzes these rules. The fourth section applies the proposed analysis to fruit contracts.

A. The Goals of Contract Reformation

Two distinct and potentially conflicting bodies of law significantly influence contract reformation. First, contract law provides the legal foundation for the enforcement of the legal parts of the contract. It places high value upon freedom of contract—the notion that private parties should be free to structure mutual agreements with the confidence that the legal system will enforce them, unless they conflict with public policy. The second body of law that influences contract reformation is antitrust law. It adds a set of considerations external to the contractual relationship between the parties and focuses on social welfare-enhancing considerations through the promotion of competition.

Antitrust law considerations focus on the public interest in the maximization of social or consumer welfare through the introduction of competition into the market. This economic goal, however, does not imply only one set of remedies. Rather, this goal can be achieved in different ways. Three main remedial goals can be identified: deterrence, compensation, and restoration of competition. Courts have adopted a prospective restoration path when dealing with anticompetitive contracts. The remedial goal of government-initiated civil actions for equitable relief is never to punish the violator, but simply to restore competition. The remedy must not impose unnecessary restrictions on the defendant, it may not be punitive, and courts may not impose penalties in the guise of preventing future violations. Could it be argued that courts should use punitive or deterrent measures if such measures would deter future violations and affect the willingness of market participants to identify anticompetitive violations and bring them to the attention of the antitrust authorities, thereby restoring competition in the market?

Equitable considerations may also come into play and introduce a third relevant body of law.


See Benjamin S. Sharp, FTC Antitrust Remedies: In the Classic Tradition, 50 Antitrust L.J. 83 (1981).


For analysis of the treble damages remedy, see Part II.E infra.
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all or in other markets. Yet it could be argued that a reformation rule that succeeds in ex ante deterring anticompetitive conduct achieves the restoration goals of antitrust law by preventing companies from distorting competition in the first place.

Contract law places significant value on the freedom of market participants to contract. Accordingly, it strives to give effect to the parties’ intent, as long as the contract does not conflict with public policy. In so doing, it is concerned with the comparative rights and duties of the contracting parties as they are reflected in the contract. Contract law goals may be relevant to contract reformation. First, to the extent possible, the court may try to give effect to the contracting parties’ intent. However, assuming that the parties intended to engage in anticompetitive conduct, the court cannot give effect to the parties’ original intent. Nevertheless, the court may give effect to the legal portions of the contract. Second, the court should strive to restore the internal balance of the contract. The fundamental question is whether the part performances enforced by the court after the contract has been remodelled are roughly equivalent in value to each of the parties when viewed against the background of their expectations. Enforcing the remainder of the contract without ensuring that this condition is met may be unfair where one party has acted and performed, or prepared to perform, in reliance on the contract’s anticompetitive provisions before receiving the return performance. Such a party may suffer loss of the reliance interest, and to the extent the reliance has conferred a benefit on the other party, there may be unjust enrichment.

Where anticompetitive contracts are at issue, however, contract law considerations should take a backseat to antitrust law. The freedom to contract is not an absolute freedom but rather a relative one that should be balanced against competing considerations. Nonetheless, antitrust law, while limiting the freedom of market participants to engage in anticompetitive contracting, promotes goals similar to those promoted by contract law—free trade, liberal values, and economic efficiency. Thus, rather than limiting the freedom of contract, antitrust law actually serves to promote it in the long run. Accordingly, antitrust law should be given primacy over contract law considerations where

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40 Intent is usually an integral part of an antitrust violation. Thus, a finding that the parties have engaged in anticompetitive conduct, includes a finding that they have intended the natural results of their conduct. See infra text accompanying note 71.
41 See E. ALLAN FARNSWORTH, CONTRACTS 358 (2d ed. 1990).
42 See id. at 23.
the two conflict. Contract law considerations nonetheless may be relevant where they do not interfere with antitrust law considerations.

B. Balancing the Considerations: Alternative Reformation Rules

Courts face several options for reformation rules that balance contract law and antitrust law considerations in different manners. First, once a court determines that the contract contains anticompetitive provisions, it may invalidate the contract in its entirety (the "invalidation rule"). Second, a court may exercise "judicial surgery" by invalidating the anticompetitive provisions and validating the remaining provisions where such severance does not alter the nature of the contract. Where severance is impossible, the court invalidates the contract in its entirety (the "severance rule"). In our example, the court strikes out the

43 See United States v. Loew's, Inc., 371 U.S. 38, 51 (1962) ("The thrust of the antitrust laws cannot be avoided merely by claiming that otherwise illegal conduct is compelled by contractual obligations. Were it otherwise, the antitrust laws could be nullified. Contractual obligations cannot thus supersede statutory imperatives.").

44 These options are based on the assumption that the court's intent is not to punish the contracting parties, but to restore competition in the market.

45 Both contract law and the common law of restraint of trade adopt a reformation rule that is similar, in many respects, to the severance rule. Under both disciplines a contract is invalid if it contravenes public policy. However, insofar as it is possible to excise the illegal restraint from the rest of the contract, most courts will take this path, provided that specified conditions are met. First, the contract should be severable in fact. To be enforceable, the promise must be a separate promise on the face of the document, supported by separate consideration, the performance of which is independent of the performance of the anticompetitive promise (the "blue pencil" principle). Second, severance must not alter the nature of the contract. The issue is whether the deletion of the invalid obligation alters entirely the scope and intention of the agreement so that what is left is no longer a reasonable arrangement between the parties or an intelligible economic transaction. See generally CHESHIRE, FIFOOT AND FURMSTON'S LAW OF CONTRACT 434-39 (M.P. Furmston ed., 13th ed. 1996). The Restatement (Second) of Contracts specifies in section 240 two requirements that must be met in order to sever the provisions of a contract. First, it must be possible to apportion the parties' performance into corresponding pairs of part performances. Second, it must be proper to regard the parts of each pair as agreed equivalents. If the agreement offends public policy two additional limitations are imposed by the court. One is that the impropriety must not affect the entire agreement; it must not be an integrated scheme to contravene public policy. The other is that the party seeking enforcement must not have engaged in serious misconduct. See RESTATEMENT (SECOND) OF CONTRACTS § 240 (1981).

In recent years, courts have been more flexible in severing contracts. Where severance operates to eliminate an entire promise, the test focuses on whether it forms the whole or only part of the consideration. If it is substantially the only return given for the promise of the other party, severance is ruled out and the contract fails in toto. If, on the other hand, it goes only to part of the consideration—if it is merely subsidiary to the main purpose of the contract—severance is permissible. Some courts have taken the additional step of reducing the scope of the contract even though the offending language could not be simply "blue penciled" out, yet such changes were minor and technical. See FARNsworth, supra note 41, at 362. n.21.
exclusive dealing clause and leaves the remaining provisions (including the consideration provision stipulating that $D$ should pay $S$ price $E$ for each widget supplied) intact. Third, a court may excise the anticompetitive provisions and restore the internal balance between the contracting parties, unless such balancing interferes with restoring competition. In cases where excising the anticompetitive provisions is not possible, courts invalidate the contract in its entirety, but nonetheless restore the internal balance between the contracting parties (the "rebalancing rule"). Such reformation is external to the contract since it changes the text by taking out the objectionable parts or by adding some other parts. In our example, the court may strike out the exclusivity clause and rewrite the consideration provision so that $D$ will have to pay $S$ price $P$ for each supplied widget. Fourth, a court may invalidate the contract in its entirety and restore the contract's internal balance by mandating restitution for part performances (the "restitution rule"). In our example, the court invalidates the contract but requires $S$ to return to $D$ a sum of $L$ times $E$. Fifth, the court may simply validate the entire contract (the "validation rule"). Although the validation rule is only a theoretical option, it is nonetheless analyzed in order to present the entire spectrum of rules available to courts.

C. Analysis of the Potential Effects of Alternative Reformation Rules

It is impossible to quantify the potential effects of alternative contract reformation rules given the plethora of cases involving anticompetitive contracts. Nevertheless, their qualitative effects

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46 See infra Part II.C.2.b.

47 The analysis in this section is based on the assumption that all parties are aware of the anticompetitive nature of their contract. This assumption will be relaxed in the following section.

are of importance. The comparative weight of these effects is analyzed below and a set of reformation rules that the courts should adopt is proposed. Each reformation rule involves a trade-off between ex ante deterrence and ex post restoration of competition, complicating the choice of an optimal rule.

1. Potential Effects of Alternative Reformation Rules

   a. Ex ante Deterrence Effects

      Two main parameters determine the ex ante deterrence effects of different reformation rules—the severity of the sanction imposed by the legal rule and the probability of enforcement.

       i. The Severity of the Sanction

      If the court preserves the internal balance and the legal provisions of the contract as the rebalancing rule suggests, the parties' initial decision to engage in anticompetitive contracting becomes less significant. Even if the contract is found to be partially anticompetitive, the remaining contractual provisions may still be enforced, and the internal balance of the contract restored, to the extent that the court determines that this does not interfere with the restoration of market competition. Thus, rebalancing significantly reduces the risk that anticompetitive provisions will cause a contract to be held unenforceable in its entirety. As a result, rebalancing potentially inhibits the deterrence of future anticompetitive contracts, unless litigation costs or the possible damage to a firm's reputation from a court's finding that that firm has engaged in anticompetitive conduct are high enough to deter the parties. The probability of a firm's being found liable for anticompetitive violations, however, is of course less than one hundred percent. Rebalancing also reduces parties' incentives to ensure that their agreement is legal at the formation and throughout the term of the contract, where the relevant law changes during that period.

      For this analysis to hold, three conditions must be satisfied: (1) the parties can predict the court's choice of reformation rule;

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49 See infra Part II.C.1.
50 See infra Part II.C.1.a.
51 See infra Part II.C.1.b.
52 See Grody, supra note 35, at 191 for analogous circumstances and reasoning.
(2) it is assumed that the court can restore the contract's internal balance correctly; and (3) all parties are aware of the anticompetitive nature of the contract. The first two conditions ensure that the parties can base their ex ante contracting decisions on predetermined considerations that the court is likely to take into account, and that the court can reach a rational outcome based on those considerations. The third condition ensures that the parties rationally decide whether to engage in anticompetitive contracting.\textsuperscript{55} The first and third assumptions are also important for the following discussion.

The invalidation rule creates a three-fold risk once a court determines that the parties have engaged in anticompetitive contracting. First, the court’s decision may create an economic imbalance between the parties when actual part performances are unbalanced. Second, the parties incur negotiation costs in order to enter into a new contractual arrangement for the legal provisions of the contract. Third, the parties also bear the risk that by the time the new contract is negotiated, market conditions and the parties’ relative bargaining positions will have changed. Parties envisioning that the market situation might change in another party’s favor could deem this risk significant and be deterred from entering into such a contract.

Nevertheless, the adoption of the invalidation rule does not necessarily mean that future parties will be deterred from engaging in anticompetitive contracting. Rather, it may create incentives to contract around the invalidation rule\textsuperscript{56} by constructing contracts so that, where possible, consideration for the anticompetitive conduct will be paid immediately upon performance of that conduct. The parties might also agree on an alternative contract that comes into effect if the original contract is invalidated.\textsuperscript{57} The first method eliminates the risk of economic imbalances, and the second eliminates the risks of added negotiation costs and changes in the parties’ bargaining positions, although both methods impose on the parties additional ex ante transaction costs. Thus, the invalidation rule will deter the parties from engaging in

\textsuperscript{54} For analysis of the court’s ability to restore the internal balance of a contract see infra Part II.C.2.

\textsuperscript{55} See discussion infra Part II.C.2 for an analysis of circumstances in which some or all of the contracting parties are not aware of the contract’s anticompetitive nature.

\textsuperscript{56} Contracting parties may have incentives, other than antitrust law considerations, to include in their contract safeguards against midterm invalidation of the contract for a wide range of reasons, such as force majeure and bankruptcy.

\textsuperscript{57} The parties may choose to initially include legal and anticompetitive provisions in one contract for several reasons, including an attempt to conceal the anticompetitive nature of their contract.
anticompetitive contracting only where these conditions are not or cannot be met, or where an alternative contract will also be invalidated by the court.

The restitution rule’s level of sanction occupies a middle ground between those of the invalidation and rebalancing rules. Future contractual parties may be deterred by the second and third risks—that is, by the need to renegotiate a new contract for the legal parts of their contractual arrangement—unless they can contract around those risks by negotiating an alternative contract ex ante.

The severance rule eliminates the risks associated with the renegotiation of a legal contractual arrangement but does not eliminate the risk of unbalanced part performances. It also adds the risk that the court will create an imbalance in favor of one or some of the parties that will continue for the duration of the contract. This may create incentives for contracting parties to reconstruct contracts so that, whenever possible, the anticompetitive provisions contain both the performance and the relevant consideration, with the consideration for anticompetitive conduct to be immediate upon the conduct. Alternatively, contracting parties may include special contractual provisions restoring the balance between them should the anticompetitive provisions be judicially stricken. Parties may also include a provision invalidating the whole contract and requiring the parties to renegotiate or to adopt an alternative contract once a court finds their current contract to be anticompetitive. Only where these conditions cannot be met will the severance rule deter the parties from engaging in anticompetitive contracts. In contrast, the validation rule has no deterrence effects.

Stated differently, if we view the choice of reformation rule as a game played between the enforcement agencies and market players, the adoption of a specific reformation rule creates a “first mover” advantage to the court. It signals to market players what the cost of a violation is, once detected. Thus, market players can calculate the risk of engaging in anticompetitive contracting by taking into account the effects of the reformation rule before acting. Contrastingly, a court’s adoption of the invalidation rule would signal to market players that the court would not deal with the consequences of an unbalanced contractual relationship under any circumstances. This, in turn, would result in substantial deterrence effects on market players, who must then try to reduce those costs either by not engaging in anticompetitive contracting or by contracting around the invalidation rule. If, on the other hand, market players may rely on the court to rebalance
contractual relationships correctly, then they will not consider the consequences of an imbalance or the consequences of the invalidation of their contract when deciding whether to enter into an anticompetitive contract.

ii. Frequency of Enforcement

The second parameter determining the deterrence effects of different reformation rules is the frequency of enforcement. This is determined by the probability of detection of antitrust violations by government authorities, which in turn is influenced by both the incentives of third parties and the contracting parties themselves to detect and report violations and the authorities' incentives to pursue such cases.

(a) Incentives of Third Parties to Investigate and Report Violations

The choice of reformation rule affects the incentives of market participants to investigate and to report antitrust violations to the relevant public authorities. Market participants will engage in investigation and reporting of an anticompetitive act only if they have sufficiently strong private incentives to do so. Where violations are readily observable, the costs of investigating the violation and informing the antitrust authorities may be low enough to induce competitors or consumers to investigate and report the violation, unless the contract is likely to be unbalanced in their rival's favor. Where investigation costs are high, however, a third party will have incentives to investigate and report a violation only if it suffers from the continuation of an anticompetitive contract, or if it is likely to gain an advantage from its investigation and reporting.

Private parties' incentives to detect and report violations are positively correlated to the harm caused to them by the conduct or the level of the sanction imposed on their rivals. Accordingly, the validation and rebalancing rules create low incentives to investigate and report because of the low-level sanctions they impose on the contracting parties. The restitution and severance rules create stronger incentives. The invalidation rule potentially creates the strongest incentives to investigate and report violations, assuming the parties cannot contract around it and the third party can ensure that the imbalance will not be in its rival's favor.
An important method of antitrust detection involves the reporting of anticompetitive contracts by contracting parties that use the reformation sanctions opportunistically in order to invalidate agreed-upon provisions that are no longer in their favor, or in order to enjoy windfall profits. When a judicial remedy may create an imbalance, the parties have different incentives with regard to the enforcement of the remainder of the contract. One party may wish to enforce it while another may wish to invalidate it or to rebalance its provisions. If, for example, a contracting party can predict with certainty that the court will invalidate the contract in its entirety and not attempt to restore the internal balance between the parties, and the parties have not contracted around this possibility, this party may try to induce the antitrust authorities to initiate litigation as a strategic device when circumstances become less favorable to perform his contractual duties, or when the imbalance in the contract is strongly in his favor.\(^{58}\)

The validation rule obviously does not create any incentives to report the contract because it does not create a benefit to any of the contracting parties. The rebalancing rule also does not create incentives to report because it ensures that the contract's internal balance will not change. The severance rule may create such incentives if the anticompetitive provisions are not severable or if severing them would create an internal imbalance, and the reporting party will benefit from such a remedy. The restitution rule creates incentives to report only if the legal contractual arrangement is no longer beneficial to the reporting party.

(c) *Enforcement Decisions of Antitrust Agencies*

The risk of sanctions is also influenced by the percentage of cases detected, investigated, and brought to trial by antitrust enforcement agencies. The choice of reformation rule has little effect on the costs of enforcement. However, it is arguable that, assuming an agency has a limited, predetermined budget, the application of the invalidation rule would enable enforcement agencies to bring more suits and thus increase the probability of sanctions. Under the invalidation rule, the agency must prove only the anticompetitive nature of the contract. All other rules, except the validation rule, may require the agency to invest additional

\(^{58}\) For instance, when the party inducing litigation by the authorities owes the other party large sums of money for anticompetitive acts already performed.
resources in verifying the claim by the contracting parties that the remedy creates a contractual imbalance, or in ensuring that the nature of the contract is not altered by the severance of its anticompetitive provisions.

b. Restoring Competition in the Market

The main goal of contract reformation is the restoration of competition in the market. The efficiency of a specific rule in restoring competition in the market ex post depends on the relevant market situation. Nonetheless, some general observations can be made. The per se validation rule will almost never restore competition, unless market conditions have changed to the extent that the natural course of events has rendered the court’s remedy unnecessary. The four remaining rules in most cases will restore competition in the market. However, the severance and invalidation rules may not achieve this goal if they create a contractual imbalance that has anticompetitive effects on the market. Such rules do not grant the court the flexibility to rebalance a contract when rebalancing is a crucial condition for restoring competition.

The issue of rebalancing contractual provisions is raised when the parties to an anticompetitive contract have not specified the consideration for the anticompetitive conduct separately from the consideration for all other provisions. While the court can easily divide one party’s obligations into two parts, only one of which is anticompetitive, the court may not be able to easily divide the other party’s corresponding obligations. Enforcing the agreement without the illegal terms and without altering the consideration provision deprives one or some parties of part of the performance they expected to receive with no concession in return. In our example, if the court invalidates only the exclusive dealing provision, D will have to pay S a price E for each widget supplied, while losing the exclusivity of the supply of the widgets. Rebalancing is also an issue where a party has relied on the contract and performed, or prepared to perform, before receiving the return performance. The internal balance between the contracting parties may be upset if the court does not mandate restitution of part performances. Without such restitution the

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59 See supra note 36.
60 The parties will most likely not renegotiate and rebalance the new contract unless the contract is only one part of a long-term or broad-scope relationship between the parties, or the parties that enjoyed a windfall gain have other reasons, external to the contract, to agree to forego some of the benefits of their windfall gain (such as ensuring that a monopolistic producer of an important input of their widgets does not go out of business). The reason is that the party in whose favor the contract is unbalanced will have
contract becomes more favorable to the party that has not yet performed. In our example, the contract is invalidated and \( S \) is not required to return the consideration that \( D \) paid for the widgets (\( E \times \) the number of widgets it expected to receive). The effect of such imbalance might be insubstantial where the excised promise is an immaterial part of the exchange, or where its influence on the economic viability of the contracting party is marginal. In other cases, however, its effect on the contracting parties may be significant, or even crucial, to their economic viability. For example, \( D \)'s economic stability might be critically impaired if he were required to continue to pay \( E \) for the contracted widgets for the full term of the contract without receiving the contracted-for exclusivity.

Enforcing a contract with a severe internal imbalance may be counterproductive to competition. First, an internal contractual imbalance might deter parties from engaging in competitive contracts where they fear that such contracts would be mischaracterized as anticompetitive and that a contractual imbalance might result. Second, in concentrated markets the impact of a contractual imbalance on the state of competition may be significant. Such imbalance might result in the creation of a significant comparative disadvantage to a market competitor.

no incentive to renegotiate new contractual terms. The parties may, nonetheless, agree on a one-time lump-sum payment that will capitalize the windfall gain and accordingly reset the contractual price.

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62 The cost is further analyzed infra Part II.D.
63 A concentrated market is a market that can support a small number of firms, such that a monopolistic or oligopolistic structure is inevitable.
64 Although an unbalanced contract does not confer a perpetual advantage on some contracting parties because it applies only to the remodeled contract, such unbalancing might be sufficient in some market situations to eliminate a competitor from the market. Areeda and Hovenkamp have acknowledged such a possibility: "Financially the monopolist may lose ... by the cancellation or modification of outstanding contracts with customers or suppliers, or other equitable relief .... It might suffer considerable deprivation as a result of a court's efforts to restore competition." AREEDA & HOVENKAMP, supra note 23, at 57. The possibility of an unbalanced contract was also acknowledged in Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971). This case was an antitrust class action in which the franchisees of defendant, the owner of a food chain, sought treble damages for injuries allegedly resulting from illegal tying restraints imposed by defendant's franchise agreements. See id. at 46-47. These agreements required franchisees to purchase certain essential utensils and ingredients exclusively from the defendant as a condition to obtaining the defendant's trademark license to operate food stores. See id. Chicken Delight argued that the arrangement was a reasonable device for measuring and collecting franchise fees. In holding that the contractual requirements constituted a tying arrangement in violation of the Sherman Act, the court nevertheless accepted defendant's argument that the contract prices for the tied items were to be the full compensation for both the tied items and the franchise license, and remanded to the district court on the basis of these factual issues. See id. at 52-53. Despite its acknowledgment of the possibility of a contractual imbalance, the court declined to
which in turn might eventually drive him out of the market. An elimination of a viable competitor from the market may severely affect the state of competition in the market if three cumulative conditions are met. First, the market can support only a small number of firms that actually compete in the market. Second, entry barriers are high. Third, a new entrant may not enter the market simply by utilizing the exiting competitor's assets and market position. For example, where reputation is an important factor in the consumer's decision, it may take a new entrant a long time to establish itself in the market. In such situations courts should be careful not to act beyond restoring conditions for competition (undoing the effects of the anticompetitive conduct agreed upon in the contract) in order to avoid creating a comparative disadvantage to some contracting parties.

Take, for example, a market situation in which the relevant market can support only three firms, and three competitors actually exist in the market. Assume that one firm is found to be engaging in anticompetitive behavior, and that the court is not sufficiently cautious in its crafting of remedies such that the firm is forced to exit the market due to a significant contractual imbalance that has created a comparative advantage in favor of its rivals. If a new entrant faces high barriers to entry, this change in market structure may affect the pricing behavior of the two remaining firms, given that it is easier for them, as a duopoly, to engage in price fixing or price coordination.

invalidate the franchise arrangements in light of the plaintiff's concern that the district court's decision might entitle the plaintiff to a royalty-free franchise license in the future, given that it was not yet clear if such imbalance would result. See id. at 53. Although the author does not agree with the court's substantive analysis, the case nonetheless serves as a good example of the difficulties associated with some contract reformation remedies. See also Dir. of Investigation & Research v. D & B Cos. of Canada, No. CT-94/1, 1995 CPR LEXIS 1983 (Competition Tribunal Aug. 30, 1995) (Can.) (acknowledging that striking the exclusivity clauses in Nielsen's contracts with its suppliers without addressing the current payment clauses which were of a blended nature, i.e., they contained a single payment for the data and exclusive access to them, may be problematic). The Canadian Competition Tribunal found that the problem was that "Nielsen might have to continue its current level of payments, without receiving the benefits of exclusivity the payments were intended to secure, while its competitor makes payments at a lower level." Id. at 282. However, the Tribunal chose to sidestep this issue by refusing to comment on whether this was a valid concern for the Tribunal to handle. See id.

65 The number of competitors is one of the conditions favoring cartelization and price coordination. Ethyl Corp. v. F.T.C., 729 F.2d 128 (2d Cir. 1984). In Ethyl Corp. only four firms operated in the market for the production of antiknock compounds. The characteristics of the industry—high concentration, small likelihood of new entries because of a sharply declining market, inelastic demand, and homogeneity of product—led to a natural oligopoly, which was more prone to price coordination. See id.; see also F.M. Scherer & David Ross, Industrial Market Structure and Economic Performance 277-79 (3d ed. 1990); John S. McGee, Ocean Freight Rate Conference and the American Merchant Marine, 27 U. Chi. L. Rev. 191, 196-204 (1960).
Rebalancing may also have great economic impact where the market can or may support only one firm, and several firms engage in competition for the market. The most efficient competitor should serve the market. However, if a superior potential competitor engages in anticompetitive conduct while competing for the market, and the court, in its efforts to undo the consequences of the firm's anticompetitive conduct, creates a comparative disadvantage to this firm, beyond undoing the consequences of its anticompetitive conduct, the firm may exit the market. Consequently, efficiency will not be achieved because the most efficient firm will be driven out of the market.

A severe contractual imbalance may also result in a windfall to some contracting parties. Such a windfall might bestow a strong comparative advantage on these contracting parties, creating an artificial obstacle to competition.

In sum, where there is a ready supply of equally efficient firms or potential entrants that can or do compete in the market, the potential elimination of a competitor due to a contractual remedy has an insignificant effect on restoring market competition. Conversely, where a small number of existing or potential competitors operate in the market and barriers to entry are high, the unbalancing of a contractual relationship might eventually eliminate an existing competitor from the market. Ultimately, this might be counterproductive to the restoration of competition. Accordingly, although antitrust is designed to protect competition


68 An important issue involves the incentives of more efficient competitors to engage in anticompetitive conduct, given that economic analysis suggests that they will most likely win the market if no artificial barriers are present. Thus, a more efficient firm might have little or no incentive to risk its comparative advantage by engaging in anticompetitive contracts that may reduce its chances of winning the market. However, the more efficient firm may use anticompetitive methods in order to shorten the struggle to win the market and hasten becoming its sole supplier.

69 If competitors possess incomplete information regarding the cost structures of their rivals, a competitor who charges low prices based on high windfall profits rather than on low production costs might drive out more efficient competitors who mistakenly assume that the price reduction is based on efficiency. While such conduct might constitute predation, it may be hard to prove if, for example, the predator engages in many vertically integrated activities, and the allocation of its costs of production for each widget is not easily determined.
rather than competitors, in some markets it may be important for courts to exercise caution with regard to crafting remedies that affect the competitors’ viability.

It should be emphasized that once the court has left the legal contractual provisions intact, the contracting parties must still act in accordance with such provisions or be in breach of the contract. The contract is valid although the antitrust court, in striking out some provisions, may have created an internal imbalance in the contract and altered the basic assumptions and principles upon which the original contract was based. The remodeled contract’s validity, however, should not be questioned by a court in a subsequent action on the contract, since this would create uncertainty and duplicate litigation costs. Thus, each contracting party faces a choice between paying damages for breach of contract or performing in accordance with the remodeled contract and, if the court has unbalanced the contract in another party’s favor, incurring the costs created by that imbalance.

These considerations favor the rebalancing, restitution, or validation rules. The severance and invalidation rules may, in some situations, create imbalances that are unlikely to restore market competition. However, assuming that the business community is a rational, profit-maximizing community that will attempt to minimize costs under any judicial rule, the rebalancing, invalidation, restitution, and severance rules all encourage informed parties to undertake risk allocation assessments, thereby minimizing the possibility of a contractual imbalance. All four rules create incentives for contracting parties to negotiate rebalancing provisions ex ante by penalizing them for not doing so.

This is an efficient outcome since the contracting parties’ ex ante ability to avoid a contractual imbalance by balancing the contract’s provisions is likely to be much better than the court’s ability to restore competition ex post. It is also cheaper for the parties to negotiate a term ex ante than for the courts to estimate ex post what the parties would have agreed upon had they not included anticompetitive provisions in their contracts.

The parties’ incentives to reduce the risk of an imbalance

\[70\] An additional condition is that the court will not further question the validity of the remaining contractual provisions.

\[71\] This conclusion assumes that the costs of contracting for rebalancing provisions do not exceed the costs of applying each of the above reformation rules.

under the invalidation and severance rules are driven by the concern that either part performances or the remaining contractual provisions will be unbalanced in one party's favor. The incentives created by the rebalancing and restitution rules are driven by doubt about the practical ability of courts to rebalance a contract. It may well be that the court will face significant technical and jurisprudential obstacles that will hamper its ability to rebalance the contract correctly. A court may not have the expertise, knowledge, or resources to fashion a new contract for the parties. It may have limited information regarding the relative economic interests of the parties, as well as the impact of its remedy on the market. For example, a court may face problems with respect to the parties' intended internal balance. Even if the court hears the arguments of all the contracting parties, some parties may prefer to conceal their incentives to engage in such contracting, and the real benefits they believe they can obtain from the contract. Consequently, the judicial decision may be predicated on incomplete information. Furthermore, the precedential value of prior decisions is limited to the extent that they are based on specific facts. This creates incentives for informed contracting parties to include provisions in their original contract that will simplify the rebalancing task for the court, if and when the matter arises. Parties may, for example, specify the consideration for the legal provisions separately from the consideration for the anticompetitive provisions. The parties will not avoid such an imbalance in three unique situations: when all or some of the contracting parties are not aware of the anticompetitive nature of the contract; where it is very costly or impossible to ensure that performances are always balanced; or where the parties deliberately use a blended consideration provision in order to conceal the anticompetitive nature of the contract.

c. Transaction Costs

The validation, severance, and rebalancing rules reduce ex

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73 Yet courts frequently engage in second guessing what the parties would have agreed upon absent the illegal restraint. For example, to ascertain whether and to what extent an unlawful contract for the sale of a widget has caused injury to a plaintiff in a private damage suit, the court must often ascertain the cost or the value of the product involved, free from the unlawful restraint. See, e.g., Perma Life Mufflers, Inc. v. Int'l Parts Corp., 392 U.S. 134, 140 (1968); Siegal v. Chicken Delight, Inc., 448 F.2d 43, 52 (9th Cir. 1971).

74 See Grody, supra note 35, at 189.

75 Informational problems are not unique, however, to contract reformation. The court may face similar problems whenever it grants a remedy that requires an analysis of the current market situation.

76 See Grody, supra note 35, at 189.
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post transaction costs (negotiation and contracting costs) of the contracting parties. The validation rule, by simply leaving the contract provisions intact, enables the contracting parties to continue to act in accordance with the contract provisions without incurring any additional transaction costs.

The rebalancing rule, by validating the legal parts of the contract while restoring the contract's internal balance, eliminates the parties' need to contract again for the legal provisions of the contract. Since the contract's internal balance is restored, the relative interests of the parties are the same as if the original contract were still valid.

The severance rule eliminates transaction costs where the contract is judged to be severable because the legal provisions of the contract remain enforceable. However, if the parties are sent back to the negotiating table, as under the invalidation rule, the restitution rule, and sometimes under the severance or the rebalancing rules, they are likely to incur contracting costs—the costs of renegotiating a contract that includes the valid parts of the original contract—especially where some parties behave opportunistically and take advantage of the situation in order to improve their contractual status, or where market conditions have changed since the contract was originally signed.

Also, assuming that the parties can contract around a given rule, the invalidation, restitution, and severance rules may increase ex ante transaction costs, since the parties will construct an alternative contract, or add provisions that would come into force once the court strikes the anticompetitive provisions. The rebalancing rule may also increase ex ante transaction costs where the parties distinguish between competitive and anticompetitive provisions in order to minimize court errors.

d. Litigation Costs

Litigation costs may be higher under the rebalancing rule than under any of the other rules, since the parties incur costs when presenting to the court issues regarding the internal balance of both the original and the remodeled contracts. Litigation costs under the severance or restitution rules may be higher than under the validation or the invalidation rules, since the parties may need to present the court with information regarding the nature and the internal balance of the original contract or the rebalancing of part performances.
e. Minimal Interference in Contractual Relationship: Giving Effect to the Contracting Parties' Intent

The legal contractual relationship between contracting parties is important to maintaining a well-functioning market. There is a case to be made for minimizing interference in this relationship, especially where the anticompetitive provision is a minor part of the parties’ extensive contractual relationship. Such relationship also serves contract law objectives by giving effect to the parties’ intent, to the extent possible.

The validation rule minimizes interference with the contractual relationship, while the invalidation and restitution rules maximize interference. Both severance and rebalancing rules fail to give effect to the parties’ full contracted intent. By changing or eliminating some of the contractual terms, the court enforces a different arrangement than the one agreed upon by the parties. Nonetheless, both rules strive to give as much effect as possible to the legal parts of the contract. The rebalancing rule, due to its flexible nature, achieves this task more frequently than does the severance rule.

The following table summarizes the effects of the alternative reformation rules on issues relevant to the majority of anticompetitive contract cases. An upward arrow indicates a positive effect (e.g., savings in Transaction Costs) while a downward arrow indicates a negative effect. A long arrow indicates a strong effect, while a short one indicates a weaker effect. If the effect is neutral or unknown, no arrow appears.

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2. Analysis and Discussion

a. Analysis of the Effects of the Reformation Options

None of the alternative reformation rules succeeds in achieving all the goals of antitrust law. The comparative weight of competing considerations thus determines the attractiveness of any rule. The preferred rule should create the strongest incentives for market players to avoid writing anticompetitive contracts in the first place or, at the very least, not interfere with restoring competition in the market should market players not be deterred from entering into such contracts.

Clearly, the validation rule should be rejected because it does not deter the formation of anticompetitive contracts and it almost never restores competition in the market, thereby failing to achieve the primary goal of contract reformation. Furthermore, it fails to induce the detection and reporting of antitrust violations.

The invalidation rule also has severe limitations in its treatment of anticompetitive contracts. In some cases, invalidation of a contract in its entirety may interfere with restoring market competition. It also maximizes negotiation costs by not allowing the court the flexibility to differentiate between the contract’s legal and anticompetitive provisions. Finally, the invalidation rule maximizes the over-deterrence effects of a false-positive error, i.e., when a court mistakenly labels a legal contract as anticompetitive.

Nonetheless, the invalidation rule is the best mechanism to transfer the role of restoring market competition. Once the contracting parties take into account, ex ante, the fact that if their contract is found to be anticompetitive it would be invalidated in its entirety, as well as the resulting increase in the rate of detection and reporting by third parties and contracting parties that invalidation would create, their incentive to refrain from such contracting is greater than under any other rule. Moreover, even if the parties engage in anticompetitive contracting, the invalidation rule creates incentives for them to write contracts that do not result in material imbalances should an antitrust court invalidate the contract. The invalidation rule also simplifies the court’s remedial decree, thereby minimizing litigation costs.

Several conditions must be satisfied for the invalidation rule to create incentives for parties to refrain from entering into

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77 See supra tbl.
78 This results from the fact that the invalidation rule imposes the highest-level sanction on the contracting parties.
anticompetitive contracts. First, the court should invalidate prewritten alternative contractual arrangements for the legal provisions of the original contract and for the rebalancing of consideration. Second, all parties should be informed about the anticompetitive nature of some or all of the contractual provisions. If this condition is not met, informed parties may use the invalidation rule to conceal the illegality of the contractual arrangement and write the contractual terms in such a manner as to grant themselves advantages were the contract to be invalidated in midterm. For example, the informed party has incentives to ensure that the other party performs its contractual duties before performing its own. The informed party may also choose not to inform the other party about the legal status of the contract in order to avoid raising its suspicion when including the anticompetitive provisions or extracting better terms. The invalidation rule thus provides little incentive for informed contracting parties to reveal the anticompetitive nature of the contract to less informed contracting parties. Alternatively, if at the time of contracting none of the parties realize that their agreement is anticompetitive, then they presumably will not contract around the invalidation rule. Yet these outcomes may have a positive effect by encouraging potential contracting parties to verify the legality of their contractual arrangement before signing the contract. These incentives are strengthened where a party anticipates dramatic changes in the market situation during the contractual term such that the party knows it will not be able to obtain such favorable terms in the future.

Where the above two conditions are satisfied, the severance rule has a lower overall deterrent effect than the invalidation rule. The condition that parties be informed of the anticompetitive nature of their contract will be met in most cases since the severance rule creates strong incentives for parties to verify the legality of their contractual arrangement. Two main concerns drive these incentives. The first concern is that another party will write contractual provisions, which, if the contract is severed, will be unbalanced in that party's favor for the duration of the contract. Second, the part performances will be unbalanced when

79 The legal status of a contract might change during its contractual term. To illustrate, an automatically renewed long-term contract for exclusive dealing between a dealer and a supplier is legal for as long as neither hold a monopolistic position in their market. However, if market conditions change and one of the contracting parties now holds a monopolistic position in its market, the legal status of the contract may change. Given that proof of specific intent to engage in anticompetitive conduct is not necessary to prove Sherman Act violations, the parties may still be found liable for anticompetitive contracting. See infra note 89.
the contract is severed. The severance rule might interfere with restoring competition in the market in a larger set of cases than the invalidation rule, since an imbalance might be created by both unbalanced part performances and unbalanced remaining provisions.

The rebalancing rule also suffers from a trade-off between ex post and ex ante effects. On the one hand, the rebalancing rule most likely will not jeopardize the restoration of competition in the market, ex post. It also reduces transaction costs and minimizes intervention in contractual arrangements. In addition, it limits the effect of false-negative court errors by minimizing interference in the contractual relationship. However, its main drawback is its low deterrence effect. The rebalancing rule creates weak incentives for parties to avoid anticompetitive contracting. Furthermore, it raises litigation costs to levels higher than those under any other rule. Finally, it creates the weakest incentive for parties to verify the legality of their contract. Although knowledgeable parties may have incentives to write contractual terms so as to grant them a possible advantage if the contract were found to contain anticompetitive provisions, those suffering from an imbalance can still attempt to convince the court that an imbalance has been created.

The restitution rule occupies a middle-ground between the invalidation and rebalancing rules. It has lower ex ante deterrence effects than the invalidation rule. It also avoids contractual imbalances that could be counterproductive to competition, and it creates incentives for informed parties to include provisions in the original contract simplifying the rebalancing task for the court. Its detection effects and litigation costs lie between those of the invalidation and the rebalancing rule.

So far, the analysis has assumed that a court may choose only one reformation rule. However, the court may choose not to limit its discretion to one reformation rule in all circumstances but rather apply the rule it deems most suitable in each case. The contracting parties will not know, ex ante, which rule the court will apply in their case. Adoption of such an approach changes some of the above effects. The uncertainty regarding the rule that the court will apply may reduce deterrence effects as the possibility that the court may adopt the rebalancing or severance rules increases. Litigation costs will be high given that the parties will

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80 For example, if the knowledgeable party is a supplier, that party has incentives to specify in the contract a lower consideration for the anticompetitive conduct and a higher consideration for the supplied widgets than the parties would have agreed upon if all were informed about the anticompetitive nature of some (or all) of the contractual provisions.
try to convince the court, ex post, to adopt their preferred rule. Additionally, it is unclear whether competition will be restored and whether there will be a need for ex post contracting. This approach might also reduce incentives to report and to investigate anticompetitive conduct created by the invalidation or the severance rules where such an investigation entails nontrivial costs. The ex ante transaction costs will most likely be as high as those under the rebalancing rule, given that the parties cannot anticipate which rule the court will apply. Another drawback of such discretionary rule is the lack of clear precedent to guide courts in exercising their discretion. It may well be that the costs of this approach outweighs its benefits, and if so it should be rejected. Alternatively, courts may adopt a predetermined combination of reformation rules that are applied in predefined circumstances, as is suggested below.\(^8\)

### b. Optimal Reformation Rules

In most cases the invalidation rule can best achieve deterrence and restoration of competition,\(^8\)\(^2\) and thus the courts should adopt it as a default rule.\(^8\)\(^3\) To maximize deterrence, courts should invalidate not only the contract before them, but also the alternative contractual arrangements agreed upon ex ante that would come into force should a court invalidate the original contract. This conclusion should not change even if the contracting parties (or some thereof) have not realized the

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81 A possible improvisation on this solution is the adoption of a reformation rule where the court severs the anticompetitive part of the contract and also changes some of the contractual provisions and creates a random imbalance. Although such a rule may create very strong deterrence effects, it is extremely problematic for several reasons. Most importantly, it grants the court the power to create an advantage to one party and a disadvantage to another with no regard for the contractual provisions. Such a remedy will not necessarily achieve the goal of restoration of competition in the specific case. Also, courts will be able to use this remedy to punish or harm firms in the guise of restoring competition.

82 See supra Parts II.C.2.a-b.

83 Another relevant consideration is whether less efficient firms are more likely to engage in anticompetitive contracting than more efficient ones. If this proposition is true, then deterrence effects should receive extra weight. While this intriguing issue is beyond the scope of this Article, several comments are warranted. As noted above, this proposition may hold true where competition for the market exists, since the winner may be able to extract monopoly profits once it controls the whole market. See supra note 60. Thus, the more efficient firm will have low incentives to risk its comparative advantage by engaging in anticompetitive conduct which, once found to be anticompetitive, might reduce its chances of winning the market, unless it envisages that such conduct would reduce significantly the length of the struggle for the market or it is uncertain whether it is the most efficient competitor. However, this observation may not hold true for all other market situations where anticompetitive contracts may allow efficient and nonefficient firms alike to earn higher profits than they would have earned absent such conduct.
HARMFUL REMEDIES

anticompetitive nature of their contractual provisions at the time of contracting.84 Where the contracting parties fail to verify the legal status of their contractual arrangement, they have taken a calculated risk and thus should bear the consequences. Moreover, the high sanctions imposed on uninformed contracting parties create strong incentives for them to verify the legal status of their arrangement.85

However, two exceptions to the application of the invalidation rule exist. The first exception occurs on the rare occasion where the parties have failed to avoid the possibility of a contractual imbalance, and such an imbalance will interfere significantly with restoring competition in the market. While generally the parties should bear the risk of a contractual imbalance, where such imbalance interferes significantly with restoring competition in the market ex post, the goal of creating ex ante deterrence effects should be subordinated to the main goal of restoring market competition. In that case, the court should apply the restitution rule because it can potentially impose the highest sanctions without interfering with the restoration of market competition. These rules would achieve the optimum mix of both ex ante deterrence and ex post restoration goals. The second exception relates to legal uncertainty as discussed below.

c. The Effect of Legal Uncertainty on Optimal Reformation Rules

Whenever the legality of the anticompetitive conduct was not settled by case law at the time the contract was formed, the second exception to the adoption of the invalidation rule applies. Once an element of legal uncertainty enters the equation, the optimal remedial policy for anticompetitive contracts changes materially.

Antitrust law is often characterized by open-ended legal standards that allow antitrust courts and enforcement agencies to exercise wide discretion. In many cases the law does not provide market players with clear rules that provide ex ante definitive guidelines on how they should behave. Rather, antitrust law often provides them with unclear criteria regarding whether an activity is of a type or was conducted in a manner that subjects one to liability. These criteria are clarified only by ex post court

84 If the amount paid for the widgets, coupled with the anticompetitive conduct, is significantly above the market price of widgets, then all parties have a strong indication of the anticompetitive nature of the contract. Yet all or some of the parties might still consider the high price to be a premium for exclusive dealing, tying, or any other conduct that gives them a comparative advantage over their rivals, even without realizing that such arrangements are, under the circumstances, anticompetitive.
85 See supra Part II.C.2.a.
decisions, which may apply differing legal standards. The source of uncertainty is the reliance on standards that provide only general criteria, rather than specific rules. This may be exacerbated further by factual uncertainty regarding market conditions and the effect of a specific conduct thereon. Moreover, given that the legality of many types of conduct is informed to a large degree by economic teachings, economic theories that relate to market behavior may be analyzed differently by antitrust courts and enforcement agencies. One example is the issue of whether and under what circumstances a vertical restraint is anticompetitive. There has been a significant shift in economic and legal commentary on this issue in the past decade from per se legality to a rule-of-reason analysis.86

Vague legal standards can lead individuals to believe they are complying with the law, when in fact they are not.87 Market players must assess where the threshold for liability lies despite some uncertainty. The absence of clear and determinate legal rules may lead to incorrect assessment of legal standards, and thus to suboptimal conduct.88 Yet these individuals may be held liable under the antitrust laws as long as the restraint of trade is a natural consequence of their business arrangements.89

86 Vertical restraints serve as a good example of changing trends. In the Reagan-era, vertical restraints were not analyzed, in most situations, as anticompetitive. This position was based on the single monopoly profit theory, endorsed by Chicago-school economists and legal commentators. The theory holds that a monopolist can extract all of the monopoly profits available in the first market without vertically integrating into a second market. Thus, a monopolist has no incentive to leverage its legitimately obtained monopoly power in one market into another, vertically related, market. Accordingly, a monopolist's decision to integrate into a second market must be motivated by procompetitive efficiency rationales and must be per se legal. See generally ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF (1978). Post-Chicago economic analysis has argued for some limiting assumptions to the single monopoly profit theory. In numerous cases integration into a second market can raise anticompetitive concerns. These include situations in which the monopolist is regulated, when markets have multiple types of buyers, and price discrimination is facilitated by vertical integration, or where the initial monopoly faces a challenge and possible dissipation by new or existing firms and leveraging is used in order to deter or destroy emerging competition. See id. This trend of analysis toward vertical restraints is exemplified by the recent Microsoft case. See generally United States v. Microsoft Corp., 56 F.3d 1448 (D.C. Cir. 1995). Unfortunately, it can never be predicted with certainty when antitrust authorities and courts will decide to base their enforcement decisions on new and evolving economic theories, or to what extent.


89 Anticompetitive agreements may come under section 1 of the Sherman Act, which is concerned with agreements that unreasonably restrain trade. The unreasonableness standard is generally interpreted in terms of the effect of the conduct on competition.
These facts bear on the optimal choice of reformation rules. Consider how the law's inaccuracy affects a market player's conduct: if the law is uncertain, parties' ex ante predictions of the legality of their conduct may differ from the social optimum. If the sanction for an anticompetitive act is high and uncertainty is present, more firms will be deterred from entering into valid competitive arrangements, since a firm will choose a course of action as long as its expected value is greater than the expected sanctions and trial expenses. Furthermore, when the law is indeterminate, false-positive errors may occur more frequently. False-positive errors impose two main costs. The direct costs of such errors are the costs of the sanction and of the judicial process. The indirect costs involve the "chilling" of future competitive behavior. In light of the possibility of court errors, individuals are more likely to exercise excessive cautiousness in business decision making and so be deterred from committing harmless acts that subject them to the risk of sanctions. The stiffer the sanction, the stronger the overdeterrence effect. The subsequent social cost is individuals' private valuation of the deterred acts as well as the positive externalities effects of the act. Accordingly, one could argue for a reduction of sanctions where uncertainty is high. Furthermore, low sanctions reduce the height
of the risk-bearing costs borne by risk-averse market players.\textsuperscript{95} Risk-bearing costs impose a deadweight loss to society since they are borne by market participants but are not offset by comparable gains to society. Less severe sanctions should nonetheless be coupled with a higher probability of enforcement in order to offset a decrease in deterrence that may be a result of less severe sanctions.\textsuperscript{96}

Higher enforcement levels may also increase the level of accuracy of legal standards and thus reduce uncertainty.\textsuperscript{97} Legal precedents have value for legal planning in standard-based law. If case law reduces the legal uncertainty, then as more cases are decided, the interpretation and the proper application of antitrust standards becomes clearer.\textsuperscript{98} Market players can then more accurately estimate legal outcomes.\textsuperscript{99} To be sure, the accumulation of precedents does not necessarily eliminate uncertainty. Complex factual settings or changing trends in economic analysis of market conduct may create new uncertainties. Yet prior decisions could serve to explicate at least some of the criteria that courts will apply, or to eliminate some uncertainties that arise in a wide range of cases. Once accuracy increases, the expected sanction for innocent acts disappears. This reduces the extent to which individuals are inefficiently induced to choose the act that does not subject them to the risk of sanctions, and thus stiffer sanctions and lower levels of enforcement can be adopted.

In the antitrust setting, however, the goals of less severe sanctions and higher enforcement levels conflict. As argued above, the stiffer the sanctions imposed on contracting parties, or the greater the gain to third parties from detecting or reporting an

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\textsuperscript{95} Risk-bearing costs are influenced by the severity of the sanction and by the probability of enforcement. Uncertainty increases the second factor. See generally Kaplow, supra note 88.

\textsuperscript{96} See id.

\textsuperscript{97} See id. Uncertainty will, in itself, increase the level of enforcement as more suits will be adjudicated rather than settled before trial. See George L. Priest & Benjamin Klein, The Selection of Disputes for Litigation, 13 J. LEGAL STUD. 1 (1984).

\textsuperscript{98} The court does not simply produce a different probability of a given outcome for the parties to consider. It changes the probability distribution into a certainty, and this can affect behavior even for risk-neutral firms. See Landes & Posner, supra note 88, at 687.

antitrust violation, the greater their incentives to report such violations, and thus the higher the enforcement probability.\textsuperscript{100} Although no reformation rule succeeds in lowering sanctions and simultaneously creating higher enforcement levels, the restitution rule comes as close as possible. While the restitution rule reduces the sanction below the level imposed by the invalidation rule, it still potentially increases enforcement levels beyond those of the rebalancing rule by increasing detection by third parties and reporting of anticompetitive contracts by contracting parties.\textsuperscript{101}

If, on the other hand, the law is determinate, as in the case of some antitrust violations,\textsuperscript{102} and sanctions are costless, sanctions should be set at the highest possible level. In our case, the adoption of the invalidation rule coupled with restitution (where the internal imbalance of the contract is counterproductive to competition) is optimal. Furthermore, as legal precedents accumulate and the law's determinacy increases, courts should switch from the weaker set of sanctions (restitution) to the stronger sanction (invalidation).

There is, however, an important caveat to this logic. Although the above proposal is theoretically optimal in achieving the goals of the law, requiring the court to assess whether or not a legal standard regulating market conduct was clear ex ante is problematic for two reasons. First, it is very difficult to draw such a distinction except in extreme cases. Second, such an assessment necessarily raises questions regarding the constitutionality of civil suits based on unformulated principles. This undermines one of the basic assumptions of the law—namely that the law provides defendants with enough information to predict, ex ante, the

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\textsuperscript{100} See \textit{supra} Part II.C.1.

\textsuperscript{101} Where law enforcement is entrusted to public authorities and they have sufficient tools to detect anticompetitive violations, they can ensure frequent enforcement and low sanctions. However, where private parties act as primary enforcers or primary detectors for antitrust violations, enforcement will be more frequent as the benefits to these plaintiffs are higher. One way to achieve the optimal mix of frequent enforcement and low sanctions is by decoupling liability. The damages that the defendant must pay are decoupled from the awards collected by the plaintiff. This can be done by compensating private plaintiffs with a public subsidy or by insurance. See Kamar, \textit{supra} note 88; A. Mitchell Polinsky & Yeon-Koo Che, \textit{Decoupling Liability: Optimal Incentives for Care and Litigation}, 22 RAND J. ECON. 562 (1991). Decoupling liability was first proposed by Warren F. Schwartz. See generally Warren F. Schwartz, \textit{An Overview of the Economics of Antitrust Enforcement}, 68 GEO. L.J. 1075 (1980) (proposing decoupling liability in the antitrust context).

\textsuperscript{102} To illustrate, price collusion has long been characterized as anticompetitive. See, \textit{e.g.}, F.T.C. v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411 (1990); United States v. Socony-Vaccum Oil Co., 310 U.S. 150 (1940); United States v. Trenton Potteries Co., 273 U.S. 392 (1927).
legality of their conduct. Thus, courts should use the restoration rule only in extreme cases in which the illegality of the anticompetitive nature of the conduct is to be clarified for the first time.

Given this analysis, the invalidation rule—under which all contractual arrangements are invalidated—should be adopted as the default reformation rule. The restitution rule should be adopted in two exceptional cases. First, whenever the contractual relationship is severely unbalanced and such imbalance may interfere with restoring competition in the market; second, in extreme cases, where the interpretation of an indeterminate legal standard is to be settled for the first time. Over time, as legal standards become more determinate, violations that were sanctioned by the restitution rule can be sanctioned by the invalidation rule.

D. Application of the Proposed Analysis to Fruit Contracts

Fruit contracts are contracts in which the internal balance of the original contract has been influenced by the prior anticompetitive conduct of one or some of the contracting parties. These parties’ anticompetitively acquired bargaining power has enabled them to extract better terms than they would have been able to obtain otherwise. Accordingly, some of the factors previously analyzed should be adjusted when applied to fruit contracts. The intent consideration, for example, should be adjusted since it may not be assumed that all contracting parties would even enter the contract absent the stronger bargaining position resulting from their prior anticompetitive conduct.

Where fruit contracts are concerned, the internal balance between the contracting parties, as restored by the court, should be based upon the contractual provisions that the parties would have agreed upon absent any anticompetitive conduct. By making these adjustments, the court is taking away from the antitrust violator the future fruits of the anticompetitive conduct. Clearly,

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103 Even if the level of accuracy in the law should affect the appropriate design of sanctions for anticompetitive contracts, a further problem can be identified in the form of treble damages that a private plaintiff can be awarded in a private antitrust suit. In private suits the sanction is not limited by considerations of the level of legal certainty. For more on this issue, see infra Part II.E.

104 This includes cases brought to trial only a short period after the indeterminacy was first settled and the parties could not have practically changed their contractual arrangement in the period following the court’s decision. It also includes cases where, although the court has dealt implicitly with a legal uncertainty in the past, its rulings, as reasonably interpreted, have not provided clear guidance for the parties in determining the legality of their contractual arrangement.
the court has a more difficult task of restoring the contractual balance in fruit contracts than in tool contracts.

Fairness considerations also weigh more heavily in the design of remedial rules for fruit contracts than for tool contracts. Given that in fruit contracts only one party is guilty of engaging in anticompetitive contracting, fairness raises the independent concern of sanctioning the innocent and benefiting the guilty. Fairness dictates that a windfall gain that might result from the use of the severance or invalidation rules should not benefit the guilty party. Accordingly, the adoption of a simple invalidation or severance rule should be rejected in favor of the rebalancing rule. The rebalancing rule also ensures that the innocent party does not incur renegotiation costs and that the stronger party will not abuse its power again in the formation of the contractual relationship. Where rebalancing a contract is a formidable task, the court may adopt the invalidation rule, as long as it ensures that the actual considerations transferred among the parties do not create an imbalance in favor of the party that included the anticompetitive provisions in the contract.

However, where fruit contracts are concerned, the remedial goal may not be to restore competition, but rather to restore injured parties to their position before the anticompetitive violation occurred.\(^{105}\) In such cases, the above analysis is not applicable.

E. Implication of the Analysis for Parallel Systems of Remedies

The antitrust system creates several different and parallel systems of remedies that are designed to ensure private compliance. In private suits, the remedy is usually the damages incurred by an injured party as a result of the anticompetitive act, coupled with a contract reformation remedy. While damages compensate identifiable victims and deprive wrongdoers of ill-gotten gains, they are also conceived in part as a punitive measure necessary to deter future wrongdoers. The main difference between government-initiated and private suits with respect to remedies is that while in the former the court has discretion—which it can and should exercise in order to avoid unbalancing a fragile market equilibrium—in private suits the court usually

\(^{105}\) This is the remedial goal, for example, of section 19 of the Federal Trade Commission Act, which authorizes the courts, upon suit by the FTC (which, under 15 U.S.C. § 45(a)(2), is empowered to prevent unfair and deceptive acts or practices), to grant relief that “may include, but shall not be limited to, rescission or reformation of contracts . . . .” 15 U.S.C § 57b(b) (emphasis added).
cannot take such considerations into account.\textsuperscript{106} Thus, a private plaintiff may obtain a remedy that is most advantageous to its own interests, even if the remedy is counterproductive to competition.\textsuperscript{107} This multiplicity of parties and remedies makes rationality of antitrust remedies difficult, if not impossible.\textsuperscript{108} The remedy sought by a public plaintiff in one case may be completely different from the remedy sought by a private plaintiff in another case against the same defendant, challenging the same conduct. Thus, the latter might disrupt carefully calibrated public policy goals based on a reasoned exercise of prosecutorial remedial discretion, such as restoring competition in the market.\textsuperscript{109} Nonetheless, application of optimal contract reformation remedies is important in order to enhance the incentives for third parties to bring suit against firms engaged in anticompetitive conduct before damage is done. It is also important when no private suits are filed, such as where the parties that have suffered injuries have no legal standing to bring such a suit.

The different remedial goals of public and private suits may be translated into an argument for placing limitations on private remedies in which the effect of unbalancing the market may be crucial to restoring competition. This does not necessarily suggest that private suits should be completely rejected, but rather it underscores the need for careful design and monitoring of private enforcement. Remedies in private suits can be designed to grant the court discretion with regard to the scale of the damages

\textsuperscript{106} While private plaintiffs must prove that the anticompetitive conduct lessened competition in order to recover damages, they need not prove that the remedy sought would be conducive to competition. See Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477 (1979). Rather, it is assumed that the treble damages remedy restores competition by deterring competitors from engaging in anticompetitive conduct in the first place while at the same time compensating victims of antitrust violations. See Ill. Brick Co. v. Illinois, 431 U.S. 720 (1977).

\textsuperscript{107} Some commentators have long pointed out that private party relief may not adequately reflect any concern for the public at large. See, e.g., Thomas E. Kauper, \textit{Competition Policy and the Institutions of Antitrust}, 23 S.D. L. REV. 1, 27 (1978).

\textsuperscript{108} See id. at 72; see also KENNETH G. ELZINGA & WILLIAM BREIT, \textit{THE ANTITRUST Penalties: A STUDY IN LAW AND ECONOMICS} (1976).

\textsuperscript{109} Robert F. Blomquist argues:

\textit{[T]he only intrinsic constraint on a private suitor seeking to use penal laws for private ends is whether the costs of litigation outweigh its potential benefits to him. In contrast, government prosecutors, when deciding whether to enforce a penal law are presumed to be substantially motivated by public interest considerations. Public prosecutors, therefore, are expected to select and pursue cases on the basis of informed, dispassionate judgment about the harmful social significance of the conduct being challenged.

awarded, so that in exceptional cases where enforcing the remedy is counterproductive to market competition, the court could reduce the damages in order to avoid such an outcome. Alternatively, the authorities that oversee competition may be granted a right to interfere in private actions and stay or preempt such actions, where such private enforcement would otherwise undermine some of the values of public enforcement. While this may introduce a degree of uncertainty into the damage remedy, which, in turn, would lower the incentives of private parties to litigate cases, it would also avoid the risk of granting a remedy that is counterproductive to competition.

III. SHAPING A RATIONAL BODY OF REFORMATION PRINCIPLES

Contract reformation is riddled with uncertainty. This part illuminates the practical applicability of the optimal set of contract reformation rules already introduced. As a general guideline, such enforcement policy should provide a remedy that is relatively certain and enforceable and reflects a rational choice predicated on concerns of effectiveness and efficiency.

In most cases the goals of antitrust law can be met simply by invalidating the contractual arrangement. When merely invalidating the contract suffices, the court need not go any further. Little is lost from enjoining the anticompetitive contract, and no disincentive to meritorious competition results from invalidating the contract.

It may even be the case that by the time the case comes before the court the anticompetitive effects of the contract will have already disappeared. In such a case the court should still invalidate the contract. Although this result may seem awkward at first glance, it is nonetheless the most suitable way to achieve the goals of antitrust law. Deterrence will be maximized when the contracting parties assume that even if market competition is restored (the natural course of events has undone what the anticompetitive conduct has achieved), they will still bear the risk of having the contract invalidated.

However, the task of devising an appropriate remedy may not end with mandating the invalidation of the anticompetitive contract. This is because a contractual imbalance might interfere with the restoration of market competition, such that simply invalidating the anticompetitive contract would not, in itself, restore competition in the market. The court may need to

110 For example, market conditions have changed to such a degree that the contract no longer has any anticompetitive effect.
mandate restitution of part performances where this condition is essential for competition to prevail. Yet the court should not mandate restitution unless invalidation of the contractual arrangement would significantly alter the internal balance between the contracting parties, thereby interfering with the restoration of market competition. While the contractual relationship is taken into account in the fashioning of such a remedy, the court will not enforce the contract (although its order may bear some resemblance to the provisions of the contract that embody the corresponding duties of the party that has not yet performed).

Of course, the court is not limited to contract reformation. If the market situation has changed to the extent that the restoration of competition necessitates more drastic measures, it may use more extreme measures such as divestiture of a firm. However, such measures should only be used where other less intrusive remedies are ineffective.

Where the anticompetitive nature of any given conduct is clarified, for the first time, by an antitrust court, the court should also apply the restitution rule. Applying the restitution rule may be a difficult task given potential informational, technical and jurisprudential obstacles. Accordingly, where such a task seems formidable, the court should not attempt to rebalance the part performances, but rather it should send the parties back to the negotiating table to settle on the sum to be repaid. Two main obstacles can be identified. Firstly, the parties will incur transaction costs. Secondly, some contracting parties may attempt to use this situation to change the contract’s provisions in their favor. The court can minimize both of these obstacles by limiting the parties’ negotiations to specific issues and by requiring parties to base their decision on the internal balance in the original contract.

The court may also deprive the contracting parties of the fruits of their anticompetitive behavior. Depriving the violators of the fruits of their conduct is both wise deterrence and may well be within the goals of the law.\footnote{It may nonetheless be necessary to go beyond depriving the violator of the fruits of its anticompetitive conduct in order to restore competition in the market. Restoring the market to its position prior to the anticompetitive contract may require paying the violator’s rivals their lost profits. It may also require courts to undo the various effects of the anticompetitive conduct with remedies that go well beyond monetary compensation to rivals, such as lowering barriers to entry created by the anticompetitive act. These propositions, however, are beyond the scope of this Article.} This raises the question of whether the court may use the costs of a contractual imbalance as an approximation for the fruits of the anticompetitive conduct, and thus use the severance rule instead of the invalidation rule. While
recognizing the practical difficulties in estimating the causal connection between anticompetitive conduct and its consequences in fashioning remedies, we cannot use a presumptive rule that approximates the two. The fruits of anticompetitive conduct are not necessarily of the same quantity as the costs of a contractual imbalance. While in some cases such a rule will "punish" some contracting parties beyond what they have gained from the anticompetitive conduct, in other cases it will not necessarily eradicate all the effects of the anticompetitive act.

CONCLUSION

The economic revolution that has transformed antitrust in recent years has dealt mainly with the quality of the antitrust injury. The analysis of antitrust remedies has failed to keep pace with this economic revolution. Such an analysis is nonetheless as important as the analysis of substantive law, otherwise nearly everything given by one hand will be taken back by the other. Antitrust remedies affect the cost-benefit calculations firms undertake when considering their course of action. In addition, remedies impact on the effectiveness and efficiency of the decision in restoring market competition. If the remedy is unsuitable, all the resources devoted to antitrust enforcement are in vain. Accordingly, this Article has analyzed one such remedy—the contract reformation remedy.

Contract reformation is used in a variety of cases where the law empowers the court to grant it. Reformation provides the court with a flexible tool, which enables it to tailor the remedy to the specific needs of any given case. The court's wide discretionary powers enable it to base its decision on a rule of reason, rather than on a per se rule or a rigorous grammatical severability test, as is commonly applied in contract law. Such discretionary powers are best suited to achieve the public interests reflected in antitrust law. The court is empowered, but not obliged, to issue an order in circumstances where all the factual prerequisites to the exercise of its jurisdiction exist. Limitations established by the parties do not bind the court. The court has the freedom and flexibility to shape the relief according to the precise needs of the case, provided that it satisfies the conditions of the law.

Contract reformation, however, is not always an easy task. As suggested in this Article, the law gives primacy to the public

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interest in restoring competition. It calls for an economic analysis of the qualitative and quantitative impact of contract reformation on the parties, and accordingly on the market conditions. Achieving this goal requires the court to restore the internal balance between the contracting parties where a contractual imbalance would interfere with restoring competition in the market. In addition, this Article recommends sensitivity toward the determinacy of legal standards. Where the legality of a specific course of conduct is to be settled for the first time, the court should apply the restoration rule. In all other cases this Article recommends the invalidation of the entire contract.

Finally, the possible anticompetitive effects of a remedy are relevant in other situations where the law (not only antitrust law) changes market conditions. Most courts, however, are not empowered to consider restoration of competition as a factor in fashioning their remedies. It is presumed that another set of considerations dominates public policy. Nonetheless, in the antitrust law setting, such considerations are highly relevant, and thus should guide courts in fashioning remedies.