

Selected Antitrust Cases

Landmark Decisions

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Preface

The purpose of this seventh edition remains that of providing students of economics, government, and business administration with an opportunity to obtain an understanding of the manner in which economic theory is reflected in antitrust policy. Teachers in these fields are almost uniform in their agreement that there is no substitute for an actual reading of the case materials in order to facilitate an understanding of the legal and economic issues raised by our antitrust laws and to provide the student with interesting concrete problems. Students can rarely be required, however, to read lengthy court opinions in addition to a standard text. Consequently, I have compiled a list of the leading decisions in this area and edited them to manageable proportions, taking care, at the same time, to preserve all that is of lasting significance in the opinions. In every instance, the original language of the court has been retained; the deletions made were not permitted to interfere with the smooth flow of thought and language of these judicial opinions. Any footnotes added by the author are initialed.

A word about the selection of cases: only those that represent truly landmark opinions have been included. An attempt has been made to select cases so that the student will have both an understanding of the law as it now stands and a knowledge of the historical development of the attitude of the courts on the various legal-economic issues. In addition, I have continued to devote substantial space to dissenting opinions so that students can better understand the inherent complexities of the economic issues faced by the courts.

Although each section of the book is self-contained in the sense that it covers an issue or problem in its entirety, the various chapters are definitely interrelated. Thus, for example, Chapter 1 treats court attitudes toward overwhelming market power, while Chapter 2 deals with the legal and economic issues raised by direct price-fixing agreements. The cases in these portions of the book were also selected so that the student might

easily compare court attitudes toward price-fixing agreements, on the one hand, and monopoly power, on the other.

This book has now been revised six times since its initial appearance 30 years ago. As in the past, the desire to keep costs at a level that would permit continued use of this book as a supplementary text had to be balanced against the need to add cases.

Although final responsibility for selection of materials remains mine, I am indebted to others for their advice. Alfred E. Kahn of Cornell University provided guidance to the structure of all previous editions and, therefore, to this one; without his assistance throughout my professional career I doubt very much whether I would have found the field as rewarding and stimulating as it has been. Howard P. Kitt, a senior vice president at National Economic Research Associates, selected and edited a number of cases in this and earlier editions and made important contributions to the structure of the book. I would also like to acknowledge the efforts of Susan Weisberg, Amanda Mardirosian, Lindi Momchilovich, and Andrew Schoenfeld, who carefully proofread each new selection against the official published decisions.

Irwin M. Stelzer

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Monopolization

Traditionally, the antitrust laws have been applied to two types of combines—the so-called close-knit combinations, formed by trust, holding company, merger or consolidation, and the loose-knit confederation to be discussed in Chapter 2. The cases presented below trace the development of court attitudes from the adoption of the “rule of reason” in the *Standard Oil* decision of 1911. This doctrine required the courts to examine the circumstances surrounding the formation of a combination and the pattern of its business behavior to determine whether an intent to monopolize existed. This culminated in the proposition, set forth in the *United States Steel* case, that the law does not make mere size an offense. Some saw a retreat from this position in the *Alcoa* and *American Tobacco* decisions (see Chapter 4)—a move to what they hailed as a “New Sherman Act,” under which the structure of an industry, rather than the behavior of firms in it, would be determinative. Whether these decisions did in fact mark the replacement of the rule of reason with a simple “size is bad” criterion is debatable. But it is generally agreed that these two cases greatly increased the ease with which the antitrust laws could be brought to bear against large firms. But the “rule of reason” survived, even if in modified form.

The *Shoe Machinery* case was an attempt to apply a rule of reason modified to account for the *Alcoa* decision. So, too, with the *Cellophane* case, which is of interest also because it represents an attempt by the judiciary to wrestle with the economist’s concept of workable or effective competition. The *Grinnell* case represents a reaffirmation of the holding of *Alcoa*—that overwhelming monopoly power, consciously acquired, necessarily runs afoul of the Sherman Act. Thus, until the *CalComp* and *Berkey* decisions, things stood about where they had been for 50 years: size alone was not an offense, but its conscious acquisition and use could put it beyond the antitrust pale. These cases represented the leading edge of what now appears to be a distinct shift in approach, a reflection of a growing hesitancy on the part of courts to curb aggressive marketplace

behavior by the large firms, on the grounds that such behavior constitutes "competition-on-the-merits." Actions once thought to constitute clearly unacceptable behavior by large firms seem no longer so easily proscribed, the courts apparently fearing that they would protect inefficient competitors if they limited the behavior of dominant firms too severely.

This shift has since been affirmed in a host of decisions concerning the distinction between competitive and predatory pricing: While the courts have recently retreated somewhat from the relatively rigid view enunciated in *CalComp*, decisions such as *Barry Wright* suggest a judicial reluctance to interfere with individual firm pricing behavior.

It is, of course, unclear whether and to what degree these decisions are colored by the fact that *CalComp* and *Berkey* were private suits brought by aggrieved competitors in pursuit of, among other things, treble damages. Indeed, the consent decree entered in *AT&T* suggests that, to paraphrase Mark Twain, rumors of the Sherman Act's demise are at least somewhat exaggerated.

Standard Oil Company of New Jersey v. United States

221 U.S. 1 (1911)

Note: MR. CHIEF JUSTICE WHITE delivered the opinion of the Court, the legal reasoning of which is abstracted below. The findings of fact, too lengthy to be set forth in detail here, were essentially as follows: Standard of Ohio, organized by John D. and William Rockefeller in 1870, had by 1872 acquired all but 3 or 4 of the 35 to 45 refineries in Cleveland. By obtaining preferential rates and large rebates from the railroads the combination was able to force competitors to join it or be driven out of business. As a result, the combine obtained control of 90 percent of the petroleum industry, a dominance which enabled it to fix the price of both crude and refined petroleum. In 1899 Standard Oil of New Jersey was established as a holding company to replace the Ohio trust. The new organization continued to obtain preferential treatment from railroads, engaged in several unfair practices against competing pipelines so as to obtain control of that means of transportation as well, engaged in local price cutting to suppress competition, set up bogus independents, engaged in industrial espionage, and earned enormous profits. The Court continued:

. . . *The text of the [Sherman Act] and its meaning.*

. . . The debates . . . conclusively show . . . that the main cause which led to the legislation was the thought that it was required by the economic condition of the times; that is, the vast accumulation of wealth in the hands of corporations and individuals, the enormous development of corporate organization, the facility for combination which such organizations afforded, the fact that the facility was being used, and that combinations known as trusts were being multiplied, and the widespread im-

pression that their power had been and would be exerted to oppress individuals and injure the public generally. . . .

There can be no doubt that the sole subject with which the first section deals is restraint of trade as therein contemplated, and that the attempt to monopolize and monopolization is the subject with which the second section is concerned. It is certain that those terms, at least in their rudimentary meaning, took their origin in the common law, and were also familiar in the law of this country prior to and at the time of the adoption of the act in question.

We shall endeavor then, first to seek their meaning . . . by making a very brief reference to the elementary and indisputable conceptions of both the English and American law on the subject prior to the passage of the Antitrust Act. . . .

Without going into detail, and but very briefly surveying the whole field, it may be with accuracy said that the dread of enhancement of prices and of other wrongs which it was thought would flow from the undue limitation on competitive conditions caused by contracts or other acts of individuals or corporations, led, as a matter of public policy, to the prohibition or treating as illegal all contracts or acts which were unreasonably restrictive of competitive conditions, either from the nature or character of the contract or act or where the surrounding circumstances were such as to justify the conclusion that they had not been entered into or performed with the legitimate purpose of reasonably forwarding personal interest and developing trade, but on the contrary were of such a character as to give rise to the inference or presumption that they had been entered into or done with the intent to do wrong to the general public and to limit the right of individuals, thus restraining the free flow of commerce and tending to bring about the evils, such as enhancement of prices, which were considered to be against public policy. It is equally true to say that the survey of the legislation in this country on this subject from the beginning will show, depending as it did, upon the economic conceptions which obtained at the time when the legislation was adopted or judicial decision was rendered, that contracts or acts were at one time deemed to be of such a character as to justify the inference of wrongful intent which were at another period thought not to be of that character. But this again, as we have seen, simply followed the line of development of the law of England.

Let us consider the language of the 1st and 2d sections, guided by the principle that where words are employed in a statute which had at the time a well-known meaning at common law or in the law of this country, they are presumed to have been used in that sense unless the context compels to the contrary.

As to the 1st section. . . . [A]s the contracts or acts embraced in the provision were not expressly defined, since the enumeration addressed itself simply to classes of acts, those classes being broad enough to embrace every conceivable contract or combination which could be made concerning trade or commerce or the subjects of such commerce, and

thus caused any act done by any of the enumerated methods anywhere in the whole field of human activity to be illegal if in restraint of trade, it inevitably follows that the provision necessarily called for the exercise of judgment which required that some standard should be resorted to for the purpose of determining whether the prohibitions contained in the statute had or had not in any given case been violated. Thus not specifying but indubitably contemplating and requiring a standard, it follows that it was intended that the standard of reason which had been applied at the common law in this country in dealing with subjects of the character embraced by the statute, was intended to be the measure used for the purpose of determining whether in a given case a particular act had or had not brought about the wrong against which the statute provided.

And a consideration of the text of the 2d section serves to establish that it was intended to supplement the 1st, and to make sure that by no possible guise could the public policy embodied in the 1st section be frustrated or evaded. . . .

. . . In other words, having by the 1st section forbidden all means of monopolizing trade, that is, unduly restraining it by means of every contract, combination, etc., the 2d section seeks, if possible, to make the prohibitions of the act all the more complete and perfect by embracing all attempts to reach the end prohibited by the 1st section, that is, restraints of trade, by any attempt to monopolize, or monopolization thereof, even although the acts by which such results are attempted to be brought about or are brought about be not embraced within the general enumeration of the 1st section. And, of course, when the 2d section is thus harmonized with and made as it was intended to be the complement of the 1st, it becomes obvious that the criteria to be resorted to in any given case for the purpose of ascertaining whether violations of the section have been committed, is the rule of reason guided by the established law and by the plain duty to enforce the prohibitions of the act, and thus the public policy which its restrictions were obviously enacted to subserve. And it is worthy of observation, as we have previously remarked concerning the common law, that although the statute, by the comprehensiveness of the enumerations embodied in both the 1st and 2d sections, makes it certain that its purpose was to prevent undue restraints of every kind or nature, nevertheless by the omission of any direct prohibition against monopoly in the concrete it indicates a consciousness that the freedom of the individual right to contract when not unduly or improperly exercised was the most efficient means for the prevention of monopoly, since the operation of the centrifugal and centripetal forces resulting from the right to freely contract was the means by which monopoly would be inevitably prevented if no extraneous or sovereign power imposed it and no right to make unlawful contracts having a monopolistic tendency were permitted. In other words that freedom to contract was the essence of freedom from undue restraint on the right to contract. . . .

. . . *The contentions of the parties as to the meaning of the statute and the decisions of this court relied upon concerning those contentions.*

In substance, the propositions urged by the Government are reducible to this: That the language of the statute embraces every contract, combination, etc., in restraint of trade, and hence its text leaves no room for the exercise of judgment, but simply imposes the plain duty of applying its prohibitions to every case within its literal language. The error involved lies in assuming the matter to be decided. This is true because as the acts which may come under the classes stated in the 1st section and the restraint of trade to which that section applies are not specifically enumerated or defined, it is obvious that judgment must in every case be called into play in order to determine whether a particular act is embraced within the statutory classes, and whether if the act is within such classes its nature or effect causes it to be a restraint of trade within the intendment of the act. To hold to the contrary would require the conclusion either that every contract, act, or combination of any kind or nature, whether it operated a restraint on trade or not, was within the statute, and thus the statute would be destructive of all right to contract or agree or combine in any respect whatever as to subjects embraced in interstate trade or commerce, or if this conclusion were not reached, then the contention would require it to be held that as the statute did not define the things to which it related and excluded resort to the only means by which the acts to which it relates could be ascertained—the light of reason—the enforcement of the statute was impossible because of its uncertainty. The merely generic enumeration which the statute makes of the acts to which it refers and the absence of any definition of restraint of trade as used in the statute leaves room for but one conclusion, which is, that it was expressly designed not to unduly limit the application of the act by precise definition, but while clearly fixing a standard, that is, by defining the ulterior boundaries which could not be transgressed with impunity, to leave it to be determined by the light of reason, guided by the principles of law and the duty to apply and enforce the public policy embodied in the statute, in every given case whether any particular act or contract was within the contemplation of the statute.

But, it is said, persuasive as these views may be, they may not be here applied, because the previous decisions of this court have given to the statute a meaning which expressly excludes the construction which must result from the reasoning stated. The cases are *United States v. [Trans-Missouri] Freight Association* . . . and *United States v. Joint Traffic Association*. . . . Both the cases involved the legality of combinations or associations of railroads engaged in interstate commerce for the purpose of controlling the conduct of the parties to the association or combination in many particulars. The association or combination was assailed in each case as being in violation of the statute. It was held that they were. It is undoubted that in the opinion in each case general language was made

use of, which, when separated from its context, would justify the conclusion that it was decided that reason could not be resorted to for the purpose of determining whether the acts complained of were within the statute. It is, however, also true that the nature and character of the contract or agreement in each case was fully referred to and suggestions as to their unreasonableness pointed out in order to indicate that they were within the prohibitions of the statute. As the cases cannot by any possible conception be treated as authoritative without the certitude that reason was resorted to for the purpose of deciding them, it follows as a matter of course that it must have been held by the light of reason, since the conclusion could not have been otherwise reached, that the assailed contracts or agreements were within the general enumeration of the statute, and that their operation and effect brought about the restraint of trade which the statute prohibited. This being inevitable, the deduction can in reason only be this: That in the cases relied upon it having been found that the acts complained of were within the statute and operated to produce the injuries which the statute forbade, that resort to reason was not permissible in order to allow that to be done which the statute prohibited. This being true, the rulings in the case relied upon when rightly appreciated were therefore this and nothing more: That as considering the contracts or agreements, their necessary effect and the character of the parties by whom they were made, they were clearly restraints of trade within the purview of the statute, they could not be taken out of that category by indulging in general reasoning as to the expediency or nonexpediency of having made the contracts or the wisdom or want of wisdom of the statute which prohibited their being made. That is to say, the cases but decided that the nature and character of the contracts, creating as they did, a conclusive presumption which brought them within the statute, such result was not to be disregarded by the substitution of a judicial appreciation of what the law ought to be for the plain judicial duty of enforcing the law as it was made.

But aside from reasoning it is true to say that the cases relied upon do not when rightly construed sustain the doctrine contended for, as established by all of the numerous decisions of this court which have applied and enforced the Anti-trust Act, since they all in the very nature of things, rest upon the premise that reason was the guide by which the provisions of the act were in every case interpreted. . . .

And in order not in the slightest degree to be wanting in frankness, we say that in so far, however, as by separating the general language used in the opinions in the *Freight Association* and *Joint Traffic* cases from the context and the subject and parties with which the cases were concerned, it may be conceived that the language referred to conflicts with the construction which we give the statute, they are necessarily now limited and qualified. . . .

. . . *The facts and the application of the statute to them.*

. . . Giving to the facts . . . the weight which it was deemed they

were entitled to, in the light afforded by the proof of other cognate facts and circumstances, the court below held that the acts and dealings established by the proof operated to destroy the "potentiality of competition" which otherwise would have existed to such an extent as to cause the transfers of stock which were made to the New Jersey corporation and the control which resulted over the many and various subsidiary corporations to be a combination or conspiracy in restraint of trade in violation of the 1st section of the act, but also to be an attempt to monopolize and a monopolization bringing about a perennial violation of the 2d section.

We see no cause to doubt the correctness of these conclusions . . .

a. Because the unification of power and control over petroleum and its products which was the inevitable result of the combining in the New Jersey corporation by the increase of its stock and the transfer to it of the stocks of so many other corporations, aggregating so vast a capital, gives rise, in and of itself, in the absence of countervailing circumstances, to say the least, to the *prima facie* presumption of intent and purpose to maintain the dominancy over the oil industry, not as a result of normal methods of industrial development, but by new means of combination which were resorted to in order that greater power might be added than would otherwise have arisen had normal methods been followed, the whole with the purpose of excluding others from the trade and thus centralizing in the combination a perpetual control of the movements of petroleum and its products in the channels of interstate commerce.

b. Because the *prima facie* presumption of intent to restrain trade, to monopolize and to bring about monopolization . . . is made conclusive by considering, 1, the conduct of the persons . . . instrumental in bringing about the extension of power . . . ; 2, . . . the proof as to what was done under those [trust] agreements . . . as well as by weighing the modes in which the power vested . . . has been exerted and the results which have arisen from it.

. . . [W]e think no disinterested mind can survey the period in question without being irresistibly driven to the conclusion that the very genius for commercial development and organization which it would seem was manifested from the beginning soon begot an intent and purpose to exclude others which was frequently manifested by acts and dealings wholly inconsistent with the theory that they were made with the single conception of advancing the development of business power by usual methods, but which on the contrary necessarily involved the intent to drive others from the field and to exclude them from their right to trade and thus accomplish the mastery which was the end in view. . . . The exercise of the power which resulted from that organization fortifies the foregoing conclusions, since the development which came, the acquisition here and there which ensued of every efficient means by which competition could have been asserted, the slow but resistless methods which followed by which means of transportation were absorbed and brought under control, the system of marketing which was adopted by which the

country was divided into districts and the trade in each district in oil was turned over to a designated corporation within the combination and all others were excluded, all lead the mind up to a conviction of a purpose and intent which we think is so certain as practically to cause the subject not to be within the domain of reasonable contention. . . .

. . . *The remedy to be administered.*

It may be conceded that ordinarily where it was found that acts had been done in violation of the statute, adequate measure of relief would result from restraining the doing of such acts in the future. . . . But in a case like this, where the condition which has been brought about in violation of the statute, in and of itself, is not only a continued attempt to monopolize, but also a monopolization, the duty to enforce the statute requires the application of broader and more controlling remedies. . . .

In applying remedies for this purpose, however, the fact must not be overlooked that injury to the public by the prevention of an undue restraint on, or the monopolization of trade or commerce is the foundation upon which the prohibitions of the statute rest, and moreover that one of the fundamental purposes of the statute is to protect, not to destroy, rights of property. . . .

So far as the decree held that the ownership of the stock of the New Jersey corporation constituted a combination in violation of the 1st section and an attempt to create a monopoly or to monopolize under the 2d section and commanded the dissolution of the combination, the decree was clearly appropriate. . . .

Our conclusion is that the decree below was right and should be affirmed, except as to the minor matters concerning which we have indicated the decree should be modified. Our order will therefore be one of affirmance with directions, however, to modify the decree in accordance with this opinion. The court below to retain jurisdiction to the extent necessary to compel compliance in every respect with its decree.

And it is so ordered.

[MR. JUSTICE HARLAN concurred in part and dissented in part.]

United States v. United States Steel Corporation

251 U.S. 417 (1920)

MR. JUSTICE McKENNA delivered the opinion of the Court.

Suit against the Steel Corporation and certain other companies which it directs and controls by reason of the ownership of their stock, it and they being separately and collectively charged as violators of the Sherman Anti-trust Act.

It is prayed that it and they be dissolved because engaged in illegal restraint of trade and the exercise of monopoly.

Special charges of illegality and monopoly are made and special redresses and remedies are prayed, among others, that there be a prohibition of stock ownership and exercise of rights under such ownership, and that there shall be such orders and distribution of the stock and other properties as shall be in accordance with equity and good conscience and "shall effectuate the purpose of the Anti-trust Act." General relief is also prayed.

The Steel Corporation is a holding company only; the other companies are the operating ones, manufacturers in the iron and steel industry, 12 in number. There are, besides, other corporations and individuals more or less connected with the activities of the other defendants, that are alleged to be instruments or accomplices in their activities and offendings; and that these activities and offendings (speaking in general terms) extend from 1901 to 1911, when the bill was filed. . . .

The case was heard in the District Court by four judges. They agreed that the bill should be dismissed; they disagreed as to the reasons for it. . . . One opinion (written by Judge Buffington and concurred in by Judge McPherson) expressed the view that the Steel Corporation was not formed with the intention or purpose to monopolize or restrain trade, and did not have the motive or effect "to prejudice the public interest by unduly restricting competition or unduly obstructing the course of trade." The corporation, in the view of the opinion, was an evolution, a natural consummation of the tendencies of the industry on account of changing conditions. . . . And the concentration of powers (we are still representing the opinion) was only such as was deemed necessary, and immediately manifested itself in improved methods and products and in an increase of domestic and foreign trade. . . .

Not monopoly, therefore, was the purpose of the organization of the corporation but concentration of efforts with resultant economies and benefits. . . .

All considerations deemed pertinent were expressed and their influence was attempted to be assigned and, while conceding that the Steel Corporation after its formation in times of financial disturbance, entered into informal agreements or understandings with its competitors to maintain prices, they terminated with their occasions, and, as they had ceased to exist, the court was not justified in dissolving the corporation.

The other opinion (by Judge Woolley and concurred in by Judge Hunt . . .) was in some particulars, in antithesis to Judge Buffington's. The view was expressed that neither the Steel Corporation nor the preceding combinations, which were in a sense its antetypes, had the justification of industrial conditions, nor were they or it impelled by the necessity for integration, or compelled to unite in comprehensive enterprise because such had become a condition of success under the new order of things. On the contrary, that the organizers of the corporation and the preceding companies had illegal purpose from the very beginning, and the

corporation became "a combination of combinations, by which, directly or indirectly, approximately 180 independent concerns were brought under one business control," which, measured by the amount of production, extended to 80 percent or 90 percent of the entire output of the country, and that its purpose was to secure great profits which were thought possible in the light of the history of its constituent combinations, and to accomplish permanently what those combinations had demonstrated could be accomplished temporarily, and thereby monopolize and restrain trade.

The organizers, however (we are still representing the opinion), underestimated the opposing conditions and at the very beginning the Corporation instead of relying upon its own power sought and obtained the assistance and the cooperation of its competitors (the independent companies). In other words, the view was expressed that the testimony did "not show that the corporation in and of itself ever possessed or exerted sufficient power when acting alone to control prices of the products of the industry." Its power was efficient only when in cooperation with its competitors, and hence it concerted with them in the expedients of pools, associations, trade meetings, and finally in a system of dinners inaugurated in 1907 by the president of the company, E. H. Gary, and called "the Gary Dinners." The dinners were congregations of producers and "were nothing but trade meetings," successors of the other means of associated action and control through such action. They were instituted first in "stress of panic," but, their potency being demonstrated, they were afterwards called to control prices "in periods of industrial calm." "They were pools without penalties" and more efficient in stabilizing prices. But it was the further declaration that "when joint action was either refused or withdrawn the Corporation's prices were controlled by competition."

The Corporation, it was said, did not at any time abuse the power or ascendancy it possessed. It resorted to none of the brutalities or tyrannies that the cases illustrate of other combinations. . . . It combined its power with that of its competitors. It did not have power in and of itself, and the control it exerted was only in and by association with its competitors. Its offense, therefore, such as it was, was not different from theirs and was distinguished from theirs "only in the leadership it assumed in promulgating and perfecting the policy." This leadership it gave up and it had ceased to offend against the law before this suit was brought. It was hence concluded that it should be distinguished from its organizers and that their intent and unsuccessful attempt should not be attributed to it, that it "in and of itself is not now and has never been a monopoly or a combination in restraint of trade," and a decree of dissolution should not be entered against it.

This summary of the opinions . . . indicates that the evidence admits of different deductions as to the genesis of the Corporation and the pur-

pose of its organizers, but only of a single deduction as to the power it attained and could exercise. Both opinions were clear and confident that the power of the Corporation never did and does not now reach to monopoly, and their review of the evidence, and our independent examination of it, enables us to elect between their respective estimates of it, and we concur in the main with that of Judges Woolley and Hunt. And we add no comment except, it may be, that they underestimated the influence of the tendency and movement to integration, the appreciation of the necessity or value of the continuity of manufacture from the ore to the finished product. . . .

. . . In other words, our consideration should be of not what the Corporation had power to do or did, but what it has now power to do and is doing, and what judgment shall be now pronounced—whether its dissolution, as the Government prays, or the dismissal of the suit, as the Corporation insists?

The alternatives are perplexing—involve conflicting considerations, which, regarded in isolation, have diverse tendencies. . . . Monopoly . . . was not achieved, and competitors had to be persuaded by pools, associations, trade meetings, and through the social form of dinners, all of them, it may be, violations of the law, but transient in their purpose and effect. They were scattered through the years from 1901 (the year of the formation of the Corporation), until 1911, but, after instances of success and failure, were abandoned nine months before this suit was brought. There is no evidence that the abandonment was in prophecy of or dread of suit; and the illegal practices have not been resumed, nor is there any evidence of an intention to resume them, and certainly no "dangerous probability" of their resumption. . . .

What, then can now be urged against the Corporation? Can comparisons in other regards be made with its competitors and by such comparisons guilty or innocent existence be assigned it? It is greater in size and productive power than any of its competitors, equal or nearly equal to them all, but its power over prices was not and is not commensurate with its power to produce.

It is true there is some testimony tending to show that the Corporation had such power, but there was also testimony and a course of action tending strongly to the contrary. The conflict was by the judges of the District Court unanimously resolved against the existence of that power, and in doing so they but gave effect to the greater weight of the evidence. It is certain that no such power was exerted. On the contrary, the only attempt at a fixation of prices was, as already said, through an appeal to and confederation with competitors, and the record shows besides that when competition occurred it was not in pretense, and the Corporation, declined in productive powers—the competitors growing either against or in consequence of the competition. If against the competition we have an instance of movement against what the Government insists was an ir-

resistible force; if in consequence of competition, we have an illustration of the adage that "competition is the life of trade" and is not easily repressed. The power of monopoly in the Corporation under either illustration is an untenable accusation. . . .

. . . [C]ompetitors, dealers, and customers of the Corporation testify in multitude that no adventitious interference was employed to either fix or maintain prices and that they were constant or varied according to natural conditions. Can this testimony be minimized or dismissed by inferring that, as intimated, it is an evidence of power not of weakness; and power exerted not only to suppress competition but to compel testimony, is the necessary inference, shading into perjury to deny its exertion? The situation is indeed singular, and we may wonder at it, wonder that the despotism of the Corporation, so baneful to the world in the representation of the Government, did not produce protesting victims.

But there are other paradoxes. . . . In one, competitors (the independents) are represented as oppressed by the superior power of the Corporation; in the other they are represented as ascending to opulence by imitating that power's prices, which they could not do if at disadvantage from the other conditions of competition; and yet confederated action is not asserted. If it were this suit would take on another cast. The competitors would cease to be the victims of the Corporation, and would become its accomplices. And there is no other alternative. The suggestion that lurks in the Government's contention that the acceptance of the Corporation's prices is the submission of impotence to irresistible power is, in view of the testimony of the competitors, untenable. They, as we have seen, deny restraint in any measure or illegal influence of any kind. The Government, therefore, is reduced to the assertion that the size of the Corporation, the power it may have, not the exertion of the power, is an abhorrence to the law, or, as the Government says, "the combination embodied in the Corporation unduly restrains competition by its *necessary effect* . . . , and therefore is unlawful regardless of purpose." . . . To assent to that, to what extremes should we be led? . . .

We have pointed out that there are several of the Government's contentions which are difficult to represent or measure, and, the one we are now considering, that is, the power is "unlawful regardless of purpose," is another of them. It seems to us that it has for its ultimate principle and justification that strength in any producer or seller is a menace to the public interest and illegal because there is potency in it for mischief. The regression is extreme, but short of it the government cannot stop. The fallacy it conveys is manifest. . . .

. . . The Corporation is undoubtedly of impressive size, and it takes an effort of resolution not to be affected by it or to exaggerate its influence. But we must adhere to the law and the law does not make mere size an offense or the existence of unexerted power an offense. It, we repeat, requires overt acts, and trusts to its prohibition of them and its power to

repress or punish them. It does not compel competition, nor require all that is possible. . . .

. . . We have seen whatever there was of wrong intent could not be executed; whatever there was of evil effect was discontinued before this suit was brought, and this, we think, determines the decree. We say this in full realization of the requirements of the law. It is clear in its denunciation of monopolies and equally clear in its direction that the courts of the Nation shall prevent and restrain them (its language is "to prevent and restrain violations of" the act), but the command is necessarily submissive to the conditions which may exist and the usual powers of a court of equity to adapt its remedies to those conditions. In other words, it is not expected to enforce abstractions and do injury thereby, it may be, to the purpose of the law. It is this flexibility of discretion—indeed essential function—that makes its value in our jurisprudence—value in this case as in others. We do not mean to say that the law is not its own measure, and that it can be disregarded, but only that the appropriate relief in each instance is remitted to a court of equity to determine, not, and let us be explicit in this, to advance a policy contrary to that of the law, but in submission to the law and its policy, and in execution of both. And it is certainly a matter for consideration that there was no legal attack on the Corporation until 1911, 10 years after its formation and the commencement of its career. We do not, however speak of the delay simply as to its time—that there is estoppel in it because of its time—but on account of what was done during that time—the many millions of dollars spent, the development made, and the enterprises undertaken, the investments by the public that have been invited and are not to be ignored. And what of the foreign trade that has been developed and exists? . . .

The Government, however, tentatively presents a proposition which has some tangibility. It submits that certain of the subsidiary companies are so mechanically equipped and so officially directed as to be released and remitted to independent action and individual interests and the competition to which such interests prompt, without any disturbance to business. . . . They are fully intergrated, it is said, possess their own supplies, facilities of transportation and distribution. They are subject to the Steel Corporation. . . in nothing but its control of their prices. We may say parenthetically that they are defendants in the suit and charged as offenders, and we have the strange circumstance of violators of the law being urged to be used as expedients of the law.

But let us see what guide to a procedure of dissolution of the corporation and the dispersion as well of its subsidiary companies, for they are asserted to be illegal combinations, is prayed. And the fact must not be overlooked or underestimated. The prayer of the Government calls for not only a disruption of present conditions, but the restoration of the conditions of 20 years ago, if not literally, substantially. . . .

In conclusion we are unable to see that the public interest will be

served by yielding to the contention of the Government respecting the dissolution of the Company or the separation from it of some of its subsidiaries; and we do see in a contrary conclusion a risk of injury to the public interest, including a material disturbance of, and, it may be serious detriment to, the foreign trade. And in submission to the policy of the law and its fortifying prohibitions the public interest is of paramount regard.

We think, therefore, that the decree of the District Court should be affirmed.

So ordered.

MR. JUSTICE McREYNOLDS and MR. JUSTICE BRANDEIS took no part in the consideration or decision of the case.

MR. JUSTICE DAY, dissenting.

This record seems to me to leave no fair room for a doubt that the defendants, in the United States Steel Corporation and the several subsidiary corporations which make up that organization, were formed in violation of the Sherman Act. I am unable to accept the conclusion which directs a dismissal of the bill instead of following the well-settled practice, sanctioned by previous decisions of this court, requiring the dissolution of combinations made in direct violation of the law.

It appears to be thoroughly established that the formation of the corporations, here under consideration, constituted combinations between competitors, in violation of law, and intended to remove competition and to directly restrain trade. I agree with the conclusions of Judges Woolley and Hunt, expressed in the court below . . . that the combinations were not submissions to business conditions but were designed to control them for illegal purposes, regardless of other consequences, and "were made upon a scale that was huge and in a manner that was wild," and "properties were assembled and combined with less regard to their importance as integral parts of an integrated whole than to the advantages expected from the elimination of the competition which theretofore existed between them." Those judges found that the constituent companies of the United States Steel Corporation, nine in number, were themselves combinations of steel manufacturers, and the effect of the organization of these combinations was to give a control over the industry at least equal to that theretofore possessed by the constituent companies and their subsidiaries; that the Steel Corporation was a combination of combinations by which directly or indirectly 180 independent concerns were brought under one control. . . .

The enormous overcapitalization of companies and the appropriation of \$100,000,000 in stock to promotion expenses were represented in the

stock issues of the new organizations thus formed, and were the basis upon which large dividends have been declared from the profits of the business. This record shows that the power obtained by the corporation brought under its control large competing companies which were of themselves illegal combinations, and succeeded to their power; that some of the organizers of the Steel Corporation were parties to the preceding combinations, participated in their illegality, and by uniting them under a common direction intended to augment and perpetuate their power. It is the irresistible conclusion from these premises that great profits to be derived from unified control were the object of these organizations.

The contention must be rejected that the combination was an inevitable evolution of industrial tendencies compelling union of endeavor. . . .

For many years, as the record discloses, this unlawful organization exerted its power to control and maintain prices by pools, associations, trade meetings, and as the result of discussion and agreements at the so-called "Gary Dinners," where the assembled trade opponents secured cooperation and joint action through the machinery of special committees of competing concerns, and by prudent prevision took into account the possibility of defection, and the means of controlling and perpetuating that industrial harmony which arose from the control and maintenance of prices.

It inevitably follows that the corporation violated the law in its formation and by its immediate practices. The power, thus obtained from the combination of resources almost unlimited in the aggregation of competing organizations, had within its control the domination of the trade, and the ability to fix prices and restrain the free flow of commerce upon a scale heretofore unapproached in the history of corporate organization in this country.

These facts established, as it seems to me they are by the record, it follows that, if the Sherman Act is to be given efficacy, there must be a decree undoing so far as is possible that which has been achieved in open, notorious, and continued violation of its provisions.

I agree that the act offers no objection to the mere size of a corporation, nor to the continued exertion of its lawful power, when that size and power have been obtained by lawful means and developed by natural growth, although its resources, capital and strength may give to such corporation a dominating place in the business and industry with which it is concerned. It is entitled to maintain its size and the power that legitimately goes with it, provided no law has been transgressed in obtaining it. But I understand the reiterated decisions of this court construing the Sherman Act to hold that this power may not legally be derived from conspiracies, combinations, or contracts in restraint of trade. To permit this would be to practically annul the Sherman Law by judicial decree. This principle has been so often declared by the decisions that it is only necessary to refer to some of them. It is the scope of such combinations,

and their power to suppress and stifle competition and create or tend to create monopolies, which, as we have declared so often as to make its reiteration monotonous, it was the purpose of the Sherman Act to condemn, including all combinations and conspiracies to restrain the free and natural flow of trade in the channels of interstate commerce. . . .

As I understand the conclusions of the court, affirming the decree directing dismissal of the bill, they amount to this: that these combinations, both the holding company and the subsidiaries which comprise it, although organized in plain violation and bold defiance of the provisions of the act, nevertheless are immune from a decree effectually ending the combinations and putting it out of their power to attain the unlawful purposes sought, because of some reasons of public policy requiring such conclusion. I know of no public policy which sanctions a violation of the law, nor of any inconvenience to trade, domestic or foreign, which should have the effect of placing combinations, which have been able thus to organize one of the greatest industries of the country in defiance of law, in an impregnable position above the control of the law forbidding such combinations. Such a conclusion does violence to the policy which the law was intended to enforce, runs counter to the decisions of the court, and necessarily results in a practical nullification of the act itself. . . .

Nor can I yield assent to the proposition that this combination has not acquired a dominant position in the trade which enables it to control prices and production when it sees fit to exert its power. Its total assets on December 31, 1913, were in excess of \$1,800,000,000; its outstanding capital stock was \$868,583,600; its surplus \$151,798,428. Its cash on hand ordinarily was \$75,000,000; this sum alone exceeded the total capitalization of any of its competitors, and with a single exception, the total capitalization and surplus of any one of them. That such an organization thus fortified and equipped could if it saw fit dominate the trade and control competition would seem to be a business proposition too plain to require extended argument to support it. Its resources, strength and comprehensive ownership of the means of production enable it to adopt measures to do again as it has done in the past, that is, to effectually dominate and control the steel business of the country. From the earliest decisions of this court it has been declared that it was the effective power of such organizations to control and restrain competition and the freedom of trade that Congress intended to limit and control. That the exercise of the power may be withheld, or exerted with forbearing benevolence, does not place such combinations beyond the authority of the statute which was intended to prohibit their formation, and when formed to deprive them of the power unlawfully attained.

It is said that a complete monopolization of the steel business was never attained by the offending combinations. To insist upon such result would be beyond the requirements of the statute and in most cases practically impossible. . . .

the District Court for a decree of dissolution would not result in a change in the conditions of the steel trade. Such is not the theory of the Sherman Act. That act was framed in the belief that attempted or accomplished monopolization, or combinations which suppress free competition, were hurtful to the public interest, and that a restoration of competitive conditions would benefit the public. We have here a combination in control of one-half of the steel business of the country. If the plan were followed, as in the *American Tobacco* case, of remanding the case to the District Court, a decree might be framed restoring competitive conditions as far as practicable. . . . In my judgment the principles there laid down if followed now would make a very material difference in the steel industry. Instead of one dominating corporation, with scattered competitors, there would be competitive conditions throughout the whole trade which would carry into effect the policy of the law.

It seems to me that if this act is to be given effect, the bill, under the findings of fact made by the court, should not be dismissed, and the cause should be remanded to the District Court, where a plan of effective and final dissolution of the corporations should be enforced by a decree framed for that purpose.

MR. JUSTICE PITNEY and MR. JUSTICE CLARKE concur in this dissent.

*United States v. Aluminum Company of America*¹

148 F.2d 416 (2d Cir. 1945)

Before L. HAND, SWAN, and AUGUSTUS N. HAND, Circuit Judges.

L. HAND, Circuit Judge.

. . . For convenience we have divided our discussion into four parts: (1) whether "Alcoa" monopolized the market in "virgin" aluminum ingot; (2) whether "Alcoa" was guilty of various unlawful practices, ancillary to the establishment of its monopoly; (3) whether [Aluminum] "Limited" and "Alcoa" were in an unlawful conspiracy; and whether, if not, "Limited" was guilty of a conspiracy with foreign producers; (4) what remedies are appropriate in the case of each defendant who may be found to have violated the Act.

I. "ALCOA'S" MONOPOLY OF "VIRGIN" INGOT

There are various ways of computing "Alcoa's" control of the aluminum market—as distinct from its production—depending upon what one

regards as competing in that market. The judge [in the District Court] figured its share—during the years 1929–1938, inclusive—as only about thirty-three percent; to do so he included “secondary,” and excluded that part of “Alcoa’s” own production which it fabricated and did not therefore sell as ingot. If, on the other hand, “Alcoa’s” total production, fabricated and sold, be included, and balanced against the sum of imported “virgin” and “secondary,” its share of the market was in the neighborhood of sixty-four percent for that period. The percentage we have already mentioned—over ninety—results only if we both include all “Alcoa’s” production and exclude “secondary.” That percentage is enough to constitute a monopoly; it is doubtful whether sixty or sixty-four percent would be enough; and certainly thirty-three percent is not. Hence it is necessary to settle what we shall treat as competing in the ingot market. That part of its production which “Alcoa” itself fabricates, does not of course ever reach the market as ingot; and we recognize that it is only when a restriction of production either inevitably affects prices, or is intended to do so, that it violates Section 1 of the Act. . . . However, even though we were to assume that a monopoly is unlawful under Section 2 only in case it controls prices, the ingot fabricated by “Alcoa,” necessarily had a direct effect upon the ingot market. All ingot—with trifling exceptions—is used to fabricate intermediate, or end, products; and therefore all intermediate, or end, products which “Alcoa” fabricates and sells, pro tanto reduce the demand for ingot itself. . . . We cannot therefore agree that the computation of the percentage of “Alcoa’s” control over the ingot market should not include the whole of its ingot production.

As to “secondary,” . . . we can say nothing more definite than that, although “secondary” does not compete at all in some uses, (whether because of “sales resistance” only, or because of actual metallurgical inferiority), for most purposes it competes upon a substantial equality with “virgin.” On these facts the judge found that “every pound of secondary or scrap aluminum which is sold in commerce displaces a pound of virgin aluminum which otherwise would, or might have been, sold.” We agree: so far as “secondary” supplies the demand of such fabricators as will accept it, it increases the amount of “virgin” which must seek sale elsewhere; and it therefore results that the supply of that part of the demand which will accept only “virgin” becomes greater in proportion as “secondary” drives away “virgin” from the demand which will accept “secondary.” (This is indeed the same argument which we used a moment ago to include in the supply that part of “virgin” which “Alcoa” fabricates; it is not apparent to us why the judge did not think it applicable to that item as well.) At any given moment therefore “secondary” competes with “virgin” in the ingot market; further, it can, and probably does, set a limit or “ceiling” beyond which the price of “virgin” cannot go, for the cost of its production will in the end depend only upon the expense of scavenging and reconditioning. It might seem for this reason that in estimating “Alcoa’s” control over the

ingot market, we ought to include the supply of “secondary,” as the judge did. Indeed, it may be thought a paradox to say that anyone has the monopoly of a market in which at all times he must meet a competition that limits his price. We shall show that it is not.

In the case of a monopoly of any commodity which does not disappear in use and which can be salvaged, the supply seeking sale at any moment will be made up of two components: (1) the part which the putative monopolist can immediately produce and sell; and (2) the part which has been, or can be, reclaimed out of what he has produced and sold in the past. By hypothesis he presently controls the first of these components; the second he has controlled in the past, although he no longer does. During the period when he did control the second, if he was aware of his interest, he was guided, not alone by its effect at that time upon the market, but by his knowledge that some part of it was likely to be reclaimed and seek the future market. That consideration will to some extent always affect his production until he decides to abandon the business, or for some other reason ceases to be concerned with the future market. Thus, in the case at bar “Alcoa” always knew that the future supply of ingot would be made up in part of what it produced at the time, and, if it was as far-sighted as it proclaims itself, that consideration must have had its share in determining how much to produce. How accurately it could forecast the effect of present production upon the future market is another matter. Experience, no doubt, would help; but it makes no difference that it had to guess; it is enough that it had an inducement to make the best guess it could, and that it would regulate that part of the future supply, so far as it should turn out to have guessed right. The competition of “secondary” must therefore be disregarded, as soon as we consider the position of “Alcoa” over a period of years; it was as much within “Alcoa’s” control as was the production of the “virgin” from which it had been derived. . . .

We conclude therefore that “Alcoa’s” control over the ingot market must be reckoned at over ninety percent; that being the proportion which its production bears to imported “virgin” ingot. . . .

. . . Was this a monopoly within the meaning of Section 2? The judge found that, over the whole half century of its existence, “Alcoa’s” profits upon capital invested, after payment of income taxes, had been only about ten percent, and, although the plaintiff puts this figure a little higher, the difference is negligible. . . . This assumed, it would be hard to say that “Alcoa” had made exorbitant profits on ingot, if it is proper to allocate the profit upon the whole business proportionately among all its products—ingot, and fabrications from ingot. A profit of ten percent in such an industry, dependent, in part at any rate, upon continued tariff protection, and subject to the vicissitudes of new demands, to the obsolescence of plant and process—which can never be accurately gauged in advance—to the chance that substitutes may at any moment be discovered which will reduce the demand, and to the other hazards which attend all industry; a

profit of ten percent, so conditioned, could hardly be considered extortionate.

There are however, two answers to any such excuse; and the first is that the profit on ingot was not necessarily the same as the profit of the business as a whole, and that we have no means of allocating its proper share to ingot. . . . But the whole issue is irrelevant anyway, for it is no excuse for "monopolizing" a market that the monopoly has not been used to extract from the consumer more than a "fair" profit. The Act has wider purposes. Indeed, even though we disregarded all but economic considerations, it would by no means follow that such concentration of producing power is to be desired, when it has not been used extortionately. Many people believe that possession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; that immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress; that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone. Such people believe that competitors, versed in the craft as no consumer can be, will be quick to detect opportunities for saving and new shifts in production, and be eager to profit by them. In any event the mere fact that a producer, having command of the domestic market, has not been able to make more than a "fair" profit, is no evidence that a "fair" profit could not have been made at lower prices. . . . True, it might have been thought adequate to condemn only those monopolies which could not show that they had exercised the highest possible ingenuity, had adopted every possible economy, had anticipated every conceivable improvement, stimulated every possible demand. No doubt, that would be one way of dealing with the matter, although it would imply constant scrutiny and constant supervision, such as courts are unable to provide. Be that as it may, that was not the way that Congress chose; it did not condone "good trusts" and condemn "bad" ones; it forbade all. Moreover, in so doing it was not necessarily actuated by economic motives alone. It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of a few. These considerations, which we have suggested only as possible purposes of the Act, we think the decisions prove to have been in fact its purposes.

It is settled, at least as to Section 1, that there are some contracts restricting competition which are unlawful, no matter how beneficial they may be; no industrial exigency will justify them; they are absolutely forbidden. . . . Starting, however, with the authoritative premise that all contracts fixing prices are unconditionally prohibited, the only possible difference between them and a monopoly is that while a monopoly necessarily involves an equal, or even greater, power to fix prices, its mere existence might be thought not to constitute an exercise of that power. That distinction is nevertheless purely formal; it would be valid only so

long as the monopoly remained wholly inert; it would disappear as soon as the monopoly began to operate; for, when it did—that is, as soon as it began to sell at all—it must sell at some price and the only price at which it could sell is a price which it itself fixed. Thereafter the power and its exercise must needs coalesce. Indeed it would be absurd to condemn such contracts unconditionally, and not to extend the condemnation to monopolies; for the contracts are only steps toward that entire control which monopoly confers: they are really partial monopolies.

But we are not left to deductive reasoning. Although in many settings it may be proper to weigh the extent and effect of restrictions in a contract against its industrial or commercial advantages, this is never to be done when the contract is made with intent to set up a monopoly. . . . Perhaps, it has been idle to labor the point at length; there can be no doubt that the vice of restrictive contracts and of monopoly is really one, it is the denial to commerce of the supposed protection of competition. To repeat, if the earlier stages are proscribed, when they are parts of a plan, the mere projecting of which condemns them unconditionally, the realization of the plan itself must also be proscribed.

We have been speaking only of the economic reasons which forbid monopoly; but, as we have already implied, there are others, based upon the belief that great industrial consolidations are inherently undesirable, regardless of their economic results. . . . Throughout the history of these [antitrust] statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other. We hold that "Alcoa's" monopoly of ingot was of the kind covered by Section 2.

It does not follow because "Alcoa" had such a monopoly, that it "monopolized" the ingot market: it may not have achieved monopoly; monopoly may have been thrust upon it. If it had been a combination of existing smelters which united the whole industry and controlled the production of all aluminum ingot, it would certainly have "monopolized" the market. . . . We may start therefore with the premise that to have combined ninety percent of the producers of ingot would have been to "monopolize" the ingot market; and, so far as concerns the public interest, it can make no difference whether an existing competition is put an end to, or whether prospective competition is prevented. . . . Nevertheless, it is unquestionably true that from the very outset the courts have at least kept in reserve the possibility that the origin of a monopoly may be critical in determining its legality. . . . This notion has usually been expressed by saying that size does not determine guilt; that there must be some "exclusion" of competitors; that the growth must be something else than "natural" or "normal"; that there must be a "wrongful intent," or some other specific intent; or that some "unduly" coercive means must be used. At times there has been emphasis upon the use of the active verb,

"monopolize," as the judge noted in the case at bar. . . . What engendered these compunctions is reasonably plain; persons may unwittingly find themselves in possession of a monopoly, automatically so to say: that is, without having intended either to put an end to existing competition, or to prevent competition from arising when none had existed; they may become monopolists by force of accident. . . . A single producer may be the survivor out of a group of active competitors, merely by virtue of his superior skill, foresight and industry. . . . The successful competitor, having been urged to compete, must not be turned upon when he wins. . . .

It would completely misconstrue "Alcoa's" position in 1940 to hold that it was the passive beneficiary of a monopoly, following upon an involuntary elimination of competitors by automatically operative economic forces. . . . This increase and this continued and undisturbed control did not fall undesigned into "Alcoa's" lap; obviously it could not have done so. It could only have resulted, as it did result, from a persistent determination to maintain the control, with which it found itself vested in 1912. There were at least one or two abortive attempts to enter the industry, but "Alcoa" effectively anticipated and forestalled all competition, and succeeded in holding the field alone. True, it stimulated demand and opened new uses for the metal, but not without making sure that it could supply what it had evoked. . . . It was not inevitable that it should always anticipate increases in the demand for ingot and be prepared to supply them. Nothing compelled it to keep doubling and redoubling its capacity before others entered the field. It insists that it never excluded competitors; but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connections and the elite of personnel. Only in case we interpret "exclusion" as limited to manoeuvres not honestly industrial, but actuated solely by a desire to prevent competition, can such a course, indefatigably pursued, be deemed not "exclusionary." So to limit it would in our judgment emasculate the Act; would permit just such consolidations as it was designed to prevent. . . .

We disregard any question of "intent." . . . By far the greatest part of the fabulous record piled up in the case at bar, was concerned with proving such an intent. The plaintiff was seeking to show that many transactions, neutral on their face, were not in fact necessary to the development of "Alcoa's" business, and had no motive except to exclude others and perpetuate its hold upon the ingot market. Upon that effort success depended in case the plaintiff failed to satisfy the court that it was unnecessary under Section 2 to convict "Alcoa" of practices unlawful of themselves. The plaintiff has so satisfied us, and the issue of intent ceases to have any importance. . . . In order to fall within Section 2, the monopolist must have both the power to monopolize, and the intent to

monopolize. . . . [N]o monopolist monopolizes unconscious of what he is doing. So here, "Alcoa" meant to keep, and did keep, that complete and exclusive hold upon the ingot market with which it started. That was to "monopolize" that market, however innocently it otherwise proceeded. So far as the judgment held that it was not within Section 2, it must be reversed. . . .

II. "ALCOA'S" UNLAWFUL PRACTICES

[Since it was found that Alcoa had monopolized the ingot market, the question of its unlawful practices would, according to the Court, be moot. But war-wrought changes in the ingot market made consideration of these charges necessary to the proper framing of a decree.]

. . . In spite of the prolixity of the evidence, the challenged practices can be divided into three classes: . . .

(a) "Pre-emption" of Bauxite and Water-Power

The plaintiff attempted to prove, and asserts that it did prove, that "Alcoa" bought up bauxite deposits . . . in excess of its needs, and under circumstances which showed that the purchases were not for the purpose of securing an adequate future supply, but only in order to seize upon any available supply and so assure its monopoly. The very statement of this charge shows that it depends upon "Alcoa's" intent, for, if the purchases provided for the future needs of the business, or for what "Alcoa" honestly believed were its future needs, they were innocent. . . . The judge . . . overruled all the plaintiff's contentions . . . [and] we should be unwarranted in declaring these findings "clearly erroneous." . . .

(b) Suppression of Competitors Seeking to Invade the Ingot Market

[Alcoa's purchases of various potential competitors were treated by the court in the same manner as its purchases of bauxite and water-power sites, i.e., the finding of the lower court that these acquisitions did not evidence an intent to suppress competition was upheld.] . . .

(c) "Alcoa's" Domination of the Fabricating Fields

The last of "Alcoa's" supposedly unlawful practices was its infiltration into, and manipulation of, some of the markets for fabricated goods. These were three kinds: (1) buying an interest in the Aluminum Castings Company, and Aluminum Manufactures, Inc.; (2) the "Price Squeeze"; (3) the "Piston Patent Pool."

(1) "Castings" were one of the earliest uses of aluminum. . . . Five of these [casting producers] combined in . . . [1909] to form the Aluminum Castings Company, of whose shares "Alcoa" received fifty percent in exchange for advances made. . . .

The Aluminum Goods Manufacturing Company makes cooking and

other utensils out of aluminum. . . . At the trial thirty-one percent of the shares were held by "Alcoa" and its officers. . . . [T]here is nothing to support the conclusion that here was a practice or manoeuvre merely to suppress or exclude competitors. . . .

(2) *The "Price Squeeze."* The plaintiff describes as the "Price Squeeze" a practice by which, it says, "Alcoa" intended to put out of business the manufacturers of aluminum "sheet" who were its competitors; for "Alcoa" was itself a large—in fact much the largest—maker of that product. . . .

The plaintiff's theory is that "Alcoa" consistently sold ingot at so high a price that the "sheet rollers," who were forced to buy from it, could not pay the expenses of "rolling" the "sheet."

. . . [W]e think that the plaintiff made out a prima facie case that "Alcoa" had been holding ingot at a price higher than a "fair price," and had reduced the price only because of pressure [resulting from a Department of Justice investigation into the complaints of several "sheet" makers]. If that was not so, it should have rebutted the inference.

In spite of this evidence the judge found that in these years [1925-1932] "Alcoa" had not intended to monopolize the "sheet" market; or to exclude others; or to fix discriminatory prices, or prices of any kind; or to sell below the cost of production, measuring ingot price as part of the cost. . . . That is indeed hard to believe. . . . That it was unlawful to set the price of "sheet" so low and hold the price of ingot so high, seems to us unquestionable, provided, as we have held, that on this record the price of ingot must be regarded as higher than a "fair price." True, this was only a consequence of "Alcoa's" control over the price of ingot, and perhaps it ought not to be considered as a separate wrong; moreover, we do not use it as part of the reasoning by which we conclude that the monopoly was unlawful. But it was at least an unlawful exercise of "Alcoa's" power after it had been put on notice by the "sheet rollers'" complaints; and this is true, even though we assent to the judge's finding that it was not part of an attempt to monopolize the "sheet" market. . . .

(3) *The Piston Patent Situation.* The plaintiff charges "Alcoa" with three kinds of misuses of patents: (1) an unlawful limitation of the production of licensees of its own patents; (2) accepting a license agreement from another patentee that unlawfully limited its own production; (3) using its own patents to force the purchase of ingot upon licensees. [The Court held that in two instances the evidence was not sufficient to establish unlawfulness, while in the third, expiration of the patents involved made it unnecessary for the court to pass upon the agreement.]

III. "LIMITED"

[In this portion of its decision the Court found that cartel arrangements between Limited, a Canadian firm, and Alliance, a Swiss concern, affected imports into the United States and therefore violated the Sherman

Act. It was held, however, that "Alcoa" had not participated in the cartel, and therefore could not be held responsible for the import restrictions.]

IV. THE REMEDIES

Nearly five years have passed since the evidence was closed; during that time the aluminum industry . . . has been revolutionized by the nation's efforts in a great crisis. That alone would make it impossible to dispose of the action upon the basis of the record as we have it. . . .

. . . [I]t is impossible to say what will be "Alcoa's" position in the industry after the war. . . . Dissolution is not a penalty but a remedy; if the industry will not need it for its protection, it will be a disservice to break up an aggregation which has for so long demonstrated its efficiency. . . .

But there is another, and even more persuasive, reason why we should not now adjudge a dissolution of any kind. The Surplus Property Act of 1944 provides . . . [that the disposal agencies shall dispose of government properties in such a manner as] ". . . to give maximum aid in the reestablishment of a peacetime economy of free independent private enterprise"; [and] ". . . to discourage monopolistic practices and to strengthen and preserve the competitive position of small business concerns in an economy of free enterprise." . . . [If the disposal authorities fail to reestablish competitive conditions, it will then be necessary for the District Court to act.]

[An injunction was then issued against resumption of the "price squeeze," and "Limited" was enjoined from entering into any agreement covering imports into this country.]

Judgment reversed, and cause remanded for further proceedings not inconsistent with the foregoing.

United States v. United Shoe Machinery Corp.

110 F. Supp. 295 (D. Mass. 1953)

aff'd per curiam 347 U.S. 521 (1954)

WYZANSKI, District Judge.

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December 15, 1947 the Government filed a complaint against United Shoe Machinery Corporation under Section 4 of the Sherman Act . . . in order to restrain alleged violations of Sections 1 and 2 of that Act. . . .

Stripped to its essentials, the 52-page complaint charged, *first*, that since 1912 United had been "monopolizing interstate trade and commerce in the shoe machinery industry of the United States." The *second* principal charge laid by the complaint was that United had been (*a*)

United States v. E. I. duPont de Nemours and Company

351 U.S. 377 (1956)

MR. JUSTICE REED delivered the opinion of the Court.

The United States brought this civil action under Section 4 of the Sherman Act. . . . The complaint, filed December 13, 1947, . . . charged duPont with monopolizing, attempting to monopolize and conspiracy to monopolize interstate commerce in cellophane and cellulosic caps and bands in violation of Section 2 of the Sherman Act. Relief by injunction was sought against defendant and its officers, forbidding monopolizing or attempting to monopolize interstate trade in cellophane. The prayer also sought action to dissipate the effect of the monopolization by divestiture or other steps. . . . [J]udgment was entered for duPont on all issues.¹

The Government's direct appeal here . . . "attacks only the ruling that duPont has not monopolized trade in cellophane." At issue for determination is only this alleged violation by duPont of Section 2. . . .

During the period that is relevant to this action, duPont produced almost 75% of the cellophane sold in the United States, and cellophane constituted less than 20% of all "flexible packaging material" sales. . . .

The Government contends that, by so dominating cellophane production, duPont monopolized a "part of the trade or commerce" in violation of Section 2. Respondent agrees that cellophane is a product which constitutes "a 'part' of commerce within the meaning of Section 2." . . . But it contends that the prohibition of Section 2 against monopolization is not violated because it does not have the power to control the price of cellophane or to exclude competitors from the market in which cellophane is sold. The court below found that the "relevant market for determining the extent of duPont's market control is the market for flexible packaging materials," and that competition from those other materials prevented duPont from possessing monopoly powers in its sales of cellophane. . . .

The Government . . . argues that the market for other wrappings is distinct from the market for cellophane and that the competition afforded cellophane by other wrappings is not strong enough to be considered in determining whether duPont has monopoly powers. Market delimitation is necessary under duPont's theory to determine whether an alleged monopolist violates Section 2. The ultimate consideration in such a determination is whether the defendants control the price and competition in the market for such part of trade or commerce as they are charged with monopolizing. Every manufacturer is the sole producer of the particular

¹ *United States v. E. I. duPont de Nemours & Co.*, 118 F. Supp. 41. The opinion occupies 192 pages of the volume. The Findings of Fact, 854 in number, cover 140 pages. . . . [Citations to the lower court's findings have been omitted. IMS.]

commodity it makes but its control in the above sense of the relevant market depends upon the availability of alternative commodities for buyers: *i.e.*, whether there is cross-elasticity of demand between cellophane and the other wrappings. This interchangeability is largely gauged by the purchase of competing products for similar uses considering the price, characteristics and adaptability of the competing commodities. The court below found that the flexible wrappings afforded such alternatives. This Court must determine whether the trial court erred in its estimate of the competition afforded cellophane by other materials. . . .

Two additional questions were raised in the record and decided by the court below. That court found, that even if duPont did possess monopoly power over sales of cellophane, it was not subject to Sherman Act prosecution, because (1) the acquisition of that power was protected by patents, and (2) that power was acquired solely through duPont's business expertise. It was thrust upon duPont. . . .

Since the Government specifically excludes attempts and conspiracies to monopolize from consideration, a conclusion that duPont has no monopoly power would obviate examination of these last two issues.

I. FACTUAL BACKGROUND

. . . In the early 1900s Jacques Brandenberger, a Swiss chemist, [inadvertently discovered the first "cellophane."] . . . This first "cellophane" was thick, hard, and not perfectly transparent, but Brandenberger apparently foresaw commercial possibilities in his discovery. . . . He obtained patents to cover . . . his process.

. . . [H]owever, . . . the disclosures of these early patents were not sufficient to make possible the manufacture of commercial cellophane. . . .

In 1917 Brandenberger assigned his patents to La Cellophane Societe Anonyme and joined that organization. . . .

In 1923 duPont organized with La Cellophane an American company for the manufacture of plain cellophane. The undisputed findings are that:

. . . La Cellophane . . . granted duPont Cellophane Company the exclusive right to make and sell in North and Central America under La Cellophane's secret processes for cellophane manufacture. DuPont Cellophane Company granted to La Cellophane exclusive rights for the rest of the world under any cellophane patents or processes duPont Cellophane Company might develop. . . .

Subsequently duPont and La Cellophane licensed several foreign companies, allowing them to manufacture and vend cellophane in limited areas. . . . Technical exchange agreements with these companies were entered into at the same time. However, in 1940, duPont notified these foreign companies that sales might be made in any country, and by 1948 all the technical exchange agreements were canceled.

Sylvania, an American affiliate of a Belgian producer of cellophane,

not covered by the license agreements above referred to, began the manufacture of cellophane in the United States in 1930. Litigation between the French and Belgian companies resulted in a settlement whereby La Cellophane came to have a stock interest in Sylvania, contrary to the La Cellophane-duPont agreement. This resulted in adjustments as compensation for the intrusion into United States of La Cellophane that extended duPont's limited territory. . . . Since 1934 Sylvania has produced about 25% of United States cellophane.

An important factor in the growth of cellophane . . . was the perfection of moistureproof cellophane, a superior product of duPont research and patented by that company through a 1927 application. . . .

In 1931 Sylvania began the manufacture of moistureproof cellophane under its own patents. After negotiations over patent rights, duPont in 1933 licensed Sylvania to manufacture and sell moistureproof cellophane produced under the duPont patents at a royalty of 2% of sales. These licenses, with the plain cellophane licenses from the Belgian Company, made Sylvania a full cellophane competitor, limited on moistureproof sales by the terms of the licenses to 20% of the combined sales of the two companies of that type by the payment of a prohibitive royalty on the excess. . . . There was never an excess production. The limiting clause was dropped on January 1, 1945, and Sylvania was acquired in 1946 by the American Viscose Corporation with assets of over \$200,000,000.

Between 1928 and 1950, duPont's sales of plain cellophane increased from \$3,131,608 to \$9,330,776. Moistureproof sales increased from \$603,222 to \$89,850,416, although prices were continuously reduced. . . . It could not be said that this immense increase in use was solely or even largely attributable to the superior quality of cellophane or to the technique or business acumen of duPont, though doubtless those factors were important. The growth was a part of the expansion of the commodity-packaging habits of business, a by-product of general efficient competitive merchandising to meet modern demands. The profits, which were large, apparently arose from this trend in marketing, the development of the industrial use of chemical research and production of synthetics, rather than from elimination of other producers from the relevant market. . . .

II. THE SHERMAN ACT AND THE COURTS

The Sherman Act has received long and careful application by this Court to achieve for the Nation the freedom of enterprise from monopoly or restraint envisaged by the Congress that passed the Act in 1890. Because the Act is couched in broad terms, it is adaptable to the changing types of commercial production and distribution that have evolved since its passage. . . . It was said in *Standard Oil Co. v. United States*, . . . that fear of the power of rapid accumulations of individual and corporate wealth from the trade and industry of a developing national

economy caused its passage. . . . While the economic picture has changed, large aggregations of private capital, with power attributes, continue. Mergers go forward. Industries such as steel, automobiles, tires, chemicals, have only a few production organizations. A considerable size is often essential for efficient operation. . . .

Judicial construction of antitrust legislation has generally been left unchanged by Congress. This is true of the Rule of Reason. While it is fair to say that the Rule is imprecise, its application in Sherman Act litigation, as directed against enhancement of price or throttling of competition, has given a workable content to antitrust legislation. . . . It was judicially declared a proper interpretation of the Sherman Act in 1911. . . . This Court has not receded from its position on the Rule. There is not, we think, any inconsistency between it and the development of the judicial theory that agreements as to maintenance of prices or division of territory are in themselves a violation of the Sherman Act. It is logical that some agreements and practices are invalid *per se*, while others are illegal only as applied to particular situations. . . .

. . . It is true that Congress has made exceptions to the generality of monopoly prohibitions. . . . But those exceptions express legislative determination of the national economy's need of reasonable limitations on cutthroat competition or prohibition of monopoly. "[W]here exceptions are made, Congress should make them." *United States v. Line Material Co.*, 333 U.S. 287, 310. . . . We therefore turn to Section 2 . . . to determine whether duPont has violated that section by its dominance in the manufacture of cellophane in the before-stated circumstances.

III. THE SHERMAN ACT, SECTION 2—MONOPOLIZATION

The only statutory language of Section 2 pertinent on this review is: "Every person who shall monopolize . . . shall be deemed guilty. . . ." . . . Our cases determine that a party has monopoly power if it has, over "any part of the trade or commerce among the several States," a power of controlling prices or unreasonably restricting competition. . . .

Senator Hoar, in discussing Section 2, pointed out that monopoly involved something more than extraordinary commercial success, "that it involved something like the use of means which made it impossible for other persons to engage in fair competition." This exception to the Sherman Act prohibitions of monopoly power is perhaps the monopoly "thrust upon" one of *United States v. Aluminum Co. of America*, 148 F.2d 416, 429. . . .

If cellophane is the "market" that duPont is found to dominate, it may be assumed it does have monopoly power over that "market." Monopoly power is the power to control prices or exclude competition. It seems apparent that duPont's power to set the price of cellophane has only been

limited by the competition afforded by other flexible packaging materials. Moreover, it may be practically impossible for anyone to commence manufacturing cellophane without full access to duPont's technique. However, duPont has no power to prevent competition from other wrapping materials. The trial court consequently had to determine whether competition from the other wrappings prevented duPont from possessing monopoly power in violation of Section 2. Price and competition are so intimately entwined that any discussion of theory must treat them as one. It is inconceivable that price could be controlled without power over competition or vice versa. This approach to the determination of monopoly power is strengthened by this Court's conclusion in prior cases that, when an alleged monopolist has power over price and competition, an intention to monopolize in a proper case may be assumed.²

If a large number of buyers and sellers deal freely in a standardized product, such as salt or wheat, we have complete or pure competition. Patents, on the other hand, furnish the most familiar type of classic monopoly. As the producers of a standardized product bring about significant differentiations of quality, design, or packaging in the product that permit differences of use, competition becomes to a greater or less degree incomplete and the producer's power over price and competition greater over his article and its use, according to the differentiation he is able to create and maintain. A retail seller may have in one sense a monopoly on certain trade because of location, as an isolated country store or filling station, or because no one else makes a product of just the quality or attractiveness of his product, as for example in cigarettes. Thus one can theorize that we have monopolistic competition in every nonstandardized commodity with each manufacturer having power over the price and production of his own product.³ However, this power that, let us say, automobile or soft-drink manufacturers have over their trademarked products is not the power that makes an illegal monopoly. Illegal power must be appraised in terms of the competitive market for the product.

Determination of the competitive market for commodities depends on how different from one another are the offered commodities in character or use, how far buyers will go to substitute one commodity for another. For example, one can think of building materials as in commodity competition but one could hardly say that brick competed with steel or wood or cement or stone in the meaning of Sherman Act litigation; the products are too different. This is the interindustry competition emphasized by some economists. . . . On the other hand, there are certain differences

in the formulae for soft drinks but one can hardly say that each one is an illegal monopoly. Whatever the market may be, we hold that control of price or competition establishes the existence of monopoly power under Section 2. Section 2 requires the application of a reasonable approach in determining the existence of monopoly power just as surely as did Section 1. This of course does not mean that there can be a reasonable monopoly. . . . Our next step is to determine whether duPont has monopoly power over cellophane: that is, power over its price in relation to or competition with other commodities. The charge was monopolization of cellophane. The defense, that cellophane was merely a part of the relevant market for flexible packaging materials.

IV. THE RELEVANT MARKET

When a product is controlled by one interest, without substitutes available in the market, there is monopoly power. Because most products have possible substitutes, we cannot, as we said in *Times-Picayune Co. v. United States*, 345 U.S. 594, 612, give "that infinite range" to the definition of substitutes. Nor is it a proper interpretation of the Sherman Act to require that products be fungible to be considered in the relevant market.

The Government argues:

We do not here urge that in *no* circumstances may competition of substitutes negative possession of monopolistic power over trade in a product. The decisions make it clear at the least that the courts will not consider substitutes other than those which are substantially fungible with the monopolized product and sell at substantially the same price.

But where there are market alternatives that buyers may readily use for their purposes, illegal monopoly does not exist merely because the product said to be monopolized differs from others. If it were not so, only physically identical products would be a part of the market. To accept the Government's argument, we would have to conclude that the manufacturers of plain as well as moistureproof cellophane were monopolists, and so with films such as Pliofilm, foil, glassine, polyethylene, and Saran, for each of these wrapping materials is distinguishable. These were all exhibits in the case. New wrappings appear, generally similar to cellophane: is each a monopoly? What is called for is an appraisal of the "cross-elasticity" of demand in the trade. . . . The varying circumstances of each case determine the result. In considering what is the relevant market for determining the control of price and competition, no more definite rule can be declared than that commodities reasonably interchangeable by consumers for the same purposes make up that "part of the trade or commerce," monopolization of which may be illegal. As respects flexible packaging materials, the market . . . is nationwide.

Industrial activities cannot be confined to trim categories. Illegal monopolies under Section 2 may well exist over limited products in nar-

² Here the Court cited *United States v. Columbia Steel Co.*, 334 U.S. 495, 525; *United States v. Paramount Pictures*, 334 U.S. 131, 173; and *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 501. IMS.

³ Here the Court cited Chamberlin, *Theory of Monopolistic Competition*, c. IV. IMS.

row fields where competition is eliminated. That does not settle the issue here. In determining the market under the Sherman Act, it is the use or uses to which the commodity is put that control. The selling price between commodities with similar uses and different characteristics may vary, so that the cheaper product can drive out the more expensive. Or, the superior quality of higher priced articles may make dominant the more desirable. Cellophane costs more than many competing products and less than a few. But whatever the price, there are various flexible wrapping materials that are bought by manufacturers for packaging their goods in their own plants or are sold to converters who shape and print them for use in the packaging of the commodities to be wrapped.

Cellophane differs from other flexible packaging materials. From some it differs more than from others. . . . It will adequately illustrate the similarity in characteristics of the various products by noting . . . [that the use of glassine] is almost as extensive as cellophane, . . . and many of its characteristics [are] equally or more satisfactory to users.

It may be admitted that cellophane combines the desirable elements of transparency, strength and cheapness more definitely than any of the others. . . .

But, despite cellophane's advantages, it has to meet competition from other materials in every one of its uses. . . . Food products are the chief outlet, with cigarettes next. The Government makes no challenge to Finding 283 that cellophane furnishes less than 7% of wrappings for bakery products, 25% for candy, 32% for snacks, 35% for meats and poultry, 27% for crackers and biscuits, 47% for fresh produce, and 34% for frozen foods. Seventy-five to 80% of cigarettes are wrapped in cellophane. . . . Thus, cellophane shares the packaging market with others. The over-all result is that cellophane accounts for 17.9% of flexible wrapping materials, measured by the wrapping surface. . . .

Moreover a very considerable degree of functional interchangeability exists between these products. . . . It will be noted . . . that except as to permeability to gases, cellophane has no qualities that are not possessed by a number of other materials. . . . Pliofilm is more expensive . . . but its superior physical characteristics apparently offset cellophane's price advantage. While retailers shift continually between the two, the trial court found that Pliofilm is increasing its share of the business. . . .

An element for consideration as to cross-elasticity of demand between products is the responsiveness of the sales of one product to price changes of the other. If a slight decrease in the price of cellophane causes a considerable number of customers of other flexible wrappings to switch to cellophane, it would be an indication that a high cross-elasticity of demand exists between them; that the products compete in the same market. The court below held that the "[g]reat sensitivity of customers in the flexible packaging markets to price or quality changes" prevented duPont

from possessing monopoly control over price. . . . The record sustains these findings. . . .

We conclude that cellophane's interchangeability with the other materials mentioned suffices to make it a part of this flexible packaging material market.

The Government stresses the fact that the variation in price between cellophane and other materials demonstrates they are noncompetitive. As these products are all flexible wrapping materials, it seems reasonable to consider, as was done at the trial, their comparative cost to the consumer in terms of square area. . . . Cellophane costs two or three times as much, surface measure, as its chief competitors for the flexible wrapping market, glassine and greaseproof papers. Other forms of cellulose wrappings and those from other chemical or mineral substances, with the exception of aluminum foil, are more expensive. The uses of these materials . . . are largely to wrap small packages for retail distribution. The wrapping is a relatively small proportion of the entire cost of the article. Different producers need different qualities in wrappings and their need may vary from time to time as their products undergo change. But the necessity for flexible wrappings is the central and unchanging demand. We cannot say that these differences in cost gave duPont monopoly power over prices in view of the findings of fact on that subject.

It is the variable characteristics of the different flexible wrappings and the energy and ability with which the manufacturers push their wares that determine choice. A glance at "Modern Packaging," a trade journal, will give, by its various advertisements, examples of the competition among manufacturers for the flexible packaging market. The trial judge visited the 1952 Annual Packaging Show at Atlantic City, with the consent of counsel. He observed exhibits offered by "machinery manufacturers, converters and manufacturers of flexible packaging materials." He states that these personal observations confirmed his estimate of the competition between cellophane and other packaging materials. . . .

The record establishes plain cellophane and moistureproof cellophane are each flexible packaging materials which are functionally interchangeable with other flexible packaging materials and sold at same time to same customers for same purpose at competitive prices; there is no cellophane market distinct and separate from the market for flexible packaging materials; the market for flexible packaging materials is the relevant market for determining nature and extent of duPont's market control; and duPont has at all times competed with other cellophane producers and manufacturers of other flexible packaging materials in all aspects of its cellophane business.

The facts above considered dispose also of any contention that competitors have been excluded by duPont from the packaging material market. That market has many producers and there is no proof duPont ever has possessed power to exclude any of them from the rapidly expanding flexible packaging market. The Government apparently concedes as

much, for it states that "lack of power to inhibit entry into this so-called market [i.e., flexible packaging materials], comprising widely disparate products, is no indicium of absence of power to exclude competition in the manufacture and sale of cellophane." The record shows the multiplicity of competitors and the financial strength of some with individual assets running to the hundreds of millions. . . . Indeed, the trial court found that duPont could not exclude competitors even from the manufacture of cellophane, . . . an immaterial matter if the market is flexible packaging material. Nor can we say that duPont's profits, while liberal (according to the Government's 15.9% net after taxes on the 1937-1947 average), demonstrate the existence of a monopoly without proof of lack of comparable profits during those years in other prosperous industries. . . . There is no showing that duPont's rate of return was greater or less than that of other producers of flexible packaging materials. . . .

The "market" which one must study to determine when a producer has monopoly power will vary with the part of commerce under consideration. The tests are constant. The market is composed of products that have reasonable interchangeability for the purposes for which they are produced—price, use and qualities considered. While the application of the tests remains uncertain, it seems to us that duPont should not be found to monopolize cellophane when that product has the competition and interchangeability with other wrappings that this record shows.

On the findings of the District Court, its judgment is *Affirmed*.

MR. JUSTICE CLARK and MR. JUSTICE HARLAN took no part in the consideration or decision of this case.

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MR. JUSTICE FRANKFURTER, concurring.

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MR. CHIEF JUSTICE WARREN, with whom MR. JUSTICE BLACK and MR. JUSTICE DOUGLAS join, dissenting.

This case, like many under the Sherman Act, turns upon the proper definition of the market. In defining the market in which duPont's economic power is to be measured, the majority virtually emasculate Section 2 of the Sherman Act. They admit that "cellophane combines the desirable elements of transparency, strength and cheapness more definitely than any of" a host of other packaging materials. Yet they hold that all of those materials are so indistinguishable from cellophane as to warrant their inclusion in the market. We cannot agree that cellophane, in the language of *Times-Picayune Publishing Co. v. United States* . . . is "the selfsame product" as glassine, greaseproof and vegetable parchment papers, waxed papers, sulphite papers, aluminum foil, cellulose acetate, and Pliofilm and other films.

The majority opinion states that "[I]t will adequately illustrate the similarity in characteristics of the various products by noting here Finding 62 as to glassine." But Finding 62 merely states the respects in which the selected flexible packaging materials are as satisfactory as cellophane; it does not compare all the physical properties of cellophane and other materials. The Table incorporated in Finding 59 does make such a comparison, and enables us to note cellophane's unique combination of qualities lacking among less expensive materials in varying degrees.⁴ Indeed, the majority go further than placing cellophane in the same market with such products. They also include the transparent films, which are more expensive than cellophane. These bear even less resemblance to the lower priced packaging materials than does cellophane. . . .

If the conduct of buyers indicated that glassine, waxed and sulphite papers and aluminum foil were actually "the selfsame products" as cellophane, the qualitative differences demonstrated by the comparison of physical properties in Finding 59 would not be conclusive. But the record provides convincing proof that businessmen did not so regard these products. During the period covered by the complaint (1923-1947) cellophane enjoyed phenomenal growth. DuPont's 1924 production was 361,249 pounds, which sold for \$1,306,662. Its 1947 production was 133,502,858 pounds, which sold for \$55,339,626. Findings 297 and 337. Yet throughout this period the price of cellophane was far greater than that of glassine, waxed paper or sulphite paper. Finding 136 states that in 1929 cellophane's price was even seven times that of glassine; in 1934, four times, and in 1949 still more than twice glassine's price. Reference to DX-994, the graph upon which Finding 136 is based, shows that cellophane had a similar price relation to waxed paper and that sulphite paper sold at even less than glassine and waxed paper. We cannot believe that buyers, practical businessmen, would have bought cellophane in increasing amounts over a quarter of a century if close substitutes were available at from one-seventh to one-half cellophane's price. That they did so is testimony to cellophane's distinctiveness.

The inference yielded by the conduct of cellophane buyers is reinforced by the conduct of sellers other than duPont. Finding 587 states that Sylvania, the only other cellophane producer, absolutely and immediately followed every duPont price change, even dating back its price list to the effective date of duPont's change. Producers of glassine and waxed paper, on the other hand, displayed apparent indifference to duPont's repeated

⁴ The majority opinion quotes at length from Stocking and Mueller, "The Cellophane Case," XLV *Amer. Economic Rev.* 29, 48-49, in noting the comparative characteristics of cellophane and other products. Unfortunately, the opinion fails to quote the conclusion reached by these economists. They state: "The [trial] court to the contrary notwithstanding, the market in which cellophane meets the 'competition' of other wrappers is narrower than the market for all flexible packaging materials." *Id.*, at 52. And they conclude that ". . . cellophane is so differentiated from other flexible wrapping materials that its cross elasticity of demand gives duPont significant and continuing monopoly power." *Id.*, at 63.

and substantial price cuts. DX-994 shows that from 1924 to 1932 duPont dropped the price of plain cellophane 84%, while the price of glassine remained constant. And during the period 1933-1946 the prices for glassine and waxed paper actually increased in the face of a further 21% decline in the price of cellophane. If "shifts of business" due to "price sensitivity" had been substantial, glassine and waxed paper producers who wanted to stay in business would have been compelled by market forces to meet duPont's price challenge just as Sylvania was. . . . Surely there was more than "a slight decrease in the price of cellophane" during the period covered by the complaint. That producers of glassine and waxed paper remained dominant in the flexible packaging materials market without meeting cellophane's tremendous price cuts convinces us that cellophane was not in effective competition with their products.⁵

Certainly duPont itself shared our view. From the first, duPont recognized that it need not concern itself with competition from other packaging materials. For example, when duPont was contemplating entry into cellophane production, its Development Department reported that glassine "is so inferior that it belongs in an entirely different class and has hardly to be considered as a competitor of cellophane." This was still duPont's view in 1950 when its survey of competitive prospects wholly omitted reference to glassine, waxed paper or sulphite paper and stated that "competition for duPont cellophane will come from competitive cellophane and from non-cellophane films made by us or by others."⁶

DuPont's every action was directed toward maintaining dominance over cellophane. Its 1923 agreements with La Cellophane, the French concern which first produced commercial cellophane, gave duPont exclusive North and Central American rights to cellophane's technology, manufacture and sale, and provided, without any limitation in time, that all existing and future information pertaining to the cellophane process be considered "secret and confidential," and be held in an exclusive common pool. In its subsequent agreements with foreign licensees, duPont was careful to preserve its continental market inviolate. In 1929, while it was still the sole domestic producer of cellophane, duPont won its long struggle to raise the tariff from 25% to 60%, ad valorem, on cellophane imports, substantially foreclosing foreign competition. When Sylvania became the second American cellophane producer the following year and duPont filed suit claiming infringement of its moistureproof patents, they settled the suit by entering into a cross-licensing agreement. . . . If close substitutes for cellophane had been commercially available, duPont, an enlightened enterprise, would not have gone to such lengths to control cellophane.

⁵ See Stocking and Mueller, "The Cellophane Case," *XLV Amer. Economic Rev.* 29, 56.

⁶ R. 4070. It is interesting to note that duPont had almost 70% of the market which this report considered relevant.

As predicted by its 1923 market analysis, duPont's dominance in cellophane proved enormously profitable from the outset. After only five years of production, when duPont bought out the minority stock interests in its cellophane subsidiary, it had to pay more than fifteen times the original price of the stock. But such success was not limited to the period of innovation, limited sales and complete domestic monopoly. A confidential duPont report shows that during the period 1937-1947, despite great expansion of sales, duPont's "operative return" (before taxes) averaged 31%, while its average "net return" (after deduction of taxes, bonuses, and fundamental research expenditures) was 15.9%. Such profits provide a powerful incentive for the entry of competitors.⁷ Yet from 1924 to 1951 only one new firm, Sylvania, was able to begin cellophane production. And Sylvania could not have entered if La Cellophane's secret process had not been stolen.⁸ It is significant that for 15 years Olin Industries, a substantial firm, was unsuccessful in its attempt to produce cellophane, finally abandoning the project in 1944 after having spent about \$1,000,000. . . .

The trial court found that

DuPont has no power to set cellophane prices arbitrarily. If prices for cellophane increase in relation to prices of other flexible packaging materials it will lose business to manufacturers of such materials in varying amounts for each of duPont's cellophane's major end uses. Finding 712.

This further reveals its misconception of the antitrust laws. A monopolist seeking to maximize profits cannot raise prices "arbitrarily." Higher prices of course mean smaller sales, but they also mean higher per-unit profit. Lower prices will increase sales but reduce per-unit profit. Within these limits a monopolist has a considerable degree of latitude in determining which course to pursue in attempting to maximize profits. The trial judge thought that, if duPont raised its price, the market would "penalize" it with smaller profits as well as lower sales. DuPont proved him wrong. When 1947 operating earnings dropped below 26% for the first time in 10 years, it increased cellophane's price 7% and boosted its earnings in 1948. DuPont's division manager then reported that "if an opera-

⁷ See Stocking and Mueller, "The Cellophane Case," *XLV Amer. Economic Rev.* 29, 60-63, where the authors compare the domestic economic history of rayon with that of cellophane. The first American rayon producer earned 64.2% on its investment in 1920, thereby attracting duPont. After a loss in 1921, duPont's average return for the next four years was roughly 32%. As more firms began rayon production, duPont's and the industry's return on investment began to drop. When 6 new firms entered the industry in 1930, bringing the number of producers to 20, average industry earnings for that year declined to 5% and duPont suffered a net loss. "From the beginning of the depression in 1929 through the succeeding recovery and the 1938 recession duPont averaged 29.6 percent before taxes on its cellophane investment. On its rayon investment it averaged only 6.3 percent." *Id.*, at 62-63.

⁸ In 1924 two of La Cellophane's principal officials absconded with complete information on the cellophane process. A Belgian concern was then set up to use this process in making cellophane, and it later organized Sylvania as an American affiliate. Findings 615-618.

tive return of 31% is considered inadequate then an upward revision in prices will be necessary to improve the return." It is this latitude with respect to price, this broad power of choice, that the antitrust laws forbid. DuPont's independent pricing policy and the great profits consistently yielded by that policy leave no room for doubt that it had power to control the price of cellophane. The findings of fact cited by the majority cannot affect this conclusion. For they merely demonstrate that, during the period covered by the complaint, duPont was a "good monopolist," *i.e.*, that it did not engage in predatory practices and that it chose to maximize profits by lowering price and expanding sales. Proof of enlightened exercise of monopoly power certainly does not refute the existence of that power.

The majority opinion purports to reject the theory of "interindustry competition." Brick, steel, wood, cement and stone, it says, are "too different" to be placed in the same market. But cellophane, glassine, wax papers, sulphite papers, greaseproof and vegetable parchment papers, aluminum foil, cellulose acetate, Pliofilm and other films are not "too different," the opinion concludes. The majority approach would apparently enable a monopolist of motion picture exhibition to avoid Sherman Act consequences by showing that motion pictures compete in substantial measure with legitimate theatre, television, radio, sporting events and other forms of entertainment. Here, too, "shifts of business" undoubtedly accompany fluctuations in price and "there are market alternatives that buyers may readily use for their purposes." . . . [T]he formula of "reasonable interchangeability," as applied by the majority, appears indistinguishable from the theory of "interindustry competition." The danger in it is that, as demonstrated in this case, it is "perfectly compatible with a fully monopolized economy."⁹

The majority hold in effect that, because cellophane meets competition for many end uses, those buyers for other uses who need or want only cellophane are not entitled to the benefits of competition within the cellophane industry. . . . Furthermore, those buyers who have "reasonable alternatives" between cellophane and other products are also entitled to competition within the cellophane industry, for such competition may lead to lower prices and improved quality.

The foregoing analysis of the record shows conclusively that cellophane is the relevant market. Since duPont has the lion's share of that market, it must have monopoly power, as the majority concede. This being so, we think it clear that, in the circumstances of this case, duPont is guilty of "monopolization." The briefest sketch of duPont's business history precludes it from falling within the "exception to the Sherman Act prohibitions of monopoly power" (majority opinion, pp. 390-391) by suc-

⁹ Adams, "The 'Rule of Reason': Workable Competition or Workable Monopoly?" 63 *Yale L. F.* 348, 364.

cessfully asserting that monopoly was "thrust upon" it. DuPont was not "the passive beneficiary of a monopoly" within the meaning of *United States v. Aluminum Co. of America*, *supra*, at 429-430. It sought and maintained dominance through illegal agreements dividing the world market, concealing and suppressing technological information, and restricting its licensee's production by prohibitive royalties, and through numerous maneuvers which might have been "honestly industrial" but whose necessary effect was nevertheless exclusionary. DuPont cannot bear "the burden of proving that it owes its monopoly *solely* to superior skill. . . ." (Emphasis supplied.) *United States v. United Shoe Machinery Corp.* . . .

Nor can duPont rely upon its moistureproof patents as a defense to the charge of monopolization. Once duPont acquired the basic cellophane process as a result of its illegal 1923 agreements with La Cellophane, development of moistureproofing was relatively easy. DuPont's moistureproof patents were fully subject to the exclusive pooling arrangements and territorial restrictions established by those agreements. And they were the subject of the illicit and exclusionary duPont-Sylvania agreement. Hence, these patents became tainted as part and parcel of duPont's illegal monopoly. Cf., *Mercoird Corp. v. Mid-Continent Co.*, 320 U.S. 661, 670. Any other result would permit one who monopolizes a market to escape the statutory liability by patenting a simple improvement on his product.

If competition is at the core of the Sherman Act, we cannot agree that it was consistent with that Act for the enormously lucrative cellophane industry to have no more than two sellers from 1924 to 1951. The conduct of duPont and Sylvania illustrates that a few sellers tend to act like one and that an industry which does not have a competitive structure will not have competitive behavior. The public should not be left to rely upon the dispensations of management in order to obtain the benefits which normally accompany competition. Such beneficence is of uncertain tenure. Only actual competition can assure long-run enjoyment of the goals of a free economy.

We would reverse the decision below and remand the cause to the District Court with directions to determine the relief which should be granted against duPont.

United States v. Grinnell Corporation

384 U.S. 563 (1966)

MR. JUSTICE DOUGLAS delivered the opinion of the Court.

This case presents an important question under §2 of the Sherman Act. . . . The District Court held for the Government and entered a decree. All parties appeal, the United States because it deems the relief

the geographical area in which the buyer has, or, in the absence of monopoly, would have, a real choice as to price and alternative facilities? This depends upon the facts of the market place, taking into account such economic factors as the distance over which supplies and services may be feasibly furnished, consistently with cost and functional efficiency. . . .

Here, there can be no doubt that the correct geographic market is local. The services at issue are intensely local: they can be furnished only locally. The business as it is done is local—not nationwide. If, as might well be the case on this record, defendants were found to have violated the Sherman Act in a number of these local areas, a proper decree, directed to those markets, as well as to general corporate features relevant to the condemned practices, could be fashioned. . . . This Court now directs the trial court to require “some [unspecified] divestiture” locally by the alarm companies. This is a recognition of the economic reality that the relevant competitive areas are local. . . .

The trial court’s definition of the “product” market even more dramatically demonstrates that its action has been Procrustean—that it has tailored the market to the dimensions of the defendants. It recognizes that a person seeking protective services has many alternative sources. . . . The court relies solely upon its finding that the services offered by accredited central stations are of better quality, and upon its conclusion that the insurance companies tend to give “noticeably larger” discounts to policyholders who use accredited central station protective services. The Court now approves this strange red-haired, bearded, one-eyed man-with-a-limp classification. . . .

Moreover, we are told that the “relevant market” must assume this strange and curious configuration despite evidence in the record and a finding of the trial court that “fringe competition” from such locally available alternatives as watchmen, local alarm systems, proprietary systems, and unaccredited central stations has, in at least 20 cities, forced the defendants to operate at a “loss” even though defendants have a total monopoly in these cities of the “market”—namely, the “accredited central station protective services.” And we are led to this odd result even though there is in the record abundant evidence that customers switch from one form of property protection to another, and not always in the direction of accredited central station service.

I believe this approach has no justification in economics, reason or law. . . . As this Court held in *Brown Shoe* . . . , the “reasonable interchangeability of use or the cross-elasticity of demand,” determines the boundaries of a product market. 370 U.S., at 325. See also the *Cellophane* case, 351 U.S., at 380. In plain language, this means that the court should have defined the relevant market here to include all services which, in light of geographical availability, price and use characteristics, are in realistic rivalry for all or some part of the business of furnishing protective services to premises. . . .

I do not suggest that wide disparities in quality, price and customer appeal could never affect the definition of the market. But this follows only where the disparities are so great that they create separate and distinct categories of buyers and sellers. The record here and the findings do not approach this standard. They fall far short of justifying the narrowing of the market as practiced here. I need refer only to the exclusion of nonaccredited central stations, which the court seeks to justify by reference to differentials in insurance discounts. These differentials may indeed affect the relative cost to the consumer of the competing modes of protection. But, in the absence of proof that they result in eliminating the competing services from the category of those to which the purchaser “can practicably turn” for supplies,⁶ they do not justify such total exclusion. This sort of exclusion of the supposedly not-quite-so-attractive service from the basic definition of the kinds of business and service against which defendants’ activity will be measured, is entirely unjustified on this record.⁷ . . .

. . . Now, because of this Court’s mandate, the market-by-market inquiry must begin for purposes of the decree. But this should have been the foundation of judgment, not its superimposed conclusion. This inquiry should—in my opinion, it must—take into account the *total* economic situation—all of the options available to one seeking protection services. It should not be limited to central stations, and certainly not to “insurance accredited central station protective services” which this Court sanctions as the relevant market. . . .

Berkey Photo, Inc. v. Eastman Kodak Company

603 F.2d 263 (2d Cir. 1979)

Cert. denied, 444 U.S. 1093 (1980)

KAUFMAN, Chief Judge.

INTRODUCTION

To millions of Americans, the name Kodak is virtually synonymous with photography. Founded over a century ago by George Eastman, the Eastman Kodak Company has long been the preeminent firm in the

⁶ *Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S., at 327.

⁷ The example used by the court in its findings is illuminating and disturbing. In explanation of its narrow market definition, the court says that the difference between the accredited central station protective services and all others “could be compared” to the difference between a compact six-cylinder car and a chauffeur-driven sedan. It is probably true that the degree of direct competition between luxury automobiles and compacts is slight. But it is by no means as clear-cut as the trial court seems to suggest. The question would require careful analysis in light of the total facts and issues. For example, if the antitrust problem at hand involved an acquisition of the business of a manufacturer of compacts by a maker of luxury cars, it is by no means inconceivable that sufficient competitive overlap would be found to place both products in the “relevant market.”

amateur photographic industry. It provides products and services covering every step in the creation of an enduring photographic record from an evanescent image. Snapshots may be taken with a Kodak camera on Kodak film, developed by Kodak's Color Print and Processing Laboratories, and printed on Kodak photographic paper. The firm has rivals at each stage of this process, but in many of them it stands, and has long stood, dominant. It is one of the giants of American enterprise, with international sales of nearly \$6 billion in 1977 and pretax profits in excess of \$1.2 billion.

This action, one of the largest and most significant private antitrust suits in history, was brought by Berkey Photo, Inc., a far smaller but still prominent participant in the industry. Berkey competes with Kodak in providing photofinishing services—the conversion of exposed film into finished prints, slides, or movies. Until 1978, Berkey sold cameras as well. It does not manufacture film, but it does purchase Kodak film for resale to its customers, and it also buys photofinishing equipment and supplies, including color print paper, from Kodak.

The two firms thus stand in a complex, multifaceted relationship, for Kodak has been Berkey's competitor in some markets and its supplier in others. In this action, Berkey claims that every aspect of the association has been infected by Kodak's monopoly power in the film, color print paper, and camera markets, willfully acquired, maintained, and exercised in violation of §2 of the Sherman Act. . . . It also charges that Kodak conspired with flashlamp manufacturers in violation of §1 of the Act. . . . A number of the charges arise from Kodak's 1972 introduction of the 110 photographic system, featuring a Pocket Instamatic camera and a new color print film, Kodacolor II, but the case is not limited to that episode. It embraces many of Kodak's activities for the last decade and, indeed, from preceding years as well. . . .

I. THE AMATEUR PHOTOGRAPHIC INDUSTRY

. . . It is, of course, a basic principle in the law of monopolization that the first step in a court's analysis must be a definition of the relevant markets. . . .

The principal markets relevant here, each nationwide in scope, are amateur conventional still cameras, conventional photographic film, photofinishing services, photofinishing equipment, and color print paper. The numerous technological interactions among the products and services constituting these markets are manifest. To take an obvious example, not only are both camera and film required to produce a snapshot, but the two must be in compatible formats. This means that the film must be cut to the right size and spooled in a roll or cartridge that will fit the camera mechanism. Berkey charges that Kodak refused to supply on economical terms film usable with camera formats designed by other manufactures,

thereby exploiting its film monopoly to obstruct its rivals in the camera market. Similarly, Berkey contends, since the emulsions and other constituents of a film determine the chemicals and processes required to develop it, Kodak was able to project its power over film into the photofinishing market as well. . . .

A. The Camera Market

The amateur conventional still camera market now consists almost entirely of the so-called 110 and 126 instant-loading cameras. These are the direct descendants of the popular box cameras, the best-known of which was Kodak's so-called Brownie. Small, simple, and relatively inexpensive, cameras of this type are designed for the mass market rather than for the serious photographer.¹

Kodak has long been the dominant firm in the market thus defined. Between 1954 and 1973 it never enjoyed less than 61 percent of the annual unit sales, nor less than 64 percent of the dollar volume, and in the peak year of 1964, Kodak cameras accounted for 90 percent of market revenues. Much of this success is no doubt due to the firm's history of innovation. In 1963 Kodak first marketed the 126 Instamatic instant-loading camera, . . . and in 1972 it came out with the much smaller 110 Pocket Instamatic. Not only are these cameras small and light, but they employ film packaged in cartridges that can simply be dropped in the back of the camera, thus obviating the need to load and position a roll manually. Their introduction triggered successive revolutions in the industry. Annual amateur still camera sales in the United States averaged 3.9 million units between 1954 and 1963, with little annual variation. In the first full year after Kodak's introduction of the 126, industry sales leaped 22 percent, and they took an even larger quantum jump when the 110 came to market. Other camera manufacturers, including Berkey, copied both these inventions, but for several months after each introduction anyone desiring to purchase a camera in the new format was perforce remitted to Kodak.

Berkey has been a camera manufacturer since its 1966 acquisition of the Keystone Camera Company, a producer of movie cameras and equipment. . . . In 1968 Berkey began to sell amateur still cameras made by other firms, and the following year the Keystone Division commenced manufacturing such cameras itself. From 1970 to 1977, Berkey accounted for 8.2 percent of the sales in the camera market in the United States, . . . reaching a peak of 10.2 percent in 1976. In 1978, Berkey sold its camera division and thus abandoned this market.

¹ More complicated cameras, such as those in the 135 format (35-millimeter) commonly used by professionals and photographic hobbyists, were found not to be part of this market. The jury also rejected Kodak's request to include in the definition instant cameras, pioneered by the Polaroid Corporation, which produce a finished print within minutes, or even seconds, after the shutter is snapped.

B. The Film Market

The relevant market for photographic film comprises color print, color slide, color movie, and black-and-white film.² Kodak's grip on this market is even stronger than its hold on cameras. Since 1952, its annual sales have always exceeded 82 percent of the nationwide volume on a unit basis, and 88 percent in revenues. Foreign competition has recently made some inroads into Kodak's monopoly, but the Rochester firm concedes that it dominated film sales throughout the period relevant to this case. Indeed, in his summation, Kodak's trial counsel told the jury that "the film market . . . has been a market where there has not been price competition and where Kodak has been able to price its products pretty much without regard to the products of competitors."

Kodak's monopoly in the film market is particularly important to this case, because the jury accepted Berkey's contention, noted above, that it had been used to disadvantage rivals in cameras, photofinishing, photofinishing equipment, and other markets. Of special relevance to this finding is the color print film segment of the industry, which Kodak has dominated since it introduced Kodacolor, the first amateur color print film, in 1942. . . . In 1963, when Kodak announced the 126 Instamatic camera, it also brought out a new, faster color print film—Kodacolor X—which was initially available to amateur photographers only in the 126 format.³ Nine years later, Kodak repeated this pattern with the simultaneous introduction of the 110 Pocket Instamatic and Kodacolor II film. For more than a year, Kodacolor II was made only for 110 cameras, and Kodak has never made any other color print film in the 110 size.

C. Photofinishing Services and Photofinishing Equipment

Before 1954, Kodak's Color Print and Processing Laboratories (CP&P) had a nearly absolute monopoly of color photofinishing maintained by a variety of practices. Accounting for over 95 percent of color film sales, Kodak sold every roll with an advance charge for processing included. Consumers had little choice but to purchase Kodak film, and in so doing they acquired the right to have that film developed and printed by CP&P at no further charge. Since few customers would duplicate their costs to procure the services of a non-Kodak photofinisher, Kodak was able to

² The jury included movie film and 35-millimeter film in this market, presumably because they are substantially identical to the film used in amateur still cameras. Instant film, however, a product chemically distinct from laboratory-processed film, was excluded.

³ . . . "Film speed" refers to an emulsion's sensitivity to light. Thus Kodacolor X—as compared to its predecessor—could produce acceptable images under markedly inferior lighting conditions.

parlay its film monopoly to achieve equivalent market power in photofinishing.⁴

This film/processing tie-in attracted the attention of the Justice Department, and in 1954 a consent decree changed the structure of the color photofinishing market drastically. Kodak was forbidden to link photofinishing to film sales, and it agreed to make its processing technology, chemicals, and paper available to rivals at reasonable rates. As a result, CP&P's share of the market plummeted from 96 percent in 1954 to 69 percent two years later, and it has declined sharply ever since. In 1970, CP&P accounted for but 17 percent of the market, and by 1976 its share reached a low of 10 percent. There are now approximately 600 independent photofinishers in the United States.

Berkey is one of the largest of these processors. It has been a photofinisher since 1933, but until 1954 its principal business was developing and printing black-and-white film. . . . In addition, Berkey purchased Kodak black-and-white film, which was sold without a processing tie-in, for resale to its photofinishing customers. After the 1954 decree, Berkey applied to Kodak for the appropriate licenses and in 1956 began to process significant amounts of color film. It now finishes more 126 and 110 color print film than does Kodak. . . .

D. The Color Paper Market

The market for color paper—that is, paper specially treated so that images from color film may be printed on it—effectively came into being after entry of the 1954 consent decree. Before then, Kodak was for all practical purposes the only color photofinisher, and its requirements for color paper were met entirely by the paper division of Kodak Park Works in Rochester. The remaining processors, who dealt with non-Kodak color film and used non-Kodak paper, occupied only 4 percent of the color photofinishing market. Consequently, the vertical foreclosure created by CP&P's lock on photofinishing and its exclusive use of Kodak color paper was virtually complete.

Although the 1954 decree steadily loosened Kodak's grip in photofinishing, it did not immediately affect the firm's control of color paper. For more than a decade, the independent photofinishers that sprang up after the decree was entered looked only to Kodak for their paper supplies. Indeed, although entry by both foreign and domestic paper manufacturers has reduced Kodak's share substantially, to a low of 60

⁴ To be sure, Kodak could not in this fashion control the market for color reprints—production of additional prints from slides or negatives. Here it resorted to other tactics. By refusing to sell the special paper or chemicals necessary to produce such reprints to rival photofinishers, it ensured—since there was no other adequate source for these supplies—that even this segment of the market did not escape its grip.

percent in 1976, the firm's color paper operations have remained remarkably profitable. Between 1968 and 1975, while its market share was falling from 94 percent to 67 percent, Kodak's earnings from operations as a percentage of sales remained virtually constant, averaging 60 percent for the period. Moreover, the most recent telling event in the market has not been entry but exit: GAF Corporation announced in 1977 that it was abandoning its effort to sell color paper, leaving Kodak with only one domestic and two foreign competitors.

Kodak, then, is indeed a titan in its field, and accordingly has almost inevitably invited attack under §2 of the Sherman Act. Few, if any, cases have presented so many diverse and difficult problems of §2 analysis. . . .

II. §2 OF THE SHERMAN ACT

. . . In passing the Sherman Act, Congress recognized that it could not enumerate all the activities that would constitute monopolization. . . . In performing that task, the courts have enunciated certain principles that by now seem almost elementary to any student of antitrust law. But, because §2 must reconcile divergent and sometimes conflicting policies it has been difficult to synthesize the parts into a coherent and consistent whole. To provide a framework for deciding the issues presented by this case, therefore, we begin by stating what we conceive to be the fundamental doctrines of §2.

A. Monopoly Power as the Essence of the §2 Violation

The gravamen of a charge under §1 of the Sherman Act is conduct in restraint of trade; no fundamental alteration of market structure is necessary. Thus, certain restrictive practices among competitors, such as price fixing, are illegal per se. That the conspirators lack the market power to affect prices is immaterial. . . . Section 2, by contrast, is aimed primarily not at improper conduct but at a pernicious market structure in which the concentration of power saps the salubrious influence of competition. . . .

This tenet is well grounded in economic analysis. There is little disagreement that a profit-maximizing monopolist will maintain his prices higher and his output lower than the socially optimal levels that would prevail in a purely competitive market. . . . The price excess represents not a reasonable return on investment but the spoils of the monopolist's power. . . .

It is not a defense to liability under §2 that monopoly power has not been used to charge more than a competitive price or extract greater than a reasonable profit. LEARNED HAND stated the rationale in the *Alcoa* case, *United States v. Aluminum Co. of America*, 148 F.2d 416, 427 (2d Cir. 1945). . . . JUDGE HAND explained, in addition, that Congress

was not "actuated by economic motives alone" in enacting §2. Id. Considerations of political and social policy form a major part of our aversion to monopolies, for concentration of power in the hands of a few obstructs opportunities for the rest.

Because, like all power, it is laden with the possibility of abuse; because it encourages sloth rather than the active quest for excellence; and because it tends to damage the very fabric of our economy and our society, monopoly power is "inherently evil." *United States v. United Shoe Machinery Corp.*, 110 F. Supp. 295, 345 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954). . . . If a finding of monopoly power were all that were necessary to complete a violation of §2, our task in this case would be considerably lightened. Kodak's control of the film and color paper markets clearly reached the level of a monopoly. And, while the issue is a much closer one, it appears that the evidence was sufficient for the jury to find that Kodak possessed such power in the camera market as well.⁵ But our inquiry into Kodak's liability cannot end there.

B. The Requirement of Anticompetitive Conduct

Despite the generally recognized evils of monopoly power, it is "well settled" . . . that §2 does not prohibit monopoly *simpliciter*—or, as the Supreme Court phrased it in the early landmark case of *Standard Oil Co. of New Jersey*, *supra*, 221 U.S. at 62, "monopoly in the concrete."

Thus, while proclaiming vigorously that monopoly power is the evil at which §2 is aimed, courts have declined to take what would have appeared to be the next logical step—declaring monopolies unlawful per se unless specifically authorized by law. To understand the reason for this, one must comprehend the fundamental tension—one might almost say the paradox—that is near the heart of §2. This tension creates much of the confusion surrounding §2. It makes the cryptic *Alcoa* opinion a litigant's wishing well, into which, it sometimes seems, one may peer and find nearly anything he wishes.

The conundrum was indicated in characteristically striking prose by Judge Hand, who was not able to resolve it. Having stated that Congress "did not condone 'good trusts' and condemn 'bad' ones; it forbade all," *Alcoa*, *supra*, 148 F.2d at 427, he declared with equal force, "The successful competitor, having been urged to compete, must not be turned upon when he wins," *id.* at 430. Hand, therefore, told us that it would be inherently unfair to condemn success when the Sherman Act itself mandates competition. Such a wooden rule, it was feared, might also deprive

⁵ . . . Kodak sold approximately two thirds of all amateur conventional still cameras throughout most of the relevant period. The frequency with which flashlamp manufacturers approached Kodak with suggestions for joint development of products and their willingness to acquiesce in arguably one-sided agreements is further evidence of Kodak's power in the camera market. . . . The precipitous decline, beginning in 1976, of Kodak's share of the camera market was evidence that the jury could consider, although it was not dispositive.

the leading firm in an industry of the incentive to exert its best efforts. Further success would yield not rewards but legal castigation. The anti-trust laws would thus compel the very sloth they were intended to prevent. We must always be mindful lest the Sherman Act be invoked perversely in favor of those who seek protection against the rigors of competition. . . .

In *Alcoa* the crosscurrents and pulls and tugs of §2 law were reconciled by noting that, although the firm controlled the aluminum ingot market, "it may not have achieved monopoly; monopoly may have been thrust upon it." 148 F.2d at 429. In examining this language, which would condemn a monopolist unless it is "the passive beneficiary of a monopoly," id. at 430, we perceive Hand the philosopher. As an operative rule of law, however, the "thrust upon" phrase does not suffice. It has been criticized by scholars, . . . and the Supreme Court appears to have abandoned it. See *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966). . . . *Grinnell* instructs that after possession of monopoly power is found, the second element of the §2 offense is "the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." 384 U.S. at 570-71. . . .

But the law's hostility to monopoly power extends beyond the means of its acquisition. Even if that power has been legitimately acquired, the monopolist may not wield it to prevent or impede competition. Once a firm gains a measure of monopoly power, whether by its own superior competitive skill or because of such actions as restrictive combinations with others, it may discover that the power is capable of being maintained and augmented merely by using it. . . . That is, a firm that has achieved dominance of a market must find its control sufficient to preserve and even extend its market share by excluding or preventing competition. A variety of techniques may be employed to achieve this end—predatory pricing, lease-only policies, and exclusive buying arrangements, to list a few.

Even if the origin of the monopoly power was innocent, therefore, the *Grinnell* rule recognizes that maintaining or extending market control by the exercise of that power is sufficient to complete a violation of §2. As we have explained, only considerations of fairness and the need to preserve proper economic incentives prevent the condemnation of §2 from extending even to one who has gained his power by purely competitive means. The district court judge correctly indicated that such a monopolist is tolerated but not cherished. . . .

The key to analysis, it must be stressed, is the concept of market power. Although power may be derived from size, . . . the two are not identical. . . . A firm that has lawfully acquired a monopoly position is not barred from taking advantage of scale economies by constructing, for example, a large and efficient factory. These benefits are a consequence

of size and not an exercise of power over the market.⁶ Nevertheless, many anticompetitive actions are possible or effective only if taken by a firm that dominates its smaller rivals. . . . Such conduct is illegal when taken by a monopolist because it tends to destroy competition, although in the hands of a smaller market participant it might be considered harmless, or even "honestly industrial." *Alcoa, supra*, 148 F.2d at 431.

In sum, although the principles announced by the §2 cases often appear to conflict, this much is clear. The mere possession of monopoly power does not ipso facto condemn a market participant. But, to avoid the proscriptions of §2, the firm must refrain at all times from conduct directed at smothering competition. This doctrine has two branches. Unlawfully acquired power remains anathema even when kept dormant. And it is no less true that a firm with a legitimately achieved monopoly may not wield the resulting power to tighten its hold on the market.

C. Monopoly Power as a Lever in Other Markets

It is clear that a firm may not employ its market position as a lever to create—or attempt to create—a monopoly in another market. . . . Kodak, in the period relevant to this suit, was never close to gaining control of the markets for photofinishing equipment or services and could not be held to have attempted to monopolize them. . . . Berkey nevertheless contends that Kodak illicitly gained an advantage in these areas by leveraging its power over film and cameras. Accordingly, we must determine whether a firm violates §2 by using its monopoly power in one market to gain a competitive advantage in another, albeit without an attempt to monopolize the second market. We hold, as did the lower court, that it does.

This conclusion appears to be an inexorable interpretation of the anti-trust laws. We tolerate the existence of monopoly power, we repeat, only insofar as necessary to preserve competitive incentives and to be fair to the firm that has attained its position innocently. There is not reason to allow the exercise of such power to the detriment of competition in either the controlled market or any other. That the competition in the leveraged market may not be destroyed but merely distorted does not make it more palatable. Social and economic effects of an extension of monopoly power militate against such conduct. . . .

This rule is linked to the prohibition against tying arrangements in the sale of goods and services. . . . And to condemn a tie, the market for the

⁶ Nor is a lawful monopolist ordinarily precluded from charging as high a price for its product as the market will accept. True, this is a use of economic power; indeed, the differential between price and marginal cost is used as an indication of the degree of monopoly power. . . . But high prices, far from damaging competition, invite new competitors into the monopolized market. . . . Excessive prices may, however, create an illegal price squeeze in another market. . . .

tied product need not be monopolized. It suffices that a "substantial" amount of competition is foreclosed. . . .

Accordingly, the use of monopoly power attained in one market to gain a competitive advantage in another is a violation of §2, even if there has not been an attempt to monopolize the second market. It is the use of economic power that creates the liability. But, as we have indicated, a large firm does not violate §2 simply by reaping the competitive rewards attributable to its efficient size, nor does an integrated business offend the Sherman Act whenever one of its departments benefits from association with a division possessing a monopoly in its own market. So long as we allow a firm to compete in several fields, we must expect it to seek the competitive advantages of its broad-based activity—more efficient production, greater ability to develop complementary products, reduced transaction costs, and so forth. These are gains that accrue to any integrated firm, regardless of its market share, and they cannot by themselves be considered uses of monopoly power.

We shall now apply to the case at bar the principles we have set forth above.

III. THE 110 SYSTEM

We commented earlier on the camera revolution sparked by Kodak's introduction of the 126 Instamatic in 1963. Ben Berkey, chairman of Berkey Photo, described the camera's cartridge-loading feature as "fool-proof" and remarked that the new simple system gave the industry "a great boost." Even before the 126 was introduced, however, Kodak had set its sights on a new, smaller line of Instamatic cameras. The aim of Kodak's Project 30, or P-30, as it was often called, was a camera barely one inch thick but capable of producing photographs as clear and large as its bulkier cousins. . . .

The early view at P-30 had been that . . . Kodacolor X [Kodak's color print film then in use] would prove "quite adequate" for the new format. By 1966, however, the Kodacolor Future System Committee, considering Kodak's film sales in the 126 size as well as in the format being created by Project 30, began actively to consider the possibility of developing a new type of Kodacolor film. . . . [T]he committee realized that basic changes in the film would require a new photofinishing process, conducted at temperatures higher than those used in the so-called C-22 method by which prints were made from Kodacolor X. Some committee members, therefore, expressed concern about the effect that a new process might have on independent photofinishers, who developed Kodak film and were purchasers of Kodak equipment and supplies. These concerns were shared by a number of Kodak scientists, such as D. M. Zwick, who feared an "unethical" attempt to create a "deliberate . . . incompatibility with systems other than Kodacolor." . . .

Nevertheless, on May 10, 1967, the committee recommended that Kodak proceed with the development of the new film and finishing process, tentatively labelled P-118. . . . [B]y 1969 Kodak decided that P-118 should be used to help launch the P-30 camera system in March 1972. This decision appears to have been influenced by the views of those Kodak officers who believed that

[w]ithout a new film, the [camera] program is not a new advertisable system. Without the film, our splicer and processors [for the new high-temperature photo-finishing process] are not required.

. . . Shortly after initial production runs began in October 1971, Kodak recognized that "several product deficiencies" would exist in the film, now called Kodacolor II, at the time of introduction. . . . Not only did Kodacolor II have a significantly shorter shelf life than had been anticipated, but it also proved grainier than Kodak had originally hoped. This problem was highly significant . . . because low graininess was supposedly the quality that made Kodacolor II especially suitable for the Pocket Instamatic cameras.⁷

Despite these deficiencies, Kodak proceeded with its plans for introduction of the 110 system, of which Kodacolor II had become an integral part. On March 16, 1972, amid great fanfare, the system was announced. Finally, said Kodak, there was a "little camera that takes big pictures." Kodacolor II was "a remarkable new film"—indeed, the best color negative film Kodak had ever manufactured. . . . In accord with Kodak's 1967 plan, Kodacolor II was sold only in the 110 format for 18 months after introduction. It remains the only 110-size color print film Kodak has ever sold. . . .

As Kodak has hoped, the 110 system proved to be a dramatic success. In 1972—the system's first year—the company sold 2,984,000 Pocket Instamatics, more than 50 percent of its sales in the amateur conventional still camera market. The new camera thus accounted in large part for a sharp increase in total market sales, from 6.2 million units in 1971 to 8.2 million in 1972. Rival manufacturers hastened to market their own 110 cameras, but Kodak stood alone until Argus made its first shipment of the Carefree 110 around Christmas 1972. The next year, although Kodak's competitors sold over 800,000 110 cameras, Kodak retained a firm lead with 5.1 million. Its share of 110 sales did not fall below 50 percent until 1976. Meanwhile, by 1973 the 110 had taken over most of the amateur market from the 126, and three years later it accounted for nearly four fifths of all sales. . . . Berkey contends that the introduction of the 110 system was both an attempt to monopolize and actual monopolization of the camera market. It also alleges that the marketing of the new camera

⁷ Kodacolor II's grain, though disappointing, was clearly superior to that of Kodacolor X. Berkey does not appear to dispute the point.

constituted an impermissible leveraging of Kodak's film monopoly into the two photofinishing markets, services and equipment. . . .

A. Attempt to Monopolize and Monopolization of the Camera Market

There is little doubt that the evidence supports the jury's implicit finding that Kodak had monopoly power in cameras. . . . The principal issues presented to us regarding the effect of the 110 introduction in the camera market are whether Kodak engaged in anticompetitive conduct and, if so, whether that conduct caused injury to Berkey.

It will be useful at the outset to present the arguments on which Berkey asks us to uphold its verdict:

1. Kodak, a film and camera monopolist, was in a position to set industry standards. Rivals could not compete effectively without offering products similar to Kodak's. Moreover, Kodak persistently refused to make film available for most formats other than those in which it made cameras. Since cameras are worthless without film, this policy effectively prevented other manufacturers from introducing cameras in new formats. Because of its dominant position astride two markets, and by use of its film monopoly to distort the camera market, Kodak forfeited its own right to reap profits from such innovations without providing its rivals with sufficient advance information to enable them to enter the market with copies of the new product on the day of Kodak's introduction. This is one of several predisclosure arguments Berkey has advanced in the course of this litigation.

2. The simultaneous introduction of the 110 camera and Kodacolor II film, together with a campaign advertising the two jointly, enabled Kodak to garner more camera sales than if it had merely scaled down Kodacolor X to fit the new camera. The jury could conclude that Kodacolor II was an inferior product and not technologically necessary for the success of the 110. In any event, Kodak's film monopoly prevented any other camera manufacturer from marketing such a film-camera system and the joint introduction was therefore anticompetitive.

3. For 18 months after its introduction, Kodacolor II was available only in the 110 format. Thus it followed that any consumer wishing to use Kodak's "remarkable new film" had to buy a 110 camera. Since Kodak was the leading—and at first the only—manufacturer of such devices, its camera sales were boosted at the expense of its competitors.

For the reasons explained below, we do not believe any of these contentions is sufficient on the facts of this case to justify an award of damages to Berkey. We therefore reverse this portion of the judgment.

1. *Predisclosures.* Through the 1960s, Kodak followed a checkered pattern of predisclosing innovations to various segments of the industry. Its purpose on these occasions evidently was to ensure that the industry would be able to meet consumers' demand for the complementary goods

and services they would need to enjoy the new Kodak products. But predisclosure would quite obviously also diminish Kodak's share of the auxiliary markets. It was therefore, in the words of Walter Fallon, Kodak's chief executive officer, "a matter of judgment on each and every occasion" whether predisclosure would be for or against Kodak's self-interest. Thus, well before the 1965 introduction of Super-8 movie films, Kodak, which had a relatively small share of the movie camera market, provided sufficient information to companies such as Keystone and Bell & Howell to enable them to make cameras to use the new film. It also released processing information so that photofinishers could develop the film. But in 1963, when Kodak came out with Kodacolor X and the 126 Instamatic, it kept its own counsel until the date of introduction.

As early as 1968, some Kodak employees urged that advance warning of the P-30 system would be needed, at least to film processors and manufacturers of photofinishing equipment, to give them time to prepare for Kodacolor II and the new high-temperature finishing process, which was eventually labeled C-41. . . . Nevertheless, Kodak decided not to release advance information about the new film and format. The decision was evidently based on the perception of Dr. Louis K. Eilers, Kodak's chief executive officer at that time, that Kodak would gain more from being first on the market for the sale of all goods and services related to the 110 system than it would lose from the inability of other photofinishers to process Kodacolor II. . . .

. . . We hold that . . . as a matter of law, Kodak did not have a duty to predisclose information about the 110 system to competing camera manufacturers.

As JUDGE FRANKEL indicated, and as Berkey concedes, a firm may normally keep its innovations secret from its rivals as long as it wishes, forcing them to catch up on the strength of their own efforts after the new product is introduced. . . . It is the possibility of success in the marketplace, attributable to superior performance, that provides the incentives on which the proper functioning of our competitive economy rests. If a firm that has engaged in the risks and expenses of research and development were required in all circumstances to share with its rivals the benefits of those endeavors, this incentive would very likely be vitiated.

Withholding from others advance knowledge of one's new products, therefore, ordinarily constitutes valid competitive conduct. Because, as we have already indicated, a monopolist is permitted, and indeed encouraged, by §2 to compete aggressively on the merits, any success that it may achieve through "the process of invention and innovation" is clearly tolerated by the antitrust laws. . . .

. . . [E]nforced predisclosure would cause undesirable consequences beyond merely encouraging the sluggishness the Sherman Act was designed to prevent. A significant vice of the theory propounded by Berkey lies in the uncertainty of its application. Berkey does not contend, in the

colorful phrase of JUDGE FRANKEL, that "Kodak has to live in a goldfish bowl," disclosing every innovation to the world at large. . . . However predictable in its application, such an extreme rule would be insupportable. Rather, Berkey postulates that Kodak had a duty to disclose limited types of information to certain competitors under specific circumstances. But it is difficult to comprehend how a major corporation, accustomed though it is to making business decisions with antitrust considerations in mind, could possess the omniscience to anticipate all the instances in which a jury might one day in the future retrospectively conclude that predisclosure was warranted.⁸ And it is equally difficult to discern workable guidelines that a court might set forth to aid the firm's decision. For example, how detailed must the information conveyed be? And how far must research have progressed before it is "ripe" for disclosure? These inherent uncertainties would have an inevitable chilling effect on innovation. They go far, we believe, towards explaining why no court has ever imposed the duty Berkey seeks to create here.

An antitrust plaintiff urging a predisclosure rule, therefore, bears a heavy burden in justifying his request. Berkey recognizes the weight of this burden. It contends that it has been met. Kodak is not a monolithic monopolist, acting in a single market. Rather, its camera monopoly was supported by its activity as a film manufacturer. Berkey therefore argues that by not disclosing the new format in which it was manufacturing film, Kodak unlawfully enhanced its power in the camera market. Indeed, Kodak not only participates in but monopolizes the film industry. The jury could easily have found that, when Kodak introduced a new film format, rival camera makers would be foreclosed from a substantial segment of the market until they were able to manufacture cameras in the new format. Accordingly, Berkey contended that Kodak illegitimately used its monopoly power in film to gain a competitive advantage in cameras. Thus Berkey insists that the jury was properly permitted to consider whether, on balance, the failure to predisclose the new format was exclusionary. We disagree.

We note that this aspect of Berkey's claim is in large measure independent of the fact that a new film, Kodacolor II, was introduced simultaneously with the new format. It is primarily introduction of the format itself—the size of the film and the cartridge in which it is packaged—of which Berkey complains. . . .

We do not perceive, however, how Kodak's introduction of a new format was rendered an unlawful act of monopolization in the camera market because the firm also manufactured film to fit the cameras. The 110 system was in substantial part a camera development. After all, P-30

⁸ Berkey's argument that Kodak considered predisclosing the 110 system, and so could not be surprised when found liable for failing to do so, is thus a two-edged sword. It illustrates the difficulties in prediction even when the problem has been squarely faced.

existed long before the P-118 film project began, and much of the creative energy behind it was consumed by efforts to produce the camera itself. . . .

Clearly, then, the policy considerations militating against predisclosure requirements for monolithic monopolists are equally applicable here. The first firm, even a monopolist, to design a new camera format has a right to the lead time that follows from its success. The mere fact that Kodak manufactured film in the new format as well, so that its customers would not be offered worthless cameras, could not deprive it of that reward. Nor is this conclusion altered because Kodak not only participated in but dominated the film market. Kodak's ability to pioneer formats does not depend on its possessing a film monopoly. Had the firm possessed a much smaller share of the film market, it would nevertheless have been able to manufacture sufficient quantities of 110-size film—either Kodacolor X or Kodacolor II—to bring the new camera to market. It is apparent, therefore, that the ability to introduce the new format without predisclosure was solely a benefit of integration and not, without more, a use of Kodak's power in the film market to gain a competitive advantage in cameras. . . .

2. *Systems Selling.* Berkey's claims regarding the introduction of the 110 camera are not limited to its asserted right to predisclosure. The Pocket Instamatic not only initiated a new camera format, it was also promoted together with a new film. As we noted earlier, the view was expressed at Kodak that "[w]ithout a new film, the [camera] program is not a new advertisable system." Responding in large measure to this perception, Kodak hastened research and development of Kodacolor II so that it could be brought to market at the same time as the 110 system. Based on such evidence, and the earlier joint introduction of Kodacolor X and the 126 camera, the jury could readily have found that the simultaneous release of Kodacolor II and the Pocket Instamatic was part of a plan by which Kodak sought to use its combined film and camera capabilities to bolster faltering camera sales. Berkey contends that this program of selling was anticompetitive and therefore violated §2. We disagree.

It is important to identify the precise harm Berkey claims to have suffered from this conduct. It cannot complain of a product introduction *simpliciter* for the same reason it could not demand predisclosure of the new format: any firm, even a monopolist, may generally bring its products to market whenever and however it chooses.⁹ Rather, Berkey's argument is more subtle. It claims that by marketing the Pocket Instamatics in a

⁹ This is not to say, of course, that new product introductions are ipso facto immune from antitrust scrutiny, and we do not agree with Kodak's argument that they are . . . ; in all such cases, however, it is not the product introduction itself, but some associated conduct, that supplies the violation.

system with a widely advertised new film, Kodak gained camera sales at Berkey's expense. And, because Kodacolor II was not necessary to produce satisfactory 110 photographs and in fact suffered from several deficiencies, these gains were unlawful. . . .

It may be conceded that, by advertising Kodacolor II as a "remarkable new film" capable of yielding "big, sharp pictures from a very small negative," Kodak sold more 110 cameras than it would have done had it merely marketed Kodacolor X in 110-size cartridges. The quality of the end product—a developed snapshot—is at least as dependent upon the characteristics of the film as upon those of the camera. It is perfectly plausible that some customers bought the Kodak 110 camera who would have purchased a competitor's camera in another format had Kodacolor II not been available and widely advertised as capable of producing "big, sharp pictures" from the tiny Pocket Instamatic. Moreover, there was also sufficient evidence for the jury to conclude that a new film was not necessary to bring the new cameras to market. . . .

But necessity is a slippery concept. Indeed, the two [Kodak] scientists, Zwick and Groet, conceded that improvements in the quality of Kodacolor X would be "most welcome." Even if the 110 camera would produce adequate snapshots with Kodacolor X, it would be difficult to fault Kodak for attempting to design a film that could provide better results. The attempt to develop superior products is, as we have explained, an essential element of lawful competition. Kodak could not have violated §2 merely by introducing the 110 camera with an improved film.

Accordingly, much of the evidence at trial concerned the dispute over the relative merits of Kodacolor II and Kodacolor X. . . . It is undisputed, however, that the grain of Kodacolor II, thought not as fine as Kodak had hoped, was better than that of the older film. . . .

In this context, therefore, the question of product quality has little meaning. A product that commends itself to many users because superior in certain respects may be rendered unsatisfactory to others by flaws they considered fatal. Millions of consumers, for example, evidently found the 110 camera highly attractive because of its "pocket-ability." Others, perhaps more concerned over the quality of their flash pictures, found the original models unsatisfactory because of the high incidence of red-eye.¹⁰ . . .

It is evident, then, that in such circumstances no one can determine with any reasonable assurance whether one product is superior to another. Preference is a matter of individual taste. The only question that can be answered is whether there is sufficient demand for a particular product to make its production worthwhile, and the response, so long as

¹⁰ Red-eye is the appearance of a red glint in the eye of the snapshot's subject on a picture taken with a flashlamp. It is a result in large part of the small distance between the flash device and the camera lens. Hence, it was a greater problem for the original 110 cameras than for their larger predecessors in the 126 format.

the free choice of consumers is preserved, can only be inferred from the reaction of the market.

When a market is dominated by a monopolist, of course, the ordinary competitive forces of supply may not be fully effective. Even a monopolist, however, must generally be responsive to the demands of customers, for if it persistently markets unappealing goods it will invite a loss of sales and an increase of competition. . . . If a monopolist's products gain acceptance in the market, therefore, it is of no importance that a judge or jury may later regard them as inferior, so long as that success was not based on any form of coercion. Certainly the mere introduction of Kodacolor II along with the Pocket Instamatics did not coerce camera purchasers. . . . Unless consumers desired to use the 110 camera for its own attractive qualities, they were not compelled to purchase Kodacolor II—especially since Kodak did not remove any other films from the market when it introduced the new one. If the availability of Kodacolor II spurred sales of the 110 camera, it did so because some consumers regarded it as superior, at least for the smaller format.¹¹

Of course, Kodak's advertising encouraged the public to take a favorable view of both Kodacolor II and the 110 camera, but that was not improper. A monopolist is not forbidden to publicize its product unless the extent of this activity is so unwarranted by competitive exigencies as to constitute an entry barrier. . . . And in its advertising, a producer is ordinarily permitted, much like an advocate at law, to bathe his cause in the best light possible.¹² Advertising that emphasizes a product's strengths and minimizes its weaknesses does not, at least unless it amounts to deception, constitute anticompetitive conduct violative of §2. . . .

3. *Restriction of Kodacolor II to the 110 Format.* [In this section, the Court held that although the restriction of Kodacolor II to the 110 format may have been unjustified, there was no evidence that Berkey was injured by this course of action.]

B. Photofinishing and Photofinishing Equipment Markets

1. *Damages.* Berkey's damages claims here are based on the fact that Kodacolor II, introduced along with the 110 camera, required the

¹¹ Thus, the situation might be completely different if, upon the introduction of the 110 system, Kodak had ceased producing film in the 126 size, thereby compelling camera purchasers to buy a Kodak 110 camera. Or had Kodak shifted production in all formats from Kodacolor X to Kodacolor II before other photofinishers could process the new film, it would force photographers to procure their photofinishing services from CP&P. In such a case the technological desirability of the product change might bear on the question of monopolistic intent. . . .

¹² Indeed, Kodak apparently did precisely that in introducing the 110 camera. Aware of the camera's substantial red-eye problem, the firm evidently decided "to provide enough ambient light for exposure without flash" at the press conference announcing the new system. This rather obvious ploy certainly did not amount to the type of deception that might. . . . support an action under §2.

new, high-temperature C-41 finishing process instead of the C-22 process used for Kodacolor X and similar films. Thus independent photofinishers could not offer processing service for Kodacolor II—the only color print film Kodak ever offered in the 110 size—until they bought new equipment and received instruction in and supplies for C-41 processing. Moreover, Kodak did not give advance warning to the independents that the new film would be introduced, nor did it predispose the C-41 process to other makers of photofinishing equipment. Accordingly, CP&P was able to begin processing Kodacolor II several weeks before its competitors. . . .

Because of its early jump and greater efficiency in the C-41 process, CP&P gained a disproportionately high share of 110 finishing, an effect Berkey contends lasted through the end of 1973. There was clear evidence that Kodak was aware of the impact its conduct would have on the business of its photofinishing rivals. . . .

Kodak's conduct with respect to the independent photofinishers perhaps may be criticized as shoddy treatment of firms providing an essential service for Kodak products. Indeed, largely for that reason a number of Kodak employees urged that photofinishers and equipment manufacturers be given advance warning of the C-41 process. The purpose of the Sherman Act, however, is not to maintain friendly business relations among firms in the same industry nor was it designed to keep these firms happy and gleeful. . . . Moreover, it is clear that Kodak did not monopolize or attempt to monopolize the photofinishing or equipment markets.¹³ Thus, it is not liable under §2 for the actions described above unless it gained a competitive advantage in these markets by use of the monopoly power it possessed in other segments of the industry.

It bears emphasis that only the wielding of power will support recovery in this context; advantages inuring to Kodak's photofinishing and equipment arms by virtue of membership in an integrated firm will not. As we suggested earlier, a use of monopoly power is an action that a firm would have found substantially less effective, or even counterproductive, if it lacked market control. Thus, the classic example of such a use is a refusal to deal in goods or services needed by a competitor in a second market. . . . But, a firm without control of the market that attempts this will simply drive the purchaser to take its patronage elsewhere. . . .

It is not clear, however, whether in bringing forth the 110 system Kodak did anything that a smaller firm with integrated capabilities but no

¹³ . . . Although Kodak was for a time the only firm able to finish Kodacolor II, and for a longer period the only company able to provide equipment for the C-41 process, the new process and the machinery used in it did not define separate markets; rather, they were, like Kodacolor II and the 110 camera itself, new entries in markets of wider scope. Kodak held a temporary monopoly in C-41 processing and equipment only in the sense that every firm initially possesses a 100 percent market share in its own innovations and the peripheral products and services associated with it. . . .

market control might not have done.¹⁴ Kodak did not use its power to shift the entire photofinishing market from C-22 to the C-41 process, for Kodacolor II was introduced only in the 110 size and at first represented a miniscule percentage of all color print photofinishing. Indeed, the film, was not marketed in other formats until 18 months later, long after the original surprise had worn off.¹⁵ In sum, Kodak's ability to gain a rapidly diminishing competitive advantage with the introduction of the 110 system may have been attributable to its innovation of a new system of photography, and not to its monopoly power. On the other hand, we cannot dismiss the possibility that Kodak's monopoly power in other markets was at least a partial root of its ability to gain an advantage over its photofinishing competitors and to sell them overpriced equipment. For example, it may be that, had Kodak possessed only a small portion of the film market, other manufacturers would have found it more feasible to bring out their C-22 films in the 110 size. CP&P would then have had no competitive advantage for a large percentage of 110 photofinishing. Moreover, absent a Kodak film monopoly, the independent photofinishers might not have felt an urgent need to buy expensive equipment for the C-41 process.¹⁶

We cannot resolve this ambiguity. . . . If the parties wish to pursue these claims to a final determination, therefore, a new trial will be necessary.

2. *Equitable Relief.* [Here the Court reversed Judge Frankel's rulings that Kodak be required (a) to "treat all photofinishers, including CP&P, alike in relevant respects" and (b) to sell color print paper without its Kodak brand name on the reverse side (known as a back print).]

IV. FILM AND COLOR PAPER CLAIMS

. . . In each of these claims Berkey's contention is that it paid an excessive price for Kodak products. They therefore raise similar issues and we shall discuss them together. We remand both claims for retrial.

¹⁴ We do not, of course, intend to cast any doubt on the well-established doctrine, which we have reaffirmed, see Part II.B *supra*, that certain actions may violate §2 when taken by a monopolist even though they would be perfectly legitimate in the hands of a firm lacking market control. Rather, our consideration rests on a simple proposition: if an action that gains a firm a competitive advantage is effective because of the company's efficiency, prestige, and innovativeness, and not because of its control over the market, the action is not a use of power.

¹⁵ In 1972, fewer than one tenth as many rolls of Kodacolor film were processed in the 110 format as were finished in the 126 size, and CP&P processed only about 15 percent of the 110 rolls. Even in 1973, photofinishers processed more than three times as many 126 Kodacolor rolls—nearly all of it Kodacolor X—as Kodacolor rolls in the 110 format, and CP&P's share in the 110 size fell to approximately 6 percent.

¹⁶ We do not hold that Kodak, which did not have a monopoly in photofinishing equipment, was required to provide such machinery for other photofinishers. But a violation might be found if Kodak's ability to market equipment at an excessive price was attributable to its monopoly power in other areas.

It is clear that Kodak possessed a monopoly in the film and color paper markets during the period relevant to this suit. Berkey contends that this power, which enabled Kodak to overcharge its customers, was acquired and maintained, at least in part, by anticompetitive conduct. . . .

Excessive prices, maintained through exercise of a monopolist's control of the market, constituted one of the primary evils that the Sherman Act was intended to correct. . . . Where a monopolist has acquired or maintained its power by anticompetitive conduct, therefore, a direct purchaser may recover the overcharge caused by the violation of §2. . . .

But unless the monopoly has bolstered its power by wrongful actions, it will not be required to pay damages merely because its prices may later be found excessive. Setting a high price may be a use of monopoly power, but it is not in itself anticompetitive. Indeed, although a monopolist may be expected to charge a somewhat higher price than would prevail in a competitive market, there is probably no better way for it to guarantee that its dominance will be challenged than by greedily extracting the highest price it can. . . . If a firm has taken no action to destroy competition, it may be unfair to deprive it of the ordinary opportunity to set prices at a profit-maximizing level. Thus, no court has required a lawful monopolist to forfeit to a purchaser three times the increment of its price over that which would prevail in a competitive market. . . . Indeed, as one commentator who might favor such a rule concedes, such judicial oversight of pricing policies would place the courts in a role akin to that of a public regulatory commission. . . . We would be wise to decline that function unless Congress clearly bestows it upon us. . . .

V. THE SECTION 1 CLAIMS

[In this section, the Court affirmed the lower court's ruling that the contracts entered into by Kodak with the General Electric Co. and Sylvania Electronic Products, Inc. constituted illegal conspiracies to restrain trade in the use of new flash devices with amateur cameras.]

United States v. Western Electric Co., Inc., and American Telephone and Telegraph Co.

522 F. Supp. 226 (D.C.D of C, 1982)

GREENE, D. J.:

Plaintiff, United States of America, having filed its complaint herein on January 14, 1949; the defendants having appeared and filed their answer to such complaint denying the substantive allegations thereof; the parties, by their attorneys, having severally consented to a Final Judgment which was entered by the Court on January 24, 1956, and the parties having subsequently agreed that modification of such Final Judgment is required

by the technological, economic and regulatory changes which have occurred since the entry of such Final Judgment:

Upon joint motion of the parties and after hearing by the Court, it is hereby:

Ordered, Adjudged, and Decreed that the Final Judgment entered on January 24, 1956, is hereby vacated in its entirety and replaced by the following items and provisions:

I. AT&T REORGANIZATION

A. Not later than six months after the effective date of this Modification of Final Judgment, defendant AT&T shall submit to the Department of Justice for its approval, and thereafter implement, a plan of reorganization. Such plan shall provide for the completion, within 18 months after the effective date of this Modification of Final Judgment, of the following steps:

1. The transfer from AT&T and its affiliates to the BOCs, or to a new entity subsequently to be separated from AT&T and to be owned by the BOCs, of sufficient facilities, personnel, systems, and rights to technical information to permit the BOCs to perform, independently of AT&T, exchange telecommunications and exchange access functions, including the procurement for, and engineering, marketing and management of, those functions, and sufficient to enable the BOCs to meet the equal exchange access requirements of [this Order] . . . ;

2. The separation within the BOCs of all facilities, personnel and books of account between those relating to the exchange telecommunications or exchange access functions and those relating to other functions (including the provision of interexchange switching and transmission and the provision of customer premises equipment to the public); . . .

3. The termination of the License Contracts between AT&T and the BOCs and other subsidiaries, and the Standard Supply Contract between Western Electric and the BOCs and other subsidiaries; and

4. The transfer of ownership of the separated portions of the BOCs providing local exchange and exchange access services from AT&T . . . ; provided that nothing in this Modification of Final Judgment shall require or prohibit the consolidation of the ownership of the BOCs into any particular number of entities.

B. Notwithstanding separation of ownership, the BOCs may support and share the costs of a centralized organization for the provision of engineering, administrative and other services which can most efficiently be provided on a centralized basis. . . .

C. Until September 1, 1987, AT&T, Western Electric, and the Bell Telephone Laboratories, shall, upon order of any BOC, provide on a priority basis all research, development, manufacturing, and other support services to enable the BOCs to fulfill the requirements of this Modification of Final Judgment. . . .

II. BOC REQUIREMENTS

A. . . . [E]ach BOC shall provide to all interexchange carriers and information service providers exchange access, information access, and exchange services for such access on an unbundled, tariffed basis, that is equal in type, quality, and price to that provided to AT&T and its affiliates.

B. No BOC shall discriminate between AT&T and its affiliates and their products and services and other persons and their products and services in the:

1. procurement of products and services;
2. establishment and dissemination of technical information and procurement and interconnection standards;
3. interconnection and use of the BOC's telecommunications service and facilities or in the charges for each element of service; and
4. provision of new services and the planning for and implementation of the construction or modification of facilities, used to provide exchange access and information access. . . .

D. After completion of the reorganization specified in section I, no BOC shall, directly or through any affiliated enterprise:

1. provide interexchange telecommunications services or information services;
2. manufacture or provide telecommunications products or customer premises equipment (except for provision of customer premises equipment for emergency services); or
3. provide any other product or service, except exchange telecommunications and exchange access service, that is not a natural monopoly service actually regulated by tariff. . . .

IV. DEFINITIONS

For the purposes of this Modification of Final Judgment:

A. "Affiliate" means any organization or entity, including defendant Western Electric Company, Incorporated, and Bell Telephone Laboratories, Incorporated, that is under direct or indirect common ownership with or control by AT&T or is owned or controlled by another affiliate. . . .

B. "AT&T" shall mean defendant American Telephone and Telegraph Company and its affiliates.

C. "Bell Operating Companies" and "BOCs" mean the corporations listed in Appendix A attached to this Modification of Final Judgment. . . .

D. "Carrier" means any person deemed a carrier under the Communications Act of 1934 or amendments thereto, or, with respect to intrastate telecommunications, under the laws of any State.

E. "Customer premises equipment" means equipment employed on the premises of a person (other than a carrier) to originate, route, or

terminate telecommunications, but does not include equipment used to multiplex, maintain, or terminate access lines.

F. "Exchange access" means the provision of exchange services for the purpose of originating or terminating interexchange telecommunications. Exchange access services include any activity or function performed by a BOC in connection with the origination or termination of interexchange telecommunications, including but not limited to, the provision of network control signalling, answer supervision, automatic calling number identification, carrier access codes, directory services, testing and maintenance of facilities and the provision of information necessary to bill customers. . . .

G. "Exchange area," or "exchange" means a geographic area established by a BOC in accordance with the following criteria:

1. any such area shall encompass one or more contiguous local exchange areas serving common social, economic, and other purposes, even where such configuration transcends municipal or other local governmental boundaries;

2. every point served by a BOC within a State shall be included within an exchange area;

3. no such area which includes part or all of one standard metropolitan statistical area (or a consolidated statistical area, in the case of densely populated States) shall include a substantial part of any other standard metropolitan statistical area (or a consolidated statistical area, in the case of densely populated States), unless the Court shall otherwise allow; and

4. except with approval of the Court, no exchange area located in one State shall include any point located within another State.

H. "Information" means knowledge or intelligence represented by any form of writing, signs, signals, pictures, sounds or other symbols.

I. "Information access" means the provision of specialized exchange telecommunications services by a BOC in an exchange area in connection with the origination, termination, transmission, switching, forwarding or routing of telecommunications traffic to or from the facilities of a provider of information services. . . .

J. "Information service" means the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information which may be conveyed via telecommunications. . . .

K. "Interexchange telecommunications" means telecommunications between a point or points located in one exchange telecommunications area and a point or points located in one or more other exchange areas or a point outside an exchange area.

L. "Technical information" means intellectual property of all types. . . .

N. "Telecommunications equipment" means equipment, other than

customer premises equipment, used by a carrier to provide telecommunications services.

O. "Telecommunications" means the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received, by means of electromagnetic transmission, with or without benefit of any closed transmission medium, including all instrumentalities, facilities. . . .

P. "Telecommunications service" means the offering for hire of telecommunications facilities or of telecommunications by means of such facilities.

Q. "Transmission facilities" means equipment (including without limitation wire, cable, microwave, satellite, and fiber-optics) that transmit information by electromagnetic means or which directly support such transmission, but does not include customer premises equipment. . . .

VII. RETENTION OF JURISDICTION

Jurisdiction is retained by this Court for the purpose of enabling any of the parties to this Modification of Final Judgment, or, after the reorganization specified in section I, a BOC to apply to this Court at any time for such further orders or directions as may be necessary or appropriate for the construction or carrying out of this Modification of Final Judgment. . . .

VIII. MODIFICATIONS

A. Notwithstanding the provisions of section II(D)(2), the separated BOCs shall be permitted to provide, but not manufacture, customer premises equipment.

B. Notwithstanding the provisions of section II(D)(3), the separated BOCs shall be permitted to produce, publish, and distribute printed directories which contain advertisements and which list general product and business categories, the service or product providers under these categories, and their names, telephone numbers, and addresses.

Notwithstanding the provisions of sections I(A)(1), I(A)(2), I(A)(4), all facilities, personnel, systems, and rights to technical information owned by AT&T, its affiliates, or the BOCs which are necessary for the production, publication, and distribution of printed advertising directories shall be transferred to the separate BOCs.

C. The restrictions imposed upon the separated BOCs by virtue of section II(D) shall be removed upon a showing by the petitioning BOC that there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter.

D. AT&T shall not engage in electronic publishing over its own transmission facilities. "Electronic publishing" means the provision of any information which AT&T or its affiliates has, or has caused to be,

originated, authored, compiled, collected, or edited, or in which it has a direct or indirect financial or proprietary interest, and which is disseminated to an unaffiliated person through some electronic means.

Nothing in this provision precludes AT&T from offering electronic directory services that list general product and business categories, the service or product providers under these categories, and their names, telephone numbers, and addresses; or from providing the time, weather, and such other audio services as are being offered as of the date of the entry of the decree to the geographic areas of the country receiving those services as of that date.

Upon application of AT&T, this restriction shall be removed after seven years from the date of entry of the decree, unless the Court finds that competitive conditions clearly require its extension.

E. If a separated BOC provides billing services to AT&T pursuant to Appendix B(C)(2), it shall include upon the portion of the bill devoted to interexchange services the following legend:

This portion of your bill is provided as a service to AT&T. There is no connection between this company and AT&T. You may choose another company for your long distance telephone calls while still receiving your local telephone service from this company. . . .

California Computer Products, Inc., et al. v. International Business Machines Corp.

613 F.2d 727 (9th Cir. 1979)

OPINION

CHOY, Circuit Judge. California Computer Products, Inc. (CalComp) appeals from the judgment entered on a directed verdict in favor of appellee International Business Machines Corp. (IBM) as to all counts of its complaint charging IBM with violations of §2 of the Sherman Act. . . . We affirm.

I. BACKGROUND AND PROCEEDINGS BELOW

IBM is one of the largest industrial corporations in the world. It achieved technical leadership in the computer industry over other early entrants, such as Sperry Rand, in the mid-1950s and thereafter pioneered the development of many electronic data processing products, including the disk products involved in this litigation.

Disk products are part of a broader category of what is known as peripheral equipment, such as disks, tapes, printers, and terminals, which is connected to the central processing unit (CPU) to enable the data processing system to perform particular functions. . . . Occasionally these devices are built into the CPU; alternatively, they exist as external components that may be "plugged into" the CPU. As a general purpose

Coals—price-fixing conspiracies were uniformly condemned, the bases of the opinions vary. Thus, where the *Trenton Potteries* condemnation hinged at least in part on the market power of the conspirators, the later and controlling *Socony-Vacuum* decision held any attempt to influence prices, regardless of the market power of the group, to be illegal. Only in the *Appalachian Coals* case did the Court explicitly attempt to consider the reasonableness of price-fixing agreements, and even here one might contend that it was the lack of market power, not the reasonableness of the agreement, which prevented condemnation.

In any event, since *Socony-Vacuum*, the courts have consistently refused to move from the clear position established therein. In *Professional Engineers* and *Catalano*, two of the more recent cases to be decided under that precedent, the Supreme Court summarily disposed of any consideration of the reasonableness of price-fixing arrangements. And enforcement authorities have moved with increasing vigor against such conspiracies.

In *U.S. Gypsum*, the first price-fixing case to reach the Supreme Court after criminal antitrust violations were raised to felony status (see Appendix), the Court reaffirmed its antipathy toward price fixing and rejected the defendants' argument that interfirm price communication was necessary to satisfy the "meeting-competition" proviso of the Robinson-Patman Act. However, in *ASCAP* and *NCAA* the Court has apparently evidenced a willingness, at least under certain circumstances, to consider reasonableness arguments as a defense. Whether this presages anything like a return to *Appalachian Coals* is, of course, too early to tell. And how far businessmen, faced with the increasing possibility of jail sentences, will be willing to test the limits of *ASCAP* and *NCAA* remains to be seen.

Addyston Pipe and Steel Company v. United States

175 U.S. 211 (1899)

Note: This case involved an agreement among the six leading manufacturers of iron pipe to divide the market into several regional monopolies, and to fix prices.

MR. JUSTICE PECKHAM . . . delivered the opinion of the court. . . .

We are thus brought to the question whether the contract or combination proved in this case is one which is either a direct restraint or a regulation of commerce among the several States or with foreign nations contrary to the act of Congress [the Sherman Act]. It is objected on the part of the appellants that even if it affected interstate commerce the contract or combination was only a reasonable restraint upon a ruinous

competition among themselves, and was formed only for the purpose of protecting the parties thereto in securing prices for their product that were fair and reasonable to themselves and the public. . . .

. . . [W]e are of opinion that the agreement or combination was not one which simply secured for its members fair and reasonable prices for the article dealt in by them. Even if the objection thus set up would, if well founded in fact, constitute a defense, we agree with the Circuit Court of Appeals in its statement of the special facts upon this branch of the case and with its opinion thereon as set forth by Circuit Judge Taft, as follows:

The defendants being manufacturers and vendors of cast-iron pipe entered into a combination to raise the prices for pipe . . . [in] considerably more than three-quarters of the territory of the United States, . . . significantly called by the associates "pay" territory. . . . Within the margin of the freight per ton which Eastern manufacturers would have to pay to deliver pipe in "pay" territory, the defendants, by controlling two-thirds of the output in "pay" territory, were practically able to fix prices. . . . The most cogent evidence that they had this power is the fact everywhere apparent in the record that they exercised it. . . .

The defendants were by their combination therefore able to deprive the public in a large territory of the advantages otherwise accruing to them from the proximity of defendants' pipe factories and, by keeping prices just low enough to prevent competition by Eastern manufacturers, to compel the public to pay an increase over what the price would have been if fixed by competition between defendants, nearly equal to the advantage in freight rates enjoyed by defendants over Eastern competitors. The defendants acquired this power by voluntarily agreeing to sell only at prices fixed by their committee and by allowing the highest bidder at the secret "auction pool" to become the lowest bidder of them at the public letting. Now, the restraint thus imposed on themselves was only partial. It did not cover the United States. There was not a complete monopoly. It was tempered by the fear of competition and it affected only a part of the price. But this certainly does not take the contract of association out of the annulling effect of the rule against monopolies. . . .

It has been earnestly pressed upon us that the prices at which the cast-iron pipe was sold in "pay" territory were reasonable. . . . We do not think the issue an important one, because . . . we do not think that at common law there is any question of reasonableness open to the courts with reference to such a contract. Its tendency was certainly to give defendants the power to charge unreasonable prices, had they chosen to do so. But if it were important we should unhesitatingly find that the prices charged in the instances which were in evidence were unreasonable. . . .

The facts thus set forth show conclusively that the effect of the combination was to enhance prices beyond a sum which was reasonable. . . .

The views above expressed lead generally to an affirmance of the judgment of the Court of Appeals. . . . [But to] the extent that the present decree includes in its scope the enjoining of defendants thus situated from

combining in regard to contracts for selling pipe in their own State, it is modified, and limited to that portion of the combination or agreement which is interstate in its character. As thus modified, the decree is *Affirmed*.

Board of Trade of the City of Chicago et al. v. United States

246 U.S. 231 (1918)

MR. JUSTICE BRANDEIS delivered the opinion of the court.

Chicago is the leading grain market in the world. Its Board of Trade is the commercial center through which most of the trading in grain is done. . . . Its 1,600 members include brokers, commission merchants, dealers, millers, maltsters, manufacturers of corn products and proprietors of elevators. Grains there dealt in are graded according to kind and quality and are sold usually "Chicago weight, inspection, and delivery." The standard forms of trading are: (a) Spot sales; that is, sales of grain already in Chicago in railroad cars or elevators for immediate delivery by order on carrier or transfer of warehouse receipt. (b) Future sales; that is, agreements for delivery later in the current or in some future month. (c) Sales "to arrive"; that is, agreements to deliver on arrival grain which is already in transit to Chicago or is to be shipped there within a time specified. On every business day sessions of the Board are held at which all bids and sales are publicly made. Spot sales and future sales are made at the regular sessions of the Board from 9.30 A.M. to 1.15 P.M., except on Saturdays, when the session closes at 12 M. Special sessions, termed the "Call," are held immediately after the close of the regular session, at which sales "to arrive" are made. These sessions are not limited as to duration, but last usually about half an hour. At all these sessions transactions are between members only; but they may trade either for themselves or on behalf of others. Members may also trade privately with one another at any place, either during the sessions or after, and they may trade with nonmembers at any time except on the premises occupied by the Board. . . .

Purchases of grain "to arrive" are made largely from country dealers and farmers throughout the whole territory tributary to Chicago, which includes besides Illinois and Iowa, Indiana, Ohio, Wisconsin, Minnesota, Missouri, Kansas, Nebraska, and even South and North Dakota. The purchases are sometimes the result of bids to individual country dealers made by telegraph or telephone either during the sessions or after; but most purchases are made by the sending out from Chicago by the after-

noon mails to hundreds of country dealers offers to buy, at the prices named, any number of carloads, subject to acceptance before 9.30 A.M. on the next business day.

In 1906 the Board adopted what is known as the "Call" rule. By it members were prohibited from purchasing or offering to purchase, during the period between the close of the Call and the opening of the session on the next business day, any wheat, corn, oats or rye "to arrive" at a price other than the closing bid at the Call. The Call was over, with rare exceptions, by 2 o'clock. The change effected was this: Before the adoption of the rule, members fixed their bids throughout the day at such prices as they respectively saw fit; after the adoption of the rule, the bids had to be fixed at the day's closing bid on the Call until the opening of the next session.

In 1913 the United States filed in the District Court for the Northern District of Illinois this suit against the Board and its executive officers and directors, to enjoin the enforcement of the Call rule, alleging it to be in violation of the Anti-Trust Law. . . . The defendants admitted the adoption and enforcement of the Call rule, and averred that its purpose was not to prevent competition or to control prices, but to promote the convenience of members by restricting their hours of business and to break up a monopoly in that branch of the grain trade acquired by four or five warehousemen in Chicago. [The District Court held that the practice constituted an illegal restraint of trade.] . . .

No opinion was delivered by the District Judge. The Government proved the existence of the rule and described its application and the change in business practice involved. It made no attempt to show that the rule was designed to or that it had the effect of limiting the amount of grain shipped to Chicago; or of retarding or accelerating shipment; or of raising or depressing prices; or of discriminating against any part of the public; or that it resulted in hardship to anyone. The case was rested upon the bald proposition, that a rule or agreement by which men occupying positions of strength in any branch of trade, fixed prices at which they would buy or sell during an important part of the business day, is an illegal restraint of trade under the Anti-Trust Law. But the legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting

decision had seemed so promising. Evidence that this reluctance has been justified can be found in the Supreme Court's recent refusal to hear the FTC's appeal of the Court of Appeals decision in *Ethyl*, which is apparently consistent with the doctrine enunciated in *Theatre Enterprises*. Thus, at least for the present, it does not appear as though the Supreme Court is prepared to reconsider its earlier position: independent but parallel action by firms in an industry with few sellers, taken in pursuit of each firm's self-interest, is acceptable.

American Tobacco Company v. United States

328 U.S. 781 (1946)

MR. JUSTICE BURTON delivered the opinion of the Court.

The petitioners are The American Tobacco Company, Liggett & Myers Tobacco Company, R. J. Reynolds Tobacco Company, American Suppliers, Inc., a subsidiary of American, and certain officials of the respective companies who were convicted by a jury, in the District Court of the United States for the Eastern District of Kentucky, of violating §§1 and 2 of the Sherman Anti-trust Act. . . .

Each petitioner was convicted on four counts: (1) conspiracy in restraint of trade, (2) monopolization, (3) attempt to monopolize, and (4) conspiracy to monopolize. Each count related to interstate and foreign trade and commerce in tobacco. No sentence was imposed under the third count as the Court held that count was merged in the second. Each petitioner was fined \$5,000 on each of the other counts, making \$15,000 for each petitioner and a total of \$255,000. . . .

The Circuit Court of Appeals for the Sixth Circuit . . . affirmed each conviction. . . . This opinion is limited to the convictions under §2 of the Sherman Act. . . .

The issue . . . emphasized in the order allowing certiorari and primarily argued by the parties has not been previously decided by this Court. It is raised by the following instructions which were especially applicable to the second count but were related also to the other counts under §2 of the Sherman Act:

Now, the term *monopolize* as used in Section 2 of the Sherman Act, as well as in the last three counts of the Information, means the joint acquisition or maintenance by the members of the conspiracy formed for that purpose, of the power to control and dominate interstate trade and commerce in a commodity to such an extent that they are able, as a group, to exclude actual or potential competitors from the field, accompanied with the intention and purpose to exercise such power.

The phrase *attempt to monopolize* means the employment of methods, means and practices which would, if successful, accomplish monopolization, and which, though falling short, nevertheless approach so close as to

create a dangerous probability of it, which methods, means and practices are so employed by the members of and pursuant to a combination or conspiracy formed for the purpose of such accomplishment.

It is in no respect a violation of the law that a number of individuals or corporations, each acting for himself or itself, may own or control a large part, or even all of a particular commodity, or all the business in a particular commodity.

An essential element of the illegal monopoly or monopolization charged in this case is the existence of a combination or conspiracy to acquire and maintain the power to exclude competitors to a substantial extent.

Thus you will see that *an indispensable ingredient of each of the offenses charged in the Information is a combination or conspiracy.* (Italics supplied [by the Supreme Court].) . . .

. . . The trial court's instructions did not call for proof of an "actual exclusion" of competitors on the part of the petitioners. For the purposes of this opinion, we shall assume, therefore, that an actual exclusion of competitors by the petitioners was not claimed or established by the prosecution. Simply stated the issue is: Do the facts called for by the trial court's definition of monopolization amount to a violation of §2 of the Sherman Act? . . .

. . . To support the verdicts it was not necessary to show power and intent to exclude *all* competitors, or to show a conspiracy to exclude *all* competitors. The requirement stated to the jury and contained in the statute was only that the offenders shall "monopolize any part of the trade or commerce among the several States, or with foreign nations." This particular conspiracy may well have derived special vitality, in the eyes of the jury, from the fact that its existence was established, not through the presentation of a formal written agreement, but through the evidence of widespread and effective conduct on the part of petitioners in relation to their existing or potential competitors. . . .

First of all, the monopoly found by the jury to exist in the present cases appears to have been completely separable from the old American Tobacco Trust which was dissolved in 1911. The conspiracy to monopolize and the monopolization charged here do not depend upon proof relating to the old tobacco trust but upon a dominance and control by petitioners in recent years over purchases of the raw material and over the sale of the finished product in the form of cigarettes. The fact, however, that the purchases of leaf tobacco and the sales of so many products of the tobacco industry have remained largely within the same general group of business organizations for over a generation, inevitably has contributed to the ease with which control over competition within the industry and the mobilization of power to resist new competition can be exercised. . . . The verdicts indicate that practices of an informal and flexible nature were adopted and that the results were so uniformly beneficial to the petitioners in protecting their common interests as against those of

competitors that, entirely from circumstantial evidence, the jury found that a combination or conspiracy existed among the petitioners from 1937 to 1940, with power and intent to exclude competitors to such a substantial extent as to violate the Sherman Act as interpreted by the trial court.

The position of the petitioners in the cigarette industry from 1931 to 1939 is clear. . . . [A]lthough American, Liggett and Reynolds gradually dropped in their percentage of the national domestic cigarette production from 90.7% in 1931 to 73.3%, 71% and 68%, respectively, in 1937, 1938 and 1939, they have accounted at all times for more than 68%, and usually for more than 75%, of the national production. The balance of the cigarette production has come from six other companies. No one of those six ever has produced more than 10.6% once reached by Brown & Williamson in 1939. . . . [W]hile the percentage of cigarettes produced by American, Liggett and Reynolds in the United States dropped gradually from 90.7% to 68%, their combined volume of production actually increased. . . .

The further dominance of American, Liggett and Reynolds within their special field of burley blend cigarettes, as compared with the so-called "10-cent cigarettes," is also apparent. In 1939, the 10-cent cigarettes constituted about 14½% of the total domestic cigarette production. Accordingly, the 68% of the total cigarette production enjoyed by American, Liggett and Reynolds amounted to 80% of that production within their special field of cigarettes. . . . In addition . . . they also produced over 63% of the smoking tobacco and over 44% of the chewing tobacco. They never were important factors in the cigar or snuff fields of the tobacco industry.

The foregoing demonstrates the basis of the claim of American, Liggett and Reynolds to the title of the "Big Three." . . . Without adverse criticism of it, comparative size on this great scale inevitably increased the power of these three to dominate all phases of their industry. . . . An intent to use this power to maintain a monopoly was found by the jury in these cases.

The record further shows that . . . [i]n each of the years 1937, 1938 and 1939, American, Liggett and Reynolds expended a total of over \$40,000,000 a year for advertising. Such advertising is not here criticized as a business expense. Such advertising may benefit indirectly the entire industry, including the competitors of the advertisers. Such tremendous advertising, however, is also a widely published warning that these companies possess and know how to use a powerful offensive and defensive weapon against new competition. New competition dare not enter such a field, unless it be well supported by comparable national advertising. Large inventories of leaf tobacco, and large sums required for payment of federal taxes in advance of actual sales, further emphasize the effectiveness of a well financed monopoly in this field against potential competitors if there merely exists an intent to exclude such competitors. Pre-

vention of all potential competition is the natural program for maintaining a monopoly here, rather than any program of actual exclusion. "Prevention" is cheaper and more effective than any amount of "cure." . . .

The verdicts show that the jury found that the petitioners conspired to fix prices and to exclude undesired competition against them in the purchase of the domestic type of flue-cured tobacco and of burley tobacco. These are raw materials essential to the production of cigarettes of the grade sold by the petitioners and also, to some extent, of the 10-cent grade of cigarettes which constitutes the only substantial competition to American, Liggett and Reynolds in the cigarette field of the domestic tobacco industry. . . . The petitioners purchased a combined total of between 50% and 80% of the domestic flue-cured tobacco. . . . [and] from 60% to 80% of the annual crop of burley.¹ . . .

The Government introduced evidence showing . . . that petitioners refused to purchase tobacco on these [auction] markets unless the other petitioners were also represented thereon. There were attempts made by others to open new tobacco markets but none of the petitioners would participate in them unless the other petitioners were present. Consequently, such markets were failures due to the absence of buyers. . . . In this way the new tobacco markets and their locations were determined by the unanimous consent of the petitioners and, in arriving at their determination, the petitioners consulted with each other as to whether or not a community deserved a market.

The Government presented evidence to support its claim that, before the markets opened, the petitioners placed limitations and restrictions on the prices which their buyers were permitted to pay for tobacco. None of the buyers exceeded these price ceilings. Grades of tobacco were formulated in such a way as to result in the absence of competition between the petitioners. There was manipulation of the price of lower grade tobaccos in order to restrict competition from manufacturers of the lower priced cigarettes. Methods used included the practice of the petitioners of calling their respective buyers in, prior to the opening of the annual markets, and giving them instructions as to the prices to be paid for leaf tobacco in each of the markets. These instructions were in terms of top prices or price ranges. The price ceilings thus established for the buyers were the same for each of them. . . .

Where one or two of the petitioners secured their percentage of the crop on a certain market or were not interested in the purchase of certain offerings of tobacco, their buyers, nevertheless, would enter the bidding in order to force the other petitioners to bid up to the maximum price. The petitioners were not so much concerned with the prices they paid for the

¹ Flue-cured, or bright tobacco, takes its name from the fact that it is cured in barns heated by a system of flues. Burley tobacco is produced largely in Kentucky and Tennessee, and is cured by exposing the leaves to the air, without heat. IMS.

leaf tobacco as that each should pay the same price for the same grade and that none would secure any advantage in purchasing tobacco. . . .

At a time when the manufacturers of lower priced cigarettes were beginning to manufacture them in quantity, the petitioners commenced to make large purchases of the cheaper tobacco leaves used for the manufacture of such lower priced cigarettes. No explanation was offered as to how or where this tobacco was used by petitioners. The compositions of their respective brands of cigarettes calling for the use of more expensive tobaccos remained unchanged during this period of controversy and up to the end of the trial. The Government claimed that such purchases of cheaper tobacco evidenced a combination and a purpose among the petitioners to deprive the manufacturers of cheaper cigarettes of the tobacco necessary for their manufacture, as well as to raise the price of such tobacco to such a point that cigarettes made therefrom could not be sold at a sufficiently low price to compete with the petitioners' more highly advertised brands.

The verdicts show also that the jury found that the petitioners conspired to fix prices and to exclude undesired competition in the distribution and sale of their principal products. The petitioners sold and distributed their products to jobbers and to selected dealers who bought at list prices less discounts. . . . The list prices charged and the discounts allowed by petitioners have been practically identical since 1923 and absolutely identical since 1928. Since the latter date, only seven changes have been made by the three companies and those have been identical in amount. The increases were first announced by Reynolds. American and Liggett thereupon increased their list prices in identical amounts.

The following record of price changes is circumstantial evidence of the existence of a conspiracy and of a power and intent to exclude competition coming from cheaper grade cigarettes. . . . [1931] was one of the worst years of financial and economic depression in the history of the country. On June 23, 1931, Reynolds, without previous notification or warning to the trade or public, raised the list price of Camel cigarettes, constituting its leading cigarette brand, from \$6.40 to \$6.85 a thousand. The same day, American increased the list price for Lucky Strike cigarettes, its leading brand, and Liggett the price for Chesterfield cigarettes, its leading brand, to the identical price of \$6.85 a thousand. No economic justification for this raise was demonstrated. The president of Reynolds stated that it was "to express our own courage for the future and our own confidence in our industry." The president of American gave as his reason for the increase, "the opportunity of making some money." . . . The officials of Liggett claimed that they thought the increase was a mistake . . . but they contended that unless they also raised their list price for Chesterfields, the other companies would have greater resources to spend in advertising and thus would put Chesterfield

cigarettes at a competitive disadvantage. This general price increase soon resulted in higher retail prices and in a loss in volume of sales. Yet in 1932, in the midst of the national depression with the sales of the petitioners' cigarettes falling off greatly in number, the petitioners still were making tremendous profits as a result of the price increase. Their net profits in that year amounted to more than \$100,000,000. This was one of the three biggest years in their history.

. . . [A]fter the above described increase in list prices of the petitioners in 1931, the 10-cent brands made serious inroads upon the sales of the petitioners. These cheaper brands of cigarettes were sold at a list price of \$4.75 a thousand and from 1931 to 1932 the sales of these cigarettes multiplied 30 times, rising from 0.28% of the total cigarette sales of the country in June, 1931, to 22.78% in November, 1932. In response to this threat of competition . . . the petitioners . . . cut the list price of their three leading brands . . . to \$5.50 a thousand. The evidence tends to show that this cut was directed at the competition of the 10-cent cigarettes. . . . Following the . . . price cut by petitioners, the sales of the 10-cent brands fell off considerably. . . . When the sale of the 10-cent brands had dropped from 22.78% of the total cigarette sales in November, 1932, to 6.43% in May, 1933, the petitioners, in January, 1934, raised the list price of their leading brands from \$5.50 back up to \$6.10 a thousand. During the period that the list price of \$5.50 a thousand was in effect, Camels and Lucky Strikes were being sold at a loss by Reynolds and American. Liggett at the same time was forced to curtail all of its normal business activities and cut its advertising to the bone in order to sell at this price. [Subsequent increases brought the price to \$6.53 by 1940.] . . .

Certain methods used by the petitioners to secure a reduction in the retail prices of their cigarettes were in evidence. Reynolds and Liggett required their retailers to price the 10-cent brands at a differential of not more than 3 cents below Camel and Chesterfield cigarettes. They insisted upon their dealers correcting a greater differential by increasing the retail price of the 10 cent brands to 11 cents with petitioners' brands at 14 cents a package, or by requiring that petitioners' brands be priced at 13 cents with the lower priced cigarettes at 10 cents a package. . . . After the list price reductions were made and at the height of the price war, the petitioners commenced the distribution of posters advertising their brands at 10 cents a package and made attempts to have dealers meet these prices. . . . In addition to the use of . . . inducements, petitioners also used threats and penalties to enforce compliance with their retail price program. . . . There was evidence that when dealers received an announcement of the price increase from one of the petitioners and attempted to purchase some of the leading brands of cigarettes from the other petitioners at their unchanged prices before announcement of a similar change, the latter refused to fill such orders until their prices were

also raised, thus bringing about the same result as if the changes had been precisely simultaneous.

It was on the basis of such evidence that the Circuit Court of Appeals found that the verdicts of the jury were sustained by sufficient evidence on each count. The question squarely presented here by the order of this Court in allowing the writs of certiorari is whether actual exclusion of competitors is necessary to the crime of monopolization in these cases under §2 of the Sherman Act. We agree with the lower courts that such actual exclusion of competitors is not necessary to that crime in these cases and that the instructions given to the jury, and hereinbefore quoted, correctly defined the crime. A correct interpretation of the statute and of the authorities makes it the crime of monopolizing, under §2 of the Sherman Act, for parties, as in these cases, to combine or conspire to acquire or maintain the power to exclude competitors from any part of the trade or commerce among the several states or with foreign nations, provided they also have such a power that they are able, as a group, to exclude actual or potential competition from the field and provided that they have the intent and purpose to exercise that power. See *United States v. Socony-Vacuum Oil Co.* . . .

It is not the form of the combination or the particular means used but the result to be achieved that the statute condemns. It is not of importance whether the means used to accomplish the unlawful objectives are in themselves lawful or unlawful. Acts done to give effect to the conspiracy may be in themselves wholly innocent acts. Yet, if they are part of the sum of the acts which are relied upon to effectuate the conspiracy which the statute forbids, they come within its prohibition. No formal agreement is necessary to constitute an unlawful conspiracy. Often crimes are a matter of inference deduced from the acts of the person accused and done in pursuance of a criminal purpose. Where the conspiracy is proved, as here, from the evidence of the action taken in concert by the parties to it, it is all the more convincing proof of an intent to exercise the power of exclusion acquired through that conspiracy. The essential combination or conspiracy in violation of the Sherman Act may be found in a course of dealing or other circumstances as well as in an exchange of words. . . . Where the circumstances are such as to warrant a jury in finding that the conspirators had a unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement, the conclusion that a conspiracy is established is justified. Neither proof of exertion of the power to exclude nor proof of actual exclusion of existing or potential competitors is essential to sustain a charge of monopolization under the Sherman Act. . . .

[The Court then took this opportunity to endorse the key portions of Judge Learned Hand's decision in *United States v. Aluminum Company of America*, 148 F.2d 416.]

In the present cases, the petitioners have been found to have conspired to establish a monopoly and also to have the power and intent to establish and maintain the monopoly. To hold that they do not come within the prohibition of the Sherman Act would destroy the force of that Act. Accordingly, the instructions of the trial court under §2 of the Act are approved and the judgment of the Circuit Court of Appeals is *Affirmed*.

MR. JUSTICE FRANKFURTER entirely agrees with the judgment and opinion in these cases. He, however, would have enlarged the scope of the orders allowing the petitions for certiorari so as to permit consideration of the alleged errors in regard to the selection of the jury.

MR. JUSTICE REED and MR. JUSTICE JACKSON took no part in the consideration or decision of these cases.

[MR. JUSTICE RUTLEDGE concurred.]

*Triangle Conduit & Cable Co., Inc. v.
Federal Trade Commission*

168 F.2d 175 (7th Cir. 1948)¹

Before SPARKS, KERNER, and MINTON, Circuit Judges.
KERNER, Circuit Judge.

Petitioners, fourteen corporate manufacturers of rigid steel conduit,² and five representatives of these corporations ask us to review and set aside a cease and desist order of the Federal Trade Commission, upon a complaint in two counts, charging that petitioners collectively have violated Section 5 of the Federal Trade Commission Act . . . , which declares unlawful "unfair methods of competition in commerce." . . .

In substance the first count alleged the existence and continuance of a conspiracy for the purpose and with the effect of substantially restricting and suppressing actual and potential competition in the distribution and sale of rigid steel conduit in commerce, effectuated by the adoption and use of a basing point method of quoting prices for rigid steel conduit. The second count did not rest upon an agreement or combination. It charged

¹ On April 25, 1949 the Supreme Court upheld the Federal Trade Commission order—affirmed in this lower court decision—under Count II of the complaint by a four-to-four tie vote. *Clayton Mark et al. v. Federal Trade Commission*, 336 U.S. 956 (1949) consists of a 23-word order. Mr. Justice Jackson took no part in the case. IMS.

² Rigid steel conduit is a steel pipe, used primarily in the roughing-in stage of building construction where electrical wiring is necessary in order to furnish a container for the wiring. It is a standard commodity made from standard steel pipe. IMS.

*Theatre Enterprises, Inc. v. Paramount
Film Distributing Corp.*

346 U.S. 537 (1954)

MR. JUSTICE CLARK delivered the opinion of the Court.

Petitioner brought this suit for treble damages and an injunction under §§4 and 16 of the Clayton Act, alleging that respondent motion picture producers and distributors had violated the antitrust laws by conspiring to restrict "first-run"¹ pictures to downtown Baltimore theatres, thus confining its suburban theatre to subsequent runs and unreasonable "clearances."² After hearing the evidence a jury returned a general verdict for respondents. The Court of Appeals for the Fourth Circuit affirmed the judgment based on the verdict. . . .

The opinion of the Court of Appeals contains a complete summary of the evidence presented to the jury. We need not recite that evidence again. It is sufficient to note that petitioner owns and operates the Crest Theatre, located in a neighborhood shopping district some six miles from the downtown shopping center in Baltimore, Maryland. The Crest, possessing the most modern improvements and appointments, opened on February 26, 1949. Before and after the opening, petitioner, through its president, repeatedly sought to obtain first-run features for the theatre. Petitioner approached each respondent separately, initially requesting exclusive first-runs, later asking for first-runs on a "day-and-date" basis.³ But respondents uniformly rebuffed petitioner's efforts and adhered to an established policy of restricting first-runs in Baltimore to the eight downtown theatres. Admittedly there is no direct evidence of illegal agreement between the respondents and no conspiracy is charged as to the independent exhibitors in Baltimore, who account for 63% of first-run exhibitions. The various respondents advanced much the same reasons for denying petitioner's offers. Among other reasons, they asserted that day-and-date first-runs are normally granted only to noncompeting theatres. Since the Crest is in "substantial competition" with the downtown theatres, a day-and-date arrangement would be economically unfeasible. And even if respondents wished to grant petitioner such a

¹ "Runs are successive exhibitions of a feature in a given area, first-run being the first exhibition in that area, second-run being the next subsequent, and so on. . . ." *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 144-45, n. 6 (1948).

² "A clearance is the period of time, usually stipulated in license contracts, which must elapse between runs of the same feature within a particular area or in specified theatres." *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 144, n. 6 (1948).

³ A first-run "day-and-date" means that two theatres exhibit a first-run at the same time. Had petitioner's request for a day-and-date first-run been granted, the Crest and a downtown theatre would have exhibited the same features simultaneously.

license, no downtown exhibitor would waive his clearance rights over the Crest and agree to a simultaneous showing. As a result, if petitioner were to receive first-runs, the license would have to be an exclusive one. However, an exclusive license would be economically unsound because the Crest is a suburban theatre, located in a small shopping center, and served by limited public transportation facilities; and, with a drawing area of less than one-tenth that of a downtown theatre, it cannot compare with those easily accessible theatres in the power to draw patrons. Hence the downtown theatres offer far greater opportunities for the widespread advertisement and exploitation of newly released features, which is thought necessary to maximize the over-all return from subsequent runs as well as first-runs. The respondents, in the light of these conditions, attacked the guaranteed offers of petitioner, one of which occurred during the trial, as not being made in good faith. Respondents Loew's and Warner refused petitioner an exclusive license because they owned the three downtown theatres receiving their first-run product.

The crucial question is whether respondents' conduct toward petitioner stemmed from independent decision or from an agreement, tacit or express. To be sure, business behavior is admissible circumstantial evidence from which the fact finder may infer agreement. . . . But this Court has never held that proof of parallel business behavior conclusively establishes agreement or, phrased differently, that such behavior itself constitutes a Sherman Act offense. Circumstantial evidence of consciously parallel behavior may have made heavy inroads into the traditional judicial attitude toward conspiracy; but "conscious parallelism" has not yet read conspiracy out of the Sherman Act entirely. Realizing this, petitioner attempts to bolster its argument . . . by urging that the conscious unanimity of action by respondents should be "measured against the background and findings in the *Paramount* case." In other words, since the same respondents had conspired in the *Paramount* case to impose a uniform system of runs and clearances without adequate explanation to sustain them as reasonable restraints of trade, use of the same device in the present case should be legally equated to conspiracy. But the *Paramount* decrees, even if admissible, were only prima facie evidence of a conspiracy covering the area and existing during the period there involved. Alone or in conjunction with the other proof of the petitioner, they would form no basis for a directed verdict. Here each of the respondents had denied the existence of any collaboration and in addition had introduced evidence of the local conditions surrounding the Crest operation which, they contended, precluded it from being a successful first-run house. They also attacked the good faith of the guaranteed offers of the petitioner for first-run pictures and attributed uniform action to individual business judgment motivated by the desire for maximum revenue. This evidence, together with other testimony of an explanatory nature, raised

fact issues requiring the trial judge to submit the issue of conspiracy to the jury. . . .

Affirmed.

E.I. du Pont de Nemours & Co. v. Federal Trade Commission;

Ethyl Corp. v. Federal Trade Commission

729 F.2d 128 (1984)

MANSFIELD, Cir. J.:

E.I. Du Pont De Nemours and Company ("Du Pont") and Ethyl Corporation ("Ethyl"), the nation's two largest manufacturers of lead antiknock gasoline additives, petition this court . . . to review and set aside a final order of the Federal Trade Commission ("FTC"). . . . The FTC held that Du Pont, Ethyl and two other antiknock compound manufacturers, PPG Industries, Inc. ("PPG") and Nalco Chemical Company ("Nalco"), had engaged in unfair methods of competition in violation of §5(a)(1) when each firm independently and unilaterally adopted at different times some or all of three business practices that were neither restrictive, predatory, nor adopted for the purpose of restraining competition. These challenged practices were: (1) the sale of the product by all four firms at a delivered price which included transportation costs, (2) the giving by Du Pont and Ethyl of extra advance notice of price increases, over and above the 30 days provided by contract, and (3) the use by Du Pont and Ethyl (and infrequently by PPG) of a "most favored nation" clause under which the seller promised that no customer would be charged a higher price than other customers. . . . The Commission reasoned that, although the petitioners' adoption of these practices was noncollusive, they collectively had the effect, by removing some of the uncertainties about price determination, of substantially lessening competition by facilitating price parallelism at noncompetitive levels higher than might have otherwise existed. . . . The order is set aside.

Lead-based antiknock compounds have been used in the refining of gasoline since the 1920s. The compounds are essentially homogeneous, consisting in part of tetraethyl lead (TEL), originally produced in the 1920s, and tetramethyl lead (TML), first produced in 1960. They are now usually sold as mixtures, sometimes with additives. The compounds are added to gasoline to prevent "knock," i.e., premature detonation in a gasoline engine's cylinders. Resistance to knock is measured by octane ratings; for a gasoline refiner use of lead-based antiknock mixtures is the most economical way to raise the octane rating of gasoline for vehicles that take leaded gas. Since the compounds are highly toxic and volatile,

great care must be taken in transporting and storing them. Refiners therefore maintain only limited inventories. Since an uninterrupted supply is important, the refiner usually purchases the compounds periodically from at least two antiknock producers pursuant to one-year contracts.

From the 1920s until 1948, Ethyl was the sole domestic producer of antiknock compounds. Demand for the compounds increased with the increase in gasoline use, however, and in 1948 Du Pont entered the industry and captured a substantial market share. In 1961 PPG (then known as Houston Chemical Company) began to manufacture and sell the compounds; and in 1964 Nalco followed suit. By 1974, Du Pont had 38.4% of the market; Ethyl 33.5%; PPG 16.2%; and Nalco 11.8%. During 1974-1979, the period of the alleged violations, these were the only four domestic producers and sellers of the compounds. No other firm has ever made or sold the compounds in this country. Thus the industry has always been highly concentrated. However, there are no technological or financial barriers to new entries.

The only purchasers of lead antiknocks are the gasoline refining companies which are large, aggressive, and sophisticated buyers. Indeed, several are among the largest industrial corporations in the world.¹ If prospective profits from the sale of antiknock compounds were sufficiently attractive, nothing would prevent them from integrating backwards into the antiknock industry. Of the 154 refiners who purchase the product, the 10 largest buy about 30% of the total amount produced in this country.

The steady increase in demand for antiknock compounds during the 1960s allowed PPG and Nalco to enter the market. From August 1971 to January 1974, however, federal controls froze the price of the compounds, and beginning in 1973 the federal government initiated steps that were to lead to a drastic reduction in demand. At that time the Environmental Protection Agency ("EPA") required that all automobiles made in the United States, beginning in 1975, be equipped with catalytic converters; since the lead in antiknock compounds fouls such converters, almost all new cars produced since 1975 require unleaded gasoline. At about the same time, in order to reduce the amount of lead in the atmosphere the EPA imposed severe limitations on the amount of lead that could be used in gasoline. As a result of these two measures the use of lead antiknock compounds sharply declined from more than 1 billion pounds in 1974 to approximately 400 million pounds in 1980, leaving manufacturers with excess capacity. . . .

Thus, even though there are no technological or financial constraints barring new entries into the industry and there were two new entrants

¹ These include Exxon Corp., Texaco Corp., Mobil Oil Co., Gulf Oil Co., Amoco, and Chevron.

Thatcher Manufacturing Company v. Federal Trade Commission

272 U.S. 554 (1926)

MR. JUSTICE McREYNOLDS delivered the opinion of the Court.

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The Commission entered complaint against the petitioner, March 1, 1921, and charged that the latter contrary to Section 7 of the Clayton Act, first acquired the stock of four competing corporations—Lockport Glass Company, Essex Glass Company, Travis Glass Company and Woodbury Glass Company—and thereafter took transfers of all the business and assets of the first three and caused their dissolution. . . . [T]he Commission ruled that the acquisitions of all these stocks were unlawful and ordered the petitioner to cease and desist from ownership, operation, management and control of the assets, properties, rights, etc., of the Lockport, Essex and Travis Glass Companies secured through such stock ownership, and to divest itself of the assets, properties, rights, etc., formerly held by them. Also, that it should divest itself of the stock of the Woodbury Glass Company.

The court below held that the last-named company was not in competition with petitioner within the meaning of the statute and modified the order accordingly. Therein we agree and to that extent affirm its decree.

The court further ruled, in effect, that as the stocks of the remaining three companies were unlawfully obtained and ownership of the assets came through them, the Commission properly ordered the holder so to dispossess itself of the properties as to restore prior lawful conditions. With this we cannot agree. When the Commission institutes a proceeding based upon the holding of stock contrary to Section 7 of the Clayton Act, its power is limited by Section 11 to an order requiring the guilty person to cease and desist from such violation, effectually to divest itself of the stock, and to make no further use of it. The Act has no application to ownership of a competitor's property and business obtained prior to any action by the Commission, even though this was brought about through stock unlawfully held. The purpose of the Act was to prevent continued holding of stock and the peculiar evils incident thereto. If purchase of property has produced an unlawful status a remedy is provided through the courts. . . . The Commission is without authority under such circumstances.

Affirmed in part; reversed in part.

[MR. JUSTICE BRANDEIS, with whom the Chief Justice, MR. JUSTICE HOLMES and MR. JUSTICE STONE joined, dissented in part.]

Brown Shoe Co., Inc. v. United States

370 U.S. 294 (1962)

MR. CHIEF JUSTICE WARREN delivered the opinion of the Court.

I

This suit was initiated in November 1955 when the Government filed a civil action in the United States District Court for the Eastern District of Missouri alleging that a contemplated merger between the G. R. Kinney Company, Inc. (Kinney), and the Brown Shoe Company, Inc. (Brown), through an exchange of Kinney for Brown stock, would violate Section 7 of the Clayton Act. . . .

The Industry

The District Court found that although domestic shoe production was scattered among a large number of manufacturers, a small number of large companies occupied a commanding position. Thus, while the 24 largest manufacturers produced about 35% of the Nation's shoes, the top 4—International, Endicott-Johnson, Brown (including Kinney) and General Shoe—alone produced approximately 23% of the Nation's shoes or 65% of the production of the top 24.

In 1955, domestic production of nonrubber shoes was 509.2 million pairs, of which about 103.6 million pairs were men's shoes, about 271 million pairs were women's shoes, and about 134.6 million pairs were children's shoes. The District Court found that men's, women's, and children's shoes are normally produced in separate factories.

The public buys these shoes through about 70,000 retail outlets, only 22,000 of which, however, derive 50% or more of their gross receipts from the sale of shoes and are classified as "shoe stores" by the Census Bureau. These 22,000 shoe stores were found generally to sell (1) men's shoes only, (2) women's shoes only, (3) women's and children's shoes, or (4) men's, women's, and children's shoes.

The District Court found a "definite trend" among shoe manufacturers to acquire retail outlets. . . . Brown, itself, with no retail outlets of its own prior to 1951, had acquired 845 such outlets by 1956. Moreover, between 1950 and 1956 nine independent shoe store chains, operating 1,114 retail shoe stores, were found to have become subsidiaries of these large firms and to have ceased their independent operations.

And once the manufacturers acquired retail outlets, the District Court found there was a "definite trend" for the parent-manufacturers to supply an ever increasing percentage of the retail outlets' needs, thereby foreclosing other manufacturers from effectively competing for the retail accounts. Manufacturer-dominated stores were found to be "drying up" the available outlets for independent producers.

Another "definite trend" found to exist in the shoe industry was a decrease in the number of plants manufacturing shoes. And there appears to have been a concomitant decrease in the number of firms manufacturing shoes. In 1947, there were 1,077 independent manufacturers of shoes, but by 1954 their number had decreased about 10% to 970.¹

Brown Shoe

Brown Shoe was found not only to have been a participant, but also a moving factor, in these industry trends. Although Brown had experimented several times with operating its own retail outlets, by 1945 it had disposed of them all. However, in 1951, Brown again began to seek retail outlets by acquiring the Nation's largest operator of leased shoe departments, Wohl Shoe Company (Wohl), which operated 250 shoe departments in department stores throughout the United States. Between 1952 and 1955 Brown made a number of smaller acquisitions. . . . In 1954, Brown made another major acquisition: Regal Shoe Corporation which, at the time, operated one manufacturing plant producing men's shoes and 110 retail outlets.

The acquisition of these corporations was found to lead to increased sales by Brown to the acquired companies. . . .

During the same period of time, Brown also acquired the stock or assets of seven companies engaged solely in shoe manufacturing. As a result, in 1955, Brown was the fourth largest shoe manufacturer in the country, producing about 25.6 million pairs of shoes or about 4% of the Nation's total footwear production.

Kinney

Kinney is principally engaged in operating the largest family-style shoe store chain in the United States. At the time of trial, Kinney was found to be operating over 400 such stores in more than 270 cities. These stores were found to make about 1.2% of all national retail shoe sales by dollar volume. Moreover, in 1955 the Kinney stores sold approximately 8 million pairs of nonrubber shoes or about 1.6% of the national pairage sales of such shoes. . . .

In addition to this extensive retail activity, Kinney owned and operated four plants which manufactured men's, women's, and children's shoes and whose combined output was 0.5% of the national shoe production in 1955, making Kinney the twelfth largest shoe manufacturer in the United States.

Kinney stores were found to obtain about 20% of their shoes from Kinney's own manufacturing plants. At the time of the merger, Kinney bought no shoes from Brown; however, in line with Brown's conceded

¹ U.S. Bureau of the Census, 1958 Census of Manufacturers, MC 58(2)-31A-6. By 1958, the number of independent manufacturers had decreased by another 10% to 872. *Ibid.*

reasons² for acquiring Kinney, Brown had, by 1957, become the largest outside supplier of Kinney's shoes, supplying 7.9% of all Kinney's needs.

III. LEGISLATIVE HISTORY

This case is one of the first to come before us in which the Government's complaint is based upon allegations that the appellant has violated Section 7 of the Clayton Act, as that section was amended in 1950. The amendments adopted in 1950 culminated extensive efforts over a number of years, on the parts of both the Federal Trade Commission and some members of Congress, to secure revision of a section of the antitrust laws considered by many observers to be ineffective in its then existing form. . . . In the light of this extensive legislative attention to the measure, and the broad, general language finally selected by Congress for the expression of its will, we think it appropriate to review the history of the amended Act in determining whether the judgment of the court below was consistent with the intent of the legislature. . . .

The dominant theme pervading congressional consideration of the 1950 amendments was a fear of what was considered to be a rising tide of economic concentration in the American economy. Apprehension in this regard was bolstered by the publication in 1948 of the Federal Trade Commission's study on corporate mergers. Statistics from this and other current studies were cited as evidence of the danger to the American economy in unchecked corporate expansions through merger. Other considerations cited in support of the bill were the desirability of retaining "local control" over industry and the protection of small businesses.³ Throughout the recorded discussion may be found examples of Congress' fear not only of accelerated concentration of economic power on economic grounds, but also of the threat to other values a trend toward concentration was thought to pose.

What were some of the factors, relevant to a judgment as to the validity of a given merger, specifically discussed by Congress in redrafting Section 7?

² As stated in the testimony of Clark R. Gamble, President of Brown Shoe Company:

"It was our feeling, in addition to getting a distribution into the field of prices which we were not covering, it was also the feeling that as Kinney moved into the shopping centers in these free standing stores, they were going into a higher income neighborhood and they would probably find the necessity of up-grading and adding additional lines to their very successful operation that they had been doing and it would give us an opportunity we hoped to be able to sell them in that category. Besides that, it was a very successful operation and would give us a good diversified investment to stabilize our earnings." . . .

³ . . . Cf. *United States v. Aluminum Co. of America*, 148 F.2d 416, 429 (C.A.2d Cir., per Learned Hand, J.): "Throughout the history of these [antitrust] statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other."

First, there is no doubt that Congress did wish to "plug the loophole" and to include within the coverage of the Act the acquisition of assets no less than the acquisition of stock.

Second, by the deletion of the "acquiring-acquired" language in the original text, it hoped to make plain that Section 7 applied not only to mergers between actual competitors, but also to vertical and conglomerate mergers whose effect may tend to lessen competition in any line of commerce in any section of the country.⁴

Third, it is apparent that a keystone in the erection of a barrier to what Congress saw was the rising tide of economic concentration, was its provision of authority for arresting mergers at a time when the trend to a lessening of competition in a line of commerce was still in its incipiency. Congress saw the process of concentration in American business as a dynamic force; it sought to assure the Federal Trade Commission and the courts the power to brake this force at its outset and before it gathered momentum.

Fourth, and closely related to the third, Congress rejected, as inappropriate to the problem it sought to remedy, the application to Section 7 cases of the standards for judging the legality of business combinations adopted by the courts in dealing with cases arising under the Sherman Act, and which may have been applied to some early cases arising under original Section 7.

Fifth, at the same time that it sought to create an effective tool for preventing all mergers having demonstrable anticompetitive effects, Congress recognized the stimulation to competition that might flow from particular mergers. When concern as to the Act's breadth was expressed, supporters of the amendments indicated that it would not impede, for example, a merger between two small companies to enable the combination to compete more effectively with larger corporations dominating the relevant market, nor a merger between a corporation which is financially healthy and a failing one which no longer can be a vital competitive factor in the market. The deletion of the word "community" in the original Act's description of the relevant geographic market is another illustration of Congress' desire to indicate that its concern was with the adverse effects of a given merger on competition only in an economically significant "section" of the country. Taken as a whole, the legislative history illuminates congressional concern with the protection of *competition*, not *competitors*, and its desire to restrain mergers only to the extent that such combinations may tend to lessen competition.

Sixth, Congress neither adopted nor rejected specifically any particular

tests for measuring the relevant markets, either as defined in terms of product or in terms of geographic locus of competition, within which the anticompetitive effects of a merger were to be judged. Nor did it adopt a definition of the word "substantially," whether in quantitative terms of sales or assets or market shares or in designated qualitative terms, by which a merger's effects on competition were to be measured.

Seventh, while providing no definite quantitative or qualitative tests by which enforcement agencies could gauge the effects of a given merger to determine whether it may "substantially" lessen competition or tend toward monopoly, Congress indicated plainly that a merger had to be functionally viewed, in the context of its particular industry. That is, whether the consolidation was to take place in an industry that was fragmented rather than concentrated, that had seen a recent trend toward domination by a few leaders or had remained fairly consistent in its distribution of market shares among the participating companies, that had experienced easy access to markets by suppliers and easy access to suppliers by buyers or had witnessed foreclosure of business, that had witnessed the ready entry of new competition or the erection of barriers to prospective entrants, all were aspects, varying in importance with the merger under consideration, which would properly be taken into account.⁵

Eighth, Congress used the words "*may be* substantially to lessen competition" (emphasis supplied), to indicate that its concern was with probabilities, not certainties. Statutes existed for dealing with clear-cut menaces to competition; no statute was sought for dealing with ephemeral possibilities. Mergers with a probable anticompetitive effect were to be proscribed by this Act.

It is against this background that we must return to the case before us.

IV. THE VERTICAL ASPECTS OF THE MERGER

Economic arrangements between companies standing in a supplier-customer relationship are characterized as "vertical." The primary vice of a vertical merger or other arrangement tying a customer to a supplier is that, by foreclosing the competitors of either party from a segment of the market otherwise open to them, the arrangement may act as a "clog on competition," *Standard Oil Co. of California v. United States*, 337 U.S.

⁵ Subsequent to the adoption of the 1950 amendments, both the Federal Trade Commission and the courts have, in the light of Congress' expressed intent, recognized the relevance and importance of economic data that places any given merger under consideration within an industry framework almost inevitably unique in every case. Statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power; but only a further examination of the particular market—its structure, history and probably future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger. . . .

⁴ That Section 7 was intended to apply to all mergers—horizontal, vertical or conglomerate—was specifically reiterated by the House Report on the final bill. H. R. Rep. No. 1191, 81st Cong., 1st Sess. 11. . . .

293, 314, which "deprive[s] . . . rivals of a fair opportunity to compete."⁶ . . . Every extended vertical arrangement by its very nature, for at least a time, denies to competitors of the supplier the opportunity to compete for part or all of the trade of the customer-party to the vertical arrangement. However, the Clayton Act does not render unlawful all such vertical arrangements, but forbids only those whose effect "may be substantially to lessen competition, or to tend to create a monopoly" "in any line of commerce in any section of the country." . . . The "area of effective competition" must be determined by reference to a product market (the "line of commerce") and a geographic market (the "section of the country").

The Product Market

The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it.⁷ However, within this broad market, well-defined submarkets may exist, which, in themselves, constitute product markets for antitrust purposes. *United States v. E. I. duPont de Nemours & Co.*, 353 U.S. 586, 593-595. The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialize vendors. Because Section 7 of the Clayton Act prohibits any merger which may substantially lessen competition "in any line of commerce" (emphasis supplied), it is necessary to examine the effects of a merger in each such economically significant submarket to determine if there is a reasonable probability that the merger will substantially lessen competition. If such a probability is found to exist, the merger is proscribed.

Applying these considerations to the present case, we conclude that the record supports the District Court's finding that the relevant lines of commerce are men's, women's, and children's shoes. These product lines are recognized by the public; each line is manufactured in separate plants; each has characteristics peculiar to itself rendering it generally noncompetitive with the others; and each is, of course, directed toward a distinct class of customers.

Appellant, however, contends that the District Court's definitions fail to recognize sufficiently "price/quality" and "age/sex" distinctions in

⁶ In addition, a vertical merger may disrupt and injure competition when those independent customers of the supplier who are in competition with the merging customer, are forced either to stop handling the supplier's lines, thereby jeopardizing the goodwill they have developed, or to retain the supplier's lines, thereby forcing them into competition with their own supplier. . . .

⁷ The cross-elasticity of production facilities may also be an important factor in defining a product market within which a vertical merger is to be viewed. . . .

shoes. Brown argues that the predominantly medium-priced shoes which it manufactures occupy a product market different from the predominantly low-priced shoes which Kinney sells. But agreement with that argument would be equivalent to holding that medium-priced shoes do not compete with low-priced shoes. We think the District Court properly found the facts to be otherwise. It would be unrealistic to accept Brown's contention that, for example, men's shoes selling below \$8.99 are in a different product market from those selling above \$9.00.

This is not to say, however, that "price/quality" differences, where they exist, are unimportant in analyzing a merger; they may be of importance in determining the likely effect of a merger. But the boundaries of the relevant market must be drawn with sufficient breadth to include the competing products of each of the merging companies and to recognize competition where, in fact, competition exists. Thus we agree with the District Court that in this case a further division of product lines based on "price/quality" differences would be "unrealistic."

Brown's contention that the District Court's product market definitions should have recognized further "age/sex" distinctions raises a different problem. Brown's sharpest criticism is directed at the District Court's finding that children's shoes constituted a single line of commerce. Brown argues, for example, that "a little boy does not wear a little girl's black patent leather pump" and that "[a] male baby cannot wear a growing boy's shoes." Thus Brown argues that "infants' and babies'" shoes, "misses' and children's" shoes and "youths' and boys'" shoes should each have been considered a separate line of commerce. Assuming, *arguendo*, that little boys' shoes, for example, do have sufficient peculiar characteristics to constitute one of the markets to be used in analyzing the effects of this merger, we do not think that in this case the District Court was required to employ finer "age/sex" distinctions than those recognized by its classifications of "men's," "women's," and "children's" shoes. Further division does not aid us in analyzing the effects of this merger. . . .

The Geographic Market

We agree with the parties and the District Court that insofar as the vertical aspect of this merger is concerned, the relevant geographic market is the entire Nation. The relationships of product value, bulk, weight and consumer demand enable manufacturers to distribute their shoes on a nationwide basis, as Brown and Kinney, in fact, do. The anticompetitive effects of the merger are to be measured within this range of distribution.

The Probable Effect of the Merger

Once the area of effective competition affected by a vertical arrangement has been defined, an analysis must be made to determine if the effect of the arrangement "may be substantially to lessen competition, or to tend to create a monopoly" in this market.

Since the diminution of the vigor of competition which may stem from a vertical arrangement results primarily from a foreclosure of a share of the market otherwise open to competitors, an important consideration in determining whether the effect of a vertical arrangement "may be substantially to lessen competition, or to tend to create a monopoly" is the size of the share of the market foreclosed. However, this factor will seldom be determinative. If the share of the market foreclosed is so large that it approaches monopoly proportions, the Clayton Act will, of course, have been violated; but the arrangement will also have run afoul of the Sherman Act. And the legislative history of Section 7 indicates clearly that the tests for measuring the legality of any particular economic arrangement under the Clayton Act are to be less stringent than those used in applying the Sherman Act. On the other hand, foreclosure of a *de minimis* share of the market will not tend "substantially to lessen competition."

Between these extremes, in cases such as the one before us, in which the foreclosure is neither of monopoly nor *de minimis* proportions, the percentage of the market foreclosed by the vertical arrangement cannot itself be decisive. In such cases, it becomes necessary to undertake an examination of various economic and historical factors in order to determine whether the arrangement under review is of the type Congress sought to proscribe.

A most important such factor to examine is the very nature and purpose of the arrangement.⁸ Congress not only indicated that "the tests of illegality [under Section 7] are intended to be similar to those which the courts have applied in interpreting the same language as used in other sections of the Clayton Act," but also chose for Section 7 language virtually identical to that of Section 3 of the Clayton Act, 15 U.S.C. Section 14, which had been interpreted by this Court to require an examination of the interdependence of the market share foreclosed by, and the economic purpose of, the vertical arrangement. Thus, for example, if a particular vertical arrangement, considered under Section 3, appears to be a limited term exclusive-dealing contract, the market foreclosure must generally be significantly greater than if the arrangement is a tying contract before the arrangement will be held to have violated the Act. . . . The reason for this is readily discernible. The usual tying contract forces the customer to take a product or brand he does not necessarily want in order to secure one which he does desire. Because such an arrangement is inherently anticompetitive, we have held that its use by an established company is likely "substantially to lessen competition" although only a relatively

⁸ Although it is "unnecessary for the Government to speculate as to what is in the 'back of the minds' of those who promote a merger," H.R. Rep. No. 1191, 81st Cong., 1st Sess. 8, evidence indicating the purpose of the merging parties, where available, is an aid in predicting the probable future conduct of the parties and thus the probable effects of the merger. *Swift & Co. v. United States*, 196 U.S. 375, 396; *United States v. Maryland & Virginia Milk Producers Assn.*, 167 F. Supp. 799, 804 (D.C.D.C.), *aff'd*, 362 U.S. 458.

small amount of commerce is affected. *International Salt Co. v. United States*. . . . Thus, unless the tying device is employed by a small company in an attempt to break into a market . . . the use of a tying device can rarely be harmonized with the strictures of the antitrust laws, which are intended primarily to preserve and stimulate competition. . . . On the other hand, requirement contracts are frequently negotiated at the behest of the customer who has chosen the particular supplier and his product upon the basis of competitive merit. . . . Of course, the fact that requirement contracts are not inherently anticompetitive will not save a particular agreement if, in fact, it is likely "substantially to lessen competition, or tend to create a monopoly." . . . Yet requirement contract may escape censure if only a small share of the market is involved, if the purpose of the agreement is to insure to the customer a sufficient supply of a commodity vital to the customer's trade or to insure to the supplier a market for his output and if there is no trend toward concentration in the industry. . . . Similar considerations are pertinent to a judgment under Section 7 of the Act.

The importance which Congress attached to economic purpose is further demonstrated by the Senate and House Reports on H. R. 2734, which evince an intention to preserve the "failing company" doctrine. . . . Similarly, Congress foresaw that the merger of two large companies or a large and a small company might violate the Clayton Act while the merger of two small companies might not, although the share of the market foreclosed be identical, if the purpose of the small companies is to enable them in combination to compete with larger corporations dominating the market.

The present merger involved neither small companies nor failing companies. In 1955, the date of this merger, Brown was the fourth largest manufacturer in the shoe industry with sales of approximately 25 million pairs of shoes and assets of over \$72,000,000 while Kinney had sales of about 8 million pairs of shoes and assets of about \$18,000,000. Not only was Brown one of the leading manufacturers of men's, women's, and children's shoes but Kinney, with over 350 retail outlets, owned and operated the largest independent chain of family shoe stores in the Nation. Thus, in this industry, no merger between a manufacturer and an independent retailer could involve a larger potential market foreclosure. Moreover, it is apparent both from past behavior of Brown and from the testimony of Brown's President, that Brown would use its ownership of Kinney to force Brown shoes into Kinney stores. Thus, in operation this vertical arrangement would be quite analogous to one involving a tying clause.⁹

Another important factor to consider is the trend toward concentration

⁹ Moreover, ownership integration is a more permanent and irreversible tie than is contract integration. See Kessler and Stern, "Competition, Contract, and Vertical Integration," 69 *Yale L. J.* 1, 78 (1959).

in the industry. It is true, of course, that the statute prohibits a given merger only if the effect of *that* merger may be substantially to lessen competition. But the very wording of Section 7 requires a prognosis of the probable *future* effect of the merger.

The existence of a trend toward vertical integration, which the District Court found, is well substantiated by the record. Moreover, the court found a tendency of the acquiring manufacturers to become increasingly important sources of supply for their acquired outlets. The necessary corollary of these trends is the foreclosure of independent manufacturers from markets otherwise open to them. And because these trends are not the product of accident but are rather the result of deliberate policies of Brown and other leading shoe manufacturers, account must be taken of these facts in order to predict the probable future consequences of this merger. It is against this background of continuing concentration that the present merger must be viewed.

Brown argues, however, that the shoe industry is at present composed of large number of manufacturers and retailers, and that the industry is dynamically competitive. But remaining vigor cannot immunize a merger if the trend in that industry is toward oligopoly. . . . It is the probable effect of the merger upon the future as well as the present which the Clayton Act commands the courts and the Commission to examine.

Moreover, as we have remarked above, not only must we consider the probable effects of the merger upon the economics of the particular markets affected but also we must consider its probable effects upon the economic way of life sought to be preserved by Congress. Congress was desirous of preventing the formation of further oligopolies with their attendant adverse effects upon local control of industry and upon small business. Where an industry was composed of numerous independent units, Congress appeared anxious to preserve this structure. . . .

The District Court's findings, and the record facts, many of them set forth in Part I of this opinion, convince us that the shoe industry is being subjected to just such a cumulative series of vertical mergers which, if left unchecked, will be likely "substantially to lessen competition."

We reach this conclusion because the trend toward vertical integration in the shoe industry, when combined with Brown's avowed policy of forcing its own shoes upon its retail subsidiaries, may foreclose competition from a substantial share of the markets for men's, women's, and children's shoes, without producing any countervailing competitive, economic, or social advantages.

V. THE HORIZONTAL ASPECTS OF THE MERGER

An economic arrangement between companies performing similar functions in the production or sale of comparable goods or services is characterized as "horizontal." The effect on competition of such an arrangement depends, of course, upon its character and scope. Thus, its

validity in the face of the antitrust laws will depend upon such factors as: the relative size and number of the parties to the arrangement; whether it allocates shares of the market among the parties; whether it fixes prices at which the parties will sell their product; or whether it absorbs or insulates competitors. Where the arrangement effects a horizontal merger between companies occupying the same product and geographic market, whatever competition previously may have existed in that market between the parties to the merger is eliminated. Section 7 of the Clayton Act, prior to its amendment, focused upon this aspect of horizontal combinations by proscribing acquisitions which might result in a lessening of competition between the acquiring and the acquired companies. The 1950 amendments made plain Congress' intent that the validity of such combinations was to be gauged on a broader scale: their effect on competition generally in an economically significant market.

Thus, again, the proper definition of the market is a "necessary predicate" to an examination of the competition that may be affected by the horizontal aspects of the merger. The acquisition of Kinney by Brown resulted in a horizontal combination at both the manufacturing and retailing levels of their businesses. Although the District Court found that the merger of Brown's and Kinney's *manufacturing* facilities was economically too insignificant to come within the prohibitions of the Clayton Act, the Government has not appealed from this portion of the lower court's decision. Therefore, we have no occasion to express our views with respect to that finding. On the other hand, appellant does contest the District Court's finding that the merger of the companies' *retail* outlets may tend substantially to lessen competition.

The Product Market

Shoes are sold in the United States in retail shoe stores and in shoe departments of general stores. These outlets sell: (1) men's shoes, (2) women's shoes, (3) women's or children's shoes, or (4) men's, women's or children's shoes. Prior to the merger, both Brown and Kinney sold their shoes in competition with one another through the enumerated kinds of outlets characteristic of the industry. . . .

The Geographic Market

The criteria to be used in determining the appropriate geographic market are essentially similar to those used to determine the relevant product market. . . . Moreover, just as a product submarket may have Section 7 significance as the proper "line of commerce," so may a geographic submarket be considered the appropriate "section of the country." . . . Congress prescribed a pragmatic, factual approach to the definition of the relevant market and not a formal, legalistic one. The geographic market selected must, therefore, both "correspond to the commercial realities" of the industry and be economically significant. Thus, although the geo-

graphic market in some instances may encompass the entire Nation, under other circumstances it may be as small as a single metropolitan area. . . . The fact that two merging firms have competed directly on the horizontal level in but a fraction of the geographic markets in which either has operated, does not, in itself, place their merger outside the scope of Section 7. That section speaks of "any . . . section of the country," and if anticompetitive effects of a merger are probable in "any" significant market, the merger—at least to that extent—is proscribed.

The parties do not dispute the findings of the District Court that the Nation as a whole is the relevant geographic market for measuring the anticompetitive effects of the merger viewed vertically or of the horizontal merger of Brown's and Kinney's manufacturing facilities. As to the retail level, however, they disagree. . . .

We believe, however, that the record fully supports the District Court's findings that shoe stores in the outskirts of cities compete effectively with stores in central downtown areas, and that while there is undoubtedly some commercial intercourse between smaller communities within a single "standard metropolitan area," the most intense and important competition in retail sales will be confined to stores within the particular communities in such an area and their immediate environs.

We therefore agree that the District Court properly defined the relevant geographic markets in which to analyze this merger as those cities with a population exceeding 10,000 and their environs in which both Brown and Kinney retailed shoes through their own outlets. Such markets are large enough to include the downtown shops and suburban shopping centers in areas contiguous to the city, which are the important competitive factors, and yet are small enough to exclude stores beyond the immediate environs of the city, which are of little competitive significance.

The Probable Effect of the Merger

Having delineated the product and geographic markets within which the effects of this merger are to be measured, we turn to an examination of the District Court's finding that as a result of the merger competition in the retailing of men's, women's and children's shoes may be lessened substantially in those cities in which both Brown and Kinney stores are located. . . .

. . . [W]e believe the record is adequate to support the findings of the District Court. While it is true that the court concentrated its attention on the structure of competition in the city in which it sat and as to which detailed evidence was most readily available, it also heard witnesses from no less than 40 other cities in which the parties to the merger operated. The court was careful to point out that it was on the basis of all the evidence that it reached its conclusions concerning the boundaries of the relevant markets and the merger's effects on competition within them. We recognize that variations of size, climate and wealth as enumerated by Brown exist in the relevant markets. However, we agree with the court

below that the markets with respect to which evidence was received provide a fair sampling of all the areas in which the impact of this merger is to be measured. The appellant has not shown how the variables it has mentioned could affect the structure of competition within any particular market so as to require a change in the conclusions drawn by the District Court. Each competitor within a given market is equally affected by these factors, even though the city in which he does business may differ from St. Louis in size, climate or wealth. Thus, we believe the District Court properly reached its conclusions on the basis of the evidence available to it. There is no reason to protract already complex antitrust litigation by detailed analyses of peripheral economic facts, if the basic issues of the case may be determined through study of a fair sample.¹⁰

In the case before us, not only was a fair sample used to demonstrate the soundness of the District Court's conclusions, but evidence of record fully substantiates those findings as to each relevant market. An analysis of undisputed statistics of sales of shoes in the cities in which both Brown and Kinney sell shoes at retail, separated into the appropriate lines of commerce, provides a persuasive factual foundation upon which the required prognosis of the merger's effects may be built. Although Brown objects to some details in the Government's computations used in drafting these exhibits, appellant cannot deny the correctness of the more general picture they reveal. . . . They show, for example, that during 1955 in 32 separate cities, ranging in size and location from Topeka, Kansas, to Batavia, New York, and Hobbs, New Mexico, the combined share of Brown and Kinney sales of women's shoes (by unit volume) exceeded 20%.¹¹ In 31 cities—some the same as those used in measuring the effect of the merger in the women's line—the combined share of children's shoes sales exceeded 20%; in 6 cities their share exceeded 40%. In Dodge City, Kansas, their combined share of the market for woman's shoes was over 57%; their share of the children's shoe market in that city was 49%. In the 7 cities in which Brown's and Kinney's combined shares of the market for women's shoes were greatest (ranging from 33% to 57%) each of the parties alone, prior to the merger, had captured substantial portions of those markets (ranging from 13% to 34%); the merger intensified this

¹⁰ See . . . U.S. Atty. Gen. Nat. Comm. to Study the Antitrust Laws, Report 126 (1955): "While sufficient data to support a conclusion is required, sufficient data to give the enforcement agencies, the courts and business certainty as to competitive consequences would nullify the words 'Where the effect may be' in the Clayton Act and convert them into 'Where the effect is.'" And the Committee of the Judicial Conference of the United States on Procedure in Antitrust and Other Protracted Cases has also emphasized the need for limiting the mass of possibly relevant evidence in cases of this type in order to avoid confusion and its concomitant increased possibility of error. 13 F.R.D. 62, 64.

¹¹ Although the sum of the parties' pre-existing shares of the market will normally equal their combined share of the immediate post-merger market, we recognize that this share need not remain stable in the future. Nevertheless, such statistics provide a graphic picture of the immediate impact of a merger, and, as such, also provide a meaningful base upon which to build conclusions of the probable future effects of the merger.

existing concentration. In 118 separate cities the combined shares of the market of Brown and Kinney in the sale of one of the relevant lines of commerce exceeded 5%. In 47 cities, their share exceeded 5% in all three lines.

The market share which companies may control by merging is one of the most important factors to be considered when determining the probable effects of the combination on effective competition in the relevant market. In an industry as fragmented as shoe retailing, the control of substantial shares of the trade in a city may have important effects on competition. If a merger achieving 5% control were now approved, we might be required to approve future merger efforts by Brown's competitors seeking similar market shares. The oligopoly Congress sought to avoid would then be furthered and it would be difficult to dissolve the combinations previously approved. Furthermore, in this fragmented industry, even if the combination controls but a small share of a particular market, the fact that this share is held by a large national chain can adversely affect competition. Testimony in the record from numerous independent retailers, based on their actual experience in the market, demonstrates that a strong, national chain of stores can insulate selected outlets from the vagaries of competition in particular locations and that the large chains can set and alter styles in footwear to an extent that renders the independents unable to maintain competitive inventories. A third significant aspect of this merger is that it creates a large national chain which is integrated with a manufacturing operation. The retail outlets of integrated companies, by eliminating wholesalers and by increasing the volume of purchases from the manufacturing division of the enterprise, can market their own brands at prices below those of competing independent retailers. Of course, some of the results of large integrated or chain operations are beneficial to consumers. Their expansion is not rendered unlawful by the mere fact that small independent stores may be adversely affected. It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.

Other factors to be considered in evaluating the probable effects of a merger in the relevant market lend additional support to the District Court's conclusion that this merger may substantially lessen competition. One such factor is the history of tendency toward concentration in the industry.¹² As we have previously pointed out, the shoe industry has, in re-

¹² . . . A Company's history of expansion through mergers presents a different economic picture than a history of expansion through unilateral growth. Internal expansion is more likely to be the result of increased demand for the company's products and is more likely to provide increased investment in plants, more jobs and greater output. Conversely,

cent years, been a prime example of such a trend. Most combinations have been between manufacturers and retailers, as each of the larger producers has sought to capture an increasing number of assured outlets for its wares. Although these mergers have been primarily vertical in their aim and effect, to the extent that they have brought ever greater numbers of retail outlets within fewer and fewer hands, they have had an additional important impact on the horizontal plane. By the merger in this case, the largest single group of retail stores still independent of one of the large manufacturers was absorbed into an already substantial aggregation of more or less controlled retail outlets. As a result of this merger, Brown moved into second place nationally in terms of retail stores directly owned. Including the stores on its franchise plan, the merger placed under Brown's control almost 1,600 shoe outlets, or about 7.2% of the Nation's retail "shoe stores" as defined by the Census Bureau and 2.3% of the Nation's total retail shoe outlets.¹³ We cannot avoid the mandate of Congress that tendencies toward concentration in industry are to be curbed in their incipency, particularly when those tendencies are being accelerated through giant steps striding across a hundred cities at a time. In the light of the trends in this industry we agree with the Government and the court below that this is an appropriate place at which to call a halt.

At the same time appellant has presented no mitigating factors, such as the business failure or the inadequate resources of one of the parties that may have prevented it from maintaining its competitive position, nor a demonstrated need for combination to enable small companies to enter into a more meaningful competition with those dominating the relevant markets. On the basis of the record before us, we believe the Government sustained its burden of proof. We hold that the District Court was correct in concluding that this merger may tend to lessen competition substantially in the retail sale of men's, women's, and children's shoes in the overwhelming majority of those cities and their environs in which both Brown and Kinney sell through owned or controlled outlets.

The judgment is *Affirmed*.

Note: In a subsequent decision, *U.S. v. Continental Can Co.*, 378 U.S. 441 (1964), the Supreme Court sharpened the economic tools developed in *Brown Shoe*, particularly in connection with their use to define relevant product markets. (See especially pp. 447-58 of that decision.)

expansion through merger is more likely to reduce available consumer choice while providing no increase in industry capacity, jobs or output. It was for these reasons, among others, Congress expressed its disapproval of successive acquisitions. Section 7 was enacted to prevent even small mergers that added to concentration in an industry. . . .

¹³ Although statistics concerning the degree of concentration and the rank of Brown-Kinney in terms of controlled retail stores in each of the relevant product and geographic markets would have been more helpful in analyzing the results of this merger, neither side has presented such statistics. The figures in the record, based on national rank, are, nevertheless, useful in depicting the trends in the industry.

United States v. Von's Grocery Company

384 U.S. 270 (1966)

MR. JUSTICE BLACK delivered the opinion of the Court.

On March 25, 1960, the United States brought this action charging that the acquisition by Von's Grocery Company of its direct competitor Shopping Bag Food Stores, both large retail grocery companies in Los Angeles, California, violated §7 of the Clayton Act . . . as amended in 1950 by the Celler-Kefauver Anti-Merger Act. . . . On March 28, 1960, three days later, the District Court refused to grant the Government's motion for a temporary restraining order and immediately Von's took over all of Shopping Bag's capital stock and assets including 36 grocery stores in the Los Angeles area. After hearing evidence on both sides, the District Court made findings of fact and concluded as a matter of law that there was "not a reasonable probability" that the merger would tend "substantially to lessen competition" or "create a monopoly" in violation of §7. For this reason the District Court entered judgment for the defendants. . . . The Government appealed directly to this Court. . . . The sole question here is whether the District Court properly concluded on the facts before it that the Government had failed to prove a violation of §7.

The record shows the following facts relevant to our decision. The market involved here is the retail grocery market in the Los Angeles area. In 1958 Von's retail sales ranked third in the area and Shopping Bag's ranked sixth. In 1960 their sales together were 7.5% of the total two and one-half billion dollars of retail groceries sold in the Los Angeles market each year. For many years before the merger both companies had enjoyed great success as rapidly growing companies. From 1948 to 1958 the number of Von's stores in the Los Angeles area practically doubled from 14 to 27, while at the same time the number of Shopping Bag's stores jumped from 15 to 34. During that same decade, Von's sales increased fourfold and its share of the market almost doubled while Shopping Bag's sales multiplied seven times and its share of the market tripled. The merger of these two highly successful, expanding and aggressive competitors created the second largest grocery chain in Los Angeles with sales of almost \$172,488,000 annually. In addition the findings of the District Court show that the number of owners operating single stores in the Los Angeles retail grocery market decreased from 5,365 in 1950 to 3,818 in 1961. By 1963, three years after the merger, the number of single-store owners had dropped still further to 3,590.¹ During roughly the same period from 1953 to 1962, the number of chains with two or more grocery

stores increased from 96 to 150. While the grocery business was being concentrated into the hands of fewer and fewer owners, the small companies were continually being absorbed by the larger firms through mergers. According to an exhibit prepared by one of the Government's expert witnesses, in the period from 1949 to 1958 nine of the top 20 chains acquired 126 stores from their smaller competitors. . . . Moreover, . . . acquisitions and mergers in the Los Angeles retail grocery market have continued at a rapid rate since the merger. These facts alone are enough to cause us to conclude contrary to the District Court that the Von's-Shopping Bag merger did violate §7. Accordingly, we reverse. . . .

Like the Sherman Act in 1890 and the Clayton Act in 1914, the basic purpose of the 1950 Celler-Kefauver Act was to prevent economic concentration in the American economy by keeping a large number of small competitors in business. . . . As we said in *Brown Shoe Co. v. United States*, 370 U.S. 294, 315, "The dominant theme pervading congressional consideration of the 1950 amendments was a fear of what was considered to be a rising tide of economic concentration in the American economy." To arrest this "rising tide" toward concentration into too few hands and to halt the gradual demise of the small businessman, Congress decided to clamp down with vigor on mergers. . . .

The facts of this case present exactly the threatening trend toward concentration which Congress wanted to halt. The number of small grocery companies in the Los Angeles retail grocery market had been declining rapidly before the merger and continued to decline rapidly afterwards. This rapid decline in the number of grocery store owners moved hand in hand with a large number of significant absorptions of the small companies by the larger ones. In the midst of this steadfast trend toward concentration, Von's and Shopping Bag, two of the most successful and largest companies in the area, jointly owning 66 grocery stores merged to become the second largest chain in Los Angeles. This merger cannot be defended on the ground that one of the companies was about to fail or that the two had to merge to save themselves from destruction by some larger and more powerful competitor. What we have on the contrary is simply the case of two already powerful companies merging in a way which makes them even more powerful than they were before. If ever such a merger would not violate §7, certainly it does when it takes place in a market characterized by a long and continuous trend toward fewer and

Angeles Metropolitan Area either in the last decade or since the merger. On the contrary, economic concentration has decreased. . . ."

This conclusion is completely contradicted by Finding No. 23 which makes plain the steady decline in the number of individual grocery store owners referred to above. It is thus apparent that the District Court, in Finding No. 80, used the term "concentration" in some sense other than a total decrease in the number of separate competitors which is the crucial point here.

¹ Despite this steadfast concentration of the Los Angeles grocery business into fewer and fewer hands, the District Court, in Finding of Fact No. 80, concluded as follows:

"There has been no increase in concentration in the retail grocery business in the Los

fewer owner-competitors which is exactly the sort of trend which Congress, with power to do so, declared must be arrested.

Appellees' primary argument is that the merger between Von's and Shopping Bag is not prohibited by §7 because the Los Angeles grocery market was competitive before the merger, has been since, and may continue to be in the future. Even so, §7 "requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future; this is what is meant when it is said that the amended §7 was intended to arrest anticompetitive tendencies in their 'incipiency.'" *U.S. v. Philadelphia Nat. Bank*, 374 U.S. 321, 362. It is enough for us that Congress feared that a market marked at the same time by both a continuous decline in the number of small businesses and a large number of mergers would slowly but inevitably gravitate from a market of many small competitors to one dominated by one or a few giants, and competition would thereby be destroyed. Congress passed the Celler-Kefauver Act to prevent such a destruction of competition. Our cases since the passage of that Act have faithfully endeavored to enforce this congressional command. We adhere to them now.

Here again as in *United States v. El Paso Gas Co.*, 376 U.S. 651, 662, since appellees "have been on notice of the antitrust charge from almost the beginning . . . we not only reverse the judgment below but direct the District Court to order divestiture without delay." . . .

Reversed and remanded.

[MR. JUSTICE FORTAS took no part in the consideration or decision of this case. MR. JUSTICE WHITE concurred.]

MR. JUSTICE STEWART, with whom MR. JUSTICE HARLAN joins, dissenting.

We first gave consideration to the 1950 amendment of §7 of the Clayton Act in *Brown Shoe Co. v. United States*. . . . The thorough opinion THE CHIEF JUSTICE wrote for the Court in that case made two things plain: First, the standards of §7 require that every corporate acquisition be judged in the light of the contemporary economic context of its industry. Second, the purpose of §7 is to protect competition, not to protect competitors, and every §7 case must be decided in the light of that clear statutory purpose. Today the Court turns its back on these two basic principles and on all the decisions that have followed them.

The Court makes no effort to appraise the competitive effects of this acquisition in terms of the contemporary economy of the retail food in-

dustry in the Los Angeles area.² Instead, through a simple exercise in sums, it finds that the number of individual competitors in the market has decreased over the years, and, apparently on the theory that the degree of competition is invariably proportional to the number of competitors, it holds that this historic reduction in the number of competing units is enough under §7 to invalidate a merger within the market, with no need to examine the economic concentration of the market, the level of competition in the market, or the potential adverse effect of the merger on that competition. This startling *per se* rule is contrary not only to our previous decisions, but contrary to the language of §7, contrary to the legislative history of the 1950 amendment, and contrary to economic reality.

Under §7, as amended, a merger can be invalidated if, and only if, "the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." No question is raised here as to the tendency of the present merger to create a monopoly. Our sole concern is with the question whether the effect of the merger may be substantially to lessen competition.

The principal danger against which the 1950 amendment was addressed was the erosion of competition through the cumulative centripetal effect of acquisitions by large corporations, none of which by itself might be sufficient to constitute a violation of the Sherman Act. Congress' immediate fear was that of large corporations buying out small companies. A major aspect of that fear was the perceived trend toward absentee ownership of local business. Another, more generalized, congressional purpose revealed by the legislative history was to protect small businessmen and to stem the rising tide of concentration in the economy.³ These goals, Congress thought, could be achieved by "arresting mergers at a time when the trend to a lessening of competition in a line of commerce was still in its incipiency." *Brown Shoe Co. v. United States*, *supra*, at 317.

² This is the first case to reach the Court under the 1950 amendment to §7 that involves a merger between firms engaged solely in retail food distribution. Kaysen & Turner, *Antitrust Policy* 40 (1959), have discussed this industry in the following terms: "As a guess, we can say that the most important distributive trades, especially the food trades, are structurally unconcentrated in the metropolitan areas. . . . [T]he significance of structural oligopoly in terms of policy is far different in [these trades] than in manufacturing and mining. . . . [T]he traditional view that the local-market industries are essentially competitive in character is probably correct. . . ."

³ Much of the fuel for the congressional debates on concentration in the American economy was derived from a contemporary study by the Federal Trade Commission on corporate acquisitions between 1940 and 1947. See Report of the Federal Trade Commission on the Merger Movement: A Summary Report (1948). A critical study of the FTC report, published while the 1950 amendment was pending in Congress, concluded that the effect of the recent merger movement on concentration had been slight. Lintner & Butters, "Effect of Mergers on Industrial Concentration, 1940-1947," 32 *Rev. of Econ. & Statistics* 30 (1950). Two economists for the Federal Trade Commission later acquiesced in that conclusion. Blair & Houghton, "The Lintner-Butters Analysis of the Effect of Mergers on Industrial Concentration, 1940-1947," 33 *Rev. of Econ. & Statistics* 63, n. 12 (1951).

. . . The legislative history leaves no doubt that the applicable standard for measuring the substantiality of the effect of a merger on competition was that of a "reasonable probability" of lessening competition. The standard was thus more stringent than that of a "mere possibility" on the one hand and more lenient than that of a "certainty" on the other.⁴ I cannot agree that the retail grocery business in Los Angeles is in an incipient or any other stage of a trend toward a lessening of competition, or that the effective level of concentration in the industry has increased. Moreover, there is no indication that the present merger, or the trend in this industry as a whole, augurs any danger whatsoever for the small businessman. The Court has substituted bare conjecture for the statutory standard of a reasonable probability that competition may be lessened.

The Court rests its conclusion on the "crucial point" that, in the 11-year period between 1950 and 1961, the number of single-store grocery firms in Los Angeles decreased 29% from 5,365 to 3,818.⁵ Such a decline should, of course, be no more than a fact calling for further investigation of the competitive trend in the industry. For the Court, however, that decline is made the end, not the beginning, of the analysis. . . .

I believe that even the most superficial analysis of the record makes plain the fallacy of the Court's syllogism that competition is necessarily reduced when the bare number of competitors has declined. In any meaningful sense, the structure of the Los Angeles grocery market remains unthreatened by concentration. Local competition is vigorous to a

⁴ Although Congress eschewed exclusively mathematical tests for assessing the impact of a merger, it offered several generalizations indicative of the sort of merger that might be proscribed, e.g.: Whether the merger eliminated an enterprise that had been a substantial factor in competition; whether the increased size of the acquiring corporation threatened to give it a decisive advantage over competitors; whether an undue number of competing enterprises had been eliminated. H. R. Rep. No. 1191, 81st Cong., 1st Sess., p. 8. See *Brown Shoe Co. v. United States*, 370 U.S. 294, 321, n. 36. Only the first of these generalizations is arguably applicable to the present merger; the market-extension aspects of the merger, as well as the evidence of Shopping Bag's declining profit margin and weak price competition, suggest that any conclusion under this test would be equivocal. See *infra*, pp. 295-296; 298, n. 30. Senator Kefauver stated explicitly on the Senate floor that the mere elimination of competition between the merged firms would not make the acquisition illegal; rather, "the merger would have to have the effect of lessening competition generally." 96 Cong. Rec. 16456.

⁵ The decline continued at approximately the same rate to 1963, the last year for which data are available, when there were 3,590 single-store grocery firms in the area. The record contains no breakdown of the figures on single-store concerns. In an extensive study of the retail grocery industry on a national scale, the Federal Trade Commission found that between 1939 and 1954 the total number of grocery stores in the United States declined by 109,000, or 28%. The entire decrease was suffered by stores with annual gross sales of less than \$50,000. During the same period, the number of stores in all higher sales brackets increased. The Commission noted that the census figures, from which its data were taken, included an undetermined number of grocery firms liquidating after 1948 that merely closed their grocery operations and continued their remaining lines of business, such as nongrocery retailing, food wholesaling, food manufacturing, etc. Staff Report to the Federal Trade Commission, Economic Inquiry Into Food Marketing, Part I, Concentration and Integration in Retailing 48, 54 (1960).

fault, not only among chain stores themselves but also between chain stores and single-store operators. The continuing population explosion of the Los Angeles area, which has outrun the expansion plans of even the largest chains, offers a surfeit of business opportunity for stores of all sizes. Affiliated with cooperatives that give the smallest store the buying strength of its largest competitors, new stores have taken full advantage of the remarkable ease of entry into the market. And, most important of all, the record simply cries out that the numerical decline in the number of single-store owners is the result of transcending social and technological changes that positively preclude the inference that competition has suffered because of the attrition of competitors.

Section 7 was never intended by Congress for use by the Court as a charter to roll back the supermarket revolution. Yet the Court's opinion is hardly more than a requiem for the so-called "Mom and Pop" grocery stores—the bakery and butcher shops, and vegetable and fish markets—that are now economically and technologically obsolete in many parts of the country. No action by this Court can resurrect the old single-line Los Angeles food stores that have been run over by the automobile or obliterated by the freeway. . . . Today's dominant enterprise in food retailing is the supermarket. Accessible to the housewife's automobile from a wide radius, it houses under a single roof the entire food requirements of the family. Only through . . . [a] reactionary philosophy . . . can the Court read into the legislative history of §7 its attempt to make the automobile stand still, to mold the food economy of today into the market pattern of another era.

. . . [T]he record offers abundant evidence of the dramatic history of growth and prosperity of the retail food business in Los Angeles.

. . . Between 1948 and 1958, the market share of Safeway, the leading grocery chain in Los Angeles, declined from 14% to 8%. The combined market shares of the top two chains declined from 21% to 14% over the same period; for the period 1952-1958, the combined shares of the three, four, and five largest firms also declined. It is true that between 1948 and 1958, the combined shares of the top 20 firms in the market increased from 44% to 57%. The crucial fact here, however, is that seven of these top 20 firms in 1958 were not even in existence as chains in 1948. Because of the substantial turnover in the membership of the top 20 firms, the increase in market share of the top 20 as a group is hardly a reliable indicator of any tendency toward market concentration.⁶

In addition, statistics in the record for the period 1953-1962 strongly suggest that the retail grocery industry in Los Angeles is less concentrated today than it was a decade ago. During this period, the number of chain

⁶ See Joskow, "Structural Indicia: Rank-Shift Analysis as a Supplement to Concentration Ratios," VI *Antitrust Bulletin* 9 (1961). In addition, the overall market share of the top 20 firms in fact showed a slight decline between 1958 and 1960. . . .

store firms in the area rose from 96 to 150, or 56%. That increase occurred overwhelmingly among chains of the very smallest size, those composed of two or three grocery stores. Between 1953 and 1962, the number of such "chains" increased from 56 to 104, or 86%. Although chains of 10 or more stores increased from 10 to 24 during the period, seven of these 24 chains were not even in existence as chains in Los Angeles in 1953.

Yet even these dramatic statistics do not fully reveal the dynamism and vitality of competition in the retail grocery business in Los Angeles during the period. The record shows that . . . during the period 1953-1962 . . . 173 new chains made their appearance in the market area, and 119 chains went out of existence as chain stores. The vast majority of this market turbulence represented turnover in chains of two or three stores. . . . [A]lmost without exception, these new chains were the outgrowth of successful one-store operations.⁷ There is no indication that comparable turmoil did not equally permeate single-store operations in the area.⁸ In fashioning its *per se* rule, based on the net arithmetical decline in the number of single-store operators, the Court completely disregards the obvious procreative vigor of competition in the market as reflected in the turbulent history of entry and exit of competing small chains.

To support its conclusion the Court invokes three sets of data regarding absorption of smaller firms by merger with larger firms. In each of the acquisitions detailed in . . . the Court's opinion, the acquired units were grocery chains. Not one of these acquisitions was of a firm operating only a single store.⁹ The Court cannot have it both ways. It is only among single-store operators that the decline in the unit number of competitors, so heavily relied upon by the Court, has taken place. Yet the . . . [data] show not a trace of merger activity involving the acquisition of single-store operators. And the number of chains in the area has in fact shown a

⁷ On the basis of these facts, one witness concluded: ". . . It must be remembered that in 1953, only 10 chains with as many as 10 stores each were operating in the area. These chains are recognized as being among the best managed, most successful and most aggressive supermarket operators in the country. They themselves have engaged in expansion programs of significant proportions since 1953. Yet, 10 years later, instead of having swept aside all competition and being left alone to compete among themselves, these same 10 chains are now faced with the necessity of competing against no less than 14 new chains of 10 or more stores each, a significantly greater number of smaller chains and a host of successful single-store operators, of whom many are affiliated with powerful voluntary chains or other cooperative groups. . . ."

⁸ Data for 1960, the only year for which such figures are available in the record, reveal a comparable agitation of entry and exit among operators of single stores. Although there was a net loss of 132 single-outlet stores in 1960, 128 new single-outlet stores opened during the year.

⁹ As to Table 1 in the Appendix of the Court's opinion, this fact is obvious on the face of the table. As to Table 2 in the Appendix, examination of the record discloses that each of the nine acquisitions listed as involving a single store represented purchases of single stores from chains ranging in size from two to 49 stores.

substantial net increase during the period, in spite of the fact that some of the chains have been absorbed by larger firms. How then can the Court rely on these acquisitions as evidence of a tendency toward market concentration in the area? . . .

The Court's reliance on the fact that nine of the top 20 chains acquired 120 stores in the Los Angeles area between 1949 and 1958 does not withstand analysis in light of the complete record. Forty percent of these acquisitions . . . were made by [chains] . . . which ranked 9th, 11th, and 20th, . . . according to 1958 sales in the market. Each of these firms subsequently went into bankruptcy as a result of overexpansion, undercapitalization, or inadequate managerial experience. This substantial post-acquisition demise of relatively large chains hardly comports with the Court's tacit portrayal of the inexorable march of the market toward oligopoly.

Further, the table relied on by the Court to sustain its view that acquisitions have continued in the Los Angeles area at a rapid rate in the three-year period following this merger indiscriminately lumps together horizontal and market-extension mergers. . . . [A]t a time when the number of single-store concerns was well over 3,500, horizontal mergers over a three-year period between going concerns achieved at most only the *de minimis* level of 10 acquisitions involving 20 stores. It cannot seriously be maintained that the effect of the negligible market share foreclosed by these horizontal mergers may be substantially to lessen competition within the meaning of §7. . . .

Moreover, contrary to the assumption on which the Court proceeds, the record establishes that the present merger itself has substantial, even predominant, market-extension overtones. The District Court found that the Von's stores were located in the southern and western portions of the Los Angeles metropolitan area, and that the Shopping Bag stores were located in the northern and eastern portions. In each of the areas in which Von's and Shopping Bag stores competed directly, there were also at least six other chain stores and several smaller stores competing for the patronage of customers. . . . Even among these stores which competed at least partially with one another, the overlap in sales represented only approximately 25% of the combined sales of the two chains in the overall Los Angeles area. The present merger was thus three parts market-extension and only one part horizontal, but the Court nowhere recognizes this market-extension aspect that exists within the local market itself. The actual market share foreclosed by the elimination of Shopping Bag as an independent competitor was thus slightly less than 1% of the total grocery store sales in the area. The share of the market preempted by the present merger was therefore practically identical with the 0.77% market foreclosure accepted as "quite insubstantial" by the Court in *Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320, 331-333.

The irony of this case is that the Court invokes its sweeping new construction of §7 to the detriment of a merger between two relatively successful, local, largely family-owned concerns, each of which had less than 5% of the local market and neither of which had any prior history of growth by acquisition.¹⁰ In a sense, the defendants are being punished for the sin of aggressive competition. The Court is inaccurate in its suggestions, *ante*, pp. 277-278, that the merger makes these firms more "powerful" than they were before, and that Shopping Bag was itself a "powerful" competitor at the time of the merger. There is simply no evidence in the record, and the Court makes no attempt to demonstrate, that the increment in market share obtained by the combined stores can be equated with an increase in the market power of the combined firm. . . .

With regard to the "plight" of the small businessman, the record is unequivocal that his competitive position is strong and secure in the Los Angeles retail grocery industry. The most aggressive competitors against the larger retail chains are frequently the operators of single stores.¹¹ The vitality of these independents is directly attributable to the recent and spectacular growth in California of three large cooperative buying organizations. . . . The rise of these cooperative organizations has introduced a significant new source of countervailing power against the market power of the chain stores, without in any way sacrificing the advantages of independent operation. In the face of the substantial assistance available to independents through membership in such cooperatives, the Court's implicit equation between the market power and the market share resulting from the present merger seems completely invalid.

Moreover, it is clear that there are no substantial barriers to market entry. The record contains references to numerous highly successful instances of entry with modest initial investments. . . . Enhancing free access to the market is the absence of any such restrictive factors as patented technology, trade secrets, or substantial product differentiation.

¹⁰ . . . So far as the record reveals, the competitive behavior of these firms was impeccable throughout their expansion, which took place solely by internal growth. In discussing the success of comparable firms *vis-à-vis* the Sherman Act, Judge Learned Hand stated: ". . . The successful competitor, having been urged to compete, must not be turned upon when he wins." *United States v. Aluminum Co. of America*, 148 F.2d 416, 430.

¹¹ One single-store operator, located adjacent to one supermarket and within a mile of two others, testified, "I have often been asked if I could compete successfully against this sort of competition. My answer is and always has been that the question is not whether I can compete against them, but whether they can compete against me."

Another single-store operator testified, "Competition in the grocery business is on a store-by-store basis and any aggressive and able operator like myself can out-compete the store of any of the chains because of personalized service, better labor relations, and being in personal charge of the store and seeing that it is run properly."

A third single-store operator testified, "The chains in this area are good operators, but when they grow too large, they are actually easier to compete with from an independent's viewpoint. If I had a choice, I would rather operate a store near a chain unit than near another independent."

Numerous other factors attest to the pugnacious level of grocery competition in Los Angeles, all of them silently ignored by the Court in its emphasis solely on the declining number of single-store competitors in the market. Three thousand five hundred and ninety single-store firms is a lot of grocery stores. The large number of separate competitors and the frequent price battles between them belie any suggestion that price competition in the area is even remotely threatened by a descent to the sort of consciously interdependent pricing that is characteristic of a market turning the corner toward oligopoly. The birth of dynamic new competitive forces—discount food houses and food departments in department stores, bantams and superettes, deli-liquor stores and drive-in dairies—promises unremitting competition in the future. In the more than four years following the merger, the District Court found not a shred of evidence that competition had been in any way impaired by the merger. . . .

The harsh standard now applied by the Court to horizontal mergers may prejudice irrevocably the already difficult choice by numerous successful small and medium-sized businessmen in the myriad smaller markets where the effect of today's decision will be felt, whether to expand by buying or by building additional facilities. And by foreclosing future sale as one attractive avenue of eventual market exit, the Court's decision may over the long run deter new market entry and tend to stifle the very competition it seeks to foster.

In a single sentence and an omnibus footnote at the close of its opinion, the Court pronounces its work consistent with the line of our decisions under §7 since the passage of the 1950 amendment. The sole consistency that I can find is that in litigation under §7, the Government always wins. The only precedent that is even within sight of today's holding is *U.S. v. Philadelphia Nat. Bank*, 374 U.S. 321. In that case, in the interest of practical judicial administration, the Court proposed a simplified test of merger illegality: "[W]e think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects." *U.S. v. Philadelphia Nat. Bank*, *supra*, at 363. The merger between Von's and Shopping Bag produced a firm with 1.4% of the grocery stores and 7.5% of grocery sales in Los Angeles, and resulted in an increase of 1.1% in the market share enjoyed by the two largest firms in the market and 3.3% in the market share of the six largest firms. The former two figures are hardly the "undue percentage" of the market, nor are the latter two figures the "significant increase" in concentration, that would make this merger inherently suspect under the standard of *Philadelphia Nat. Bank*. Instead,

the circumstances of the present merger fall far outside the simplified test established by that case for precisely the sort of merger here involved.¹² . . .

The emotional impact of a merger between the third and sixth largest competitors in a given market, however fragmented, is understandable, but that impact cannot substitute for the analysis of the effect of the merger on competition that Congress required by the 1950 amendment. Nothing in the present record indicates that there is more than an ephemeral possibility that the effect of this merger may be substantially to lessen competition. Section 7 clearly takes "reasonable probability" as its standard. That standard has not been met here, and I would therefore affirm the judgment of the District Court.

United States v. General Dynamics Corp.

415 U.S. 486 (1974)

MR. JUSTICE STEWART delivered the opinion of the Court. . . .

I

At the time of the acquisition involved here, Material Service Corp. was a large midwest producer and supplier of building materials, concrete, limestone, and coal. All of its coal production was from deep-shaft mines operated by it or its affiliate, appellee Freeman Coal Mining Corp., and production from these operations amounted to 6.9 million tons of coal in 1959 and 8.4 million tons in 1967. In 1954, Material Service began to

¹² . . . The Court's opinion is remarkable for its failure to support its conclusion by reference to even a single piece of economic theory. I shall not dwell here on the barometers of competition that have been suggested by the commentators. But it seems important to note that the present merger falls either outside, or at the very fringe, of the various mechanical tests that had been proposed. See, e.g., Kaysen & Turner, *Antitrust Policy* 133-136 (1959) (horizontal merger with direct competitor is prima facie unlawful where acquiring company accounts for 20% or more of the market, or where merging companies together constitute 20% or more of the market; acquisitions producing less than 20% market control unlawful only where special circumstances are present, such as serious barriers to entry or substantial influence on prices by the acquired company); Stigler, "Mergers and Preventive Antitrust Policy," 104 *U. Pa. L. Rev.* 176, 179-182 (1955) (acquisition unlawful if it produces a combined market share of 20% or more; acquisition permitted if the combined share is less than 5-10%); Bok, Section 7 of The Clayton Act and the Merging of Law and Economics, 74 *Harv. L. Rev.* 226, 308-329 (1960) (no merger by the dominant firm in an industry if its market share is increased by more than 2-3%; no merger by other large firms in the industry where the combined market shares of the two-to-eight largest firms after the merger are increased by 7-8% or more over the shares that existed at any time during the preceding 5-10 years; no merger where acquired firm has 5% market share or more). See also Markham, "Merger Policy Under the New Section 7: A Six-Year Appraisal," 43 *Va. L. Rev.* 489, 521-522 (1957). The 40% rule promoted by the concurring opinion in the present case seems no more than an ad hoc endeavor to rationalize the holding of the Court.

acquire the stock of United Electric Coal Companies. United Electric at all relevant times operated only strip or open-pit mines in Illinois and Kentucky; at the time of trial in 1970 a number of its mines had closed and its operations had been reduced to four mines in Illinois and none in Kentucky. . . . Material Service's purchase of United Electric stock continued until 1959. At this point Material's holdings amounted to more than 34% of United Electric's outstanding shares and—all parties are now agreed on this point—Material had effective control of United Electric. . . .

Some months after this takeover, Material Service was itself acquired by the appellee General Dynamics Corp. General Dynamics is a large diversified corporation, much of its revenues coming from sales of aircraft, communications, and marine products to Government agencies. . . . As a result of the purchase of Material Service, and through it, of Freeman and United Electric, General Dynamics became the Nation's fifth largest commercial coal producer. During the early 1960s General Dynamics increased its equity in United Electric by direct purchases of United Electric stock, and by 1966 it held or controlled 66.15% of United Electric's outstanding shares. In September 1966 the board of directors of General Dynamics authorized a tender offer to holders of the remaining United Electric stock. This offer was successful, and United Electric shortly thereafter became a wholly owned subsidiary of General Dynamics.

The thrust of the Government's complaint was that the acquisition of United Electric by Material Service in 1959 violated §7 of the Clayton Act . . . because the takeover substantially lessened competition in the production and sale of coal in either or both of two geographic markets. It contended that a relevant "section of the country" within the meaning of §7 was, alternatively, the State of Illinois or the Eastern Interior Coal Province Sales Area, the latter being one of four major coal distribution areas recognized by the coal industry and comprising Illinois and Indiana, and parts of Kentucky, Tennessee, Iowa, Minnesota, Wisconsin, and Missouri.¹

At trial controversy focused on three basic issues: the propriety of coal as a "line of commerce," the definition of Illinois or the Eastern Interior Coal Province Sales Area as a relevant "section of the country," and the

¹ Testimony at trial indicated that the Eastern Interior Coal Province—the area of coal production upon which the Eastern Coal Province Sales Area was based—was originally named by United States Geological Survey maps of the coalfields in the United States and described one portion of a sequence of coal-bearing rock formations known geologically as the Pennsylvania System. The Sales Area of the Eastern Interior Coal Province was derived from the assumption, acknowledged in the trial court's opinion, that the high costs of transporting coal—which may amount to 40% of the price of delivered coal—will inevitably give producers of coal a clear competitive advantage in sales in the immediate areas of the mines.

easy to constrain the prices charged by WMI's subs, we reverse on the grounds that the merged firm does not substantially lessen competition.

DISCUSSION

WMI raises the following claims which we treat *seriatim*: (1) the district court's definition of the relevant geographic and product markets and its determination of WMI's post-merger market share are erroneous; and (2) the district court erred in rejecting WMI's rebuttal of the *prima facie* case.

A. Market Definition and Determination of Market Share

In determining the relevant product and geographic market, Judge Griesa considered only firms that presently collect waste in competition with WMI's subs TIDI and ACS. He thus did not consider the effect of potential competition by new entrants upon the market power of the merged firm but rather treated this as part of the rebuttal to the *prima facie* case. Although potential competition resulting from easy entry can as logically be appraised as part of market definition, see R. Posner, Antitrust Law 132-33 (1976), we will utilize the traditional analysis of defining the market in terms of existing competitors.

We thus begin by determining which firms presently collect waste in actual competition with WMI (a term we use henceforth to include TIDI and ACS). WMI provides waste disposal services to business and industrial customers as do a number of other private haulers. Neither WMI nor these other haulers provides substantial services to residential customers since residential waste is generally collected by private or municipal haulers who provide only limited services to business/industrial customers. Residential and business/industrial customers are thus served largely by different firms.

One reason for the distinction between residential and business/industrial collection is found in customer preferences for collection by particular equipment at existing prices. Thus, residential customers largely prefer non-containerized service while business/industrial customers usually opt for containerized hauling. There is of course overlap, and the district court therefore did not define the market solely in terms of equipment distinctions. Some large apartment complexes prefer containerized service (and were included by Judge Griesa as customers in the relevant market), and some businesses make do with hand collection (also included as customers in the relevant market).

Another reason for the distinction (as modified by the overlaps) between the residential and business/industrial collection is that most private haulers provide only containerized service and most municipalities provide only non-containerized service. The largest municipality, the City of Dallas, provides no containerized service. Moreover, the few municipalities that do provide containerized service to business/industrial customers were included as sellers in the the relevant product market.

At bottom, however, the distinction between residential and business/industrial service rests on two facts, one economic and the other political. First, customers with large amounts of trash have a greater need for containerized service than do customers with smaller quantities; the former tend to be business/industrial and the latter residential. Second, the latter customers are, for political reasons, served by hand collection provided at low prices by municipalities. At the fringe, of course, some business/industrial customers have sufficiently little trash to be able to choose hand collection at existing prices while some residential customers, such as large apartment complexes, prefer containerized service. Some business/industrial customers haul their trash themselves, although the record indicates that is not a feasible alternative for many at existing prices.

Customer preferences for service, therefore, turn largely on the quantity of trash produced, and different kinds of equipment are most useful for different quantities of trash. It might be that in a market without municipal haulers the larger private haulers would offer a full line of services, and the relevant product market would be all trash collection. However, the decision of the City of Dallas and other municipalities to provide non-containerized service has narrowed the market available to private haulers. The fact that only a small fringe of customers have a meaningful choice at existing prices between hand collection, containerized service, or self-hauling demonstrates that the bulk of business/industrial customers will view the alternatives as economically feasible only when confronted with substantial increases in the cost of containerized service. We regard this as legally sufficient to support Judge Griesa's view of which existing firms presently compete with WMI. . . .

Nor is there support for WMI's claim that the power of Dallas or other municipalities to provide containerized service is a constraint on the prices charged by private firms serving the market so defined. Such an expansion of services would be essentially political since the City of Dallas is not a profit-seeking entrepreneur, and there is no evidence that such a decision is likely absent very substantial price increases by private haulers. . . .

The district court found the relevant geographic market to be Dallas County, plus a small fringe, but not Tarrant County, of which the city of Fort Worth is part. WMI argued below, and continues to argue here, that the relevant geographic market consists of the entire Dallas-Fort Worth metropolitan area. We disagree. Dallas and Fort Worth constitute a single Standard Metropolitan Statistical Area based on the Office of Management and Budget's judgments regarding economic and social integration. Nevertheless, the bulk of existing Dallas and Fort Worth haulers presently operate exclusively in their respective cities. Only a few, situated near the border between Dallas and Tarrant Counties, do business in both. The area between the two cities is not heavily urbanized, and some of the towns between them have granted long-term exclusive franchises to

waste collectors. Since the travel times between the more heavily populated cities is 45 to 50 minutes, daily service between both areas by the same trucks would be costly. Existing firms that presently compete with WMI are thus found for the most part only in Dallas County. . . .

The district court found that TIDI's and ACS's combined share of the market so defined was 48.8%. This finding was based on a comparison of revenues of the various haulers within this market, and it is to that evidence that we now turn.

In the pre-acquisition Budget Questionnaire filled out by TIDI, it listed its major competitors and gave their approximate market shares. TIDI's responses and Judge Griesa's findings are compared as follows:

Name	TIDI's Estimate of Approximate percent of Market	Judge Griesa's Finding of percent of Market
ACS.....	26	22.5
Moore Ind.	15	11.1
BFI.....	10	7.2
AIDS.....	5	3.4
S.C.A.....	4	2.5

TIDI calculated its own market share as 40–45%, as compared with the 26.3% found by Judge Griesa. The difference between TIDI estimates and Judge Griesa's findings are accounted for by Judge Griesa's inclusion of municipal revenues from business/industrial waste disposal. . . .

B. WMI's Rebuttal

A post-merger market share of 48.8% is sufficient to establish *prima facie* illegality under *United States v. Philadelphia National Bank* . . . , and its progeny. That decision held that large market shares are a convenient proxy for appraising the danger of monopoly power resulting from a horizontal merger. . . . Under its rationale, a merger resulting in a large market share is presumptively illegal, rebuttable only by a demonstration that the merger will not have anticompetitive effects. . . . Thus in *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974), the Court upheld a merger of two leading coal producers because substantially all of the production of one firm was tied up in long-term contracts and its reserves were insubstantial. Since that firm's future ability to compete was negligible, the Court reasoned that its disappearance as an independent competitor could not affect the market.

WMI does not claim that 48.8% is too small a share to trigger the *Philadelphia National Bank* presumption. Rather, it argues that the presumption is rebutted by the fact that competitors can enter the Dallas

waste hauling market with such ease that the finding of a 48.8% market share does not accurately reflect market power. WMI argues that it is unable to raise prices over the competitive level because new firms would quickly enter the market and undercut them. . . .

The Supreme Court has never directly held that ease of entry may rebut a showing of *prima facie* illegality under *Philadelphia National Bank*. However, on several occasions it has held that appraisal of the impact of a proposed merger upon competition must take into account potential competition from firms not presently active in the relevant product and geographic markets. *United States v. Falstaff Brewing Corp.*, 410 U.S. 526 (1973). . . . *Falstaff*, for example, involved a large national brewer that did no business in the northeast section of the country until it acquired Narrangansett, the largest brewer in New England. Reversing a district court finding that Falstaff was not likely to enter the New England market *de novo*, the Supreme Court concluded that the very existence of Falstaff as a potential entrant might constrain brewers in the northeast to maintain competitive price levels as a means of forestalling entry by Falstaff. Under that decision, therefore, potential entrants must be considered in appraising a merger.

Moreover, under *General Dynamics*, a substantial existing market share is insufficient to void a merger where that share is misleading as to actual future competitive effect. In that case, long-term contracts and declining reserves negated the inference of market power drawn from the existing market share. In the present case, a market definition artificially restricted to existing firms competing at one moment may yield market share statistics that are not an accurate proxy for market power when substantial potential competition able to respond quickly to price increases exists.

Finally, the *Merger Guidelines* issued by the government itself not only recognize the economic principle that ease of entry is relevant to appraising the impact upon competition of a merger but also state that it may override all other factors. Where entry is "so easy that existing competitors could not succeed in raising prices for any significant period of time," the government has announced that it will usually not challenge a merger. *United States Department of Justice 1984 Merger Guidelines*, 46 Antitrust & Trade Reg. Rep. (BNA) No. 1169 Spec. Supp. §3.3, at S-6. If the Department of Justice routinely considers ease of entry as relevant to determining the competitive impact of a merger, it may not argue to a court addressing the same issue that ease of entry is irrelevant. We conclude, therefore, that entry by potential competitors may be considered in appraising whether a merger will "substantially lessen competition." . . .

Turning to the evidence in this case, we believe that entry into the relevant product and geographic market by new firms or by existing firms in the Fort Worth area is so easy that any anticompetitive impact of the

merger before us would be eliminated more quickly by such competition than by litigation. . . . Judge Griesa specifically found that individuals operating out of their homes can acquire trucks and some containers and compete successfully "with any other company." The government's response to this factual finding is largely to the effect that economies of scale are more important than Judge Griesa believed. As with his other findings of fact, however, this one is not clearly erroneous, as there are examples in the record of such entrepreneurs entering and prospering.

In any event, entry by larger companies is also relatively easy. At existing prices most Fort Worth and Dallas haulers operate within their own cities, but it is clear from the record that Fort Worth haulers could easily establish themselves in Dallas if the price of trash collection rose above the competitive level. Although it may be true that daily travel from Fort Worth to Dallas and back is costly, there is no barrier to Fort Worth haulers' acquiring garage facilities in Dallas permitting them to station some of their trucks there permanently or for portions of each week. The risks of such a strategy are low since substantial business can be assured through bidding on contracts even before such garage facilities are acquired, as one Fort Worth firm demonstrated by winning such a contract and then opening a facility in a Dallas suburb. That example can hardly be ignored by WMI or other Dallas haulers (not to mention their customers) in arriving at contract bids. The existence of haulers in Fort Worth, therefore, constrains prices charged by Dallas haulers, much as Falstaff constrained pricing by northeast breweries.

The fact that such entry has not happened more frequently reflects only the existence of competitive, entry-forestalling prices, as contemplated in *Falstaff*. . . . We have no doubt that, if WMI were now to seek to acquire a major hauler in Fort Worth, the *Falstaff* decision would compel us to treat the Fort Worth hauler as a potential competitor of WMI. We perceive no reason why Fort Worth haulers should be treated as potential competitors in those circumstances but not in the present case.

Judge Griesa's conclusion that "there is no showing of any circumstances, related to ease of entry or the trend of the business, which promises in and of itself to materially erode the competitive strength of TIDI and ACS" is consistent with our decision. TIDI and ACS may well retain their present market share. However, in view of the findings as to ease of entry, that share can be retained only by competitive pricing. Ease of entry constrains not only WMI, but every firm in the market. Should WMI attempt to exercise market power by raising prices, none of its smaller competitors would be able to follow the price increases because of the ease with which new competitors would appear. WMI would then face lower prices charged by all existing competitors as well as entry by new ones, a condition fatal to its economic prospects if not rectified.

The government argues that consumers may prefer WMI's services, even at a higher price, over those of a new entrant because of its "proven track record." We fail to see how the existence of good will achieved through effective service is an impediment to, rather than the natural result of, competition. The government also argues that existing contracts bind most customers to a particular hauler and thereby prevent new entrants from acquiring business. If so, they also prevent the price increases until new entrants can submit competitive bids.

Given Judge Griesa's factual findings, we conclude that the 48.8% market share attributed to WMI does not accurately reflect future market power. Since that power is in fact insubstantial, the merger does not, therefore, substantially lessen competition in the relevant market and does not violate Section 7.

Reversed.

6

Mergers and Product/ Market Extension

The third category of mergers—conglomerates—involves those among firms which formerly were neither customers, suppliers, nor direct competitors of one another. This third category can be divided into three types of mergers. First, there are product-extension mergers. These involve industries and products into which either or both of the merger partners might logically be expected to enter *de novo*—without using merger as the entry route. Second, there are market-extension mergers, involving firms which produce substitutable products, but which market them in separate geographic areas. As with product-extension mergers, there is often a possibility that, absent the merger, *de novo* entry might occur.

Third, there are what might be called pure conglomerates—mergers of firms with no discernible relationship to one another. These are generally aimed at achieving greater use of management or other generalized capabilities, attaining financial or strategic advantages, or enhancing an organization's sheer size.

Adjudication of product- and market-extension mergers has frequently involved a determination of the importance of the acquiring firm as a potential competitor—would the firm either have entered by itself, thereby increasing the number of competitors? Or would it at least have remained at the edge of the market, thereby providing a constraint upon the activities of those firms already a part of the market?

Another aspect which has often been crucial to the outcome of these cases has been the Court's estimate of the power brought to the industry by the acquiring firm. More specifically, will the "deep financial pockets" of the acquiring firm give the newly acquired firm an unfair advantage over its rivals, ultimately lessening competition?

These issues were graphically presented in the *Procter & Gamble*, *Falstaff*, *Budd* and *Marine Bancorporation* cases. The *Budd* decision is particularly interesting in that it attempts to enunciate a rule for identifying toehold acquisitions, whereby product-extension mergers may be

permitted by a powerful outsider with an industry's smaller firms, so as to enable the acquiring firm to gain a toehold in the industry. *Falstaff* and *Marine Bancorporation* are of interest both for their treatment of market-extension and potential competition factors generally and for their analysis of the means by which potential entrants are identified and evaluated.

Finally, related collaterally to market extension is reciprocity: the possibility that a firm engaged in many areas of activity can demand from suppliers of one division reciprocal business for another, thereby foreclosing potentially important markets to competing suppliers. While enforcement activity in this area has not been particularly active, *Consolidated Foods* illustrates the willingness of the Supreme Court to consider evidence of the extent to which an acquiring firm actively sought reciprocity and the effect thereon of the challenged acquisition.

Pure conglomerate mergers remain one of the more difficult areas: antitrust traditionalists contend that, by definition, these lead to no enhancement of power in any relevant market, while enforcers worry about the social and economic consequences of the massive size of some of these combinations. But the courts have not spoken clearly on this subject—yet.

Federal Trade Commission v. Consolidated Foods Corp.

380 U.S. 592 (1965)

MR. JUSTICE DOUGLAS delivered the opinion of the Court.

The question presented involves an important construction and application of Section 7 of the Clayton Act . . . amended. . . . Consolidated Foods Corp.—which owns food processing plants and a network of wholesale and retail food stores—acquired Gentry, Inc., in 1951. Gentry manufactures principally dehydrated onion and garlic. The Federal Trade Commission held that the acquisition violated Section 7 because it gave respondent the advantage of a mixed threat and lure of reciprocal buying in its competition for business and "the power to foreclose competition from a substantial share of the markets for dehydrated onion and garlic." It concluded, in other words, that the effect of the acquisition "may be substantially to lessen competition" within the meaning of Section 7, and it ordered divestiture and gave other relief. . . . The Court of Appeals, relying mainly on 10 years of post-acquisition experience, held that the Commission had failed to show a probability that the acquisition would substantially lessen competition. . . . The case is here on certiorari. . . .

We hold at the outset that the "reciprocity" made possible by such an acquisition is one of the congeries of anticompetitive practices at which the antitrust laws are aimed. The practice results in "an irrelevant and

alien factor," . . . intruding into the choice among competing products, creating at the least "a priority on the business at equal prices." *International Salt Co. v. United States* . . . ; *Northern Pac. R. Co. v. United States* . . . Reciprocal trading may ensue not from bludgeoning or coercion but from more subtle arrangements. A threatened withdrawal of orders if products of an affiliate cease being bought, as well as a conditioning of future purchases on the receipt of orders for products of that affiliate, is an anticompetitive practice. Section 7 of the Clayton Act is concerned "with probabilities, not certainties." *Brown Shoe Co. v. United States* . . . ; *United States v. Philadelphia Nat. Bank* . . . Reciprocity in trading as a result of an acquisition violates Section 7, if the probability of a lessening of competition is shown. We turn then to that, the principal, aspect of the present case.

Consolidated is a substantial purchaser of the products of food processors who in turn purchase dehydrated onion and garlic for use in preparing and packaging their food. Gentry, which as noted is principally engaged in the manufacture of dehydrated onion and garlic, had in 1950, immediately prior to its acquisition by Consolidated, about 32% of the total sales of the dehydrated garlic and onion industry and, together with its principal competitor, Basic Vegetable Products, Inc., accounted for almost 90% of the total industry sales. The remaining 10% was divided between two other firms. By 1958 the total industry output of both products had doubled, Gentry's share rising to 35% and the combined share of Gentry and Basic remaining at about 90%.

After the acquisition Consolidated (though later disclaiming adherence to any policy of reciprocity) did undertake to assist Gentry in selling. An official of Consolidated wrote as follows to its distributing divisions:

Oftentimes, it is a great advantage to know when you are calling on a prospect, whether or not that prospect is a supplier of someone within your own organization. Everyone believes in reciprocity providing all things are equal.

Attached is a list of prospects for our Gentry products. We would like to have you indicate on the list whether or not you are purchasing any of your supplies from them. If so, indicate whether your purchases are relatively large, small or insignificant. . . .

Food processors who sold to Consolidated stated they would give their onion and garlic business to Gentry for reciprocity reasons if it could meet the price and quality of its competitors' products. . . .

Some suppliers responded and gave reciprocal orders. Some who first gave generous orders later reduced them or abandoned the practice. It is impossible to recreate the precise anatomy of the market arrangements following the acquisition, though respondent offers a factual brief seeking to prove that "reciprocity" either failed or was not a major factor in the post-acquisition history.

The Commission found, however, that "merely as a result of its connection with Consolidated, and without any action on the latter's part, Gentry would have an unfair advantage over competitors enabling it to make sales that otherwise might not have been made." . . .

The Court of Appeals, on the other hand, gave post-acquisition evidence almost conclusive weight. It pointed out that, while Gentry's share of the dehydrated onion market increased by some 7%, its share of the dehydrated garlic market decreased 12%. . . . It also relied on apparently unsuccessful attempts at reciprocal buying. . . . The Court of Appeals concluded that "Probability can best be gauged by what the past has taught." . . .

The Court of Appeals was not in error in considering the post-acquisition evidence in this case. . . . But we think it gave too much weight to it. . . . No group acquiring a company with reciprocal buying opportunities is entitled to a "free trial" period. To give it such would be to distort the scheme of Section 7. . . . Probability of the proscribed evil is required, as we have noted. If the post-acquisition evidence were given conclusive weight or allowed to override all probabilities, then acquisitions would go forward willy-nilly, the parties biding their time until reciprocity was allowed fully to bloom. It is, of course, true that post-acquisition conduct may amount to a violation of Section 7 even though there is no evidence to establish probability *in limine*. . . . But the force of Section 7 is still in probabilities, not in what later transpired. That must necessarily be the case, for once the two companies are united no one knows what the fate of the acquired company and its competitors would have been but for the merger.

Moreover, the post-acquisition evidence here tends to confirm, rather than cast doubt upon, the probable anticompetitive effect which the Commission found the merger would have. The Commission found that Basic's product was superior to Gentry's—as Gentry's president freely and repeatedly admitted. Yet Gentry, in a rapidly expanding market, was able to increase its share of onion sales by 7% and to hold its losses in garlic to a 12% decrease. . . .

We do not go so far as to say any acquisition, no matter how small, violates Section 7 if there is a probability of reciprocal buying. Some situations may amount only to *de minimis*. But where, as here, the acquisition is of a company that commands a substantial share of a market, a finding of probability of reciprocal buying by the Commission, whose expertise the Congress trusts, should be honored, if there is substantial evidence to support it.

The evidence is in our view plainly substantial. Reciprocity was tried over and again and it sometimes worked. The industry structure was peculiar, Basic being the leader with Gentry closing the gap. Moreover there is evidence, as the Commission found, "that many buyers have determined that their source of supply may best be protected by a policy

of buying from two suppliers." When reciprocal buying—or the inducement of it—is added, the Commission observed:

Buyers are likely to lean toward Basic on the ground of quality, but, in seeking a second, protective supply channel, to purchase from Gentry in the belief that this will further their sales to Consolidated. Not only does Gentry thus obtain sales that might otherwise go to Basic or Puccinelli, but the two-firm oligopoly structure of the industry is strengthened and solidified and new entry by others is discouraged. . . .

We conclude that there is substantial evidence to sustain that conclusion and that the order of the Commission should not have been denied enforcement. The judgment of the Court of Appeals is accordingly

Reversed.

[MR. JUSTICE HARLAN concurred.]

MR. JUSTICE STEWART, concurring in the judgment.

. . . While I agree with the result that the Court has reached, I am persuaded to file this separate statement of my views regarding the issues involved.

Clearly the opportunity for reciprocity is not alone enough to invalidate a merger under Section 7. The Clayton Act was not passed to outlaw diversification. Yet large scale diversity of industrial interests almost always presents the possibility of some reciprocal relationships. Often the purpose of diversification is to acquire companies whose present management can benefit from the technical skills and sales acumen of the acquiring corporation. Without more, Section 7 of the Clayton Act does not prohibit mergers whose sole effect is to introduce into an arena of "soft" competition the experience and skills of a more aggressive organization.

It obviously requires more than this kind of bare potential for reciprocal buying to bring a merger within the ban of Section 7. Before a merger may be properly outlawed under Section 7 on the basis solely of reciprocal buying potentials, the law requires a more closely textured economic analysis. . . .

. . . Certainly the mere effort at reciprocity cannot be the basis for finding the probability of a significant alteration in the market structure. Section 7 does not punish intent. No matter how bent on reciprocity Consolidated might have been, if its activities would not have the requisite probable impact on competition, it cannot be held to have violated this law. And, I think, it is not enough to say that the merger is illegal

merely because the reciprocity attempts "sometimes worked." If the opportunity for reciprocity itself is not a violation of the Act when the merger occurs, then some standard must be established for determining how effective reciprocity must be before the merger is subject to invalidation. Nor do I think that illegality of this merger can be rested upon the fact that "[t]he industry structure was peculiar, Basic being the leader with Gentry closing the gap." There is evidence that in the years following 1951, when the merger took place, increased emphasis was placed on solving technical problems which had prevented some processors from relying on dehydrated, rather than raw, onions. The 1950s were a time of flux for the industry. Basic was sometimes the innovator of technological change leading to increased sales; sometimes Gentry had the upper hand. It is possible that this shift to more intensive competition was connected with the merger. Faced with a new competitive situation, Basic may have determined to solve quality control problems which had long been dormant. Indeed, the evidence seems to show that, after the acquisition, the industry reflected the salutary qualities normally associated with free competition. Overall, both Basic and Gentry were furnishing a better product at the end of this period than at the beginning. It is true that the industry had oligopolistic features, but there is no evidence to indicate that barriers to entry were particularly severe.¹ And Gentry, while it was "closing the gap" with regard to dehydrated onions, was falling even farther behind Basic in the sales of dehydrated garlic. Finally, I can attach no significance to the fact that processors, seeking a second source of supply, normally relied on Gentry rather than Puccinelli. That fact can rest on so many alternative hypotheses that it is persuasive as to none.

The touchstone of Section 7 is the probability that competition will be lessened. But before a court takes the drastic step of ordering divestiture, the evidence must be clear that such a probability exists. . . .

To determine that probability, the courts and the Commission should rely on the best information available, whether it is an examination of the market structure before the merger has taken place, or facts concerning the changes in the market after the merger has been consummated. For that reason, I differ with the Court in its assessment of the weight to be accorded post-acquisition evidence. That evidence is the best evidence available to determine whether the merger will distort market forces in the dehydrated onion and garlic industry. The Court of Appeals, in my view, was not wrong because it "gave too much weight" to the post-acquisition evidence. It erred because of the gloss it placed on the statistics and testimony adduced before the hearing examiner and the Commission. . . .

¹ Indeed, by the time of the Commission's decision an additional firm, Gilroy Foods, Inc., had entered this market.

Federal Trade Commission v. Procter & Gamble Co.

386 U.S. 568 (1967)

MR. JUSTICE DOUGLAS delivered the opinion of the Court.

This is a proceeding initiated by the Federal Trade Commission charging that respondent, Procter & Gamble Co., had acquired the assets of Clorox Chemical Co. in violation of §7 of the Clayton Act, . . . as amended by the Celler-Kefauver Act. . . . The charge was that Procter's acquisition of Clorox might substantially lessen competition or tend to create a monopoly in the production and sale of household liquid bleaches. . . .

As indicated by the Commission in its painstaking and illuminating report, it does not particularly aid analysis to talk of this merger in conventional terms, namely, horizontal or vertical or conglomerate. This merger may most appropriately be described as a "product-extension merger," as the Commission stated. . . .

At the time of the merger, in 1957, Clorox was the leading manufacturer in the heavily concentrated household liquid bleach industry. It is agreed that household liquid bleach is the relevant line of commerce. The product is used in the home as a germicide and disinfectant, and, more importantly, as a whitening agent in washing clothes and fabrics. It is a distinctive product with no close substitutes. Liquid bleach is a low-price, high-turnover consumer product sold mainly through grocery stores and supermarkets. The relevant geographical market is the Nation and a series of regional markets. Because of high shipping costs and low sales price, it is not feasible to ship the product more than 300 miles from its point of manufacture. Most manufacturers are limited to competition within a single region since they have but one plant. Clorox is the only firm selling nationally; it has 13 plants distributed throughout the Nation. Purex, Clorox's closest competitor in size, does not distribute its bleach in the northeast or mid-Atlantic States; in 1957, Purex's bleach was available in less than 50% of the national market.

At the time of the acquisition, Clorox was the leading manufacturer of household liquid bleach, with 48.8% of the national sales—annual sales of slightly less than \$40,000,000. Its market share had been steadily increasing for the five years prior to the merger. Its nearest rival was Purex, which manufactures a number of products other than household liquid bleaches, including abrasive cleaners, toilet soap, and detergents. Purex accounted for 15.7% of the household liquid bleach market. The industry is highly concentrated; in 1957, Clorox and Purex accounted for almost 65% of the Nation's household liquid bleach sales, and, together with four other firms, for almost 80%. The remaining 20% was divided among over 200 small producers. Clorox had total assets of \$12,000,000; only eight

producers had assets in excess of \$1,000,000 and very few had assets of more than \$75,000.

In light of the territorial limitations on distribution, national figures do not give an accurate picture of Clorox's dominance in the various regions. Thus, Clorox's seven principal competitors did no business in New England, the mid-Atlantic States, or metropolitan New York. Clorox's share of the sales in those areas was 56%, 72%, and 64% respectively. Even in regions where its principal competitors were active, Clorox maintained a dominant position. Except in metropolitan Chicago and the west-central States Clorox accounted for at least 39%, and often a much higher percentage, of liquid bleach sales.

Since all liquid bleach is chemically identical, advertising and sales promotion are vital. In 1957 Clorox spent almost \$3,700,000 on advertising, imprinting the value of its bleach in the mind of the consumer. In addition, it spent \$1,700,000 for other promotional activities. The Commission found that these heavy expenditures went far to explain why Clorox maintained so high a market share despite the fact that its brand, though chemically indistinguishable from rival brands, retailed for a price equal to or, in many instances, higher than its competitors.

Procter is a large, diversified manufacturer of low-price, high-turnover household products sold through grocery, drug, and department stores. Prior to its acquisition of Clorox, it did not produce household liquid bleach. Its 1957 sales were in excess of \$1,100,000,000 from which it realized profits of more than \$67,000,000; its assets were over \$500,000,000. Procter has been marked by rapid growth and diversification. It has successfully developed and introduced a number of new products. Its primary activity is in the general area of soaps, detergents, and cleansers; in 1957, of total domestic sales, more than one-half (over \$500,000,000) were in this field. Procter was the dominant factor in this area. It accounted for 54.4% of all packaged detergent sales. The industry is heavily concentrated—Procter and its nearest competitors, Colgate-Palmolive and Lever Brothers, account for 80% of the market.

In the marketing of soaps, detergents, and cleansers, as in the marketing of household liquid bleach, advertising and sales promotion are vital. In 1957, Procter was the Nation's largest advertiser, spending more than \$80,000,000 on advertising and an additional \$47,000,000 on sales promotion. Due to its tremendous volume, Procter receives substantial discounts from the media. As a multiproduct producer Procter enjoys substantial advantages in advertising and sales promotion. Thus, it can and does feature several products in its promotions, reducing the printing, mailing, and other costs for each product. It also purchases network programs on behalf of several products, enabling it to give each product network exposure at a fraction of the cost per product that a firm with only one product to advertise would incur.

Prior to the acquisition, Procter was in the course of diversifying into

product lines related to its basic detergent-soap-cleanser business. Liquid bleach was a distinct possibility since packaged detergents—Procter's primary product line—and liquid bleach are used complementarily in washing clothes and fabrics, and in general household cleaning. As noted by the Commission:

... From the consumer's viewpoint, packaged detergents and liquid bleach are closely related products. But the area of relatedness between products of Procter and of Clorox is wider. Household cleansing agents in general, like household liquid bleach, are low-cost, high-turnover household consumer goods marketed chiefly through grocery stores and pre-sold to the consumer by the manufacturer through mass advertising and sales promotions. Since products of both parties to the merger are sold to the same customers, at the same stores, and by the same merchandising methods, the possibility arises of significant integration at both the marketing and distribution levels. . . .

The decision to acquire Clorox was the result of a study conducted by Procter's promotion department designed to determine the advisability of entering the liquid bleach industry. The initial report noted the ascendancy of liquid bleach in the large and expanding household bleach market, and recommended that Procter purchase Clorox rather than enter independently. Since a large investment would be needed to obtain a satisfactory market share, acquisition of the industry's leading firm was attractive. . . .

The Commission found that the acquisition might substantially lessen competition. . . .

The Court of Appeals said that the Commission's finding of illegality had been based on "treacherous conjecture," mere possibility and suspicion. . . . [It] also heavily relied on post-acquisition "evidence . . . to the effect that the other producers subsequent to the merger were selling more bleach for more money than ever before" (358 F.2d, at 80), and that "[t]here [had] been no significant change in Clorox's market share in the four years subsequent to the merger" (*ibid.*). . . . The Court of Appeals, in our view, misapprehended the standards for its review and the standards applicable in a §7 proceeding.

Section 7 of the Clayton Act was intended to arrest the anticompetitive effects of market power in their incipiency. The core question is whether a merger may substantially lessen competition, and necessarily requires a prediction of the merger's impact on competition, present and future. . . . The section can deal only with probabilities, not with certainties. . . . And there is certainly no requirement that the anticompetitive power manifest itself in anticompetitive action before §7 can be called into play. If the enforcement of §7 turned on the existence of actual anticompetitive practices, the congressional policy of thwarting such practices in their incipiency would be frustrated.

All mergers are within the reach of §7, and all must be tested by the same standard, whether they are classified as horizontal, vertical, conglomerate¹ or other. As noted by the Commission, this merger is neither horizontal, vertical, nor conglomerate. Since the products of the acquired company are complementary to those of the acquiring company and may be produced with similar facilities, marketed through the same channels and in the same manner, and advertised by the same media, the Commission aptly called this acquisition a "product-extension merger." . . .

The anticompetitive effects with which this product-extension merger is fraught can easily be seen: (1) the substitution of the powerful acquiring firm for the smaller, but already dominant, firm may substantially reduce the competitive structure of the industry by raising entry barriers and by dissuading the smaller firms from aggressively competing; (2) the acquisition eliminates the potential competition of the acquiring firm.

The liquid bleach industry was already oligopolistic before the acquisition, and price competition was certainly not as vigorous as it would have been if the industry were competitive. Clorox enjoyed a dominant position nationally, and its position approached monopoly proportions in certain areas. The existence of some 200 fringe firms certainly does not belie that fact. Nor does the fact, relied upon by the court below, that, after the merger, producers other than Clorox "were selling more bleach for more money than ever before." 358 F.2d, at 80. In the same period, Clorox increased its share from 48.8% to 52%. The interjection of Procter into the market considerably changed the situation. There is every reason to assume that the smaller firms would become more cautious in competing due to their fear of retaliation by Procter. It is probable that Procter would become the price leader and that oligopoly would become more rigid.

The acquisition may also have the tendency of raising the barriers to new entry. The major competitive weapon in the successful marketing of bleach is advertising. Clorox was limited in this area by its relatively small budget and its inability to obtain substantial discounts. By contrast, Procter's budget was much larger; and, although it would not devote its entire budget to advertising Clorox, it could divert a large portion to meet the short-term threat of a new entrant. Procter would be able to use its volume discounts to advantage in advertising Clorox. Thus, a new entrant would be much more reluctant to face the giant Procter than it would have been to face the smaller Clorox.²

¹ A pure conglomerate merger is one in which there are no economic relationships between the acquiring and the acquired firm.

² The barriers to entry have been raised both for entry by new firms and for entry into new geographical markets by established firms. The latter aspect is demonstrated by Purex's lesson in Erie, Pennsylvania. In October 1957, Purex selected Erie, Pennsylvania—where it had not sold previously—as an area in which to test the salability, under competitive conditions, of a new bleach. The leading brands in Erie were Clorox, with 52%, and the "101"

Possible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition

The Commission also found that the acquisition of Clorox by Procter eliminated Procter as a potential competitor. The Court of Appeals declared that this finding was not supported by evidence because there was no evidence that Procter's management had ever intended to enter the industry independently and that Procter had never attempted to enter. The evidence, however, clearly shows that Procter was the most likely entrant. Procter had recently launched a new abrasive cleaner in an industry similar to the liquid bleach industry, and had wrested leadership from a brand that had enjoyed even a larger market share than had Clorox. Procter was engaged in a vigorous program of diversifying into product lines closely related to its basic products. Liquid bleach was a natural avenue of diversification since it is complementary to Procter's products, is sold to the same customers through the same channels, and is advertised and merchandised in the same manner. Procter had substantial advantages in advertising and sales promotion, which, as we have seen, are vital to the success of liquid bleach. No manufacturer had a patent on the product or its manufacture, necessary information relating to manufacturing methods and processes was readily available, there was no shortage of raw material, and the machinery and equipment required for a plant of efficient capacity were available at reasonable costs. Procter's management was experienced in producing and marketing goods similar to liquid bleach. Procter had considered the possibility of independently entering but decided against it because the acquisition of Clorox would enable Procter to capture a more commanding share of the market.

It is clear that the existence of Procter at the edge of the industry exerted considerable influence on the market. First, the market behavior of the liquid bleach industry was influenced by each firm's prediction of the market behavior of its competitors, actual and potential. Second, the barriers to entry by a firm of Procter's size and with its advantages were not significant. There is no indication that the barriers were so high that the price Procter would have to charge would be above the price that would maximize the profits of the existing firms. Third, the number of potential entrants was not so large that the elimination of one would be insignificant. Few firms would have the temerity to challenge a firm as

brand, sold by Gardner Manufacturing Company, with 29% of the market. Purex launched an advertising and promotional campaign to obtain a broad distribution in a short time, and in five months captured 33% of the Erie market. Clorox's share dropped to 35% and 101's to 17%. Clorox responded by offering its bleach at reduced prices, and then added an offer of a \$1-value ironing board cover for 50¢ with each purchase of Clorox at the reduced price. It also increased its advertising with television spots. The result was to restore Clorox's lost market share and, indeed, to increase it slightly. Purex's share fell to 7%. . . .

solidly entrenched as Clorox. Fourth, Procter was found by the Commission to be the most likely entrant. These findings of the Commission were amply supported by the evidence.

The judgment of the Court of Appeals is reversed and remanded with instructions to affirm and enforce the Commission's order.

It is so ordered.

MR. JUSTICE STEWART and MR. JUSTICE FORTAS took no part in the consideration or decision of this case.

MR. JUSTICE HARLAN, concurring.

I agree that the Commission's order should be sustained, but . . . [i]t is regrettable to see this Court as it enters this comparatively new field of economic adjudication starting off with what has almost become a kind of *res ipsa loquitur* approach to antitrust cases.

The type of merger represented by the transaction before us is becoming increasingly important as large corporations seek to diversify their operations . . . and "[c]ompanies looking for new lines of business tend to buy into those fields with which they have at least some degree of familiarity, and where economies and efficiencies from assimilation are at least possible." Turner, *Conglomerate Mergers* and Section 7 of the Clayton Act, 78 Harv. L. Rev. 1313, 1315. Application of §7 to such mergers has been troubling to the Commission and the lower courts. . . .

I thus believe that it is incumbent upon us to make a careful study of the facts and opinions below in this case, and at least to embark upon the formulation of standards for the application of §7 to mergers which are neither horizontal nor vertical and which previously have not been considered in depth by this Court. . . . My prime difficulty with the Court's opinion is that it makes no effort in this direction at all, and leaves the commission, lawyers, and businessmen at large as to what is to be expected of them in future cases of this kind.

I

The Court's opinion rests on three separate findings of anticompetitive effect. The Court first declares that the market here was "oligopolistic" and that interjection of Procter would make the oligopoly "more rigid" because "[t]here is every reason to assume that the smaller firms would become more cautious in competing due to their fear of retaliation by Procter." The Court, however, does not indicate exactly what reasons lie behind this assumption or by what standard such an effect is deemed "reasonably probable." It could equally be assumed that smaller firms would become more aggressive in competing due to their fear that other-

wise Procter might ultimately absorb their markets and that Procter, as a new entrant in the bleach field, was vulnerable to attack.

But assumption is no substitute for reasonable probability as a measure of illegality under §7 . . . and Congress has not mandated the Commission or the courts "to campaign against 'superconcentration' in the absence of any evidence of harm to competition." Turner *supra*, at 1395. . . .

The Court next stresses the increase in barriers to new entry into the liquid bleach field caused primarily, it is thought, by the substitution of the larger advertising capabilities of Procter for those of Clorox. Economic theory would certainly indicate that a heightening of such barriers has taken place. But the Court does not explain why it considers this change to have significance under §7, nor does it indicate when or how entry barriers affect competition in a relevant market. In this case, for example, the difficulties of introducing a new nationally advertised bleach were already so great that even a great company like Procter, which the Court finds the most likely entrant, believed that entry would not "pay out." Why then does the Court find that a further increase of incalculable proportions in such barriers substantially lessens competition? Such a conclusion at least needs the support of reasoned analysis.³

Finally, the Court places much emphasis on the loss to the market of the most likely potential entrant, Procter. Two entirely separate anticompetitive effects might be traced to this loss, and the Court fails to distinguish between them. The first is simply that loss of the most likely entrant increases the operative barriers to entry by decreasing the likelihood that any firm will attempt to surmount them.⁴ But this effect merely reinforces the Court's previous entry-barrier argument, which I do not find convincing as presented. The second possible effect is that a reasonably probable entrant has been excluded from the market and a measure of horizontal competition has been lost. Certainly the exclusion of what would promise to be an important independent competitor from the market may be sufficient, in itself, to support a finding of illegality under §7, . . . when the market has few competitors. The Commission, however, expressly refused to find a reasonable probability that Procter would

³ The need for analysis is even clearer in light of the fact that entry into the market by producers of nonadvertised, locally distributed bleaches was found to be easy. There were no technological barriers to entry, and the capital requirements for entry, with the exception of advertising costs, were small. The Court must at least explain why the threat of such entry and the presence of small competitors in existing regional markets cannot be considered the predominant, and unaffected, form of competition. To establish its point, the Court must either minimize the importance of such competition or show why it would be substantially lessened by the merger.

⁴ Bain's pioneering study of barriers to entry, *Barriers to New Competition*, recognized that such barriers could be surmounted at different price levels by different potential entrants. Thus even without change in the nature of the barriers themselves, the market could become more insulated through loss of the most likely entrant simply because the prevailing market price would have to rise to a higher level than before to induce entry.

have entered this market on its own, and the Sixth Circuit was in emphatic agreement. . . .

Thus I believe, with all respect, that the Court has failed to make a convincing analysis of the difficult problem presented, and were no more to be said in favor of the Commission's order I would vote to set it aside.

II

The Court, following the Commission, points out that this merger is not a pure "conglomerate" merger but may more aptly be labeled a "product-extension" merger. . . .

At the outset, it seems to me that there is a serious question whether the state of our economic knowledge is sufficiently advanced to enable a surefooted administrative or judicial determination to be made *a priori* of substantial anticompetitive effect in mergers of this kind. It is clear enough that Congress desired that conglomerate and product-extension mergers be brought under §7 scrutiny, but well versed economists have argued that such scrutiny can never lead to a valid finding of illegality. . . .

Lending strength to this position is the fact that such mergers do provide significant economic benefits which argue against excessive controls being imposed on them. The ability to merge brings large firms into the market for capital assets and encourages economic development by holding out the incentive of easy and profitable liquidation to others. Here, for example, the owners of Clorox who had built the business, were able to liquefy their capital on profitable terms without dismantling the enterprise they had created. Also merger allows an active management to move rapidly into new markets bringing with its intervention competitive stimulation and innovation. It permits a large corporation to protect its shareholders from business fluctuation through diversification, and may facilitate the introduction of capital resources, allowing significant economies of scale, into a stagnating market. . . .

At the other end of the spectrum, it has been argued that the entry of a large conglomerate enterprise may have a destructive effect on competition in any market. . . . Thus it is contended that a large conglomerate may underprice in one market, adversely affecting competition, and subsidize the operation by benefits accruing elsewhere.⁵ It is also argued that the large company generates psychological pressure which may force smaller ones to follow its pricing policies, and that its very presence in the market may discourage entrants or make lending institutions unwilling to finance them. . . . [T]hese observations do indicate that significant dangers to competition may be presented by some conglomerate and prod-

⁵ But see Turner, "Conglomerate Mergers and Section 7 of the Clayton Act," 78 *Harv. L. Rev.* 1313, 1340. "[T]he belief that predatory pricing is a likely consequence of conglomerate size, and hence of conglomerate merger, is wholly unverified by any careful studies"

uct-extension mergers. Further, congressional concern in enacting §7 extended not only to anticompetitive behavior in particular markets, but also to the possible economic dominance of large companies which had grown through merger. Thus, while fully agreeing that mergers of this kind are not to be regarded as something entirely set apart from scrutiny under §7, I am of the view that when this Court does undertake to establish the standards for judging their legality, it should proceed with utmost circumspection. . . .

III

In adjudicating horizontal and vertical combinations under §7 where the effects on competition are reasonably obvious and substantiality is the key issue, the responsible agencies have moved away from an initial emphasis on comprehensive scrutiny and opted for more precise rules of thumb which provide advantages of administrative convenience and predictability for the business world. . . . A conglomerate case, however, is not only too new to our experience to allow the formulation of simple rules but also involves "concepts of economic power and competitive effect that are still largely unformulated." . . .

Procter . . . has insisted throughout this proceeding that anticompetitive effects must be proved *in fact* from post-merger evidence in order for §7 to be applied. The Court gives little attention to this contention, but I think it must be considered seriously, both because it is arguable and because it was, in a sense, the main source of difference between the Commission and the Sixth Circuit. . . .

If §7 is to serve the purposes Congress intended for it, we must, I think, stand with the Commission on this issue. Only by focusing on market structure can we begin to formulate standards which will allow the responsible agencies to give proper consideration to such mergers and allow businessmen to plan their actions with a fair degree of certainty The value of post-merger evidence seems more than offset by the difficulties encountered in obtaining it. And the post-merger evidence before us in this proceeding is at best inconclusive.

Deciding that §7 inquiry in conglomerate or product-extension merger cases should be directed toward reasonably probable changes in market structure does not, however, determine how that inquiry should be narrowed and focused. The Commission and the Court isolate two separate structural elements, the degree of concentration in the existing market and the "condition of entry." The interplay of these two factors is said to determine the existence and extent of market power, since the "condition of entry" determines the limits potential competition places on the existing market. It must be noted, however, that economic theory teaches that potential competition will have no effect on the market behavior of existing firms unless present market power is sufficient to drive the market price to the point where entry would become a real possibility. So long as

existing competition is sufficient to keep the market price below that point, potential competition is of marginal significance as a market regulator. Thus in a conglomerate or product-extension case, where the effects on market structure which are easiest to discover are generally effects on the "condition of entry," an understanding of the workings of the premerger market cannot be ignored, and indeed, is critical to a determination whether the visible effects on "condition of entry" have any competitive significance.

The Commission pinned its analysis of the premerger market exclusively on its concentration, the large market share enjoyed by the leading firms. . . . The Sixth Circuit discounted the Commission's analysis because of the presence of some 200 small competitors in the market. The Court bases its agreement with the Commission and its rejection of the Court of Appeals' position on Clorox's alleged domination of the market. But domination is an elusive term, for dominance in terms of percentage of sales is not the equivalent of dominance in terms of control over price or other aspects of market behavior. Just as the total number of sellers in the market is not determinative of its operation, the percentage of sales made by any group of sellers is similarly not conclusive. The determinative issue is, instead, how the sellers interact and establish the pattern of market behavior. The significance of concentration analysis is that it allows measurement of one easily determined variable to serve as an opening key to the pattern of market behavior.

I think that the Commission, on *this* record, was entitled to regard the market as "oligopolistic" and that it could properly ignore the impact of the smaller firms. I hasten to add, however, that there are significant "economic dissents" from oligopoly analysis in general. . . . In adjudicating §7 questions in a conglomerate or product-extension merger context where the pattern of behavior in the existing market is apt to be crucial, I would, therefore, allow the introduction by a defendant of evidence designed to show that the actual operation of the market did not accord with oligopoly theory, or whatever other theory the Commission desires to apply. In other words, I believe that defendants in §7 proceedings are entitled, in the case of conglomerate or product-extension mergers, to build their own economic cases for the proposition that the mergers will not substantially impair competition. . . . But to challenge effectively the presumption which the Commission is entitled to draw from general economic theory, a defendant must present, in my opinion, not only contradictory facts but a more cogent explanation of the pattern of market behavior.

If the proof as a whole establishes that pricing power may be exercised by a firm or firms in the market—that prices may be raised in the long run over competitive prices—then the Commission may legitimately focus on the role of potential competition and the "condition of entry." . . . In so doing, however, a new difficulty is encountered. The threat of potential

competition merely affects the range over which price power extends. Potential competition does not compel more vigorous striving in the market, nor advance any other social goal which Congress might be said to have favored in passing §7. Thus it may legitimately be questioned whether even a substantial increase in entry barriers creates a substantial lessening of competition or tendency to monopoly as required by §7.

Two justifications for the use of entry barriers as a determinant under §7 can be given. The first is that an increased range over which pricing power may be exercised is contrary to the mandate of §7 because Congress' use of the word "competition" was a shorthand for the invocation of the benefits of a competitive market, one of which is a price close to average cost. Such an approach leads also to the conclusion that economic efficiencies produced by the merger must be weighed against anticompetitive consequences in the final determination whether the net effect on competition is substantially adverse. . . . The second justification is found in the tendency-to-monopoly clause of §7. Certainly the clearest evil of monopoly is the excessive power the monopolist has over price. Since "antitrust operates to forestall concentrations of economic power which, if allowed to develop unhindered, would call for much more intrusive government supervision of the economy," Blake & Jones, In Defense of Antitrust, 65 Col. L. Rev. 377, 383, increased power over price should be attackable under §7. . . . For these reasons I conclude that the Commission may properly find a conglomerate or product-extension merger illegal under §7 because it substantially increases pricing power in the relevant market.

Given the development of a case against the merger in this area, however, the problem of efficiencies raised above must still be faced. The Court attempts to brush the question aside by asserting that Congress preferred competition to economies, but neglects to determine whether certain economies are inherent in the idea of competition. If it is conceded, as it must be, that Congress had reasons for favoring competition, then more efficient operation must have been among them. It is of course true that a firm's ability to achieve economies enhances its competitive position, but adverse effects on competitors must be distinguished from adverse effects on competition. . . . Economies achieved by one firm may stimulate matching innovation by others, the very essence of competition. They always allow the total output to be delivered to the consumer with an expenditure of fewer resources. Thus when the case against a conglomerate or product-extension merger rests on a market-structure demonstration that the likelihood of anticompetitive consequences has been substantially increased, the responsible agency should then move on to examine and weigh possible efficiencies arising from the merger in order to determine whether, on balance, competition has been substantially lessened. Where detriments to competition are apt to be "highly speculative" it seems wisest to conclude that "possibilities of adverse

effects on competitive behavior are worth worrying about only when the merger does not involve substantial economies. . . ." Turner, *supra*, at 1354. . . .

To summarize then, four important guides to the adjudication of conglomerate or product-extension mergers under §7 seem to come forward. First, the decision can rest on analysis of market structure without resort to evidence of post-merger anticompetitive behavior. Second, the operation of the premerger market must be understood as the foundation of successful analysis. The responsible agency may presume that the market operates in accord with generally accepted principles of economic theory, but the presumption must be open to challenge of alternative operational formulations. Third, if it is reasonably probable that there will be a change in market structure which will allow the exercise of substantially greater market power, then a *prima facie* case has been made out under §7. Fourth, where the case against the merger rests on the probability of increased market power, the merging companies may attempt to prove that there are countervailing economies reasonably probable which should be weighed against the adverse effects.

IV

The Commission's decision did, I think, conform to this analysis. . . .

To hold the merger unlawful, the Commission relied on five factors which taken together convinced it that "substantial" anticompetitive consequences could be expected. A "substantial" impact was said to be "significant and real, and discernible not merely to theorists or scholars but to practical, hard-headed businessmen." . . . The relevant factors were (1) the excessive concentration in the industry at the time of the merger and the commanding market position of Clorox, (2) the relative disparity in size and strength between Procter and the firms in the liquid bleach industry, (3) the position of Procter in other markets, (4) the elimination of Procter as a potential competitor, and (5) the nature of the "economies" expected from the merger. The net of these factors was to establish a substantial effect on the market structure variable involved, condition of entry. . . .

. . . The Commission—in my opinion quite correctly—seemed to accept the idea that economies could be used to defend a merger, noting that "[a] merger that results in increased efficiency of production, distribution or marketing may, in certain cases, increase the vigor of competition in the relevant market." . . . But advertising economies were placed in a different classification since they were said "only to increase the barriers to new entry" and to be "offensive to at least the spirit, if not the letter, of the antitrust laws." . . . Advertising was thought to benefit only the sellers by entrenching his market position, and to be of no use to the consumer.

I think the Commission's view overstated and oversimplified. Proper advertising serves a legitimate and important purpose in the market by educating the consumer as to available alternatives. This process contributes to consumer demand being developed to the point at which economies of scale can be realized in production. The advertiser's brand name may also be an assurance of quality, and the value of this benefit is demonstrated by the general willingness of consumers to pay a premium for the advertised brands. Undeniably advertising may sometimes be used to create irrational brand preferences and mislead consumers as to the actual differences between products, but it is very difficult to discover at what point advertising ceases to be an aspect of healthy competition. . . . It is not the Commission's function to decide which lawful elements of the "product" offered the consumer should be considered useful and which should be considered the symptoms of industrial "sickness." It is the consumer who must make that election through the exercise of his purchasing power. In my view, true efficiencies in the use of advertising must be considered in assessing economies in the marketing process, which as has been noted are factors in the sort of §7 proceeding involved here.

I do not think, however, that on the record presented Procter has shown any true efficiencies in advertising. Procter has merely shown that it is able to command equivalent resources at a lower dollar cost than other bleach producers. No peculiarly efficient marketing techniques have been demonstrated, nor does the record show that a smaller net advertising expenditure could be expected. Economies cannot be premised solely on dollar figures, lest accounting controversies dominate §7 proceedings. Economies employed in defense of a merger must be shown in what economists label "real" terms, that is in terms of resources applied to the accomplishment of the objective. For this reason, the Commission, I think, was justified in discounting Procter's efficiency defense.

In the Matter of the Budd Company

86 F.T.C. 518 (1975)

OPINION OF THE COMMISSION

By ENGMAN, Commissioner: The Budd Company appeals from the Initial Decision in this matter in which the Administrative Law Judge found that its acquisition of the Gindy Manufacturing Corporation (Gindy) in 1968 violated Section 7 of the Clayton Act.

According to the *Fortune Directory of the 500 Largest United States Industrial Corporations*, in 1967 Budd was the 250th largest industrial corporation in the nation in terms of sales (\$469.5 million) and was one of the largest independent automotive suppliers in the nation and the largest independent supplier of body parts to the automotive industry. Budd

principally manufactured automotive bodies, wheels, rims, hubs, drums, brakes, jigs and dies used in the manufacture of automotive body parts. In addition it was a leading manufacturer of railroad and mass transit cars.

Prior to its acquisition by Budd on October 22, 1968, Gindy was a Pennsylvania corporation engaged in the manufacture and sale of van trailers, containers and container chassis. For fiscal year 1968, Gindy sales were approximately \$32 million and its assets amounted to about \$44 million. . . .

The complaint alleges that prior to the acquisition Budd was one of the most likely potential entrants into the manufacture and sale of van trailers, closed-top dry freight van trailers, open-top van trailers, and containers and container chassis, and that by acquiring Gindy, Budd eliminated itself as a substantial potential competitor in these markets. The complaint further alleges that these markets and segments thereof are highly concentrated and characterized by high entry barriers. . . .

I. Relevant Product Markets

The broadest product markets found by the ALJ to be appropriate for this case are (1) van trailers and (2) containers and chassis. Van trailers refers to the large box-type trailers attached permanently to a chassis with wheels that are pulled by a truck tractor. Truck trailers are *not* van trailers. Truck trailers would include tank and bulk commodity trailers (for hauling liquids, gas, cement, and the like); platform trailers and low bed heavy haulers (used, for instance, to transport heavy machinery and girders); pole and logging trailers; and dump trailers. Trucks and truck bodies are not included with the term "van trailers" which is used exclusively to refer to trailers of five-ton capacity or more that are pulled by a truck tractor. A van trailer can be open or closed at the top and is usually made with aluminum or steel or both. Vans represent by far the largest percentage of all types of truck trailers.

Containers and chassis refer to large, closed box-type structures which can be used for intermodal transportation of goods, by rail, motor carrier, or ship. The container is designed to be detachable from the chassis on which it sits when pulled by a truck. Sizes are standardized and containers must be strong enough to be hoisted and stacked on top of one another during shipboard transit. . . .

We are satisfied that the van trailers and containers and chassis each constitute appropriate markets for purposes of the case. It is not disputed that van trailers are produced on fairly unique production lines which cannot be quickly utilized to produce other types of non-van trailers such as tank, platform, logging, or dump trailers. Also, because of their special design, there is little or no substitution in end use between van trailers and these other types of truck trailers. Likewise, containers and chassis serve a distinct function that separates them from van trailers and they are usually constructed on different assembly lines than those used to build van trailers.

In addition to the foregoing product markets, the ALJ found that sub-categories of van trailers listed by the Department of Census as closed-top van trailers, constitute relevant submarkets for purposes of this case. Respondent takes sharp issue that these finer divisions constitute markets. . . .

We agree with respondent . . . that closed-top dry freight van trailers and open-top van trailers do not constitute meaningful economic markets. The market for open-top trailers is limited as they are used mainly to carry freight, such as steel lengths, which must be loaded from the top by cranes. . . . Although it is true that a buyer may not find these types substitutable for particular end uses, the record nevertheless establishes that production and distribution facilities for each are identical and are essentially identical among other types of vans. Both closed- and open-top vans are commonly made by all van trailer manufacturers, including Gindy, and do not require separate assembly lines. . . .

No doubt the reason that complaint counsel urge the existence of separate closed-top and open-top van markets is that Gindy's market share is much higher if these product lines are used. . . . The inappropriateness of making a distinction in market definitions based on the presence or absence of a top on the trailer¹ is evidenced by the fact that in the following year, although Gindy's market share and ranking stayed nearly the same in overall van sales, its shipment of open-top trailers declined precipitously from \$3,150,000 to \$1,268,000 resulting in a drop from 15 percent to 7.8 percent of the industry total in just one year. The difference was made up by the production of other types of van trailers, thus evidencing ease of production flexibility. . . .

The ALJ, in accepting complaint counsel's argument that closed-top and open-top van trailers each constitute a relevant submarket, mechanically relied on the fact that several of the submarket criteria referred to in *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962) were applicable, such as peculiar characteristics and uses, distinct prices, and industry recognition of open-top van trailers as a category of truck trailers. But as the Court observed in a later case, "[T]hese [*Brown Shoe*] guidelines offer no precise formula for judgment and they necessitate, rather than avoid, careful consideration based upon the entire record" *United States v. Continental Can Co.*, 378 U.S. 441, 449 (1964). Cross-elasticity of supply can also be an important consideration in defining markets. . . . The interchangeability of production and distribution facilities between two

products is a strong indication that in measuring the relevant market and the degree of market power held by firms, the output of both products should be included since the manufacturer of one can shift readily to the production and sale of the other in response to profit opportunities. . . . Because the record establishes such a high degree of cross-elasticity of production, and identical marketing ease, among van trailers, we conclude that open-top and closed-top van trailers do not constitute separate submarkets.

In adopting van trailers and containers and chassis as lines of commerce, we do not deny that there is probably an even broader economic market encompassing these and other trailers. It appears that there is considerable interchangeability in production equipment and skills over the long-run between all types of truck trailers, except for tank and bulk commodity trailers which seem to fall in a specialized production class all of their own. . . . Consequently, in addition to the two product markets adopted in the initial decision, we will also examine the instant acquisition in terms of market share statistics for a broader market consisting of all truck trailers (except tank and bulk commodity trailers).

II. Geographic Market

The record supports the ALJ's findings that the relevant geographic market . . . [is] in the United States as a whole for sales of van trailers and containers and chassis. This is not to say that all trailer manufacturers are able to compete uniformly throughout the nation. High transportation costs, even for such mobile products as trailers, make it difficult to supply trailers to distant locations. Nevertheless neither party suggests that anything less than the nation should be considered the proper geographic market.

Respondent does argue that foreign producers of containers have competed with domestic producers of containers and that purchasers of containers look beyond the boundaries of the United States for supplies of this product. . . . The record indicates that there has been little competition from foreign-made containers insofar as domestic consumption in this country is concerned. Shipping lines are the primary buyers of containers and federal regulations prohibit American shipping line operators from purchasing cargo containers of foreign manufacture with capital reserve funds. . . . Furthermore, since the devaluation of the U.S. dollar, foreign container manufacturers have found it particularly difficult to sell containers in this country.

III. Market Concentration

Universe figures for the various lines of commerce described above were taken from Census Bureau publications. Shipments of individual firms were obtained directly from the manufacturers. . . .

. . . Before the loss of a potential entrant can be viewed as violating Section 7, it must be established that the market is concentrated or

¹ There are differences in construction between open-top and closed-top freight trailers in addition to the presence or absence of a roof. Open-top trailers must have stronger top rails among other things and in fact sell for a slightly higher price than equivalent size closed-top vans. Nevertheless, as noted, production procedures and equipment are the same. Both types of trailers are produced on the same assembly line, and no additional expenditures are required to switch production capability from one to the other (Tr. 386-87, 1343).

threatens to become so, that entry barriers are high, and that the acquired firm is a leading factor in the market. . . . If the market is not concentrated, there is usually little opportunity for the sellers to collectively maintain prices above competitive levels and any diminution of potential competition will not be material. On the other hand, if the market is concentrated but entry barriers are low, potential competition will be important but since there will be a large number of firms able to come into the market under approximately the same conditions, the merger of one of those firms with an existing seller will make no difference because the threat of new entry will remain approximately the same. . . .

As the [available data] . . . show, four-firm concentration ratios are approximately 60 percent or more, with the largest firm, Fruehauf, usually representing about 25 percent of output. The top three firms (Fruehauf, Trailmobile, and Strick) collectively shared more than 50 percent of the output in each of the markets during the three years leading up to the year of acquisition. Although the record indicates that the balance of the markets are shared by nearly a hundred firms, clearly these markets are substantially concentrated. . . .

In addition, the ALJ found that there were substantial barriers to entry insofar as entering on a substantial level of production is concerned. . . . [W]e think the record bears out the ALJ's finding, although the term *barriers to effective competition* might convey a more accurate picture than *barriers to entry*. . . . Small van trailer manufacturers generally do not have the ability to extend or obtain credit to finance a sale of a large number of trailers to large customers or to offer finance terms competitive with terms offered by the large trailer manufacturers. It is not uncommon for the largest companies in the industry to sell trailers to fleet operators with virtually no downpayment on six- to eight-year credit terms. . . . Manufacturers who do not have the capital resources to finance sales on these terms generally cannot arrange such favorable terms through banks. . . .

In addition, the larger van manufacturers have an advantage as they have geographically-dispersed branch outlets that enable them to service and resell large lots of used trailers that have been accepted as trade-ins in sales to fleet operators.

Respondent argues that these requirements are merely incremental in nature since any given sales transaction requires a small additional amount of money and it is possible to enter on a shoestring if one is willing to do so. This may be so, but the most important customers are the large motor common carriers and truck-leasing companies who buy in large lots—often a hundred or several hundred units at a time. Only a few trailer manufacturers, led by Fruehauf and Trailmobile, have had the facilities to deal with these fleet operators who prefer to place their orders with manufacturers who can accept trade-ins on a large scale and extend favorable financing terms.

Lest there be any misunderstanding, we do not suggest as does the

Initial Decision, that the superior ability of the larger trailer manufacturers to offer services and financing is an unfair advantage that is somehow anticompetitive. The advantages are ones that basically arise out of firm size and, although in part may be caused by imperfections in the capital market, are nevertheless beneficial to the customers who are served thereby. They should therefore, be viewed as providing real, and not simply pecuniary, economies.

The ALJ found that the trailer manufacturing industry is highly profitable. However there is little concrete evidence in the record in the form of actual profit data. Although Gindy in the year preceding the acquisition had been highly profitable (this fact quickened Budd's interest in acquiring it), little information is revealed by the profit and loss statements of the top firms since for the most part they are parts of conglomerate corporations which do not report profits and losses on a product-line basis.² There was much testimony to the effect that the industry is at least *regarded* by both insiders and outsiders as a low-profit industry. A number of firms have exited from the industry in recent years because of losses, including Highway Trailer Company, which in 1968 ranked number six in the van trailer market.

The record indicates that from 1966 onward van trailer prices have not risen at a pace commensurate with increases in cost of labor and material. Prices even declined to below 1966 levels from 1967 through 1969. . . .

The foregoing suggests that despite the degree of concentration evidenced by the market share figures, the market may have been performing in a manner that has yielded prices and profits at a competitive or near-competitive level. The Commission has taken this into account in evaluating complaint counsel's argument that the loss of Budd as a grass-roots entrant was an important loss to the market.

IV. Budd as a Potential Entrant

The Administrative Law Judge found that since at least 1956 Budd has been a potential entrant into the manufacture and sale of van trailers and containers and chassis and that by acquiring Gindy, Budd removed itself as an actual future entrant in these markets either by entry *de novo*³ or by acquisition of a small company. In addition he found that Budd was perceived by firms in the market as a potential entrant and loss of its presence at the edge of the market removed any disciplining effects that would have ensued from its continued presence as a perceived potential entrant . . .

On the question of whether Budd was a perceived potential entrant, we

² By 1968, Fruehauf was a large diversified corporation. In terms of assets it exceeded Budd in size and ranked as the 234th largest industrial corporation in the country. Trailmobile was owned by the Pullman Company which was the 149th largest corporation. Until December 1968 Strick was a subsidiary of Penn Central. Brown Trailers was a division of the Clark Equipment Company, the 193rd largest corporation in terms of sales. Great Dane Trailers was a subsidiary of United States Freight Company.

³ Italics missing from original document—editor's note.

disagree with the ALJ. A large number of industry witnesses testified in this proceeding and when asked whether they had viewed Budd as a potential entrant before the Gindy acquisition, the response was uniformly "no." . . .

. . . [E]xecutives from Miller, Dorsey, Theurer and Utility testified they did not perceive Budd as a potential entrant. . . . Prior to the time Budd acquired Gindy, these and the other trailer companies who appeared at the hearing did not take Budd into account in formulating competitive practices and prices. . . . Nor is there any reason to believe that had the Gindy acquisition not taken place Budd's continued presence outside the market would have influenced industry prices. Numerous industry witnesses, including representatives from the market leaders, identified other firms and types of firms they considered more likely to enter the truck trailer industry than Budd. These included automobile manufacturers. . . . truck tractor manufacturers . . . and truck body manufacturers. . . . No witness testified that their prices or practices were affected by these firms. The only conclusion that can be reasonably drawn from the evidence is that there is no basis upon which to believe that Budd's continued presence at the edge of the market would have any greater effect on market performance.

We are left then with the argument that Budd was a likely actual entrant which would have entered the market at some time in the future by means other than the Gindy acquisition. . . . We find it unnecessary, however, to review the lengthy arguments that have been presented on this issue.

Although the ALJ found that Budd was an actual potential entrant into the van and container markets, we think he jumped too quickly to the conclusion that entry by way of acquiring Gindy was anticompetitive. Insufficient attention was paid to whether Gindy should be viewed as a toehold or foothold firm, acquisition of which would lead to improved competition against dominant market leaders. As the Commission observed in *Bendix Corporation*, . . . 77 F.T.C. [731] at 818-19 (1970); "[I]n a highly concentrated, sluggish market, the acquisition of a small industry member by a powerful, innovative firm which, by building upon the base of the smaller firm can pose a more effective competitive challenge to the industry giants [may promote competition]. Such procompetitive mergers are not only not forbidden by Section 7, they are positively encouraged." "[T]he threat of a toehold merger by a powerful firm may often serve as a much greater incentive to competitive performance in the affected market than the prospect of more costly and slower internal, *de novo* expansion." *id.* at 819.⁴

⁴ See also *Brown Shoe Co. v. United States*, 370 U.S. 294, 319: "When concern as to the Act's breadth [amended Section 7] was expressed, supporters of the amendments indicated that it would not impede, for example, a merger between two small companies to enable the combination to compete more effectively with larger corporations dominating the relevant market. . . ."

In the *Bendix* case the Commission struck down the acquisition by Bendix of the third-ranking firm (Fram) which had 17.2 percent of the market. However it characterized as a toehold firm that could lawfully have been acquired by Bendix, fourth-ranking Wix Manufacturing Company which had 9.5 percent of the market and was not shown to be technologically inferior. Similarly, the Ajax Company, recognized as a permissible toehold or foothold candidate in *Stanley Words*, 78 F.T.C. 1023, 1072 (1971) . . . ranked third in the market with a share of about 8 percent. As we recently noted, the Commission has generally considered "firms having market shares below 10 percent as toehold companies, acquisition of which would have been procompetitive" *Beatrice Foods Company*, Dkt. 8864 (July 1, 1975, slip opinion p. 17 n. 8).

V. Gindy's Position in the Industry

Market share data set forth *supra*, show that Gindy ranked considerably below Fruehauf, Trailmobile, and Strick. In the overall trailer market Gindy's share fluctuated between 4.9 percent and 6.5 percent during the three years prior to the merger. In the van-trailer market, where Gindy's share was highest, it never rose appreciably above 7 to 8 percent as compared to Fruehauf's 27 percent and Trailmobile's 17 percent. Gindy's market position in 1968 was much closer to firms ranking below it, such as Brown Trailer (6.6 percent of the van-trailer market in 1968), Highway (5.5 percent), and Great Dane (5.1 percent). Complaint counsel in fact characterize Highway and Great Dane as available toehold firms. In the container-and-chassis market, Gindy ranked number 6 with only 3.8 percent of the market.

At the time of acquisition, Gindy's principal manufacturing plant was located in Eagle, Pennsylvania, in addition to which it had a manufacturing plant located in Lebanon, Pennsylvania, and in Martinsville, Virginia; [sic] and a relatively small production facility in St. Louis, Missouri, which was later closed down as obsolete. Gindy was described by numerous industry witnesses as being a regional producer. Ninety-five percent of its sales were made in the eastern part of the United States. In contrast, Fruehauf and Trailmobile were viewed by industry witnesses as the national companies and for many years have dominated the industry. . . .

Fruehauf, Trailmobile, and Strick had their own finance divisions, which because of their leverage in the money market, were able to offer financing on better terms than were generally available from banks. Prior to the merger, Gindy depended upon credit arrangements with several banks and an insurance company. . . .

The Administrative Law Judge, in holding that Gindy could not be viewed as a toehold or foothold acquisition candidate, relied on the fact that Gindy's shares in the alleged submarket, closed-top freight vans, exceeded 10 percent in 1968 and 1969. . . . However, as we have held, this is not a meaningful economic market or submarket, and Gindy's

shares varied from 3 percent to 8 percent in the relevant markets during the years immediately prior to the merger.

We believe it to be desirable to observe a general rule in potential competition cases that firms possessing no more than 10 percent in a target market (where, as here, the four-firm concentration is approximately 60 percent or more) should ordinarily be presumed to be toehold or foothold firms. This presumption by no means is conclusive, and the inference of lack of anticompetitive effects flowing from acquisition of such a firm can be rebutted in particular cases. . . . The 10 percent demarcation is supported by the prior Commission cases, as noted, and is not inconsistent with the Department of Justice Merger Guidelines. . . .

In this case, the presumption is supported by the record which shows that the acquisition of Gindy by Budd engendered increased capacity and other procompetitive forces, the very effects the toehold doctrine was designed to elicit.

The record shows that to compete optimally in this industry, a producer of trailers must have a network of plants and sales and service facilities geographically dispersed throughout the country, a broad line of truck trailer products, and capability to provide financing customers' purchases of trailers on competitive terms. . . . Geographic dispersion of plants and outlets is required for several reasons. Customers of trailer manufacturers have been getting larger and so have the size of their orders. Freight costs of delivering are substantial, and it is difficult to compete in states which are far distant from a manufacturing plant. . . . Branch factories and outlets provide greater capacity to fill large orders, take trades, and provide service and repair facilities. . . .

We have already noted that at the time of acquisition Fruehauf and Trailmobile were the only producers of trailers and containers that operated on a nationwide basis. Their product lines were far broader than other producers of van trailers and chassis. . . . Fruehauf, Trailmobile, and Strick were offering more attractive finance terms than Gindy was able to obtain or offer.

In the opinion of Gindy officials, without the financial assistance Budd made available to Gindy subsequent to the acquisition, it is doubtful that Gindy would have substantially augmented its preacquisition level of operations. . . . Budd officials viewed Gindy as undercapitalized in comparison to Fruehauf and other major trailer companies, and that with Budd's help it could grow to become a more effective competitor, particularly in the area of financing trailer sales, and could be expanded from a regional to a national competitor. . . .

Subsequent to the acquisition, Budd established a financial corporation to help finance the van trailers sold by Gindy as well as sales by other Budd divisions. By virtue of this finance subsidiary, Gindy was able to finance trailer sales on more competitive terms. Furthermore, for the first time it was able to provide customer finance on container sales, which

theretofore had been considered too risky by commercial banks. This enabled Gindy to compete in container sales and financing with Fruehauf and Trailmobile. . . .

In addition, Budd enlarged Gindy's Eagle plant and increased its capacity by 40 percent at a cost to Budd of \$1.75 million. An addition to the Lebanon plant was made by Budd and a cost to it of \$500,000. The record supports the ALJ's finding that these alterations made Gindy by 1971 "a more efficient van trailer producer than it was at the time of acquisition." . . .

The law judge, relying on the foregoing and other post-acquisition changes made by Budd in the Gindy Company, concluded that the acquisition also violated Section 7 because it entrenched Gindy and raised entry barriers. Contrary to the conclusions reached by the ALJ, there is nothing in the record to support the view that the acquisition has raised existing entry barriers or has otherwise entrenched Gindy. Between 1968 and 1972 Gindy's dollar sales of trailers increased from \$35.7 million to \$56.5 million, its share of that market increasing from 6.01 percent to 7.07 percent. But it appears that Gindy's gain was Fruehauf's loss. Fruehauf's market share dropped during the same period of time from 28.88 percent to 23.28 percent. (The aggregate share of the three leading firms also declined, from 52.47 percent to 47.61 percent). [sic] Representatives of smaller firms testified that they did not believe the acquisition had made it more difficult for them to grow. For the most part the smaller trailer manufacturers increased their respective shares of the market after 1968. . . . Although these postacquisition data do not conclusively settle the question, clearly these are not the trends of a less competitive market.

In view of our finding that the acquisition did not lessen competition, *the initial decision will be vacated and the complaint dismissed.*

DISSENTING STATEMENT OF COMMISSIONER DIXON

By Commissioner DIXON: My reading of the record in this matter convinces me that Budd was an actual potential entrant into the markets found relevant by the administrative law judge,⁵ and that Budd's entry

⁵ Based on the finding that closed-top dry freight trailers and open-top van trailers could be manufactured by the same machinery and distributed through the same channels, the majority concluded that these two products should not be viewed as comprising distinct submarkets. Although cross-elasticity of production and distribution is determinative when considering the outer boundaries of a market, such cross-elasticity is the only one of the factors to be considered when drawing submarkets. My reading of the record comports with that of the administrative law judge insofar as he finds that these closed- and open-top van trailers are sufficiently distinct to warrant the finding that each should be considered a relevant submarket. Particularly persuasive in this connection is the administrative law judge's finding that these two products are sold to different customers because their end uses are distinct and the finding that there is no cross-elasticity as to price between them. It may be, as an example, that peanut butter and peanut oil are produced by the same machines and distributed by the same wholesalers. Yet we would not conclude from their cross-elasticity

through Gindy was anticompetitive as it did not come about through internal expansion or by acquisition of a toehold firm. I cannot accept the majority's holding that Gindy was a toehold firm. It is my understanding that a firm cannot qualify as a toehold if it is already a significant competitive factor in the relevant markets, or is likely to achieve that status without the infusion of capital from the acquiring firm. Assuming, *arguendo*, that Gindy became significant only after the challenged acquisition, . . . the manner in which it achieved this position demonstrates that Gindy was capable of ascending to such a position in the relevant markets on its own, and that it was likely to do so. There is no dispute that Budd's investment of a few million dollars increased Gindy's production capacity and geographical distribution and was all that was required to bring Gindy into more direct competition with the industry giants. In brief, it was well within the capacity of Gindy to become, through internal expansion, a significant competitor of Fruehauf, Strick, and Trailmobile, if it was not already at the time of the acquisition. Since this prospect was obviated by the Budd acquisition, as was the potential for Budd to become a significant competitor through internal expansion or acquisition of one of the smaller firms in the relevant markets, the acquisition should not be permitted to stand.

DISSENTING STATEMENT OF COMMISSIONER HANFORD

By Commissioner HANFORD: I agree with Commissioner Dixon that open-top van trailers and closed-top dry freight vans are distinct product submarkets, and that the submarket which the majority has defined as encompassing both types of trailers fails to reflect economic reality. Accordingly, I find I am unable to agree with the majority's conclusion that Budd's purchase of Gindy constitutes entry by toehold acquisition. . . .

What we have here is a situation in which Budd was, prior to the acquisition, an actual potential entrant into markets which are characterized by high concentration and substantial barriers to effective competition. Moreover, it was one of the few most likely potential entrants into these markets. Budd could have entered these markets by toehold acquisition or *de novo* through internal expansion. It had the capacity to do so. Had it entered in either of these two ways, it would have been a direct competitor of Gindy, which at the time of the acquisition was ranked number two in the production of open-top van trailers. In addition, the other leading firms in this market would have had to contend with aggressive new competition from Budd as well as the existing competition from Gindy. . . .

of production and distribution that each does not comprise a separate product market. That one can be substituted for the other by the end user, and that there is no price cross-elasticity between them would be determinative. So it should be with open- and closed-top van trailers.

United States v. Falstaff Brewing Corp.

410 U.S. 526 (1973)

MR. JUSTICE WHITE delivered the opinion of the Court. . . .

As stipulated by the parties, the relevant product market is the production and sale of beer, and the six New England States¹ compose the geographic market. While beer sales in New England increased approximately 9.5% in the four years preceding the acquisition, the eight largest sellers increased their share of these sales from approximately 74% to 81.2%. In 1960, approximately 50% of the sales were made by the four largest sellers; by 1964, their share of the market was 54%; and by 1965, the year of acquisition, their share was 61.3%. The number of brewers operating plants in the geographic market decreased from 32 in 1935, to 11 in 1957, to six in 1964.²

Of the Nation's 10 largest brewers in 1964, only Falstaff and two others did not sell beer in New England; Falstaff was the largest of the three and had the closest brewery.³ In relation to the New England market, Falstaff sold its product in western Ohio, to the west and in Washington, D.C., to the south.

The acquired firm, Narragansett, was the largest seller of beer in New England at the time of its acquisition, with approximately 20% of the market; had been the largest seller for the five preceding years; had constantly expanded its brewery capacity between 1960 and 1965; and had acquired either the assets or the trademarks of several smaller brewers in and around the geographic market.

The fourth largest producer of beer in the United States at the time of acquisition, Falstaff was a regional brewer⁴ with 5.9% of the nation's production in 1964, having grown steadily since its beginning as a brewer in 1933 through acquisition and expansion of other breweries. As of January 1965, Falstaff sold beer in 32 states, but did not sell in the Northeast, an area composed of New England and states such as New York and New Jersey; the area being the highest beer consumption region in the United States. . . .

Falstaff met increasingly strong competition in the 1960s from four brewers who sold in all of the significant markets. National brewers pos-

¹ Maine, New Hampshire, Vermont, Massachusetts, Connecticut, and Rhode Island.

² Nationally, the number of brewers decreased from 663 in 1935 to 140 in 1965.

³ Of the three "top ten" brewers that were not selling in New England, Falstaff ranked fourth nationally, the other two ranking eighth and ninth. From Boston, Massachusetts, the distance to Falstaff's closest brewery was 844 miles, while the distance to the eighth and ninth largest sellers' breweries was 1,385 and 2,000 miles respectively.

⁴ A "regional," as contrasted with a "national" brewer, is one that is not selling in all the significant national markets.

sess competitive advantages since they are able to advertise on a nationwide basis, their beers have greater prestige than regional or local beers, and they are less affected by the weather or labor problems in a particular region. Thus Falstaff concluded that it must convert from "regional" to "national" status, if it was to compete effectively with the national producers.⁵ . . .

Before the acquisition was accomplished, the United States brought suit . . . alleging that the acquisition would violate §7 because its effect may be to substantially lessen competition in the production and sale of beer in the New England market. This contention was based on two grounds: because Falstaff was a potential entrant and because the acquisition eliminated competition that would have existed had Falstaff entered the market *de novo* or by acquisition and expansion of a smaller firm, a so-called toehold acquisition.⁶ . . .

After a trial on the merits, the District Court found that the geographic market was highly competitive; that Falstaff was desirous of becoming a national brewer by entering the Northeast; that its management was committed against *de novo* entry; and that competition had not diminished since the acquisition. . . .

Also finding that the Government had failed to establish that the acquisition would result in a substantial lessening of competition, the District Court entered judgment for Falstaff and dismissed the complaint.

I

Section 7 of the Clayton Act forbids mergers in any line of commerce where the effect may be substantially to lessen competition or tend to create a monopoly. The section proscribes many mergers between competitors in a market . . . ; it also bars certain acquisitions of a market competitor by a noncompetitor, such as a merger by an entrant who threatens to dominate the market or otherwise upset market conditions to the detriment of competition. . . . Suspect also is the acquisition by a company not competing in the market but so situated as to be a potential competitor and likely to exercise substantial influence on market behavior. Entry through merger by such a company, although its competitive conduct in the market may be the mirror image of that of the acquired company, may nevertheless violate §7 because the entry eliminates a potential competitor exercising present influence on the market. . . .

In the case before us, Falstaff was not a competitor in the New England market, nor is it contended that its merger with Narragansett represented an entry by a dominant market force. It was urged, however, that Falstaff

was a potential competitor so situated that its entry by merger rather than *de novo* violated §7. The District Court, however, relying heavily on testimony of Falstaff officers, concluded that the company had no intent to enter the New England market except through acquisition and that it therefore could not be considered a potential competitor in that market. Having put aside Falstaff as a potential *de novo* competitor, it followed for the District Court that entry by a merger would not adversely affect competition in New England.

The District Court erred as a matter of law. The error lay in the assumption that because Falstaff, as a matter of fact, would never have entered the market *de novo*, it could in no sense be considered a potential competitor. More specifically, the District Court failed to give separate consideration to whether Falstaff was a potential competitor in the sense that it was so positioned on the edge of the market that it exerted beneficial influence on competitive conditions in that market. . . .

The specific question with respect to this phase of the case is not what Falstaff's internal company decisions were but whether, given its financial capabilities and conditions in the New England market, it would be reasonable to consider it a potential entrant into that market. Surely, it could not be said on this record that Falstaff's general interest in the New England market was unknown; . . . and if it would appear to rational beer merchants in New England that Falstaff might well build a new brewery to supply the northeastern market then its entry by merger becomes suspect under §7. The District Court should therefore have appraised the economic facts about Falstaff and the New England market in order to determine whether in any realistic sense Falstaff could be said to be a potential competitor on the fringe of the market with likely influence on existing competition.⁷ This does not mean that the testimony of company officials about actual intentions of the company is irrelevant or is to be looked upon with suspicion; but it does mean that theirs is not necessarily the last word in arriving at a conclusion about how Falstaff should be considered in terms of its status as a potential entrant into the market in issue.

Since it appears that the District Court entertained too narrow a view of Falstaff as a potential competitor and since it appears that the District Court's conclusion that the merger posed no probable threat to competition followed automatically from the finding that Falstaff had no intent to

⁷ . . . Nor was there any lack of circumstantial evidence of Falstaff's on-the-fringe competitive impact. As the record shows, Falstaff was in the relevant line of commerce, was admittedly interested in entering the Northeast, and had, among other ways . . . made its interest known by prior-acquisition discussions. Moreover, there were, as my Brother MARSHALL would put it, objective economic facts as to Falstaff's capability to enter the New England market; and the same facts which he would have the District Court look to in determining whether the particular theory of potential competition we do not reach has been violated, would be probative of violation of §7 through loss of a procompetitive on-the-fringe influence. . . .

⁵ In 1958, Falstaff commissioned a study of actions it should take to maximize profits. The study recommended, *inter alia*, that Falstaff become a national brewer by entering those areas where it was not then marketing its product, especially the Northeast, and that Falstaff should build a brewery on the East Coast rather than buy.

⁶ Hereinafter, reference to *de novo* entry includes toehold acquisition as well.

enter *de novo*, we remand this case for the District Court to make the proper assessment of Falstaff as a potential competitor.

II

Because we remand for proper assessment of Falstaff as an on-the-fringe potential competitor, it is not necessary to reach the question of whether §7 bars a market-extension merger by a company whose entry into the market would have no influence whatsoever on the present state of competition in the market—that is, the entrant will not be a dominant force in the market and has no current influence in the marketplace. We leave for another day the question of the applicability of §7 to a merger that will leave competition in the marketplace exactly as it was, neither hurt nor helped, and that it is challengeable under §7 only on grounds that the company could, but did not, enter *de novo* or through toehold acquisition and that there is less competition than there would have been had entry been in such a manner. . . .

The judgment of the District Court dismissing the complaint against Falstaff is reversed, and the case is remanded for further proceedings consistent with this opinion.

So ordered.

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MR. JUSTICE MARSHALL, concurring in the result.

. . . I would hold that where, as here, strong objective evidence indicates that a firm is a potential entrant into a market, it is error for the trial judge to rely solely on the firm's subjective prediction of its own future conduct. While such subjective evidence is probative on the issue of potential entry, it is inherently unreliable and must be used with great care. Ordinarily, the district court should presume that objectively measurable market forces will govern a firm's future conduct. Only when there is a compelling demonstration that a firm will not follow its economic self-interest may the district court consider subjective evidence in predicting that conduct. Even then, subjective evidence should be preferred only when the objective evidence is weak or contradictory. Because the District Court failed to apply these standards, I would remand the case for further consideration.

I

[In this section, MR. JUSTICE MARSHALL presents a detailed discussion of the nature of the relevant product and geographic markets, the structure of the beer industry, and the salient characteristics of Falstaff and Narragansett.]

II

[After discussing the factual background MR. JUSTICE MARSHALL turns to a discussion of the appropriate legal standards to be applied in this case.]

A. The Purposes of §7

As is clear from its face, §7 was designed to deal with the anticompetitive effects of excessive industrial concentration caused by the corporate marriage of two competitors. "It is the basic premise of [§7] that competition will be most vital 'when there are many sellers, none of which has any significant market share.'" *United States v. Aluminum Co. of America*, 377 U.S., at 280.

But §7 does more than prohibit mergers with immediate anticompetitive effects. The Act by its terms prohibits acquisitions which "may . . . substantially . . . lessen competition, or . . . tend to create a monopoly." The use of the subjunctive indicates that Congress was concerned with the *potential* effects of mergers even though, at the time they occur, they may cause no present anticompetitive consequences. See, e.g., *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577 (1967). . . .

B. Modes of Potential Competition

Since 1950, we have repeatedly applied §7 to cases where the merging firms competed in the same line of commerce, and we have been willing to define the line of commerce liberally so as to reach anticompetitive practices in their "incipiency." . . . But in keeping with the spirit of the Celler-Kefauver Amendment, we have also applied §7 to cases where the acquiring firm is outside the market in which the acquired firm competes. These cases fall into three broad categories which, while frequently overlapping, can be dealt with separately for analytical purposes.

1. *The Dominant Entrant.* In some situations, a firm outside the market may have overpowering resources which, if brought to bear within the market, could ultimately have a substantial anticompetitive effect. If such a firm were to acquire a company within the relevant market, it might drive other marginal companies out of business, thus creating an oligopoly, or it might raise entry barriers to such an extent that potential new entrants would be discouraged from entering the market. Cf. *Ford Motor Co. v. United States*, 405 U.S. 562, 567-568 (1972); *FTC v. Procter & Gamble Co.*, 386 U.S., at 575.⁸ Such a danger is especially intense

⁸ To be sure, in terms of anticompetitive effects, the dominant firm's acquisition of another firm within the market might be functionally indistinguishable from a *de novo* entry, which §7 does not forbid. But "surely one premise of an antimerger statute such as §7 is that corporate growth by internal expansion is socially preferable to growth by acquisition." *United States v. Philadelphia National Bank*, 374 U.S. 321, 370 (1963). Moreover, entry by acquisition has the added evil of eliminating one firm in the market and thus increasing the burden on the remaining firms which must compete with the dominant entering firm.

when the market is already highly concentrated or entry barriers are already unusually high before the dominant firm enters the market.

2. *The Perceived Potential Entrant.* Even if the entry of a firm does not upset the competitive balance within the market, it may be that the removal of the firm from the fringe of the market has a present anticompetitive effect. In a concentrated oligopolistic market, the presence of a large potential competitor on the edge of the market, apparently ready to enter if entry barriers are lowered, may deter anticompetitive conduct within the market. . . . When the lingering firm enters the market by acquisition, the competitive influence exerted by the firm is lost with no offsetting gain through an increase in the number of companies seeking a share of the relevant market. The result is a net decrease in competitive pressure.⁹ . . .

3. *The Actual Potential Entrant.* Since the effect of a perceived potential entrant depends upon the perception of those already in the market, it may in some cases be difficult to prove. Moreover, in a market which is already competitive, the existence of a perceived potential entrant will have no present effect at all.¹⁰ The entry by acquisition of such a firm may nonetheless have an anticompetitive effect by eliminating an actual potential competitor. When a firm enters the market by acquiring a strong company within the market, it merely assumes the position of that company without necessarily increasing competitive pressures. Had such a firm not entered by acquisition, it might at some point have entered *de novo*. An entry *de novo* would increase competitive pressures within the market, and an entry by acquisition eliminates the possibility that such an increase will take place in the future. Thus, even if a firm at the fringe of the market exerts no present procompetitive effect, its entry by acquisition may end for all time the promise of more effective competition at some future date.

Obviously, the anticompetitive effect of such an acquisition depends on the possibility that the firm would have entered *de novo* had it not

⁹ Thus, whereas the practical difference between entry by acquisition and entry *de novo* may be marginal in the case of a dominant entrant, . . . it is crucial in the case of a perceived potential entrant. If the perceived potential entrant enters *de novo*, its deterrent effect on anticompetitive practices remains and the total number of firms competing for market shares increases. But when such a firm enters by acquisition, it merely steps into the shoes of the acquired firm. The result is no net increase in the actual competition for market shares and the removal of a threat exerting procompetitive influence from outside the market.

¹⁰ Still, even if the market is presently competitive, it is possible that it might grow less competitive in the future. For example, a market might be so concentrated that even though it is presently competitive, there is a serious risk that parallel pricing policies might emerge sometime in the near future. In such a situation, an effective competitor lingering on the fringe of the market—what might be called a *potential* perceived potential entrant—could exert a deterrent force when anticompetitive conduct is about to emerge. As its very name suggests, however, such a firm would be still a further step removed from the exertion of actual, present competitive influence, and the problems of proof are compounded accordingly—particularly in light of the showing of reasonable probability required under §7.

entered by acquisition. If the company would have remained outside the market but for the possibility of entry by acquisition, and if it is exerting no influence as a perceived potential entrant, then there will normally be no competitive loss when it enters by acquisition. Indeed, there may even be a competitive gain to the extent that it strengthens the market position of the acquired firm.¹¹ Thus, mere entry by acquisition would not *prima facie* establish a firm's status as an actual potential entrant. For example, a firm, although able to enter the market by acquisition, might, because of inability to shoulder the *de novo* start-up costs, be unable to enter *de novo*. But where a powerful firm is engaging in a related line of commerce at the fringe of the relevant market, where it has a strong incentive to enter the market *de novo*, and where it has the financial capabilities to do so, we have not hesitated to ascribe to it the role of an actual potential entrant. In such cases, we have held that §7 prohibits an entry by acquisition since such an entry eliminates the possibility of future actual competition which would occur if there were an entry *de novo*. . . .

C. Problems of Proof—The Role of Subjective Evidence

. . . The unavoidable problems of proof are compounded in some cases by the relevance of subjective statements of future intent by the managers of the acquiring firm. Although not susceptible of precise analysis, the objective conditions of the market may at least be measured and quantified. But there exists no very good way of evaluating a subjective statement by the manager of a firm that the firm does or does not intend to enter a given market at some future date.

Fortunately, in two of the three forms of potential competition, such subjective evidence has no role to play. Clearly, in the case of a dominant entrant, the only issue is whether the firm's entry by acquisition will so upset objective market forces as to substantially reduce future competition. Since the firm will have already taken steps to enter the market by the time a §7 action is filed, its statements of subjective intent are irrelevant.

Similarly, when the Government proceeds on the theory that the acquiring firm is a perceived potential entrant, testimony as to the subjective intent of the acquiring firm is not probative. The perceived potential entrant exerts a procompetitive effect because companies in the market *perceive* it as a potential entrant. The companies in the market may entertain this perception whether the perceived potential entrant is *in fact* a potential entrant or not. Thus, a firm on the fringe of the market may exert a procompetitive effect even if it has no intention of entering the market, so long as it seems to those within the market that it may have such an

¹¹ However, if the acquired firm is strengthened to such an extent that it upsets the market balance and drives its competitors out of the market, the acquiring firm takes on the characteristics of a dominant entrant, and the merger may therefore violate §7 under that theory. . . .

intention. . . . It follows that subjective testimony by the managers of the perceived potential entrant is irrelevant.¹²

However, subjective statements of management are probative in cases where the acquiring firm is alleged to be an actual potential entrant. First, management's statements that it does not intend to make a *de novo* market entry, together with its associated reasons, provide an expert judgment on the conclusions to be drawn by the trier of fact from the objective market forces. Just as the Government may introduce expert testimony to inform and guide the trial court with respect to the appropriate business judgments to be derived from the objective data, so too the defendant is entitled to present the evaluation of its own "experts" who may include its management personnel. Although such evidence from management is obviously biased and self-serving, it is nonetheless admissible to prove that the objective market pressures do not favor a *de novo* entry.

More significantly, management's statement of subjective intent, if believed, affects the firm's status as an actual potential entrant. As indicated above, the actual potential entrant's entry by acquisition is anticompetitive only if it eliminates some future possibility that it might have entered *de novo*. An unequivocal statement by management that it has absolutely no intention of entering the market *de novo* at any time in the future is relevant to the issue of whether the possibility of such an entry exists. After all, the character of management is itself essentially an objective factor in determining whether the acquiring firm is an actual potential entrant.

But although subjective evidence is probative and admissible in actual potential-entry cases, its utility is sharply limited. We have certainly never suggested that subjective evidence of likely future entry is *required* to make out a §7 case. . . .

Nor do our prior cases hold that the district courts are bound by subjective statements of company officials that they have no intention of making a *de novo* entry. We have emphasized that the decision whether the acquiring firm is an actual potential entrant is, in the last analysis, an independent one to be made by the trial court on the basis of all relevant evidence properly weighted according to its credibility. . . .

. . . [S]ubjective evidence has, at best, only a marginal role to play in actual potential-entry cases. In order to make out a *prima facie* case, the Government need only show that objectively measurable market data favor a *de novo* entry and that the alleged potential entrant has the economic capability to make such an entry. To be sure, the defendant may

¹² Public statements by management that the firm does not intend to enter the market may be relevant. To the extent that such statements are believed by the firms within the market, they affect their perception of the firm outside the market as a potential entrant. But in that event, the statements of intent are admissible, not to show subjective state of mind, but, rather, as one of the objective factors controlling the perception of the firms within the market.

then introduce subjective testimony in rebuttal, and in the rare case where the objective evidence is evenly divided, it is conceivable that extremely credible subjective evidence might tip the balance. But where objectively measurable market forces make clear that it is in a firm's economic self-interest to make a *de novo* entry and that the firm has the economic capability to do so, I would hold that it is error for the District Court to conclude that the firm is not an actual potential entrant on the basis of testimony by company officials as to the firm's future intent.¹³

. . . [A]ny statement of future intent will be inherently self-serving. A defendant in a §7 case such as this wishes to enter the market by acquisition and its managers know that its ability to do so depends upon whether it can convince a court that it would not have entered *de novo* if entry by acquisition were prevented. It is thus strongly in management's interest to represent that it has no intention of entering *de novo*—a representation which is not subject to external verification and which is so speculative in nature that it could virtually never serve as the predicate for a perjury charge.

Moreover, in a case where the objective evidence strongly favors entry *de novo*, a firm which asks us to believe that it does not intend to enter *de novo* by implication asks us to believe that it does not intend to act in its own economic self-interest. But corporations are, after all, profit-making institutions, and, absent special circumstances, they can be expected to follow courses of action most likely to maximize profits. . . . The trier of fact should, therefore, look with great suspicion upon a suggestion that a company with an opportunity to expand its market and the means to seize upon that opportunity will follow a deliberate policy of self-abnegation if the route of expansion first selected is legally foreclosed to it. . . .

III

. . . The objective evidence in the record strongly suggests that Falstaff had both the capability and the incentive to enter the New England market *de novo*. It is undisputed that it was in Falstaff's interest to gain the status of a national brewer in the near future and that New

¹³ It might be argued that economic decisions are "inherently subjective" and that any attempt to derive objective conclusions from economic data is futile. If this observation means that different people reach different conclusions from the same objective data, then the point must, of course, be conceded. Similarly, if the point is that economic predictions are difficult and fraught with uncertainty, it is well taken. . . . But although the factual controversies in §7 cases may prove difficult to resolve, the statutory scheme clearly demands their resolution. . . . Section 7 by its terms requires the trial judge to make a prediction, and it is entirely possible that others may reasonably disagree with the conclusion he reaches. . . . While it may be true that different people see economic facts in different light, §7 gives federal judges and juries the responsibility to reach *their* conclusions as to the economic facts. And "[i]f justice requires the fact to be ascertained, the difficulty of doing so is no ground for refusing to try." O. Holmes, *The Common Law* 48.

England was a logical area to begin its expansion. Indeed, Falstaff's own actions in entering the New England market support this conclusion. Nor can it be doubted that Falstaff had the economic capability to enter New England. Falstaff is the Nation's fourth largest brewer and the largest still outside of New England. It has been consistently profitable in recent years, has an excellent credit rating, and had, in 1964, enough excess capital to finance a 10-year, \$35 million expansion project. . . .

To be sure, Falstaff introduced a great deal of evidence tending to show that entry *de novo* would have been less profitable for it than entry by acquisition. I have no doubt that this is true. Indeed, if it can be assumed that Falstaff is a rational, profit-maximizing corporation, its own decision offers strong proof that entry by acquisition was the preferable alternative. But the test in §7 cases is not whether anticompetitive conduct is profit maximizing. The very purpose of §7 is to direct the profit incentive into channels which are procompetitive. Thus, the proper test is whether Falstaff would have entered the market *de novo* if the preferable alternative of entry by acquisition had been denied it. The objective evidence strongly suggests that such an entry would have occurred. . . .

MR. JUSTICE REHNQUIST, with whom MR. JUSTICE STEWART concurs, dissenting.

. . . Although agreeing with my Brother MARSHALL'S criticism of the Court's reason for remanding this case, I cannot agree with his grounds for remanding to the District Court for reconsideration. That theory is based, erroneously I believe, on the notion that there is an identifiable difference between "objective" and "subjective" evidence in an antitrust case such as this. My Brother MARSHALL would have the District Court weigh "objective" evidence more heavily than "subjective" evidence. In the field of economic forecasting in general, and in the area of potential competition in particular, however, the distinction between "objective" and "subjective" evidence is largely illusory. It is, I believe, incorrect to state that a trier of fact can determine "objectively" what "is in a firm's economic self-interest." Such a determination is guesswork. The term "economic self-interest" is a convenient shorthand for describing the economic decision reached by an individual or firm, but does not connote some simple, mechanical formula which determines the input values, or their assigned weight, in the process of economic decision-making. The simple fact is that any economic decision is largely subjective. In the instant case, Falstaff sought to prove why it was not in the "economic self-interest" of that firm to enter a new geographic market without an established distribution system. Its explanation is as "objective" as any of the evidence offered by the Government to show why a hypothetical Falstaff should enter the market. The question of who is an

"actual potential competitor" is entirely factual. In deciding questions of fact, it is the province of the trier to weigh all of the evidence; but it is peculiarly his province to determine questions of credibility. . . .

United States v. Marine Bancorporation, Inc., et al.

418 U.S. 602 (1974)

MR. JUSTICE POWELL delivered the opinion of the Court.

The United States brought this civil antitrust action under §7 of the Clayton Act . . . to challenge a proposed merger between two commercial banks. The acquiring bank is a large, nationally chartered bank based in Seattle, Washington, and the acquired bank is a medium-size, state-chartered bank located at the opposite end of the State in Spokane. The banks are not direct competitors to any significant degree in Spokane or any other part of the State. They have no banking offices in each other's home cities. The merger agreement would substitute the acquiring bank for the acquired bank in Spokane and would permit the former for the first time to operate as a direct participant in the Spokane market.

The proposed merger would have no effect on the number of banks in Spokane. The United States bases its case exclusively on the potential-competition doctrine under §7 of the Clayton Act. It contends that if the merger is prohibited, the acquiring bank would find an alternate and more competitive means for entering the Spokane area and that the acquired bank would ultimately develop by internal expansion or mergers with smaller banks into an actual competitor of the acquiring bank and other large banks in sections of the State outside Spokane. The Government further submits that the merger would terminate the alleged procompetitive influence that the acquiring bank presently exerts over Spokane banks due to the potential for its entry into that market.

After a full trial, the District Court held against the Government on all aspects of the case. We affirm that court's judgment. We hold that in applying the potential-competition doctrine to commercial banking, courts must take into account the extensive federal and state regulation of banks, particularly the legal restraints on entry unique to this line of commerce. The legal barriers to entry in the instant case, notably state-law prohibitions against *de novo* branching, against branching from a branch office, and against multibank holding companies, compel us to conclude that the challenged merger is not in violation of §7.

I. BACKGROUND

A. Facts

The acquiring bank, National Bank of Commerce (NBC), is a national banking association with its principal office in Seattle, Washington. Lo-

clude for themselves that there is a realistic expectation that the new entrant will appropriate for itself a substantial part of the business of the major competitors in the market.

The Court then delivers the *coup de grace* by imposing its own visions of reality in commercial banking markets: without unlimited branching authority in the market involved, no newcomer to the market can be sufficiently successful against others, who have the authority, to be a substantial competitor and to merit recognition under doctrines of potential competition. No new entrant can attain, let us say, 15 or 20 percent of the banking business in the Spokane area unless it has branching authority. The Court apparently insists this will be true no matter where the new banking office is located and no matter who and how well equipped and financed and new entrant may be. This is claiming a prescience that I doubt the Court has and is a view of the effectiveness and worth of competition, though having modest beginnings, that I do not share. . . .

7

Joint Ventures— A Form of Merger

Joint ventures can be defined as the creation of new, jointly owned business enterprises by two or more corporations. Such ventures provide especially formidable problems for students of antitrust because of their potential for both good and evil. On the one hand, they provide a means by which resources can be pooled and risks shared; this often makes possible the completion of projects which, but for the joint venture, would not have been undertaken. On the other hand, the fact that potential competitors choose to operate jointly, rather than as rivals, is disturbing. The courts, in apparent recognition of the potential of joint ventures for increasing competition in some instances and diminishing it in others, have adopted a relatively flexible position toward them. In the *Terminal Railroad* decision, the Supreme Court recognized the value of the venture itself, yet sought to mitigate its anticompetitive consequences through the requirement of fair and equal access. In the *Penn-Olin* case the Court sought to extend and refine its analysis of joint ventures, particularly as it related to the question of potential competition.¹

United States v. Terminal Railroad Association of St. Louis

224 U.S. 383 (1912)

MR. JUSTICE LURTON delivered the opinion of the Court.

The United States filed this bill to enforce the provisions of the Sherman Act of July 2, 1890 . . . against thirty-eight corporate and individual defendants . . . as a combination in restraint of interstate commerce and as a monopoly forbidden by that law. . . .

The principal defendant is the Terminal Railroad Association of St.

¹ In this regard see especially Section 8 of the decision, wherein JUSTICE CLARK attempts to define a series of rules for evaluating the consequences of joint ventures.

Louis, hereinafter designated as the Terminal Company. It is a corporation of the State of Missouri, and was organized under an agreement made in 1889 between Mr. Jay Gould and a number of the defendant railroad companies for the express purpose of acquiring the properties of several independent terminal companies at St. Louis with a view to combining and operating them as a unitary system.

. . . These properties included the great union station, the only existing railroad bridge—the Eads or St. Louis Bridge—and every connecting or terminal company by means of which that bridge could be used by railroads terminating on either side of the river. . . .

. . . [F]or a time, there existed three independent methods by which connection was maintained between railroads terminating on either side of the river at St. Louis: first, the original Wiggins Ferry Company, and its railway terminal connections; second, the Eads Railroad Bridge and the several terminal companies by means of which railroads terminating at St. Louis were able to use that bridge and connect with one another, constituting the system controlled by the Terminal Company, and, third, [t]he Merchants' Bridge and terminal facilities owned and operated by companies in connection therewith.

This resulted in some cases in an unnecessary duplication of facilities, but it at least gave to carriers and shippers some choice, a condition which, if it does not lead to competition in charges, does insure competition in service. Important as were the considerations mentioned, their independence of one another served to keep open the means for the entrance of new lines to the city, and was an obstacle to united opposition from existing lines. The importance of this will be more clearly seen when we come to consider the topographical conditions of the situation.

That the promoters of the Terminal Company designed to obtain the control of every feasible means of railroad access to St. Louis, or means of connecting the lines of railway entering on opposite sides of the river, is manifested by the declarations of the original agreement, as well as by the successive steps which followed. . . .

We come, then, to the question upon which the case must turn: Has the unification of substantially every terminal facility by which the traffic of St. Louis is served resulted in a combination which is in restraint of trade within the meaning and purpose of the Anti-trust Act?

It is not contended that the unification of the terminal facilities of a great city where many railroad systems center is, under all circumstances and conditions, a combination in restraint of trade or commerce. Whether it is a facility in aid of interstate commerce or an unreasonable restraint forbidden by the act of Congress . . . will depend upon the intent to be inferred from the extent of the control thereby secured over instrumentalities which such commerce is under compulsion to use, the method by which such control has been brought about and the manner in which that control has been exerted.

The consequence to interstate commerce of this combination cannot be appreciated without a consideration of natural conditions greatly affecting the railroad situation at St. Louis. Though twenty-four lines of railway converge at St. Louis, not one of them passes through. About one-half of these lines have their termini on the Illinois side of the river. The others, coming from the west and north, have their termini either in the city or on its northern edge. . . . The cost of construction and maintenance of railroad bridges over so great a river makes it impractical for every road desiring to enter or pass through the city to have its own bridge. The obvious solution is the maintenance of toll bridges open to the use of any and all lines upon identical terms. . . . The first bridge, called the Eads Bridge, was, and is, a toll bridge. Any carrier may use it on equal terms. But to use it there must be access over rails connecting the bridge and the railway. On the St. Louis side the bridge terminates at the foot of the great hills upon which the city is built; on the Illinois side it ends in the low and wide valley of the Mississippi. This condition resulted in the organization of independent companies which undertook to connect the bridge on each side with the various railroad termini. . . . Thus, though the bridge might be used by all upon equal terms, it was accessible only by means of the several terminal companies operating lines connecting it with the railroad termini.

This brought about a condition which led to the construction of the second bridge, the Merchants' Bridge. This, too, was, and is, a toll bridge, and may be used by all upon equal terms. . . . But this Merchants' Bridge, like the Eads Bridge, had no rail connections with any of the existing railroad systems, and these facilities, as in the case of the Eads Bridge, were supplied by a number of independent railway companies who undertook to fill in the gaps between the bridge ends and the termini of railroads on both sides of the river. . . . Now, it is evident that these lines connecting railroad termini with the railroad bridges dominated the situation. They stood, as it were, just outside the gateway, and none could enter, though the gate stood open, who did not comply with their terms. . . .

The result of the geographical and topographical situation is that it is, as a practical matter, impossible for any railroad company to pass through, or even enter St. Louis, so as to be within reach of its industries or commerce, without using the facilities entirely controlled by the Terminal Company. . . . Nor is this effect denied, for the learned counsel representing the proprietary companies, as well as the Terminal Company, say in their filed brief: "There indeed is compulsion, but it is inherent in the situation. The other companies use the terminal properties because it is not possible to acquire adequate facilities for themselves. The cost to any one company is prohibitive." Obviously, this was not true before the consolidation of the systems of the Wiggins Ferry Company and the Merchants' Bridge Company with the system theretofore con-

trolled by the Terminal Company. That the nonproprietary companies might have been compelled to use the instrumentalities of one or the other of the three systems then available, and that the advantages secured might not have been so great as those offered by the unified system now operated by the Terminal Company, must be admitted. But that there existed before the three terminal systems were combined a considerable measure of competition for the business of the other companies, and a larger power of competition, is undeniable. . . . The independent existence of these three terminal systems was, therefore, a menace to complete domination as keeping open the way for greater competition. Only by their absorption or some equivalent arrangement was it possible to exclude from independent entrance . . . any . . . company which might desire its own terminals. . . .

The physical conditions which compel the use of the combined system by every road which desires to cross the river, either to serve the commerce of the city or to connect with lines separated by the river, is the factor which gives greatest color to the unlawfulness of the combination as now controlled and operated. If the Terminal Company was in law and fact the agent of all, the mere unification which has occurred would take on quite a different aspect. It becomes, therefore, of the utmost importance to know the character and purpose of the corporation. . . . The fact that the Terminal Company is not an independent corporation at all is of the utmost significance. There are twenty-four railroads converging at St. Louis. The relation of the Terminal Company is not one of impartiality to each of them. It was organized in 1889, at the instance of six of these railroad companies, for the purpose of acquiring all existing terminal instrumentalities for the benefit of the combination, and such other companies as they might thereafter admit to joint ownership by unanimous consent, and upon a consideration to be agreed upon. . . .

That these facilities were not to be acquired for the benefit of any railroad company which might desire a joint use thereof was made plain by a provision in the contract [of 1889] . . . which stipulated that other railroad companies not named therein as proprietary companies might only be admitted "to joint use of said terminal system on unanimous consent, but not otherwise, of the directors of the first party, and on payment of such a consideration as they may determine, and on signing this agreement," etc. Inasmuch as the directors of the Terminal Company consisted of one representative of each of the proprietary companies, selected by itself, it is plain that each of said companies had and still has a veto upon any joint use or control of terminals by any non-proprietary company. . . .

We fail to find . . . any provision abrogating the requirement of unanimous consent to the admission of other companies to the ownership of the Terminal Company, though counsel say that no such company will

now find itself excluded from joint use or ownership upon application. . . .

By still another clause in the agreement the proprietary companies obligate themselves to forever use the facilities of the Terminal Company for all business destined to cross the river. This would seem to guarantee against any competitive system, since the companies to the agreement now control about one-third of the railroad mileage of the United States. . . .

That through their ownership and exclusive control they are in possession of advantages in respect to the enormous traffic which must use the St. Louis gateway, is undeniable. That the proprietary companies have not availed themselves of the full measure of their power to impede free competition of outside companies, may be true. Aside from their power under all of the conditions to exclude independent entrance to the city by any outside company, their control has resulted in certain methods which are not consistent with freedom of competition. . . .

We are not unmindful of the essential difference between terminal systems properly so described and railroad transportation companies. The first are but instrumentalities which assist the latter in the transfer of traffic between different lines, and in the collection and distribution of traffic. They are a modern evolution in the doing of railroad business, and are of the greatest public utility. They, under proper conditions, do not restrain, but promote commerce. . . .

While, therefore, the mere combining of several independent terminal systems into one may not operate as a restraint upon the interstate commerce which must use them, yet there may be conditions which will bring such a combination under the prohibition of the Sherman Act. . . .

It cannot be controverted that, in ordinary circumstances, a number of independent companies might combine for the purpose of controlling or acquiring terminals for their common but exclusive use. In such cases other companies might be admitted upon terms or excluded altogether. If such terms were too onerous, there would ordinarily remain the right and power to construct their own terminals. But the situation at St. Louis is most extraordinary, and we base our conclusion in this case, in a large measure, upon that fact. The "physical or topographical condition peculiar to the locality," which is advanced as a prime justification for a unified system of terminals, constitutes a most obvious reason why such a unified system is an obstacle, a hindrance and a restriction upon interstate commerce, unless it is the impartial agent of all who, owing to conditions, are under such compulsion, as here exists, to use its facilities. The witness upon whom the defendants chiefly rely to uphold the advantages of the unified system which has been constructed, Mr. Albert L. Perkins, gives this as his unqualified judgment. . . . The witness, however, points out that such a terminal company should be the agent of every company and,

furthermore, that its service should not be for profit or gain. In short, that every railroad using the service should be a joint owner and equally interested in the control and management. . . .

The terminal properties in question are not so controlled and managed, in view of the inherent local conditions, as to escape condemnation as a restraint upon commerce. They are not under a common control and ownership. Nor can this be brought about unless the prohibition against the admission of other companies to such control is stricken out and provision made for the admission of any company to an equal control and management upon an equal basis with the present proprietary companies. . . .

We come now to the remedy. . . . If, as we have already said, the combination of two or more mere terminal companies into a single system does not violate the prohibition of the statute against contracts and combinations in restraint of interstate commerce, it is because such a combination may be of the greatest public utility. But when, as here, the inherent conditions are such as to prohibit any other reasonable means of entering the city, the combination of every such facility under the exclusive ownership and control of less than all of the companies under compulsion to use them violates both the first and second sections of the act, in that it constitutes a contract or combination in restraint of commerce among the States and an attempt to monopolize commerce among the States which must pass through the gateway of St. Louis. . . .

Plainly the combination which has occurred would not be an illegal restraint under the terms of the statute if it were what is claimed for it, a proper terminal association acting as the impartial agent of every line which is under compulsion to use its instrumentalities. If, as we have pointed out, the violation of the statute, in view of the inherent physical conditions, grows out of administrative conditions which may be eliminated and the obvious advantages of unification preserved, such a modification of the agreement between the Terminal Company and the proprietary companies as shall constitute the former the *bona fide* agent and servant of every railroad line which shall use its facilities, and an inhibition of certain methods of administration to which we have referred, will amply vindicate the wise purpose of the statute, and will preserve to the public a system of great public advantage.

These considerations lead to a reversal of the decree dismissing the bill. This is accordingly adjudged and the case is remanded to the District Court, with directions that a decree be there entered directing the parties to submit to the court, within ninety days after receipt of mandate, a plan for the reorganization of the contract between the fourteen defendant railroad companies and the Terminal Company, which we have pointed out as bringing the combination within the inhibition of the statute.

First. By providing for the admission of any existing or future railroad to joint ownership and control of the combined terminal properties, upon

such just and reasonable terms as shall place such applying company upon a plane of equality in respect of benefits and burdens with the present proprietary companies.

Second. Such plan of reorganization must also provide definitely for the use of terminal facilities by any other railroad not electing to become a joint owner, upon such just and reasonable terms and regulations as will, in respect of use, character and cost of service, place every such company upon as nearly an equal plane as may be with respect to expenses and charges as that occupied by the proprietary companies. . . .

Reversed and remanded accordingly.

United States v. Penn-Olin Chemical Co.

378 U.S. 158 (1964)

MR. JUSTICE CLARK delivered the opinion of the Court.

Pennsalt Chemicals Corporation and Olin Mathieson Chemical Corporation jointly formed Penn-Olin Chemical Company to produce and sell sodium chlorate in the southeastern United States. The Government seeks to dissolve this joint venture as violative of both Section 7 of the Clayton Act and Section 1 of the Sherman Act. This direct appeal . . . from the United States District Court for the District of Delaware, raises two questions. First, whether Section 7 of the Clayton Act is applicable where two corporations form a third to engage in a new enterprise; and, second, if this question is answered in the affirmative, whether there is a violation of Section 1 or Section 7 under the facts of this case. The trial court found that the joint venture, on this record, violated neither of these sections and found it unnecessary to reach the first question. . . . In view of the importance of each of these questions in the administration of the antitrust laws, we noted probable jurisdiction. . . . We have concluded that a joint venture as organized here would be subject to the regulation of Section 7 of the Clayton Act and, reaching the merits, we hold that while on the present record there is no violation of Section 1 of the Sherman Act, the District Court erred in dismissing the complaint as to Section 7 of the Clayton Act. Accordingly, the judgment is vacated and remanded for further consideration.

1. LINE OF COMMERCE, RELEVANT MARKET, ETC.

At the outset it is well to note that some of the troublesome questions ordinarily found in antitrust cases have been eliminated by the parties. First, the line of commerce is a chemical known as sodium chlorate. . . . All sodium chlorate of like purity is usable interchangeably and is used primarily in the pulp and paper industry to bleach the pulp, making for a brighter and higher quality paper. . . . The pulp and paper

industry consumes about 64% of total production of sodium chlorate. The chemical is also employed in the production of herbicides, agricultural chemicals and in certain derivatives, such as ammonium perchlorate. Next, the relevant market is not disputed. It is the southeastern part of the United States. Nor is the fact that Olin has never engaged in the commercial production of sodium chlorate contested. It has purchased and does purchase amounts of the chemical for internal consumption and has acted as sales agent for Pennsalt in the southeastern territory under contracts dated in December 1957 and February 1958. Olin also owns a patented process for bleaching pulp with chlorine dioxide. This process requires sodium chlorate and has been widely used by paper manufacturers under royalty-free licenses. . . .

2. THE COMPANIES INVOLVED

Pennsalt is engaged solely in the production and sale of chemicals and chemical products throughout the United States. Its assets are around a hundred million dollars and its sales are about the same amount. Its sodium chlorate production is located at Portland, Oregon, with a capacity of some 15,000 tons as of 1959. It occupied 57.8% of the market west of the Rocky Mountains. It has marketed sodium chlorate in the southeastern United States to some extent since 1957. Its shipments into that territory in 1960 were 4,186 tons of which Olin sold 3,202 tons on its sales agency contract.

Olin is a large diversified corporation, the result of a merger of Olin Industries, Inc., and Mathieson Chemical Corporation in 1954. One of its seven divisions operates plants in 15 States and produces a wide range of chemicals and chemical products accounting for about 30% of Olin's revenues. Olin's sales in 1960 grossed some \$690,000,000 and its total assets were \$860,000,000.

Penn-Olin was organized in 1960 as a joint venture of Olin and Pennsalt. Each owns 50% of its stock and the officers and directors are divided equally between the parents. Its plant at Calvert City, Kentucky, was built by equal contribution of the two parents and cost \$6,500,000. It has a capacity to produce 26,500 tons of sodium chlorate annually and began operations in 1961. Pennsalt operates the plant and Olin handles the sales. Penn-Olin deals in no other chemicals.

3. BACKGROUND AND STATISTICS OF THE INDUSTRY

Prior to 1961 the sodium chlorate industry in the United States was made up of three producing companies. The largest producer, Hooker Chemical Corporation, entered the industry in 1956 when it acquired Oldbury Electro Chemical Company, which had been producing sodium chlorate for over half a century. Hooker now has two plants, one in the relevant marketing area at Columbus, Mississippi, which originally had a capacity of 16,000 tons but which was doubled in 1962. The other plant is

at Niagara Falls, New York, with a capacity of 18,000 tons. Hooker has assets of almost \$200,000,000. American Potash & Chemical Corporation entered the industry in 1955 by the acquisition of Western Electro Chemical Company. American Potash also has two plants, one located at Henderson, Nevada, with a 27,000-ton capacity and the other at Aberdeen, Mississippi (built in 1957), the capacity of which was 15,000 tons. Its assets are almost \$100,000,000. The trial court found that these two corporations "had a virtual monopoly" in the relevant southeast market, holding over 90% of the market.

A third company in the industry was Pennsalt which had a 15,392-ton plant at Portland, Oregon. It entered seriously into the relevant marketing area through a sales arrangement with Olin dated December 1957 and finalized in 1958, which was aimed at testing the availability of the southeastern market. Olin as an exclusive seller was to undertake the sale of 2,000 tons of sodium chlorate per year to pulp and paper mills in the southeast (except for Buckeye Cellulose Co., at Foley, Florida, which Pennsalt reserved to serve directly). In 1960, 4,186 tons of sodium chlorate were marketed in the relevant market with the aid of this agreement. This accounted for 8.9% of the sales in that market.

During the previous decade no new firms had entered the sodium chlorate industry, and little effort had been made by existing companies to expand their facilities prior to 1957. In 1953 Olin had made available to Pennsalt its Mathieson patented process for bleaching pulp with chlorine dioxide and the latter had installed it 100% in all of the western paper mills. This process uses sodium chlorate. At about the same time the process was likewise made available, royalty free, to the entire pulp and paper industry. By 1960 most of the chlorine dioxide generated by paper manufacturers was being produced under the Olin controlled process. This created an expanding demand for sodium chlorate and by 1960 the heaviest concentration of purchasers was located in the relevant southeastern territory. By 1957 Hooker began increasing the capacity of its Columbus plant and by 1960 it had been almost doubled. American Potash sensed the need of a plant in Mississippi to compete with Hooker and began its Aberdeen plant in 1957. It was completed to a 15,000-ton capacity in 1959, and this capacity was expanded 50% by 1961.

The sales arrangement between Pennsalt and Olin, previously mentioned, was superseded by the joint venture agreement on February 11, 1960, and the Penn-Olin plant operations at Calvert City, Kentucky, began in 1961. In the same year Pittsburgh Plate Glass Company announced that it would build a plant at Lake Charles, Louisiana, with a capacity of 15,000 tons. Pittsburgh Plate Glass had operated a sodium chlorate plant in Canada.

As a result of these expansions and new entries into the southeastern market, the projected production of sodium chlorate there more than doubled. . . . Penn-Olin's share of the expanded relevant market was about 27.6%. . . .

4. THE SETTING FROM WHICH THE JOINT VENTURE EMERGED

As early as 1951 Pennsalt had considered building a plant at Calvert City and starting in 1955 it initiated several cost and market studies for a sodium chlorate plant in the southeast. Three different proposals from within its own organization were rejected prior to 1957, apparently because the rate of return was so unattractive that "the expense of refining these figures further would be unwarranted." When Hooker announced in December 1956 that it was going to increase the capacity of its Columbus plant, the interest of Pennsalt management was reactivated. It appointed a "task force" to evaluate the company's future in the eastern market; it retained management consultants to study that market and its chief engineer prepared cost estimates. However, in December 1957 the management decided that the estimated rate of return was unattractive and considered it "unlikely" that Pennsalt would go it alone. It was suggested that Olin would be a "logical partner" in a joint venture and might in the interim be interested in distributing in the East 2,000 tons of the Portland sodium chlorate production. The sales agreement with Olin, heretofore mentioned, was eventually made. In the final draft the parties agreed that "neither . . . should move in the chlorate or perchlorate field without keeping the other party informed . . ." and that one would "bring to the attention of the other any unusual aspects of this business which might make it desirable to proceed further with production plans." Pennsalt claims that it finally decided, prior to this agreement, that it should not build a plant itself and that this decision was never reconsidered or changed. But the District Court found to the contrary.

During this same period—beginning slightly earlier—Olin began investigating the possibility of entering the sodium chlorate industry. It had never produced sodium chlorate commercially, although its predecessor had done so years before. However, the electrolytic process used in making sodium chlorate is intimately related to other operations of Olin and required the same general knowledge. Olin also possessed extensive experience in the technical aspects of bleaching pulp and paper and was intimate with the pulp and paper mills of the southeast. In April 1958 Olin's chemical division wrote and circulated to the management a "Whither Report" which stated in part:

We have an unparalleled opportunity to move sodium chlorate into the paper industry as the result of our work on the installation of chlorine dioxide generators. We have a captive consumption for sodium chlorate.

And Olin's engineering supervisor concluded that entry into sodium chlorate production was "an attractive venture" since it "represents a logical expansion of the product line of the Industrial Chemicals Division . . ." with respect to "one of the major markets, pulp and paper bleaching, [with which] we have a favorable marketing position, particularly in the southeast."

The staff, however, did not agree with the engineering supervisor or the "Whither Report." . . . But, as the trial court found, the testimony indicated that Olin's decision to enter the joint venture was made without determining that Olin could not or would not be an independent competitor. That question, the president of Penn-Olin testified, "never reached the point of final decision."

This led the District Court to find that "[t]he possibility of individual entry into the southeastern market had not been completely rejected by either Pennsalt or Olin before they decided upon the joint venture." . . .

5. SECTION 7 OF THE CLAYTON ACT APPLIES TO "JOINT VENTURES"

Appellees argue that Section 7 applies only where the acquired company is "engaged" in commerce and that it would not apply to a newly formed corporation, such as Penn-Olin. The test, they say, is whether the enterprise to be acquired is engaged in commerce—not whether a corporation formed as the instrumentality for the acquisition is itself engaged in commerce at the moment of its formation. We believe that this logic fails in the light of the wording of the section and its legislative background. The test of the section is the effect of the acquisition. Certainly the formation of a joint venture and purchase by the organizers of its stock would substantially lessen competition—indeed foreclose it—as between them, both being engaged in commerce. This would be true whether they were in actual or potential competition with each other and even though the new corporation was formed to create a wholly new enterprise. Realistically, the parents would not compete with their progeny. Moreover, in this case the progeny was organized to further the business of its parents, already in commerce, and the fact that it was organized specifically to engage in commerce should bring it within the coverage of Section 7. In addition, long prior to trial Penn-Olin was actually engaged in commerce. To hold that it was not "would be illogical and disrespectful of the plain congressional purpose in amending Section 7 . . . [for] it would create a large loophole in a statute designed to close a loophole." *United States v. Philadelphia National Bank* . . . (1963). In any event, Penn-Olin was engaged in commerce at the time of suit and the economic effects of an acquisition are to be measured at that point rather than at the time of acquisition. *United States v. E. I. duPont de Nemours & Co.* . . . (1957). The technicality could, therefore, be averted by merely re-filing an amended complaint at the time of trial. This would be a useless requirement.

6. THE APPLICATION OF THE MERGER DOCTRINE

This is the first case reaching this Court and on which we have written that directly involves the validity under Section 7 of the joint participation of two corporations in the creation of a third as a new domestic producing

organization.¹ We are, therefore, plowing new ground. If it is true, however, that some aspects of the problem might be found in *United States v. Terminal R. Assn.*, 224 U.S. 383 (1912), and *Associated Press v. United States*, 326 U.S. 1 (1945), where joint ventures with great market power were subjected to control, even prior to the amendment to Section 7.

. . . Their [joint ventures] economic significance has grown tremendously in the last score of years, having been spurred on by the need for speed and size in fashioning a war machine during the early forties. Post-war use of joint subsidiaries and joint projects led to the spawning of thousands of such ventures in an effort to perform the commercial tasks confronting an expanding economy.

The joint venture, like the "merger" and the "conglomeration," often creates anticompetitive dangers. It is the chosen competitive instrument of two or more corporations previously acting independently and usually competitively with one another. The result is "a triumvirate of associated corporations."² If the parent companies are in competition, or might compete absent the joint venture, it may be assumed that neither will compete with the progeny in its line of commerce. Inevitably, the operations of the joint venture will be frozen to those lines of commerce which will not bring it into competition with the parents, and the latter, by the same token will be foreclosed from the joint venture's market.

This is not to say that the joint venture is controlled by the same criteria as the merger or conglomeration. The merger eliminates one of the participating corporations from the market while a joint venture creates a new competitive force therein. . . .

Overall, the same considerations apply to joint ventures as to mergers, for in each instance we are but expounding a national policy enunciated by the Congress to preserve and promote a free competitive economy. In furtherance of that policy, now entering upon its 75th year, this Court has formulated appropriate criteria, first under the Sherman Act and now, also, under the Clayton Act and other antitrust legislation. The Celler-Kefauver Amendment to Section 7, with which we now deal, was the answer of the Congress to a loophole found to exist in the original enactment. . . . The grand design of the original Section 7, as to stock acquisitions, as well as the Celler-Kefauver Amendment, as to the acquisition of assets, was to arrest incipient threats to competition which the Sherman Act did not ordinarily reach. It follows that actual restraints need not be proved. The requirements of the amendment are satisfied when a "tendency" toward monopoly or the "reasonable likelihood" of a substantial lessening of competition in the relevant market is shown. Con-

gress made it plain that the validity of such arrangements was to be gauged on a broader scale by using the words "may be substantially to lessen competition" which "indicate that its concern was with probabilities, not certainties." . . .

7. THE CRITERIA GOVERNING SECTION 7 CASES

We apply the light of these considerations in the merger cases to the problem confronting us here. The District Court found that "Pennsalt and Olin each possessed the resources and general capability needed to build its own plant in the southeast and to compete with Hooker and [American Potash] in that market. Each could have done so if it had wished." . . .³ In addition, the District Court found that, contrary to the position of the management of Olin and Pennsalt, "the forecasts of each company indicated that a plant could be operated with profit." . . .

The District Court held, however, that these considerations had no controlling significance, except "as a factor in determining whether as a matter of probability *both* companies would have entered the market as individual competitors if Penn-Olin had not been formed. Only in this event would potential competition between the two companies have been foreclosed by the joint venture." . . . In this regard the court found it "impossible to conclude that as a matter of reasonable probability *both* Pennsalt and Olin would have built plants in the southeast if Penn-Olin had not been created." . . . The court made no decision concerning the probability that one would have built "while the other continued to ponder." It found that this "hypothesized situation affords no basis for concluding that Penn-Olin had the effect of substantially lessening competition." . . . That would depend, the court said, "upon the competitive impact which Penn-Olin will have as against that which might have resulted in Pennsalt or Olin had been an individual market entrant." . . . The court found that this impact could not be determined from the record in this case. "Solely as a matter of theory," it said, ". . . no reason exists to suppose that Penn-Olin will be a less effective competitor than Pennsalt or Olin would have been. The contrary conclusion is the more reasonable." . . .

¹ For a discussion of the problem, see Kaysen & Turner, *Antitrust Policy*, 136-141 (1959).

² See Note, "Applicability of Section 7 to a Joint Venture," 11 *U.C.L.A. L. Rev.* 393, 396.

³ The court explained further: "At the time when the joint venture was agreed upon Pennsalt and Olin each had an extensive background in sodium chlorate. Pennsalt had years of experience in manufacturing and selling it. Although Olin had never been a commercial manufacturer, it possessed a substantially developed manufacturing technique of its own, and also had available to it a process developed by Vickers-Krebs with whom it had been negotiating to construct a plant. Olin had contracts among the southeastern pulp and paper mills which Pennsalt lacked, but Pennsalt's own estimates indicate that in a reasonable time it would develop adequate business to support a plant if it decided to build. A suitable location for a plant was available to each company—Calvert City, Kentucky for Pennsalt, and the TVA area around Chattanooga, Tennessee for Olin. The financing required would not have been a problem for either company." . . .

We believe that the court erred in this regard. Certainly the sole test would not be the probability that *both* companies would have entered the market. Nor would the consideration be limited to the probability that one entered alone. There still remained for consideration the fact that Penn-Olin eliminated the potential competition of the corporation that might have remained at the edge of the market, continually threatening to enter. Just as a merger eliminates actual competition, this joint venture may well foreclose any prospect of competition between Olin and Pennsalt in the relevant sodium chlorate market. The difference, of course, is that the merger's foreclosure is present while the joint venture's is prospective. Nevertheless, "[p]otential competition . . . as a substitute for . . . [actual competition] may restrain producers from overcharging those to whom they sell or underpaying those from whom they buy. . . . Potential competition, insofar as the threat survives [as it would have here in the absence of Penn-Olin], may compensate in part for the imperfection characteristic of actual competition in the great majority of competitive markets." Wilcox, *Competition and Monopoly in American Industry*, TNEC Monograph No. 21 (1940) 7-8. Potential competition cannot be put to a subjective test. It is not "susceptible of a ready and precise answer." . . . The existence of an aggressive, well equipped and well financed corporation engaged in the same or related lines of commerce waiting anxiously to enter an oligopolistic market would be a substantial incentive to competition which cannot be underestimated. Witness the expansion undertaken by Hooker and American Potash as soon as they heard of the interest of Olin Mathieson and of Pennsalt in southeast territory. This same situation might well have come about had either Olin or Pennsalt entered the relevant market alone and the other remained aloof watching developments.

8. THE PROBLEM OF PROOF

Here the evidence shows beyond question that the industry was rapidly expanding; the relevant southeast market was requiring about one-half of the national production of sodium chlorate; few corporations had the inclination, resources and know-how to enter this market; both parent corporations of Penn-Olin had great resources; each had long been identified with the industry, one owning valuable patent rights while the other had engaged in sodium chlorate production for years; each had other chemicals, the production of which required the use of sodium chlorate; right up to the creation of Penn-Olin, each had evidenced a long-sustained and strong interest in entering the relevant market area; each enjoyed good reputation and business connections with the major consumers of sodium chlorate in the relevant market, *i.e.*, the pulp and paper mills; and finally, each had the know-how and the capacity to enter that market and could have done so individually at a reasonable profit. Moreover, each

company had compelling reasons for entering the southeast market. Pennsalt needed to expand its sales to the southeast, which it could not do economically without a plant in that area. Olin was motivated by "the fact that [it was] already buying and using a fair quantity [of sodium chlorate] for the production of sodium chlorite and that [it was] promoting the Mathieson process of the generation of chlorine dioxide which uses sodium chlorate." Unless we are going to require subjective evidence, this array of probability certainly reaches the *prima facie* stage. As we have indicated, to require more would be to read the statutory requirement of reasonable probability into a requirement of certainty. This we will not do.

However, despite these strong circumstances, we are not disposed to disturb the court's finding that there was not a reasonable probability that both Pennsalt and Olin would have built a plant in the relevant market area. But we have concluded that a finding should have been made as to the reasonable probability that either one of the corporations would have entered the market by building a plant, while the other would have remained a significant potential competitor. The trial court said that this question "need not be decided." . . . [W]e prefer that the trial court pass upon this question and we venture no opinion thereon. Since the trial court might have been concerned over whether there was evidence on this point,⁴ we reiterate that it is impossible to demonstrate the *precise* competitive effects of the elimination of either Pennsalt or Olin as a potential competitor. . . . There being no proof of specific intent to use Penn-Olin as a vehicle to eliminate competition, nor evidence of collateral restrictive agreements between the joint venturers, we put those situations to one side. We note generally the following criteria which the trial court might take into account in assessing the probability of a substantial lessening of competition: the number and power of the competitors in the relevant market; the background of their growth; the power of the joint venturers; the relationship of their lines of commerce; the competition existing between them and the power of each in dealing with the competitors of the other; the setting in which the joint venture was created; the reasons and necessities for its existence, the joint venture's line of commerce and the relationship thereof to that of its parents; the adaptability of its line of commerce to noncompetitive practices; the potential power of the joint venture in the relevant market; an appraisal of what the competition in the relevant market would have been if one of the joint venturers had entered it alone instead of through Penn-Olin; the effect, in the event of this occurrence, of the other joint venturer's potential competition; and such other factors as might indicate potential risk to competition in the relevant

⁴ In this regard, the court should, of course, open the record for further testimony if the parties so desire.

market. In weighing these factors the court should remember that the mandate of the Congress is in terms of the probability of a lessening of substantial competition, not in terms of tangible present restraint.

The judgment is therefore vacated and the case is remanded for further proceedings in conformity with this opinion.

Vacated and remanded.

MR. JUSTICE WHITE dissents.

MR. JUSTICE DOUGLAS with whom MR. JUSTICE BLACK agrees, dissenting.

Agreements among competitors to divide markets are *per se* violations of the Sherman Act.⁵ The most detailed, grandiose scheme of that kind is disclosed in *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211, where industrialists, acting like commissars in modern communist countries, determined what tonnage should be produced by each company and what territory was "free" and what was "bonus." . . .

In *United States v. National Lead Co.* . . . a Sherman Act violation resulted from a division of world markets for titanium pigments, the key being allocation of territories through patent license agreements. A similar arrangement was struck down in *Timken Co. v. United States* . . . where world trade territories were allocated among an American, a British, and a French company through intercorporate arrangements called a "joint venture." *Nationwide Trailer Rental System, Inc. v. United States*, 355 U.S. 10 (affirming 156 F. Supp. 800), held violative of the antitrust laws an agreement establishing exclusive territories for each member of an organization set up to regulate the one-way trailer rental industry and empowering a member to prevent any other operator from becoming a member in his area.

In the late 1950s the only producers of sodium chlorate in the United States were Pennsalt, one of the appellees in this case, Hooker Chemical Corporation, and American Potash and Chemical Corporation. No new firms had entered the industry for a decade. Prices seemed to be stable and little effort had been made to expand existing uses or to develop new ones. But during the 1950s the sodium chlorate market began to grow, chiefly on account of the adoption of chlorine dioxide bleaching in the pulp industry. Domestic production more than quadrupled between 1950 and 1960. The growth was the most pronounced in the southeast. By 1960 the southeast had the heaviest concentration of sodium chlorate buyers, the largest being the pulp and paper mills; and nearly half the national

sodium chlorate productive capacity. In 1960 the southeast market was divided among the three producers as follows: Hooker, 49.5%, American Potash, 41.6%, Pennsalt, 8.9%.

Pennsalt, whose only sodium chlorate plant was at Portland, Oregon, became interested in establishing a plant in the rapidly growing southeast sodium chlorate market. It made cost studies as early as 1951 for such a project; and from 1955 on it gave the matter almost continuous consideration. . . .

In the early 1950s Olin too was investigating the possibilities of entering the southeast industry. It took various steps looking toward establishment of a production plant in the southeastern United States. . . .

During the years when Pennsalt and Olin were considering independent entry into the southeast market, they were also discussing joint entry. In order to test the southeast market the two agreed in December of 1957 that Pennsalt would make available to Olin, as exclusive seller, 2,000 tons of sodium chlorate per year for two or three years, Olin agreeing to sell the chemical only to pulp and paper companies in the southeast, except for one company which Pennsalt reserved the right to serve directly. Another agreement entered into in February 1958 provided that neither of the two companies would "move in the chlorate or perchlorate field without keeping the other party informed." And each by the agreement bound itself "to bring to the attention of the other any unusual aspects of this business which might make it desirable to proceed further with production plans." The purpose of this latter agreement, it was found, was to assure that each party would advise the other of any plans independently to enter the market before it would take any definite action on its own.

So what we have in substance is two major companies who on the eve of competitive projects in the southeastern market join forces. In principle the case is no different from one where Pennsalt and Olin decide to divide the southeastern market as was done in *Addyston Pipe* and in the other division-of-markets cases already summarized. Through the "joint venture" they do indeed divide it fifty-fifty. That division through the device of the "joint venture" is as plain and precise as though made in more formal agreements. As we saw in the *Timken* case, "agreements between legally separate persons and companies to suppress competition among themselves and others" cannot be justified "by labeling the project a 'joint venture.'" . . . And we added, "Perhaps every agreement and combination to restrain trade could be so labeled." . . . What may not be done by two companies who decide to divide a market surely cannot be done by the convenient creation of a legal umbrella—whether joint venture or common ownership and control . . . —under which they achieve the same objective by moving in unison.

An actual division of the market through the device of "joint venture" has, I think, the effect "substantially to lessen competition" within the meaning of Section 7 of the Clayton Act. . . .

⁵ See Oppenheim, "Antitrust Booms and Boomerangs," 59 *Nw. U. L. Rev.* 33, 35 (1964).

We do not, of course, know for certain what would have happened if the "joint venture" had not materialized. But we do know that Section 7 deals only with probabilities, not certainties. We know that the interest of each company in the project was lively, that one if not both of them would probably have entered that market, and that even if only one had entered at the beginning the presence of the other on the periphery would in all likelihood have been a potent competitive factor. Cf. *United States v. El Paso Natural Gas Co.* . . . We also know that as between Pennsalt and Olin the "joint venture" foreclosed all future competition by dividing the market fifty-fifty. That could not have been done consistently with our decisions had the "joint venture" been created after Pennsalt and Olin had entered the market or after either had done so. To allow the joint venture to obtain antitrust immunity because it was launched at the very threshold of the entry of two potential competitors into a territory is to let Section 7 be avoided by sophisticated devices.

There is no need to remand this case for a finding "as to the reasonable probability that either one of the corporations would have entered the market by building a plant, while the other would have remained a significant potential competitor." . . . This case—now almost three years in litigation—has already produced a trial extending over a 23-day period, the introduction of approximately 450 exhibits, and a 1,600-page record. We should not require the investment of additional time, money, and effort where, as here, a case turns on one crucial finding and the record is sufficient to enable this Court—which is as competent in this regard as the District Court—to supply it.

MR. JUSTICE HARLAN, dissenting.

I can see no purpose to be served by this remand except to give the Government an opportunity to retrieve an antitrust case which it has lost, and properly so. Believing that this Court should not lend itself to such a course, I would affirm the judgment of the District Court.

Note: On remand, the District Court found no reasonable probability that either company would have entered unilaterally [246 F. Supp. 917 (D. Del. 1965)]. This was ultimately affirmed by an equally divided Supreme Court [389 U.S. 308 (1967)].

PART FOUR

Trade Practices

Federal Trade Commission v. Morton Salt Company

334 U.S. 37 (1948)

MR. JUSTICE BLACK delivered the opinion of the Court.

The Federal Trade Commission, after a hearing, found that the respondent, which manufactures and sells table salt in interstate commerce, had discriminated in price between different purchasers of like grades and qualities, and concluded that such discriminations were in violation of Section 2 of the Clayton Act . . . as amended by the Robinson-Patman Act. . . . It accordingly issued a cease and desist order. . . . Upon petition of the respondent the Circuit Court of Appeals, with one judge dissenting, set aside the Commission's findings and order, directed the Commission to dismiss its complaint against respondent, and denied a cross petition of the Commission for enforcement of its order. 162 F.2d 949. The Court's judgment rested on its construction of the Act, its holding that crucial findings of the Commission were either not supported by evidence or were contrary to the evidence, and its conclusion that the Commission's order was too broad. Since questions of importance in the construction and administration of the Act were presented, we granted certiorari. . . .

Respondent manufactures several different brands of table salt and sells them directly to (1) wholesalers or jobbers, who in turn resell to the retail trade, and (2) large retailers, including chain store retailers. Respondent sells its finest brand of table salt, known as Blue Label, on what it terms a standard quantity discount system available to all customers. Under this system the purchasers pay a delivered price and the cost to both wholesale and retail purchasers of this brand differs according to the quantities bought. These prices are as follows, after making allowance for rebates and discounts:

	Per Case
Less-than-carload purchases	\$1.60
Carload purchases	1.50
5,000-case purchases in any consecutive 12 months	1.40
50,000-case purchases in any consecutive 12 months	1.35

Only five companies have ever bought sufficient quantities of respondent's salt to obtain the \$1.35 per case price. These companies could buy in such quantities because they operate large chains of retail stores in various parts of the country. As a result of this low price these five companies have been able to sell Blue Label salt at retail cheaper than wholesale purchasers from respondent could reasonably sell the same brand of salt to independently operated retail stores, many of whom competed with the local outlets of the five chain stores. . . .

In addition to these standard quantity discounts, special allowances were granted certain favored customers who competed with other customers to whom they were denied.

First. Respondent's basic contention, which it argues this case hinges upon, is that its "standard quantity discounts, available to all on equal terms, as contrasted, for example, to hidden or special rebates, allowances, prices or discounts, are not discriminatory within the meaning of the Robinson-Patman Act." Theoretically, these discounts are equally available to all, but functionally they are not. For as the record indicates (if reference to it on this point were necessary) no single independent retail grocery store, and probably no single wholesaler, bought as many as 50,000 cases or as much as \$50,000 worth of table salt in one year. Furthermore, the record shows that, while certain purchasers were enjoying one or more of respondent's standard quantity discounts, some of their competitors made purchases in such small quantities that they could not qualify for any of respondent's discounts, even those based on carload shipments. The legislative history of the Robinson-Patman Act makes it abundantly clear that Congress considered it to be an evil that a large buyer could secure a competitive advantage over a small buyer solely because of the large buyer's quantity purchasing ability. The Robinson-Patman Act was passed to deprive a large buyer of such advantages except to the extent that a lower price could be justified by reason of a seller's diminished costs due to quantity manufacture, delivery or sale, or by reason of the seller's good faith effort to meet a competitor's equally low price.

Section 2 of the original Clayton Act had included a proviso that nothing contained in it should prevent "discrimination in price . . . on account of differences in the grade, quality, or quantity of the commodity sold, or that makes only due allowance for difference in the cost of selling or transportation. . . ." That section has been construed as permitting quantity discounts, such as those here, without regard to the amount of the seller's actual savings in cost attributable to quantity sales or quantity deliveries. . . . The House Committee Report on the Robinson-Patman Act considered that the Clayton Act's proviso allowing quantity discounts so weakened Section 2 "as to render it inadequate, if not almost a nullity." . . . And it was . . . to protect competition from all price differentials except those based in full on cost savings that Section 2(a) of the amendment provided "That nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered."

The foregoing references, without regard to others which could be mentioned, establish that respondent's standard quantity discounts are discriminatory within the meaning of the Act, and are prohibited by it whenever they have the defined effect on competition. . . .

Second. The Government interprets the opinion of the Circuit Court of Appeals as having held that in order to establish "discrimination in price" under the Act the burden rested on the Commission to prove that respondent's quantity discount differentials were not justified by its cost savings. Respondent does not so understand the Court of Appeals decision, and furthermore admits that no such burden rests on the Commission. We agree that it does not. . . . [S]ection 2(b) of the Act specifically imposes the burden of showing justification upon one who is shown to have discriminated in prices. . . .

Third. It is argued that the findings fail to show that respondent's discriminatory discounts had in fact caused injury to competition. There are specific findings that such injuries had resulted from respondent's discounts, although the statute does not require the Commission to find that injury has actually resulted. The statute requires no more than that the effect of the prohibited price discriminations "may be substantially to lessen competition . . . or to injure, destroy, or prevent competition." After a careful consideration of this provision of the Robinson-Patman Act, we have said that "the statute does not require that the discriminations must in fact have harmed competition, but only that there is a reasonable possibility that they 'may' have such an effect." *Corn Products Co. v. Federal Trade Comm'n*, 324 U.S. 726, 742. Here the Commission found what would appear to be obvious, that the competitive opportunities of certain merchants were injured when they had to pay respondent substantially more for their goods than their competitors had to pay. The findings are adequate.

Fourth. It is urged that the evidence is inadequate to support the Commission's findings of injury to competition. As we have pointed out, however, the Commission is authorized by the Act to bar discriminatory prices upon the "reasonable possibility" that different prices for like goods to competing purchasers may have the defined effect on competition. That respondent's quantity discounts did result in price differentials between competing purchasers sufficient in amount to influence their resale prices of salt was shown by evidence. This showing in itself is adequate to support the Commission's appropriate findings that the effect of such price discriminations "may be substantially to lessen competition . . . and to injure, destroy, and prevent competition."

The adequacy of the evidence to support the Commission's findings of reasonably possible injury to competition from respondent's price differentials between competing carload and less-than-carload purchasers is singled out for special attacks here. . . . The argument is that there is an obvious saving to a seller who delivers goods in carload lots. Assuming this to be true, that fact would not tend to disprove injury to the merchant compelled to pay the less-than-carload price. For a ten-cent carload price differential against a merchant would injure him competitively just as much as a ten-cent differential under any other name. However relevant

the separate carload argument might be to the question of justifying a differential by cost savings, it has no relevancy in determining whether the differential works an injury to a competitor. Since Congress has not seen fit to give carload discounts any favored classification we cannot do so. Such discounts, like all others, can be justified by a seller who proves that the full amount of the discount is based on his actual savings in cost. The trouble with this phase of respondent's case is that it has thus far failed to make such proof.

It is also argued that respondent's less-than-carload sales are very small in comparison with the total volume of its business and for that reason we should reject the Commission's finding that the effect of the carload discrimination may substantially lessen competition and may injure competition between purchasers who are granted and those who are denied this discriminatory discount. To support this argument, reference is made to the fact that salt is a small item in most wholesale and retail businesses and in consumers' budgets. For several reasons we cannot accept this contention.

There are many articles in a grocery store that, considered separately, are comparatively small parts of a merchant's stock. Congress intended to protect a merchant from competitive injury attributable to discriminatory prices on any or all goods sold in interstate commerce, whether the particular goods constituted a major or minor portion of his stock. Since a grocery store consists of many comparatively small articles, there is no possible way effectively to protect a grocer from discriminatory prices except by applying the prohibitions of the Act to each individual article in the store.

Furthermore, in enacting the Robinson-Patman Act, Congress was especially concerned with protecting small businesses which were unable to buy in quantities, such as the merchants here who purchased in less-than-carload lots. To this end it undertook to strengthen this very phase of the old Clayton Act. . . . Since there was evidence sufficient to show that the less-than-carload purchasers might have been handicapped in competing with the more favored carload purchasers by the differential in price established by respondent, the Commission was justified in finding that competition might have thereby been substantially lessened or have been injured within the meaning of the Act.

Apprehension is expressed in this Court that enforcement of the Commission's order against respondent's continued violations of the Robinson-Patman Act might lead respondent to raise table salt prices to its carload purchasers. Such a conceivable, though, we think, highly improbable, contingency, could afford us no reason for upsetting the Commission's findings and declining to direct compliance with a statute passed by Congress.

The Commission here went much further in receiving evidence than the statute requires. It heard testimony from many witnesses in various parts

of the country to show that they had suffered actual financial losses on account of respondent's discriminatory prices. Experts were offered to prove the tendency of injury from such prices. The evidence covers about two thousand pages, largely devoted to this single issue—injury to competition. It would greatly handicap effective enforcement of the Act to require testimony to show that which we believe to be self-evident, namely, that there is a "reasonable possibility" that competition may be adversely affected by a practice under which manufacturers and producers sell their goods to some customers substantially cheaper than they sell like goods to the competitors of these customers. This showing in itself is sufficient to justify our conclusion that the Commission's findings of injury to competition were adequately supported by evidence.

Fifth. The Circuit Court of Appeals held, and respondent here contends, that the order was too sweeping. . . .

. . . True, the Commission did not merely prohibit future discounts, rebates, and allowances in the exact mathematical percentages previously utilized by respondent. Had the order done no more than that, respondent could have continued substantially the same unlawful practices despite the order by simply altering the discount percentages and the quantities of salt to which the percentages applied. . . .

The judgment of the Circuit Court of Appeals is reversed and the proceedings are remanded to that court to be disposed of in conformity with this opinion.

Reversed.

[MR. JUSTICE JACKSON with whom MR. JUSTICE FRANKFURTER jointed, dissented in part.]

*Standard Oil Company (of Indiana) v.
Federal Trade Commission*

340 U.S. 231 (1951)

MR. JUSTICE BURTON delivered the opinion of the Court.

In this case the Federal Trade Commission challenged the right of the Standard Oil Company, under the Robinson-Patman Act, to sell gasoline to four comparatively large "jobber" customers in Detroit as a less price per gallon than it sold like gasoline to many comparatively small service station customers in the same area. The Company's defenses were that (1) the sales involved were not in interstate commerce and (2) its lower price to the jobbers was justified because it was made to retain them as customers and in good faith to meet an equally low price of a competitor. The

Commission, with one member dissenting, ordered the company to cease and desist from making such a price differential. 43 F.T.C. 56. The Court of Appeals slightly modified the order and required its enforcement as modified. 173 F.2d 210. We granted certiorari on petition of the company because the case presents an important issue under the Robinson-Patman Act which has not been settled by this Court. . . .

For the reasons hereinafter stated, we agree with the court below that the sales were made in interstate commerce but we agree with petitioner that, under the Act, the lower price to the jobbers was justified if it was made to retain each of them as a customer and in good faith to meet an equally low price of a competitor.

. . . [T]he material facts are summarized here on the basis of the Commission's findings. The sales described are those of Red Crown gasoline because those sales raise all of the material issues and constitute about 90% of petitioner's sales in the Detroit area.

Since the effective date of the Robinson-Patman Act, June 19, 1936, petitioner has sold its Red Crown gasoline to its "jobber" customers at its tank-car prices. Those prices have been 1½¢ per gallon less than its tank-wagon prices to service station customers for identical gasoline in the same area. In practice, the service stations have resold the gasoline at the prevailing retail service station prices. Each of petitioner's so-called "jobber" customers has been free to resell its gasoline at retail or wholesale. Each, at some time, has resold some of it at retail. One now resells it only at retail. The others now resell it largely at wholesale. As to resale prices, two of the "jobbers" have resold their gasoline only at the prevailing wholesale or retail rates. The other two, however, have reflected, in varying degrees, petitioner's reductions in the cost of the gasoline to them by reducing their resale prices of that gasoline below the prevailing rates. The effect of these reductions has thus reached competing retail service stations in part through retail stations operated by the "jobbers" and in part through retail stations which purchased gasoline from the "jobbers" at less than the prevailing tank-wagon prices. The Commission found that such reduced resale prices "have resulted in injuring, destroying, and preventing competition between said favored dealers and retail dealers in respondent's [petitioner's] gasoline and other major brands of gasoline. . . ." . . . The distinctive characteristics of these "jobbers" are that each (1) maintains sufficient bulk storage to take delivery of gasoline in tank-car quantities (of 8,000 to 12,000 gallons) rather than in tank-wagon quantities (or 700 to 800 gallons) as is customary for service stations; (2) owns and operates tank wagons and other facilities for delivery of gasoline to service stations; (3) has an established business sufficient to insure purchases of from one to two million gallons a year; and (4) has adequate credit responsibility. While the cost of petitioner's sales and deliveries of gasoline to each of these four "job-

Congress, and I would, therefore, affirm the judgment of the Court of Appeals.

Utah Pie Co. v. Continental Baking Co.

386 U.S. 685 (1967)

MR. JUSTICE WHITE delivered the opinion of the Court.

This suit for treble damages and injunction under §§4 and 16 of the Clayton Act . . . was brought by petitioner, Utah Pie Company, against respondents, Continental Baking Company, Carnation Company and Pet Milk Company. The complaint charged a conspiracy under §§1 and 2 of the Sherman Act . . . and violations by each respondent of §2(a) of the Clayton Act as amended by the Robinson-Patman Act. . . . The jury found for respondents on the conspiracy charge and for petitioner on the price discrimination charge. . . . The Court of Appeals reversed, addressing itself to the single issue of whether the evidence against each of the respondents was sufficient to support a finding of probable injury to competition within the meaning of §2(a) and holding that it was not. 349 F.2d 122. We granted certiorari. . . . We reverse.

The product involved is frozen dessert pies—apple, cherry, boysenberry, peach, pumpkin, and mince. The period covered by the suit comprised the years 1958, 1959, and 1960 and the first eight months of 1961. Petitioner is a Utah corporation which for 30 years has been baking pies in its plant in Salt Lake City and selling them in Utah and surrounding States. It entered the frozen pie business in late 1957. It was immediately successful with its new line and built a new plant in Salt Lake City in 1958. The frozen pie market was a rapidly expanding one: 57,060 dozen frozen pies were sold in the Salt Lake City market in 1958, 111,729 dozen in 1959, 184,569 dozen in 1960, and 266,908 dozen in 1961. Utah Pie's share of this market in those years was 66.5%, 34.3%, 45.5%, and 45.3% respectively, its sales volume steadily increasing over the four years. Its financial position also improved. Petitioner is not, however, a large company. . . .

Each of the respondents is a large company and each of them is a major factor in the frozen pie market in one or more regions of the country. Each entered the Salt Lake City frozen pie market before petitioner began freezing dessert pies. None of them had a plant in Utah. . . . The Salt Lake City market was supplied by respondents chiefly from their California operations. They sold primarily on a delivered price basis.

The "Utah" label was petitioner's proprietary brand. Beginning in 1960, it also sold pies of like grade and quality under the controlled label "Frost 'N' Flame" to Associated Grocers and in 1961 it began selling to American Food Stores under the "Mayfresh" label. It also, on a seasonal

basis, sold pumpkin and mince frozen pies to Safeway under Safeway's own "Bel-air" label.

The major competitive weapon in the Utah market was price. The location of petitioner's plant gave it natural advantages in the Salt Lake City marketing area and it entered the market at a price below the then going prices for respondents' comparable pies. For most of the period involved here its prices were the lowest in the Salt Lake City market. It was, however, challenged by each of the respondents at one time or another and for varying periods. There was ample evidence to show that each of the respondents contributed to what proved to be a deteriorating price structure over the period covered by this suit, and each of the respondents in the course of the ongoing price competition sold frozen pies in the Salt Lake market at prices lower than it sold pies of like grade and quality in other markets considerably closer to its plants. Utah Pie, which entered the market at a price of \$4.15 per dozen at the beginning of the relevant period, was selling "Utah" and "Frost 'N' Flame" pies for \$2.75 per dozen when the instant suit was filed some 44 months later. Pet, which was offering pies at \$4.92 per dozen in February 1958, was offering "Pet-Ritz" and "Bel-air" pies at \$3.56 and \$3.46 per dozen respectively in March and April 1961. Carnation's price in early 1958 was \$4.82 per dozen but it was selling at \$3.46 per dozen at the conclusion of the period, meanwhile having been down as low as \$3.30 per dozen. The price range experienced by Continental during the period covered by this suit ran from a 1958 high of over \$5 per dozen to a 1961 low of \$2.85 per dozen.

I

We deal first with petitioner's case against the Pet Milk Company. . . . Pet's initial emphasis was on quality, but in the face of competition from regional and local companies and in an expanding market where price proved to be a crucial factor, Pet was forced to take steps to reduce the price of its pies to the ultimate consumer. These developments had consequences in the Salt Lake City market which are the substance of petitioner's case against Pet.

First, Pet successfully concluded an arrangement with Safeway, which is one of the three largest customers for frozen pies in the Salt Lake market, whereby it would sell frozen pies to Safeway under the latter's own "Bel-air" label at a price significantly lower than it was selling its comparable "Pet-Ritz" brand in the same Salt Lake market and elsewhere. . . .

Second, it introduced a 20-ounce economy pie under the "Swiss Miss" label and began selling the new pie in the Salt Lake market in August 1960 at prices ranging from \$3.25 to \$3.30 for the remainder of the period. This pie was at times sold at a lower price in the Salt Lake City market than it was sold in other markets.

Third, Pet became more competitive with respect to the prices for its "Pet-Ritz" proprietary label. . . . According to the Court of Appeals, in seven of the 44 months Pet's prices in Salt Lake were lower than prices charged in the California markets. This was true although selling in Salt Lake involved a 30- to 35-cent freight cost.

The Court of Appeals first concluded that Pet's price differential on sales to Safeway must be put aside in considering injury to competition because in its view of the evidence the differential had been completely cost justified and because Utah would not in any event have been able to enjoy the Safeway custom. Second, it concluded that the remaining discriminations on "Pet-Ritz" and "Swiss Miss" pies were an insufficient predicate on which the jury could have found a reasonably possible injury either to Utah Pie as a competitive force or to competition generally.

We disagree with the Court of Appeals in several respects. First, there was evidence from which the jury could have found considerably more price discrimination by Pet with respect to "Pet-Ritz" and "Swiss Miss" pies than was considered by the Court of Appeals. In addition to the seven months during which Pet's prices in Salt Lake were lower than prices in the California markets, there was evidence from which the jury could reasonably have found that in 10 additional months the Salt Lake City prices for "Pet-Ritz" pies were discriminatory as compared with sales in western markets other than California. Likewise, with respect to "Swiss Miss" pies, there was evidence in the record from which the jury could have found that in five of the 13 months during which the "Swiss Miss" pies were sold prior to the filing of this suit, prices in Salt Lake City were lower than those charged by Pet in either California or some other western market.

Second, with respect to Pet's Safeway business, the burden of proving cost justification was on Pet and, in our view, reasonable men could have found that Pet's lower priced, "Bel-air" sales to Safeway were not cost justified in their entirety. Pet introduced cost data for 1961 indicating a cost saving on the Safeway business greater than the price advantage extended to that customer. These statistics were not particularized for the Salt Lake market, but assuming that they were adequate to justify the 1961 sales, they related to only 24% of the Safeway sales over the relevant period. The evidence concerning the remaining 76% was at best incomplete and inferential. It was insufficient to take the defense of cost justification from the jury, which reasonably could have found a greater incidence of unjustified price discrimination than that allowed by the Court of Appeals' view of the evidence.¹

¹ . . . Pet admitted that its cost-justification figures were drawn from past performance, so even crediting the data accompanying the 1960 contract regarding cost differences, Pet's additional evidence would bring under the justification umbrella only the 1959 sales. Thus, at

With respect to whether Utah would have enjoyed Safeway's business absent the Pet contract with Safeway, it seems clear that whatever the fact is in this regard, it is not determinative of the impact of that contract on competitors other than Utah and on competition generally. There were other companies seeking the Safeway business, including Continental and Carnation, whose pies may have been excluded from the Safeway shelves by what the jury could have found to be discriminatory sales to Safeway. What is more, Pet's evidence that Utah's unwillingness to install quality control equipment prevented Utah from enjoying Safeway's private label business is not the only evidence in the record relevant to that question. There was other evidence to the contrary. The jury would not have been compelled to find that Utah Pie could not have gained more of the Safeway business.

Third, the Court of Appeals almost entirely ignored other evidence which provides material support for the jury's conclusion that Pet's behavior satisfied the statutory test regarding competitive injury. This evidence bore on the issue of Pet's predatory intent to injure Utah Pie.² As an initial matter, the jury could have concluded that Pet's discriminatory pricing was aimed at Utah Pie; Pet's own management, as early as 1959, identified Utah Pie as an "unfavorable factor," one which "d[u]g holes in our operation" and posed a constant "check" on Pet's performance in the Salt Lake City market. Moreover, Pet candidly admitted that during the period when it was establishing its relationship with Safeway, it sent into Utah Pie's plant an industrial spy to seek information that would be of use to Pet in convincing Safeway that Utah Pie was not worthy of its custom. . . . Finally, Pet does not deny that the evidence showed it suffered substantial losses on its frozen pie sales during the greater part of time involved in this suit, and there was evidence from which the jury could have concluded that the losses Pet sustained in Salt Lake City were greater than those incurred elsewhere. It would not have been an irrational step if the jury concluded that there was a relationship between price and the losses.

the least, the jury was free to consider the 1960 Safeway sales as inadequately cost justified. Those sales accounted for 12.3% of the entire Salt Lake City market in that year. In the context of this case, the sales to Safeway are particularly relevant since there was evidence that private label sales influenced the general market, in this case depressing overall market prices.

² . . . [In] *Anheuser-Busch, Inc. v. F.T.C.*, 289 F.2d 835 . . . the court went so far as to suggest that: "If . . . the projection [to ascertain the future effect of price discrimination] is based upon predatoriness or buccaneering, it can reasonably be forecast that an adverse effect on competition may occur. In that event, the discriminations in their incipency are such that they may have the prescribed effect to establish a violation of §2(a). If one engages in the latter type of pricing activity, a reasonable probability may be inferred that its willful misconduct may substantially lessen, injure, destroy or prevent competition." 289 F.2d, at 843. . . .

It seems clear to us that the jury heard adequate evidence from which it could have concluded that Pet had engaged in predatory tactics in waging competitive warfare in the Salt Lake City market. Coupled with the incidence of price discrimination attributable to Pet, the evidence as a whole established, rather than negated, the reasonable possibility that Pet's behavior produced a lessening of competition proscribed by the Act.

II

Petitioner's case against Continental is not complicated. Continental was a substantial factor in the market in 1957. But its sales of frozen 22-ounce dessert pies, sold under the "Morton" brand, amounted to only 1.3% of the market in 1958, 2.9% in 1959, and 1.8% in 1960. Its problems were primarily that of cost and in turn that of price, the controlling factor in the market. In late 1960 it worked out a co-packing arrangement in California by which fruit would be processed directly from the trees into the finished pies without large intermediate packing, storing, and shipping expenses. Having improved its position, it attempted to increase its share of the Salt Lake City market by utilizing a local broker and offering short-term price concessions in varying amounts. Its efforts for seven months were not spectacularly successful. Then in June 1961, it took the steps which are the heart of petitioner's complaint against it. Effective for the last two weeks of June it offered its 22-ounce frozen apple pies in the Utah area at \$2.85 per dozen. It was then selling the same pies at substantially higher prices in other markets. The Salt Lake City price was less than its direct cost plus an allocation for overhead. . . . Utah's response was immediate. It reduced its price on all of its apple pies to \$2.75 per dozen. . . . Continental's total sales of frozen pies increased from 3,350 dozen in 1960 to 18,800 dozen in 1961. Its market share increased from 1.8% in 1960 to 8.3% in 1961. The Court of Appeals concluded that Continental's conduct had had only minimal effect, that it had not injured or weakened Utah Pie as a competitor, that it had not substantially lessened competition and that there was no reasonable possibility that it would do so in the future.

We again differ with the Court of Appeals. Its opinion that Utah was not damaged as a competitive force apparently rested on the fact that Utah's sales volume continued to climb in 1961 and on the court's own factual conclusion that Utah was not deprived of any pie business which it otherwise might have had. But this retrospective assessment fails to note that Continental's discriminatory below-cost price caused Utah Pie to reduce its price to \$2.75. The jury was entitled to consider the potential impact of Continental's price reduction absent any responsive price cut by Utah Pie. Price was a major factor in the Salt Lake City market. Safeway, which had been buying Utah brand pies, immediately reacted and purchased a five-week supply of frozen pies from Continental, thereby tem-

porarily foreclosing the proprietary brands of Utah and other firms from the Salt Lake City Safeway market. The jury could rationally have concluded that had Utah not lowered its price, Continental, which repeated its offer once, would have continued it, that Safeway would have continued to buy from Continental and that other buyers, large as well as small, would have followed suit. It could also have reasonably concluded that a competitor who is forced to reduce his price to a new all-time low in a market of declining prices will in time feel the financial pinch and will be a less effective competitive force.

Even if the impact on Utah Pie as a competitor was negligible, there remain the consequences to others in the market who had to compete not only with Continental's 22-ounce pie at \$2.85 but with Utah's even lower price of \$2.75 per dozen for both its proprietary and controlled labels. . . . The evidence was that there were nine other sellers in 1960 who sold 23,473 dozen pies, 12.7% of the total market. In 1961 there were eight other sellers who sold less than the year before—18,565 dozen or 8.2% of the total—although the total market had expanded from 184,569 dozen to 226,908 dozen. We think there was sufficient evidence from which the jury could find a violation of §2(a) by Continental.

III

The Carnation Company entered the frozen dessert pie business in 1955 through the acquisition of "Mrs. Lee's Pies" which was then engaged in manufacturing and selling frozen pies in Utah and elsewhere under the "Simple Simon" label. Carnation also quickly found the market extremely sensitive to price. Carnation decided, however, not to enter an economy product in the market, and during the period covered by this suit it offered only its quality "Simple Simon" brand. Its primary method of meeting competition in its markets was to offer a variety of discounts and other reductions, and the technique was not unsuccessful. . . .

. . . After Carnation's temporary setback in 1959 it instituted a new pricing policy to regain business in the Salt Lake City market. The new policy involved a slash in price of 60¢ per dozen pies, which brought Carnation's price to a level admittedly well below its costs, and well below the other prices prevailing in the market. The impact of the move was felt immediately, and the two other major sellers in the market reduced their prices. Carnation's banner year, 1960, in the end involved eight months during which the prices in Salt Lake City were lower than prices charged in other markets. The trend continued during the eight months in 1961 that preceded the filing of the complaint in this case. In each of those months the Salt Lake City prices charged by Carnation were well below prices charged in other markets, and in all but August 1961 the Salt Lake City delivered price was 20¢ to 50¢ lower than the prices charged in distant San Francisco. The Court of Appeals held that only the early 1960 prices could

be found to have been below cost. That holding, however, simply overlooks evidence from which the jury could have concluded that throughout 1961 Carnation maintained a below-cost price structure and that Carnation's discriminatory pricing, no less than that of Pet and Continental, had an important effect on the Salt Lake City market. We cannot say that the evidence precluded the jury from finding it reasonably possible that Carnation's conduct would injure competition.

IV

Section 2(a) does not forbid price competition which will probably injure or lessen competition by eliminating competitors, discouraging entry into the market or enhancing the market shares of the dominant sellers. But Congress has established some ground rules for the game. Sellers may not sell like goods to different purchasers at different prices if the result may be to injure competition to either the sellers' or the buyers' market unless such discriminations are justified as permitted by the Act. This case concerns the sellers' market. In this context, the Court of Appeals placed heavy emphasis on the fact that Utah Pie constantly increased its sales volume and continued to make a profit. But we disagree with its apparent view that there is no reasonably possible injury to competition as long as the volume of sales in a particular market is expanding and at least some of the competitors in the market continue to operate at a profit. Nor do we think that the Act only comes into play to regulate the conduct of price discriminators when their discriminatory prices consistently undercut other competitors. . . . In this case there was some evidence of predatory intent with respect to each of these respondents.³ There was also other evidence upon which the jury could rationally find the requisite injury to competition. The frozen pie market in Salt Lake City was highly competitive. At times Utah Pie was a leader in moving the general level of prices down, and at other times each of the respondents also bore responsibility for the downward pressure on the price structure. We believe that the Act reaches price discrimination that erodes competition as much as it does price discrimination that is intended to have immediate destructive impact. In this case, the evidence shows a drastically declining price structure which the jury could rationally attribute to continued or sporadic price discrimination. The jury was entitled to conclude that "the effect of such discrimination," by each of these respondents, "may be substantially to lessen competition. . . . or to injure, destroy, or prevent

³ It might be argued that the respondents' conduct displayed only fierce competitive instincts. Actual intent to injure another competitor does not, however, fall into that category, and neither, when viewed in the context of the Robinson-Patman Act, do persistent sales below cost and radical price cuts which are themselves discriminatory. Nor does the fact that a local competitor has a major share of the market make him fair game for discriminatory price cutting free of Robinson-Patman Act proscriptions. . . .

competition with any person who either grants or knowingly receives the benefit of such discrimination. . . ." The statutory test is one that necessarily looks forward on the basis of proven conduct in the past. Proper application of that standard here requires reversal of the judgment of the Court of Appeals.⁴

It is so ordered.

THE CHIEF JUSTICE took no part in the decision of this case.

MR. JUSTICE STEWART, with whom MR. JUSTICE HARLAN joins, dissenting.

I would affirm the judgment, agreeing substantially with the reasoning of the Court of Appeals as expressed in the thorough and conscientious opinion of Judge Phillips.

There is only one issue on this case in its present posture: . . . [D]id the respondents' actions have the anticompetitive effect required by the statute as an element of a cause of action?

The Court's own description of the Salt Lake City frozen pie market from 1958 through 1961, shows that the answer to that question must be no. In 1958 Utah Pie had a quasi-monopolistic 66.5% of the market. In 1961—after the alleged predations of the respondents—Utah Pie still had a commanding 45.3%, Pet had 29.4%, and the remainder of the market was divided almost equally between Continental, Carnation, and other, small local bakers. Unless we disregard the lessons so laboriously learned in scores of Sherman and Clayton Act cases, the 1961 situation has to be considered more competitive than that of 1958. Thus, if we assume that the price discrimination proven against the respondents had any effect on competition, that effect must have been beneficial.

That the Court has fallen into the error of reading the Robinson-Patman Act as protecting competitors, instead of competition, can be seen from its unsuccessful attempt to distinguish cases relied upon by the respondents. Those cases are said to be inapposite because they involved "no general decline in price structure," and no "lasting impact upon prices." But lower prices are the hallmark of intensified competition. . . .

⁴ Each respondent argues here that prior price discrimination cases in the courts and before the Federal Trade Commission, in which no primary line injury to competition was found, establish a standard which compels affirmance of the Court of Appeals' holding. But the cases upon which the respondents rely are readily distinguishable. In *Anheuser-Busch, Inc. v. F.T.C.*, 289 F.2d 835, 839, there was no general decline in price structure attributable to the defendant's price discriminations, nor was there any evidence that the price discriminations were "a single lethal weapon aimed at a victim for a predatory purpose." *Id.*, at 842. In *Borden Co. v. F.T.C.*, 339 F.2d 953, the court reversed the Commission's decision on price discrimination in one market for want of sufficient interstate connection, and the Commission's charge regarding the other market failed to show any lasting impact upon prices caused by the single, isolated incident of price discrimination proved. . . .

I cannot hold that Utah Pie's monopolistic position was protected by the federal antitrust laws from effective price competition, and I therefore respectfully dissent.

*International Air Industries, Inc., et al. v.
American Excelsior Company*

517 F.2d 714 (1975)

cert. denied

424 U.S. 943 (1975)

LEWIS R. MORGAN, Circuit Judge.

Appellants Vebco, Inc., and International Air Industries, Inc.,¹ filed a complaint . . . charging AMXCO, Inc.,² with a violation of the antitrust laws. A lengthy, complex and seemingly disorganized jury trial was held, resulting in a verdict in AMXCO's favor. Vebco appeals, alleging at least 20 substantive trial errors. We affirm the judgment below.

I

The facts in this case are heatedly contested. Since the trial below resulted in AMXCO's favor, we consider the facts in a light most favorable to it.

Vebco, Inc., is a New Mexico corporation with its principal place of business in El Paso, Texas. It was incorporated in 1959. Vebco is primarily a distributor of heating and air conditioning equipment, although it does manufacture some products, including handmade evaporative cooler pads. It sells its pads primarily in Arizona, New Mexico, and West Texas. . . .

AMXCO, a subsidiary of Texstar Company, has its principal place of business in Arlington, Texas. It maintains a branch office in El Paso, Texas, and manufactures evaporative cooler pads which it sells throughout the southwestern and far western parts of the United States.

The source of the controversy in this case is the cooler pad, an object made of aspen wood shavings covered with crinoline cloth, used in evaporative air conditioners. Such pads have historically been made by hand, but around 1960 AMXCO achieved a breakthrough in the field and began to produce a machine-made pad. Hand- and machine-made pads

are interchangeable in use, but the latter can be produced, transported, and stored more cheaply. Through its technological success and business expansion AMXCO became the world's largest producer of cooler pads.

Vebco and AMXCO have enjoyed a lengthy business relationship. The founder of Vebco, Vernon Britt, began to distribute pads for AMXCO in 1953. Until 1969, with only one short exception, the only pads Vebco distributed were manufactured by AMXCO. By selling AMXCO's pads, Vebco developed a highly successful business and gradually expanded its operations to include a complete line of heating and cooling implements.

Except for direct sales to "national accounts," AMXCO marketed all of its cooler pads through independent distributors such as Vebco. Vebco's primary customers in the El Paso-Las Cruces trade area were discount stores. The only large discount store in the area to which Vebco did not sell cooler pads was K Mart, serviced by Passage Supply, an independent distributor for AMXCO.

Prior to 1969, AMXCO favored its El Paso distributors over its Arizona distributors in freight policy: AMXCO paid freight costs of its El Paso distributors to their customers in Arizona but did not pay the freight costs of distributors in Arizona to their customers in El Paso and Las Cruces. In order to rectify this competitive inequity, AMXCO decided to eliminate the freight prepayment for its El Paso distributors. When AMXCO adopted a uniform freight policy, Vebco decided to set up its own manufacturing plant for cooler pads. With the aid of three former employees of AMXCO, the owners of Vebco formed a corporation and built a plant to manufacture cooler pads by hand in 1969. Vebco then entered the market as a manufacturer and successfully competed with AMXCO. Later that same year, Southwest Industries was formed. Like AMXCO, Southwest manufactured and marketed machine-made cooler pads. There were also numerous small-scale handmade pad manufacturers in the market.

When AMXCO learned that Vebco was manufacturing its own cooler pads, AMXCO terminated its distribution relationship with Vebco. Although it lost customers to Vebco in 1969, AMXCO took no action in regard to price. . . .

In late January, 1971, Vebco dropped its price to discount houses 5 percent below the price currently being quoted by both AMXCO and Vebco. . . .to a 14.5 percent discount below list price. This price cut brought Vebco considerable business, including the very lucrative K Mart account which had previously been serviced by AMXCO's distributor, Passage Supply. The record indicates that AMXCO's distributors complained that they could not effectively compete with Vebco, because the latter manufactured its own pads for distribution. . . .

Based on previous public bids by Vebco and Southwest, and on information received from customers, AMXCO determined that a 25 percent discount would be competitive in the market. AMXCO then contacted its

¹ Although Vebco and International were nominally separate business entities, they operated as one business. . . . Therefore, "Vebco" will hereinafter refer to both plaintiffs, unless otherwise indicated.

² American Excelsior Company was the named defendant in the district court, but during the course of discovery Vebco realized that AMXCO, Inc., was the corporate successor to that company. The defendant-appellant will therefore hereinafter be referred to as "AMXCO."

9

Tying Devices

The Supreme Court noted in the *Standard Stations* case (see Chapter 10) that, "tying agreements serve hardly any purpose beyond the suppression of competition." Yet, because of the possibility that such agreements might under some circumstances be economically justified and legally unexceptionable, the courts have hesitated to declare them unlawful *per se*. Once again, it becomes necessary to examine a trade practice—in this instance tying devices—on a case-by-case basis. The decisions presented below indicate that the crucial test in these cases is whether the tie-in involves one product or service in which the company enjoys substantial market power. In other words, the courts attempt to discover whether the tie-in represents an attempt by a firm to exert leverage so that its monopoly power in one area may be extended into another. In the *Northern Pacific* case the Court concluded that Northern Pacific's dominance of strategically situated landholdings in the Pacific Northwest was being used as a lever with which to induce purchasers and lessees of such landholdings to use its freight transportation facilities to the exclusion of competitors. Thus, the "preferential routing" clauses contained in its purchase and rental contracts constituted an illegal tying arrangement. In the *Jerrold* case, on the other hand, the Court recognized that under certain conditions tying contracts may result in positive economic benefits. Accordingly, if refused to strike down an arrangement whereby Jerrold, a new entrant, sold electronic equipment to community antenna television companies only on a full system basis and in conjunction with a service contract.

The *Fortner* case probably represents the high-water mark for the restrictive approach to the legality of tying devices. (This opinion might profitably be read in connection with the *International Salt* case presented in Chapter 13.) The courts have since retreated from the view expressed in *Fortner*—in apparent response to recent trends in economic analysis. Indeed, while *Hyde* may superficially be considered in line with the reasoning of *Fortner*, both the majority opinion and—even more

explicitly—Justice O'Connor's concurring opinion demonstrate a clear willingness to abandon altogether the Court's traditional *per se* approach.

Northern Pacific Railway Company v. United States

356 U.S. 1 (1958)

MR. JUSTICE BLACK delivered the opinion of the Court.

In 1864 and 1870 Congress granted the predecessor of the Northern Pacific Railway Company approximately forty million acres of land in several Northwestern States and Territories to facilitate its construction of a railroad line from Lake Superior to Puget Sound. In general terms, this grant consisted of every alternate section of land in a belt 20 miles wide on each side of the track through States and 40 miles wide through Territories. The granted lands were of various kinds; some contained great stands of timber, some iron ore or other valuable mineral deposits, some oil or natural gas, while still other sections were useful for agriculture, grazing or industrial purposes. By 1949 the Railroad had sold about 37,000,000 acres of its holdings, but had reserved mineral rights in 6,500,000 of those acres. Most of the unsold land was leased for one purpose or another. In a large number of its sales contracts and most of its lease agreements the Railroad had inserted "preferential routing" clauses which compelled the grantee or lessee to ship over its lines all commodities produced or manufactured on the land, provided that its rates (and in some instances its service) were equal to those of competing carriers. Since many of the goods produced on the lands subject to these "preferential routing" provisions are shipped from one State to another the actual and potential amount of interstate commerce affected is substantial. Alternative means of transportation exist for a large portion of these shipments including the facilities of two other major railroad systems.

In 1949 the Government filed suit under Section 4 of the Sherman Act seeking a declaration that the defendant's "preferential routing" agreements were unlawful as unreasonable restraints of trade under Section 1 of that Act. After various pretrial proceedings the Government moved for summary judgment contending that on the undisputed facts it was entitled, as a matter of law, to the relief demanded. The district judge made numerous findings, as set forth in substance in the preceding paragraph, based on the voluminous pleadings, stipulations, depositions and answers to interrogatories filed in the case, and then granted the Government's motion (with an exception not relevant here). 142 F. Supp. 679. He issued an order enjoining the defendant from enforcing the existing "preferential routing" clauses or from entering into any future agreements containing them. The defendant took a direct appeal to this Court. . . .

The Sherman Act was designed to be a comprehensive charter of eco-

conomic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions. But even were that premise open to question, the policy unequivocally laid down by the Act is competition. And to this end it prohibits "Every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States." Although this prohibition is literally all-encompassing, the courts have construed it as precluding only those contracts or combinations which "unreasonably" restrain competition. . . .

However, there are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of *per se* unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable—an inquiry so often wholly fruitless when undertaken. Among the practices which the courts have heretofore deemed to be unlawful in and of themselves are price fixing, *United States v. Socony-Vacuum Oil Co.* . . . ; division of markets, *United States v. Addyston Pipe & Steel Co.* . . . ; group boycotts, *Fashion Originators' Guild v. Federal Trade Comm'n* . . . ; and tying arrangements, *International Salt Co. v. United States*. . . .

For our purposes a tying arrangement may be defined as an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier. Where such conditions are successfully exacted competition on the merits with respect to the tied product is inevitably curbed. Indeed "tying agreements serve hardly any purpose beyond the suppression of competition." *Standard Oil Co. of California v. United States*. . . . They deny competitors free access to the market for the tied product, not because the party imposing the tying requirements has a better product or a lower price but because of his power or leverage in another market. At the same time buyers are forced to forego their free choice between competing products. For these reasons "tying agreements fare harshly under the laws forbidding restraints of trade." *Times-Picayune Publishing Co. v. United States*. . . . They are unreasonable in and of themselves whenever a party has

sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product and a "not insubstantial" amount of interstate commerce is affected. *International Salt Co. v. United States*. . . . Cf. *United States v. Paramount Pictures*. . . . Of course where the seller has no control or dominance over the tying product so that it does not represent an effectual weapon to pressure buyers into taking the tied item any restraint of trade attributable to such tying arrangements would obviously be insignificant at most. . . .

In this case we believe the district judge was clearly correct in entering summary judgment declaring the defendant's "preferential routing" clauses unlawful restraints of trade. We wholly agree that the undisputed facts established beyond any genuine question that the defendant possessed substantial economic power by virtue of its extensive landholdings which it used as leverage to induce large numbers of purchasers and lessees to give it preference, to the exclusion of its competitors, in carrying goods or produce from the land transferred to them. Nor can there be any real doubt that a "not insubstantial" amount of interstate commerce was and is affected by these restrictive provisions.

As pointed out before, the defendant was initially granted large acreages by Congress in the several northwestern states through which its lines now run. This land was strategically located in checkerboard fashion amid private holdings and within economic distance of transportation facilities. Not only the testimony of various witnesses but common sense makes it evident that this particular land was often prized by those who purchased or leased it and was frequently essential to their business activities. In disposing of its holdings the defendant entered into contracts of sale or lease covering at least several million acres of land which included "preferential routing" clauses. The very existence of this host of tying arrangements is itself compelling evidence of the defendant's great power, at least where, as here, no other explanation has been offered for the existence of these restraints. The "preferential routing" clauses conferred no benefit on the purchasers or lessees. While they got the land they wanted by yielding their freedom to deal with competing carriers, the defendant makes no claim that it came any cheaper than if the restrictive clauses had been omitted. In fact any such price reduction in return for rail shipments would have quite plainly constituted an unlawful rebate to the shipper. So far as the Railroad was concerned its purpose obviously was to fence out competitors, to stifle competition. While this may have been exceedingly beneficial to its business, it is the very type of thing the Sherman Act condemns. In short, we are convinced that the essential prerequisites for treating the defendant's tying arrangements as unreasonable "*per se*" were conclusively established below and that the defendant has offered to prove nothing there or here which would alter this conclusion.

In our view *International Salt Co. v. United States*, . . . which has been unqualifiedly approved by subsequent decisions, is ample authority for affirming the judgment below. . . .

The defendant attempts to evade the force of *International Salt* on the ground that the tying product there was patented while here it is not. But we do not believe this distinction has, or should have, any significance. In arriving at its decision in *International Salt* the Court placed no reliance on the fact that a patent was involved nor did it give the slightest intimation that the outcome would have been any different if that had not been the case. If anything, the Court held the challenged tying arrangements unlawful *despite* the fact that the tying item was patented, not because of it. . . .

The defendant argues that the holding in *International Salt* was limited by the decision in *Times-Picayune Publishing Co. v. United States*. . . . There the Court held that a unit system of advertising in two local newspapers did not violate Section 1 of the Sherman Act. . . . But the Court was extremely careful to confine its decision to the narrow record before it. . . .

While there is some language in the *Times-Picayune* opinion which speaks of "monopoly power" or "dominance" over the tying product as a necessary precondition for application of the rule of *per se* unreasonableness to tying arrangements, we do not construe this general language as requiring anything more than sufficient economic power to impose an appreciable restraint on free competition in the tied product (assuming all the time, of course, that a "not insubstantial" amount of interstate commerce is affected). . . . *Times-Picayune* . . . makes clear . . . that the vice of tying arrangements lies in the use of economic power in one market to restrict competition on the merits in another, regardless of the source from which the power is derived and whether the power takes the form of a monopoly or not.

The defendant contends that its "preferential routing" clauses are subject to so many exceptions and have been administered so leniently that they do not significantly restrain competition. . . . [I]f these restrictive provisions are merely harmless sieves with no tendency to restrain competition, as the defendant's argument seems to imply, it is hard to understand why it has expended so much effort in obtaining them in vast numbers and upholding their validity, or how they are of any benefit to anyone, even the defendant. But however that may be, the essential fact remains that these agreements are binding obligations held over the heads of vendees which deny defendant's competitors access to the fenced-off market on the same terms as the defendant. . . . All of this is only aggravated, of course, here in the regulated transportation industry where there is frequently no real rate competition at all and such effective competition as actually thrives takes other forms.

Affirmed.

[MR. JUSTICE CLARK took no part in the consideration or decision of this case. MR. JUSTICE HARLAN, whom MR. JUSTICE FRANKFURTER and MR. JUSTICE WHITTAKER joined, dissented.]

Fortner Enterprises, Inc. v. United States Steel Corp.

394 U.S. 495 (1969)

MR. JUSTICE BLACK delivered the opinion of the Court [on a motion for summary judgment].

. . . Petitioner, Fortner Enterprises, Inc., filed this suit seeking treble damages and an injunction against alleged violations of §§1 and 2 of the Sherman Act. . . . The complaint charged that respondents, United States Steel Corp. and its wholly owned subsidiary, the United States Steel Homes Credit Corp., had engaged in a contract, combination, and conspiracy to restrain trade and to monopolize trade in the sale of prefabricated houses. It alleged that there was a continuing agreement between respondents "to force corporations and individuals, including the plaintiff, as a condition to availing themselves of the services of United States Steel Homes Credit Corporation, to purchase at artificially high prices only United States Steel Homes. . . ." Specifically, petitioner claimed that in order to obtain loans totaling over \$2,000,000 from the Credit Corp. for the purchase and development of certain land in the Louisville, Kentucky, area, it had been required to agree, as a condition of the loans, to erect a prefabricated house manufactured by U.S. Steel on each of the lots purchased with the loan proceeds. Petitioner claimed that the prefabricated materials were then supplied by U.S. Steel at unreasonably high prices and proved to be defective and unusable, thus requiring the expenditure of additional sums and delaying the completion date for the development. Petitioner sought treble damages for the profits thus lost, along with a decree enjoining respondents from enforcing the requirement of the loan agreement that petitioner use only houses manufactured by U.S. Steel.

. . . Noting that the agreement involved here was essentially a tying arrangement, under which the purchaser was required to take a tied product—here prefabricated homes—as a condition of being allowed to purchase the tying product—here credit, the District Judge held that petitioner had failed to establish the prerequisites of illegality under our tying cases, namely sufficient market power over the tying product and foreclosure of a substantial volume of commerce in the tied product. . . . Since we find no basis for sustaining this summary judgment, we reverse and order that the case proceed to trial.

We agree with the District Court that the conduct challenged here primarily involves a tying arrangement of the traditional kind. The Credit Corp. sold its credit only on the condition that petitioner purchase a

product. To apply this rule to a situation where the only "leverage" is a lower price for the article sold or more advantageous financing or credit terms for the article sold and for ancillary costs connected with the sale is to distort the doctrine, and indeed, to convert it into an instrument which penalizes price competition for the article that is sold. . . .

The effect of this novel extension—this distortion, as I view it—of the tying doctrine may be vast and destructive. It is common in our economy for a seller to extend financing to a distributor or franchisee to enable him to purchase and handle the seller's goods at retail, to rent retail facilities, to acquire fixtures or machinery for service to customers in connection with distribution of the seller's goods, or, as here, to prepare the land for and to acquire and erect the seller's houses for sale to the public. . . . Arrangements of this sort run throughout the economy. They frequently, and perhaps characteristically, represent an indispensable method of financing distributive and service trades, and not until today has it been held that they are tying arrangements and therefore *per se* unlawful. . . .

. . . Almost all modern selling involves providing some ancillary services in connection with making the sale—delivery, installation, supplying fixtures, servicing, training of the customer's personnel in use of the material sold, furnishing display material and sales aids, extension of credit. Customarily—indeed almost invariably—the seller offers these ancillary services only in connection with the sale of his own products, and they are often offered without cost or at bargain rates. It is possible that in some situations, such arrangements could be used to restrain competition or might have that effect, but to condemn them out-of-hand under the "tying" rubric, is, I suggest, to use the antitrust laws themselves as an instrument in restraint of competition.

For these reasons, I dissent.

Note: On remand, the District Court directed a verdict in favor of Fortner, on the ground that U.S. Steel possessed sufficient economic power in the credit market. The Court of Appeals reversed and remanded for a new trial by the District Court, which again found for Fortner. This time, the Court of Appeals affirmed, only to have the Supreme Court, in 1977, find for U.S. Steel (*Fortner II*), on the grounds that it did *not* possess the requisite economic power.

United States v. Jerrold Electronics Corporation

187 F. Supp. 545 (E.D.Pa. 1960),
affirmed *per curiam* 365 U.S. 567 (1961)

VAN DUSEN, District Judge.

This action was commenced with the filing of a complaint on February 15, 1957, charging Jerrold Electronics Corporation, its president, Milton

Jerrold Shapp, and five of its corporate subsidiaries with being parties to a conspiracy and contracts in unreasonable restraint of trade and commerce in community television antenna equipment in violation of Section 1 of the Sherman Act . . . ; with being parties to a conspiracy and attempting to monopolize trade and commerce in community television antenna equipment in violation of Section 2 of the Sherman Act . . . ; and with contracting to sell and making sales upon unlawful conditions in violation of Section 3 of the Clayton Act. . . .

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II. BACKGROUND

Jerrold Electronics Corporation (hereinafter "Jerrold") was incorporated under the laws of Pennsylvania in March 1948 by Milton Shapp to engage in the sale of a television booster developed by one of his friends. This device was designed to improve television reception in fringe areas by amplifying the weak signals available there. At Shapp's request, his friend began working on the development of master antenna equipment. The purpose of this equipment was to enable a single antenna to serve a number of television receivers. . . .

Jerrold installed the first operational master antenna system for Montgomery Ward in Baltimore during the summer of 1949. The success of this system resulted in a number of orders from other dealers. At first, this master antenna equipment was sold through the distributors who were handling Jerrold's booster. This proved unsatisfactory, however, because these distributors and their customers lacked the technical training and experience with respect to master antenna systems which was necessary to install and maintain them properly. . . .

In October 1950, Shapp was approached by a group of men from Lansford, Pennsylvania, who were interested in bringing television into their community. The people of Lansford were unable to receive any television signals through the use of conventional equipment because of the town's location. It was possible to receive a signal on a hilltop approximately a mile outside of town, however. They wanted to set up an antenna at this site and hook it up with receivers in the town. Subscribers to their service would pay a connection fee and monthly service charge. . . . It was . . . apparent to . . . [Shapp] that this was a natural and promising area for Jerrold to enter, since there were many communities which, because of distance or topographical features, were in the same predicament as Lansford and had no immediate hope of obtaining television from any other source because of the freeze on the licensing of new television stations in effect at that time.

Shapp and the Lansford group finally worked out a mutually satisfactory arrangement. Jerrold was to install a system using its standard equipment, which the Lansford people would purchase. Jerrold was to use the system as an on-the-spot laboratory to work on the problems it anticipated, discover new problems, and develop the equipment neces-

sary to eliminate them. . . . A few days later, a similar arrangement was made with a group from Mahanoy City, Pennsylvania. . . .

The Lansford system was "turned on" in mid-December 1950 and the Mahanoy City system went into operation in January 1951. . . . The initial results were deemed successful and the systems received considerable publicity, including articles in the *Wall Street Journal* and *Newsweek* magazine, since they were the first significant operational systems of this kind. As a result of the publicity, Shapp was approached by people from hundreds of communities interested in community antenna systems, both as a means of bringing television into their homes and as a profitable investment. These people came from all walks of life. Many of them had little or no technical background or knowledge. Furthermore, the system that went into operation in Lansford in December 1950 was only connected to a few showrooms. With the extension and continual operation of the system, the anticipated problems began to arise. They were of such a magnitude that Shapp's organization was completely tied up analyzing them and designing new equipment to cope with them. Also, there were several instances in which aspiring community system operators had obtained Jerrold's standard equipment through its distributors and attempted to install systems with unsatisfactory results. Under these circumstances, it was decided that no Jerrold equipment would be sold for community purposes until gear adequate to the task had been developed.

Some acquaintance with the technical aspects of a community television antenna system is essential to a full understanding of the contentions of both parties in this matter. This seems to be the most appropriate point to digress from the narrative to describe the nature of such a system and some of the particular problems which faced Jerrold and other companies which entered this field.

There are four parts to a community television antenna system. The first is the antenna site, referred to in the trade as the "head end." The second is the apparatus which carries the signal from the antenna into the community, known as the "run to town." The third is the "skeleton system" that is constructed through the town to carry the television signals to the extremities of the area to be covered. Finally, there is the "tap-off" from the skeleton system which carries the signal to the home of each subscriber to the service. . . .

The installation of a successful community television antenna system involves more than simply purchasing certain items of equipment and hooking them together. Each system presents different problems giving rise to different equipment needs because of variations in the frequency, quantity and quality of the signals available at the antenna site, the length of the run to town, and the layout of the town itself. Proper planning is necessary to keep equipment costs at a minimum and, at the same time, produce a saleable picture in town. In the first place, the best antenna site must be determined considering the signals present and the distance from

town. The run to town must be set up keeping in mind future maintenance problems. Similarly, the most efficient routing of the lines in town must be determined. In this connection, there arises a special problem of negotiating with the utility companies for the use of their poles. This aspect is important, both in terms of costs and acceptability to the community, since there may be an adverse reaction to the erection of additional poles and wires. Then there is the problem of selecting equipment of the proper specifications, including antennas and cable, as well as electronic gear. Finally, it is essential that the equipment be properly spaced along the line so that the input signal is at a proper level.

III. TIE-IN SALES

By the spring of 1951, the Jerrold people felt they were prepared to start selling equipment for community television antenna purposes. As a result of their work in Lansford and Mahanoy City, they had developed a new line of equipment for community antenna systems designated "W" equipment. After consulting with his engineers and several of Jerrold's commission salesmen who dealt with the distributors, Shapp decided that the W equipment should only be sold with engineering services to insure that the system would function properly. A general policy, therefore, was established of selling electronic equipment to community antenna companies only on a full system basis and in conjunction with a service contract which provided for technical services with respect to the layout, installation and operation of the system.

The first of the service contracts employed by Jerrold in executing this policy was designated Form 103. . . . Paragraph 8 . . . provided:

8. That in the event Antenna Company desires to receive and distribute the signals of any television stations other than those being received and distributed at the time of the initial installation of the System, Antenna Company agrees to purchase, at the then prevailing prices, whatever additional Jerrold Equipment may be necessary to receive and distribute the desired signals throughout the System, and it is understood that a maximum of three (3) television channels can be so received and distributed in the presently designed System.

Paragraph 12 of the contract provided:

12. That Antenna Company agrees that it will not install, as part of the System, any Equipment or attachments which in the opinion of Jerrold will impair the operation of the System or impair the quality of television reception and signal distribution capabilities of the System, or that might cause damage to or impair the efficiency of any of the Equipment comprising the System.

In October 1953, the Form 103A and 103B service contracts were replaced by the WK-1 Form. . . . The new contract was generally the

same as its predecessors. A few changes were made in some of the provisions relevant to the case at bar. The provision contained in paragraph 8 of the earlier contracts was eliminated. Also, the language formerly appearing in paragraph 12 now appeared in paragraph 8 and was revised to read as follows:

VIII. Since the parties acknowledge that Jerrold cannot reasonably be required to perform its obligations hereunder if the System comprises electronic equipment other than that manufactured by Jerrold Electronics Corporation, Antenna Company agrees that it will not install, as a part of the System any equipment or attachments which, in the opinion of Jerrold, will impair the quality of television reception and signal distribution capabilities of the System, or which might cause damage to, or impair the efficiency of, any of the Equipment comprising the System.

Finally, the duration of the contract was reduced from five to two and one-half years.

On March 16, 1954, Jerrold offered its customers two more service contracts designated SP-1 . . . and SP-2. . . . The period of their use overlapped that of the WK-1 contract. The SP-1 contract was designed to accompany the sale of new systems and was of six months' duration. The SP-2 contract was designed to make Jerrold service available to existing systems and was of one year's duration. Each of these contracts contained the following provision, similar to those in the earlier contracts:

Since we cannot reasonably be required to perform our obligations as enumerated in this letter if the system contains electronic equipment other than that manufactured by Jerrold Electronics Corporation, you agree not to install, as part of the system, any equipment or attachments which, in our opinion, will impair the quality of television reception and signal distribution capabilities of the system, or which might cause damage to, or impair the efficiency of, any of the equipment comprising the System.

The Government contends that Jerrold's policy and practice of selling on a system basis only and of making sales only in conjunction with a service contract constituted unlawful tie-ins in violation of Section 1 of the Sherman Act . . . and Section 3 of the Clayton Act. . . . It also asserts that the provision in the 103 series contracts for the exclusive use of Jerrold equipment for the addition of extra channels to the system, and the provision in all of the contracts not to install unapproved, non-Jerrold equipment, violated these sections of the anti-trust laws.

III-A. Service Contracts

The Government concedes that Section 3 of the Clayton Act does not apply to . . . tie-ins involving services. The government asserts, how-

ever, that sales upon the condition that the purchaser subscribe to the services of the vendor constitute an unreasonable restraint of trade in violation of Section 1 of the Sherman Act. The defendants claim that this requirement was reasonable and offered evidence on this point, which was received over the objection of the Government which maintained that the contracts were unreasonable *per se* under the decision in *Northern Pacific Railway Co. v. United States*. . . .

It is clear from the amount of service rendered by Jerrold under its compulsory service contracts that a "not insubstantial" amount of interstate commerce was affected, particularly in view of the relatively limited market. . . .

A more difficult question is presented by the second requirement that Jerrold be shown to have sufficient economic power with respect to its equipment to appreciably restrain free competition in the market for the services it rendered. The minimum amount of economic power required is by no means clear. Fortunately, the facts of this case obviate the necessity of ascertaining that standard. In resolving this matter, the first task is to determine the relevant market in which to measure Jerrold's power. Since in this aspect of the case we are only concerned with power which will appreciably restrain competition in the market for the services of installing, maintaining and operating community antenna systems, we are necessarily only interested in power over equipment used in community systems. Jerrold admits that, as to the sale of complete community television antenna systems, it was an undoubted leader up until mid-1954, and more than a majority of the new systems from 1950 to mid-1954 were purchased from it. Indeed, Jerrold consistently advertised throughout this period that at least 75% of the community systems in the United States were "Jerrold systems." Economic power over a product can be inferred from sales leadership. . . . The Supreme Court also stated in the *Northern Pacific* case that the requisite economic power can be inferred from the very existence of the tying clauses where no other explanation for their use is offered. The majority of the court appears to feel that this explanation must include a showing of some benefit conferred upon the purchasers in return for their sacrifice of a free choice of alternatives, but also considered the seller's motive. This is an extremely difficult burden to meet and, in the opinion of this court, it has not been satisfied by the evidence offered by the defendants in the case at bar. Another fact from which economic power can be inferred is the desirability of the tying product to the purchaser. *Northern Pacific Railway Co. v. United States*, *supra* . . . (dissent). Mr. Shapp has stated that Jerrold's highly specialized head end equipment was the only equipment available which was designed to meet all of the varying problems arising at the antenna site. It was thus in great demand by system operators. This placed Jerrold in a strategic position and gave it the leverage necessary to persuade

customers to agree to its service contracts. This leverage constitutes "economic power" sufficient to invoke the doctrine of *per se* unreasonableness.

While the trial judge is of the opinion that the Government has established both of the prerequisites necessary for treating Jerrold's policy and practice of selling its community equipment only in conjunction with a service contract as unreasonable, *per se*, under the *Northern Pacific* decision, he does not believe that the inquiry must end there in view of the rather unique circumstances involved in this particular case. Any judicially, as opposed to legislatively, declared *per se* rule is not conclusively binding on this court as to any set of facts not basically the same as those in the cases in which the rule was applied. In laying down such a rule, a court would be, in effect, stating that in all the possible situations it can think of, it is unable to see any redeeming virtue in tying arrangements which would make them reasonable. The Supreme Court of the United States did not purport in the *Northern Pacific* case to anticipate all of the possible circumstances under which a tying arrangement might be used. Therefore, while the *per se* rule should be followed in almost all cases, the court must always be conscious of the fact that a case might arise in which the facts indicate that an injustice would be done by blindly accepting the *per se* rule. In this case, the court felt that the facts asserted by the defendants in their pre-trial statement and trial brief warranted hearing their testimony and argument on the issue of reasonableness. It was partly influenced in this decision by the fact that the history of the industry was brief, and the position of the defendants did not seem to require a prolonged economic investigation—factors which the Supreme Court felt justified the *per se* rule.

When Jerrold was ready to place its W equipment on the market in May 1950, it was confronted with a rather unique situation. In the first place, while it was convinced that its equipment would work, Jerrold recognized that it was sensitive and unstable. Consequently, modifications were still being made. . . . Secondly, as has already been noted, there were hundreds of people anxious to set up community antenna systems. Most of these people had no technical background at all. None of them had any experience with community systems since, at that time, there was only one other operating system in the country besides the Jerrold systems in Lansford and Mahanoy City.¹ In addition, many of these people did not have solid or extensive financing to back their proposed venture. Finally, Jerrold had directed most of its resources towards the development of its community equipment. It was of utmost importance to it that its investment prove successful.

Shapp, his engineers and salesmen, envisioned widespread chaos if Jerrold simply sold its community equipment to anyone who wanted it.

¹ This was an experimental system of R.C.A.'s in Pottsville, Pa.

This fear was based on more than mere speculation. . . . The amount of capital necessary to start a system was substantial. Interest would wane rapidly if the systems installed did not consistently produce satisfactory results. Not only Jerrold's reputation but the growth of the entire industry was at stake during the development period. In addition to its reputation, Jerrold was also dependent upon successful system operation for payment. Many operators were not in a position to pay cash for the necessary equipment and the risks were such that outside financing could not be obtained. Therefore, payment was often contingent on the success of the system. It appeared that it was cheaper and more practical to insure that a system was properly installed in the first place than to attempt to get it operating once it was strung up. Furthermore, as has already been noted, use of existing utility poles was an important cost and public relations factor. The utility companies were reluctant to have men of unknown ability working on their poles. Therefore, it was desirable that the system be installed under the supervision of men whose ability was known to the utility companies through other dealings. For these reasons, it was decided that community equipment should be sold with engineering services in order to foster the orderly growth of the industry on which the future of Jerrold depended.

The Government does not dispute the reasonableness of the contracts for services but objects to the fact that they were compulsory. The crucial question, therefore, is whether Jerrold could have accomplished the ends it sought without requiring the contracts. It has been suggested that Jerrold could have accomplished the same results by addressing the persuasive argument it made to this court to its customers and leaving use of the contracts on a voluntary basis. . . . This argument assumes that Jerrold and the industry could survive the "transitory disloyalties" this approach would entail. Jerrold's service was costly and many operators, because of their limited finances, preferred to do-it-themselves and save the expense. . . . If Jerrold's equipment was available without a contract, many impatient operators probably would have attempted to install their systems without assistance. . . . Jerrold's supply of equipment was limited. Unrestricted sales would have resulted in much of this equipment going into systems where prospects of success were at best extremely doubtful. Jerrold's short and long-term well-being depended on the success of these first systems. It could not afford to permit some of its limited equipment to be used in such a way that it would work against its interests. A wave of system failures at the start would have greatly retarded, if not destroyed, this new industry and would have been disastrous for Jerrold, who, unlike others experimenting in this field such as R.C.A. and Philco, did not have a diversified business to fall back on but had put most of its eggs in one precarious basket in an all out effort to open up this new field. . . . For these reasons, this court concludes that Jerrold's policy and practice of selling its community equipment only in conjunction with

a service contract was reasonable and not in violation of Section 1 of the Sherman Act at the time of its inception. . . .

The court's conclusion is based primarily on the fact that the tie-in was instituted in the launching of a new business with a highly uncertain future. As the industry took root and grew, the reasons for the blanket insistence on a service contract disappeared. The development of the community antenna industry throughout the country was not uniform. It advanced and became established most rapidly in the East, particularly in Pennsylvania. Progress was slower in the Northwest and Southwest. Thus, when the reasons for this policy ceased to exist in the East, there were still good reasons for its continuance in other areas. Oral reports of successful systems 3,000 miles away are not as convincing as a number of failures nearby. Jerrold recognized this fact and abandoned its policy gradually. In March 1954, it dropped the policy as a general rule and thereafter applied it on an area-by-area and case-by-case basis.² Mr. Shapp candidly admits that he can "not make the assertion that in each stage of this evolution our timing has been exactly correct." . . . [W]hile Jerrold has satisfied this court that its policy was reasonable at its inception, it has failed to satisfy us that it remained reasonable throughout the period of its use,³ even allowing it a reasonable time to recognize and adjust its policies to changing conditions. Accordingly, the court concludes that the defendants' refusal to sell Jerrold equipment except in conjunction with a service contract violated Section 1 of the Sherman Act during part of the time this policy was in effect.

III-B. Full System Sales

Jerrold also admits that it was its policy and practice from May 1951 to March 1954 not to sell its various items of equipment designed for community antenna systems separately, but only to sell them as components of a complete system. As a result of this program, individual pieces of Jerrold equipment were unavailable for both new systems and existing non-Jerrold systems. The government contends that this too constitutes an unlawful tie-in because Jerrold is driving competitors from the field by

² The Government contends that Jerrold abandoned this policy because of the threat of Government antitrust action. The court finds to the contrary. It is clear that Jerrold persisted in this policy in some areas of the country after it was aware of the Government's interest in the matter. It would, therefore, seem that the Government's activity was not a motivating factor.

³ In addition to changes in the condition of the industry, it is also noted that there is some indication in the record that in some areas of the country Jerrold was unable to give the service it felt was necessary to install a successful system. Nevertheless, a contract was required. While this court feels that Jerrold was hopeful that the service would be adequate, it feels that it was unreasonable to make sales on this condition when it could not meet its obligations. The proper course would have been to make sales free of any contract requirement or refuse to make any sales at all, as it had done between January and May 1951.

using its market power with respect to some of its equipment to induce the purchase of other equipment it manufactures.

Since this aspect of Jerrold's activity involves the tying of goods to goods, Section 3 of the Clayton Act, as well as Section 1 of the Sherman Act, is applicable. . . . The court's determination of the relevant market and finding as to Jerrold's position in that market when considering the engineering service contract requirement are equally applicable to this aspect of the case. The record also makes it clear that a not insubstantial amount of commerce was affected.

[Judge Van Deusen then rejected Jerrold's contention that its antenna system was a single product, and hence concluded that its method of selling did constitute a tying arrangement.]

Balancing these considerations only, the defendants' position would seem to be highly questionable. . . . There is a further factor, however, which, in the court's opinion, makes Jerrold's decision to sell only full systems reasonable. There was a sound business reason for Jerrold to adopt this policy. Jerrold's decision was intimately associated with its belief that a service contract was essential. This court has already determined that, in view of the condition of Jerrold, the equipment, and the potential customers, the defendants' policy of insisting on a service contract was reasonable at its inception. Jerrold could not render the service it promised and deemed necessary if the customer could purchase any kind of equipment he desired. The limited knowledge and instability of equipment made specifications an impractical, if not impossible, alternative. Furthermore, Jerrold's policy could not have been carried out if separate items of its equipment were made available to existing systems or any other customer because the demand was so great that this equipment would find its way to a new system.⁴ Thus, the court concludes that Jerrold's policy of full system sales was a necessary adjunct to its policy of compulsory service and was reasonably regarded as a product as long as the conditions which dictated the use of the service contract continued to exist.⁵ As the circumstances changed and the need for compulsory service contracts disappeared, the economic reasons for exclusively selling complete systems were eliminated. Absent these economic reasons, the court feels that a full system was not an appropriate sales unit. . . .

The defendants also assert a further justification for its policy insofar as it applied to systems using a large quantity of non-Jerrold equipment.

⁴ There are numerous references in the record to cases where Jerrold's equipment was discovered in non-Jerrold systems; it was procured from system operators as second-hand and excess equipment and from Jerrold distributors in violations of their authority from Jerrold.

⁵ Jerrold's argument that it was selling a legitimate single product and that no tying was involved would also apply to the installation aspect of the service contracts, since this covers the assembly of the components into the marketed product.

Jerrold spent considerable time and effort in developing its head end equipment. As a result, its equipment was considered the best available and an asset to any system, since it affected the quality of the initial signal which would be transmitted through the rest of the system. The head end equipment, while intricate, did not represent a large portion of the investment in a system because only a few items were involved. The real profit in a system came from the sale of the amplifiers, since a large number were involved. Jerrold felt that other companies who had not invested time and money into the development of satisfactory head end equipment sought to take advantage of it by competing with it as to the amplifiers, but relying on Jerrold's head end equipment to make the system successful. Shapp resented these other companies "picking our brains" and competing for the real source of profit. Jerrold, therefore, felt justified in recovering its substantial investment in the development of superior head end equipment by using it to preserve for itself a share of the more lucrative market for amplifiers. While the court is sympathetic with Jerrold's predicament, it does not feel that it provides sufficient justification for the use of a tying arrangement. If the demand for Jerrold's equipment was so great, it could recover its investment by raising its prices. Admittedly, the return would not be as great, but it provides sufficient protection to serve as a more reasonable and less restrictive alternative to a tying arrangement.

The court concludes that the defendants' policy of selling full systems only was lawful at its inception but constituted a violation of Section 1 of the Sherman Act and Section 3 of the Clayton Act during part of the time it was in effect.

III-C. The Veto Provisions

In addition to initially selling its equipment only on a full system basis, Jerrold also imposed certain limitations on the equipment that could be added to the system in the future by means of certain provisions in its service contracts. One of these is the provision appearing in all of the contracts to the effect that the operator shall not install any unapproved, non-Jerrold equipment. The Government contends that these clauses prohibit the use of competitive equipment. It is apparent that these clauses do not absolutely require the use of Jerrold equipment. . . . Equipment approved by Jerrold was also permitted. . . .

. . . An examination of the record discloses uncontradicted testimony concerning numerous systems which used non-Jerrold equipment without objection, although this fact was known to the defendants. On the other hand, no instances were brought to the court's attention in which it is clear that an operator considered himself unable to obtain non-Jerrold equipment because of the veto clause. The court finds that these provisions were not intended, and were not used, to prevent the use of competitive equipment in systems covered by a service contract.

The veto provisions were necessary to protect Jerrold in view of its maintenance obligations under the contracts and its financial interest in the success of the systems. Reasonable restraints are permissible for such purposes. *International Salt Co., Inc. v. United States, supra*. The restraint imposed by the requirement that Jerrold approve all equipment other than that it manufactured is reasonable in view of the meaning given to this provision as evidenced by Jerrold's conduct with respect to it. It must also be noted that, because of the instability of the equipment and rapid growth of the industry, the use of pre-determined specifications, rather than the more flexible approval approach, would probably have been more restrictive if Jerrold was to be afforded the protection to which it was entitled.

III-D. The Additional Channels Provision

The Government also challenges the provision appearing in the 103 series contracts which requires operators to purchase from Jerrold the equipment necessary to receive any stations in addition to those received at the time of the initial installation. . . . The defendants argue that this provision was justified because "it would be a business folly to try to fit someone else's equipment into the actual spaces provided for additional channels." They also urge that these provisions are consistent with its policy of full system sales.

The court agrees with the Government that these provisions constitute unlawful tie-ins in violation of Section 1 of the Sherman Act and Section 3 of the Clayton Act, regardless of the defendants' actual motives. It can discover no reasons which justify this absolute restriction on the operator's choice of equipment which are not served by the "veto provision." . . .

IV. CORPORATE ACQUISITIONS

[In a lengthy section of its decision the court found that the effect of a series of acquisitions by Jerrold of CATV systems "is to foreclose competitors . . . from a share of the market in community television antenna system equipment." Additional acquisitions were barred for three years.]

V. CONSPIRACY AND ATTEMPT TO MONOPOLIZE

The trial judge finds that Jerrold's policy of selling its equipment exclusively on a full system basis and in conjunction with a service contract, while not shown to be reasonable at all times in which it was in effect, was never intended by the defendants to drive competitors from the business of supplying equipment for community television antenna systems and to achieve a monopoly in this field for Jerrold. Among other things, it must be kept in mind that this policy was evolved and put into effect when

Jerrold first marketed community antenna equipment. At that time, both R.C.A. and Philco were entering the business. Furthermore, the future of this brand new field was quite uncertain. It is highly unlikely that the most ambitious businessman would enter this business from the beginning with a policy intended to force such formidable competitors as these from the field and acquire the power to control prices or foreclose access to this market. . . .

FINAL JUDGMENT

.

The defendants are enjoined and restrained from, directly or indirectly:

(A) Selling or offering to sell equipment on the condition or understanding that the purchaser thereof purchase services from the defendants;

(B) Furnishing or offering to furnish services on the condition or understanding that the recipient thereof purchase any Jerrold equipment;

(C) Selling or offering to sell any item of Jerrold equipment on the condition or understanding that the purchaser thereof buy or use any other Jerrold equipment;

(D) Selling or offering to sell any equipment on the condition or understanding that the purchaser thereof will not purchase or use equipment manufactured or sold by any other person; provided, however, this subsection (D) shall not prohibit defendants from electing to sell or offer for sale Jerrold equipment upon the condition or understanding that defendants will not guarantee, warrant or, in any manner, be responsible for, the operation or efficiency of such equipment, or the system in which the same may be installed or used, if the purchaser thereof installs, as a part of such system, any equipment or attachments manufactured by any other person which, in defendants' opinion, might either (a) impair the quality of television reception or signal distribution capability of the system, or (b) cause damage to, or impair the operation or efficiency of, any of the Jerrold equipment sold or offered for sale. . . .

Jefferson Parish Hospital District No. 2 et al. v. Edwin G. Hyde

104 U.S. 1551 (1984)

JUSTICE STEVENS delivered the opinion of the Court:

At issue in this case is the validity of an exclusive contract between a hospital and a firm of anesthesiologists. We must decide whether the contract gives rise to a *per se* violation of §1 of the Sherman Act . . . because every patient undergoing surgery at the hospital must use the services of one firm of anesthesiologists, and, if not, whether the contract

is nevertheless illegal because it unreasonably restrains competition among anesthesiologists.

In July 1977, respondent Edwin G. Hyde, a board certified anesthesiologist, applied for admission to the medical staff of East Jefferson Hospital. The credentials committee and the medical staff executive recommended approval, but the hospital board denied the application because the hospital was a party to a contract providing that all anesthesiological services required by the hospital's patients would be performed by Roux & Associates, a professional medical corporation. Respondent then commenced this action seeking a declaratory judgment that the contract is unlawful and an injunction ordering petitioners to appoint him to the hospital staff. . . . After trial, the District Court denied relief, finding that the anticompetitive consequences of the Roux contract were minimal and outweighed by benefits in the form of improved patient care. 513 F.Supp. 532 (ED La. 1981). The Court of Appeals reversed because it was persuaded that the contract was illegal *per se*. 686 F.2d 286 (5th Cir. 1982). We granted certiorari . . . and now reverse.

I

In February 1971, shortly before East Jefferson Hospital opened, it entered into an "Anesthesiology Agreement" with Roux & Associates ("Roux"), a firm that had recently been organized by Dr. Kermit Roux. The contract provided that any anesthesiologist designated by Roux would be admitted to the hospital's medical staff. The hospital agreed to provide the space, equipment, maintenance, and other supporting services necessary to operate the anesthesiology department. It also agreed to purchase all necessary drugs and other supplies. All nursing personnel required by the anesthesia department were to be supplied by the hospital, but Roux had the right to approve their selection and retention. . . . The hospital agreed to "restrict the use of its anesthesia department to Roux & Associates and [that] no other persons, parties or entities shall perform such services within the Hospital for the term of this contract." App. 19. . . .

The exclusive contract had an impact on two different segments of the economy: consumers of medical services, and providers of anesthesiological services. Any consumer of medical services who elects to have an operation performed at East Jefferson Hospital may not employ any anesthesiologist not associated with Roux. No anesthesiologists except those employed by Roux may practice at East Jefferson.

There are at least 20 hospitals in the New Orleans metropolitan area, and about 70 percent of the patients living in Jefferson Parish go to hospitals other than East Jefferson. Because it regarded the entire New Orleans metropolitan area as the relevant geographic market in which hospitals compete, this evidence convinced the District Court that East Jefferson does not possess any significant "market power"; therefore it

***Standard Fashion Company v.
Magrane-Houston Company***

258 U.S. 346 (1922)

MR. JUSTICE DAY delivered the opinion of the Court.

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Petitioner is a New York corporation engaged in the manufacture and distribution of patterns. Respondent conducted a retail dry goods business . . . in the City of Boston. On November 25, 1914, the parties entered into a contract by which the petitioner granted to the respondent an agency for the sale of Standard patterns at respondent's store, for a term of two years from the date of the contract, and from term to term thereafter until the agreement should be terminated as thereafter provided. Petitioner agreed to sell to respondent Standard Patterns at a discount of 50 percent from retail prices, with advertising matter and publications upon terms stated. . . . Respondent agreed not to assign or transfer the agency, or to remove it from its original location without the written consent of the petitioner, and not to sell or permit to be sold on its premises during the term of the contract any other make of patterns, and not to sell Standard Patterns except at label prices. . . .

The principal question in the case, and the one upon which the writ of certiorari was granted involves the construction of Section 3 of the Clayton Act. . . .

. . . The real question is: Does the contract of sale come within the third section of the Clayton Act, because the [effect of the] covenant not to sell the patterns of others "may be to substantially lessen competition or tend to create a monopoly."

The Clayton Act, as its title and the history of its enactment disclose, was intended to supplement the purpose and effect of other anti-trust legislation, principally the Sherman Act of 1890. . . .

The Clayton Act sought to reach the agreements embraced within its sphere in their incipiency, and in the section under consideration to determine their legality by specific tests of its own which declared illegal contracts of sale made upon the agreement or understanding that the purchaser shall not deal in the goods of a competitor or competitors of the seller, which may "substantially lessen competition or tend to create a monopoly." . . .

Section 3 condemns sales or agreements where the effect of such sale or contract of sale "may" be to substantially lessen competition or tend to create a monopoly. It thus deals with consequences to follow the making of the restrictive covenant limiting the right of the purchaser to deal in the goods of the seller only. But we do not think that the purpose in using the word "may" was to prohibit the mere possibility of the consequences described. It was intended to prevent such agreements as would under the

circumstances disclosed probably lessen competition, or create an actual tendency to monopoly. That it was not intended to reach every remote lessening of competition is shown in the requirement that such lessening must be substantial.

Both courts below found that the contract interpreted in the light of the circumstances surrounding the making of it was within the provisions of the Clayton Act as one which substantially lessened competition and tended to create monopoly. These courts put special stress upon the fact found that, of 52,000 so-called pattern agencies in the entire country, the petitioner, or a holding company controlling it and two other pattern companies, approximately controlled two-fifths of such agencies. As the Circuit Court of Appeals summarizing the matter, pertinently observed:

The restriction of each merchant to one pattern manufacturer must in hundreds, perhaps in thousands, of small communities amount to giving such single pattern manufacturer a monopoly of the business in such community. Even in the larger cities, to limit to a single pattern maker the pattern business of dealers most resorted to by customers whose purchases tend to give fashions their vogue, may tend to facilitate further combinations; so that the plaintiff, or some other aggressive concern, instead of controlling two-fifths, will shortly have almost, if not quite, all the pattern business.

We agree with these conclusions, and have no doubt that the contract, properly interpreted, with restrictive covenant, brings it fairly within the section of the Clayton Act under consideration.

Affirmed.

***Standard Oil Company of California (and Standard
Stations, Inc.) v. United States***

337 U.S. 293 (1949)

MR. JUSTICE FRANKFURTER delivered the opinion of the Court.

This is an appeal to review a decree enjoining the Standard Oil Company of California and its wholly-owned subsidiary, Standard Stations, Inc., from enforcing or entering into exclusive supply contracts with any independent dealer in petroleum products and automobile accessories. . . . The use of such contracts was successfully assailed by the United States as violative of Section 1 of the Sherman Act and Section 3 of the Clayton Act.

The Standard Oil Company of California . . . owns petroleum-producing resources and refining plants in California and sells petroleum products in what has been termed in these proceedings the "Western area". . . . It sells through its own service stations, to the operators of

independent service stations, and to industrial users. It is the largest seller of gasoline in the area. In 1946 its combined sales amounted to 23% of the total taxable gallonage sold there in that year: sales by company-owned service stations constituted 6.8% of the total, sales under exclusive dealing contracts with independent service stations, 6.7% of the total; the remainder were sales to industrial users. Retail service-station sales by Standard's six leading competitors absorbed 42.5% of the total taxable gallonage; the remaining retail sales were divided between more than seventy small companies. It is undisputed that Standard's major competitors employ similar exclusive dealing arrangements. In 1948 only 1.6% of retail outlets were what is known as "split-pump" stations, that is, sold the gasoline of more than one supplier.

Exclusive supply contracts with Standard had been entered into, as of March 12, 1947, by the operators of 5,937 independent stations, or 16% of the retail gasoline outlets in the Western area, which purchased from Standard in 1947, \$57,646,233 worth of gasoline and \$8,200,089.21 worth of other products. Some outlets are covered by more than one contract so that in all about 8,000 exclusive supply contracts are here in issue. These are of several types, but a feature common to each is the dealer's undertaking to purchase from Standard all his requirements of one or more products. Two types, covering 2,777 outlets, bind the dealer to purchase of Standard all his requirements of gasoline and other petroleum products as well as tires, tubes, and batteries. The remaining written agreements, 4,368 in number, bind the dealer to purchase of Standard all his requirements of petroleum products only. It was also found that independent dealers had entered 742 oral contracts by which they agreed to sell only Standard's gasoline. . . .

Between 1936 and 1946 Standard's sales of gasoline through independent dealers remained at a practically constant proportion of the area's total sales; its sales of lubricating oil declined slightly during that period from 6.2% to 5% of the total. Its proportionate sales of tires and batteries for 1946 were slightly higher than they were in 1936, though somewhat lower than for some intervening years; they have never, as to either of these products, exceeded 2% of the total sales in the Western area.

Since Section 3 of the Clayton Act was directed to prohibiting specific practices even though not covered by the broad terms of the Sherman Act, it is appropriate to consider first whether the enjoined contracts fall within the prohibition of the narrower Act. . . .

The District Court held that the requirement of showing an actual or potential lessening of competition or a tendency to establish monopoly was adequately met by proof that the contracts covered "a substantial number of outlets and a substantial amount of products, whether considered comparatively or not." . . . Given such quantitative substantiality, the substantial lessening of competition—so the court reasoned—is an automatic result, for the very existence of such contracts denies dealers

opportunity to deal in the products of competing suppliers and excludes supplies from access to the outlets controlled by those dealers. . . .

The issue before us, therefore, is whether the requirement of showing that the effect of the agreements "may be to substantially lessen competition" may be met simply by proof that a substantial portion of commerce is affected or whether it must also be demonstrated that competitive activity has actually diminished or probably will diminish. . . .

It is . . . apparent that none of these [earlier] cases¹ controls the disposition of the present appeal, for Standard's share of the retail market for gasoline, even including sales through company-owned stations, is hardly large enough to conclude as a matter of law that it occupies a dominant position, nor did the trial court so find. The cases do indicate, however, that some sort of showing as to the actual or probable economic consequences of the agreements, if only the inferences to be drawn from the fact of dominant power, is important, and to that extent they tend to support appellant's position.

Two of the three cases decided by this Court which have held Section 3 inapplicable also lend support to the view that such a showing is necessary. These are, *Federal Trade Comm'n v. Sinclair Co.*, 261 U.S. 463, and *Pick Mfg. Co. v. General Motors Corp.*, 299 U.S. 3. The third . . . is of no present relevance. . . .

But then came *International Salt Co. v. United States*, 332 U.S. 392. That decision, at least as to contracts tying the sale of a nonpatented to a patented product, rejected the necessity of demonstrating economic consequences once it has been established that "the volume of business affected" is not "insignificant or insubstantial" and that the effect of the contracts is to "foreclose competitors from [a] substantial market." . . . Upon that basis we affirmed a summary judgment granting an injunction against the leasing of machines for the utilization of salt products on the condition that the lessee use in them only salt supplied by defendant. . . . It is clear, therefore, that unless a distinction is to be drawn for purposes of the applicability of Section 3 between requirements contracts and contracts tying the sale of a nonpatented to a patented product, the showing that Standard's requirements contracts affected a gross business of \$58,000,000 comprising 6.7% of the total in the area goes far toward supporting the inference that competition has been or probably will be substantially lessened.

In favor of confining the standard laid down by the *International Salt* case to tying agreements, important economic differences may be noted.

¹ The Court had summarized its opinions in the five earlier cases in which it had found violations of Section 3. These were: *United Shoe Machinery Corp. v. United States*, 258 U.S. 451; *International Business Machines Corp. v. United States*, 298 U.S. 131; *International Salt Company v. United States*, 332 U.S. 392; *Standard Fashion Co. v. Magrane-Houston Co.*, 258 U.S. 364; and *Fashion Originators' Guild v. Federal Trade Commission*, 312 U.S. 457. IMS.

Tying agreements serve hardly any purpose beyond the suppression of competition. The justification most often advanced in their defense—the protection of the good will of the manufacturer of the tying device—fails in the usual situation because specification of the type and quality of the product to be used in connection with the tying device is protection enough. If the manufacturer's brand of the tied product is in fact superior to that of competitors, the buyer will presumably choose it anyway. The only situation, indeed, in which the protection of good will may necessitate the use of tying clauses is where specifications for a substitute would be so detailed that they could not practicably be supplied. In the usual case only the prospect of reducing competition would persuade a seller to adopt such a contract and only his control of the supply of the tying device, whether conferred by patent monopoly or otherwise obtained, could induce a buyer to enter one. . . . The existence of market control of the tying device, therefore, affords a strong foundation for the presumption that it has been or probably will be used to limit competition in the tied product also.

Requirements contracts, on the other hand, may well be of economic advantage to buyers as well as to sellers, and thus indirectly of advantage to the consuming public. In the case of the buyer, they may assure supply, afford protection against rises in price, enable long-term planning on the basis of known costs, and obviate the expense and risk of storage in the quantity necessary for a commodity having a fluctuating demand. From the seller's point of view, requirements contracts may make possible the substantial reduction of selling expenses, give protection against price fluctuations, and—of particular advantage to a newcomer to the field to whom it is important to know what capital expenditures are justified—offer the possibility of a predictable market. . . . They may be useful, moreover, to a seller trying to establish a foothold against the counterattacks of entrenched competitors. . . . Since these advantages of requirements contracts may often be sufficient to account for their use, the coverage by such contracts of a substantial amount of business affords a weaker basis for the inference that competition may be lessened than would similar coverage by tying clauses, especially where use of the latter is combined with market control of the tying device. A patent, moreover, although in fact there may be many competing substitutes for the patented article, is at least *prima facie* evidence of such control. And so we could not dispose of this case merely by citing *International Salt Co. v. United States*. . . .

Thus, even though the qualifying clause of Section 3 is appended without distinction of terms equally to the prohibition of tying clauses and of requirements contracts, pertinent considerations support, certainly as a matter of economic reasoning, varying standards as to each for the proof necessary to fulfill the conditions of that clause. If this distinction were accepted, various tests of the economic usefulness or restrictive effect of

requirements contracts would become relevant. Among them would be evidence that competition has flourished despite use of the contracts, and under this test much of the evidence tendered by appellant in this case would be important. . . . Likewise bearing on whether or not the contracts were being used to suppress competition, would be the conformity of the length of their term to the reasonable requirements of the field of commerce in which they were used. . . . Still another test would be the status of the defendant as a struggling newcomer or an established competitor. Perhaps most important, however, would be the defendant's degree of market control, for the greater the dominance of his position, the stronger the inference that an important factor in attaining and maintaining that position had been the use of requirements contracts to stifle competition rather than to serve legitimate economic needs. . . .

Yet serious difficulties would attend the attempt to apply these tests. We may assume, as did the court below, that no improvement of Standard's competitive position has coincided with the period during which the requirements-contract system of distribution has been in effect. We may assume further that the duration of the contracts is not excessive and that Standard does not by itself dominate the market. But Standard was a major competitor when the present system was adopted, and it is possible that its position would have deteriorated but for the adoption of that system. When it is remembered that all the other major suppliers have also been using requirements contracts, and when it is noted that the relative share of the business which fell to each has remained about the same during the period of their use, it would not be farfetched to infer that their effect has been to enable the established suppliers individually to maintain their own standing and at the same time collectively, even though not collusively, to prevent a late arrival from wresting away more than an insignificant portion of the market. If, indeed, this were a result of the system, it would seem unimportant that a short-run by-product of stability may have been greater efficiency and lower costs, for it is the theory of the antitrust laws that the long-run advantage of the community depends upon the removal of restraints upon competition. . . .

Moreover, to demand that bare inference be supported by evidence as to what would have happened but for the adoption of the practice that was in fact adopted or to require firm prediction of an increase of competition as a probable result of ordering the abandonment of the practice, would be a standard of proof, if not virtually impossible to meet, at least most ill-suited for ascertainment by courts. . . .

. . . Though it may be that such an alternative to the present system as buying out independent dealers and making them dependent employees of Standard Stations, Inc., would be a greater detriment to the public interest than perpetuation of the system, this is an issue, like the choice between greater efficiency and freer competition, that has not been submitted to our decision. We are faced, not with a broadly phrased expres-

sion of general policy, but merely a broadly phrased qualification of an otherwise narrowly directed statutory provision. . . .

We conclude, therefore, that the qualifying clause of Section 3 is satisfied by proof that competition has been foreclosed in a substantial share of the line of commerce affected. It cannot be gainsaid that observance by a dealer of his requirements contract with Standard does effectively foreclose whatever opportunity there might be for competing suppliers to attract his patronage, and it is clear that the affected proportion of retail sales of petroleum products is substantial. In view of the widespread adoption of such contracts by Standard's competitors and the availability of alternative ways of obtaining an assured market, evidence that competitive activity has not actually declined is inconclusive. Standard's use of the contracts creates just such a potential clog on competition as it was the purpose of Section 3 to remove wherever, were it to become actual, it would impede a substantial amount of competitive activity.

Since the decree below is sustained by our interpretation of Section 3 of the Clayton Act, we need not go on to consider whether it might also be sustained by Section 1 of the Sherman Act. . . .

The judgment below is Affirmed.

[MR. JUSTICE JACKSON, with whom THE CHIEF JUSTICE and MR. JUSTICE BURTON joined, dissented. MR. JUSTICE DOUGLAS separately dissented.]

Tampa Electric Co. v. Nashville Coal Co.

365 U.S. 320 (1961)

MR. JUSTICE CLARK delivered the opinion of the Court.

We granted certiorari to review a declaratory judgment holding illegal under Section 3 of the Clayton Act a requirements contract between the parties providing for the purchase by petitioner of all the coal it would require as boiler fuel at its Gannon Station in Tampa, Florida, over a 20-year period. . . . Both the District Court . . . and the Court of Appeals, . . . Judge Weick dissenting, agreed with respondents that the contract fell within the proscription of Section 3 and therefore was illegal and unenforceable. We cannot agree that the contract suffers the claimed antitrust illegality¹ and, therefore, do not find it necessary to consider respondents' additional argument that such illegality is a defense to the action and a bar to enforceability.

¹ In addition to their claim under Section 3 of the Clayton Act, respondents argue the contract is illegal under the Sherman Act, 15 U.S.C. Sections 1-2.

THE FACTS

Petitioner Tampa Electric Company is a public utility located in Tampa, Florida. It produces and sells electric energy to a service area, including the city, extending from Tampa Bay eastward 60 miles to the center of the State, and some 30 miles in width. As of 1954 petitioner operated two electrical generating plants comprising a total of 11 individual generating units, all of which consumed oil in their burners. In 1955 Tampa Electric decided to expand its facilities by the construction of an additional generating plant to be comprised ultimately of six generating units, and to be known as the "Francis J. Gannon Station." Although every electrical generating plant in peninsular Florida burned oil at that time, Tampa Electric decided to try coal as boiler fuel in the first two units constructed at the Gannon Station. Accordingly, it contracted with the respondents² to furnish the expected coal requirements for the units. The agreement, dated May 23, 1955, embraced Tampa Electric's "total requirements of fuel . . . for the operation of its first two units to be installed at the Gannon Station . . . not less than 225,000 tons of coal per unit per year," for a period of 20 years. The contract further provided that "if during the first 10 years of the term . . . the Buyer constructs additional units [at Gannon] in which coal is used as the fuel, it shall give the Seller notice thereof two years prior to the completion of such unit or units and upon completion of same the fuel requirements thereof shall be added to this contract." It was understood and agreed, however, that "the Buyer has the option to be exercised two years prior to completion of said unit or units of determining whether coal or some other fuel shall be used in same." Tampa Electric had the further option of reducing, up to 15%, the amount of its coal purchases covered by the contract after giving six months' notice of an intention to use as fuel a by-product of any of its local customers. The minimum price was set at \$6.40 per ton delivered, subject to an escalation clause based on labor cost and other factors. Deliveries were originally expected to begin in March 1957, for the first unit, and for the second unit at the completion of its construction.

In April 1957, soon before the first coal was actually to be delivered and after Tampa Electric, in order to equip its first two Gannon units for the use of coal, had expended some \$3,000,000 more than the cost of constructing oil-burning units, and after respondents had expended approximately \$7,500,000 readying themselves to perform the contract, the latter advised petitioner that the contract was illegal under the antitrust laws, would therefore not be performed, and no coal would be delivered. This turn of events required Tampa Electric to look elsewhere for its coal

² The original contract was with Potter Towing Company, and by subsequent agreements with Tampa Electric responsibility thereunder was assumed by respondent West Kentucky Coal Company.

requirements. The first unit at Gannon began operating August 1, 1957, using coal purchased on a temporary basis, but on December 23, 1957, a purchase order contract for the total coal requirements of the Gannon Station was made with Love and Amos Coal Company. It was for an indefinite period cancellable on 12 months' notice by either party, or immediately upon tender of performance by respondents under the contract sued upon here. The maximum price was \$8.80 per ton, depending upon the freight rate. In its purchase order to the Love and Amos Company, Tampa estimated that its requirements at the Gannon Station would be 350,000 tons in 1958; 700,000 tons in 1959 and 1960; 1,000,000 tons in 1961; and would increase thereafter, as required, to "about 2,250,000 tons per year." The second unit at Gannon Station commenced operation 14 months after the first, *i.e.*, October 1958. Construction of a third unit, the coal for which was to have been provided under the original contract, was also begun.

The record indicates that the total consumption of coal in peninsular Florida, as of 1958, aside from Gannon Station, was approximately 700,000 tons annually. It further shows that there were some 700 coal suppliers in the producing area where respondents operated, and that Tampa Electric's anticipated maximum requirements at Gannon Station, *i.e.*, 2,250,000 tons annually, would approximate 1% of the total coal of the same type produced and marketed from respondents' producing area.

Petitioner brought this suit in the District Court pursuant to 28 U.S.C. Section 2201, for a declaration that its contract with respondents was valid, and for enforcement according to its terms. In addition to its Clayton Act defense, respondents contended that the contract violated both Sections 1 and 2 of the Sherman Act which, it claimed, likewise precluded its enforcement. The District Court, however, granted respondents' motion for summary judgment on the sole ground that the undisputed facts, recited above showed the contract to be a violation of Section 3 of the Clayton Act. The Court of Appeals agreed. Neither court found it necessary to consider the applicability of the Sherman Act.

DECISIONS OF DISTRICT COURT AND COURT OF APPEALS

Both courts admitted that the contract "does not expressly contain the 'condition'" that Tampa Electric would not use or deal in the coal of respondents' competitors. Nonetheless, they reasoned, the "total requirements" provision had the same practical effect, for it prevented Tampa Electric for a period of 20 years from buying coal from any other source for use at that station. Each court cast aside as "irrelevant" arguments citing the use of oil as boiler fuel by Tampa Electric as its other stations, and by other utilities in peninsular Florida, because oil was not in fact used at Gannon Station, and the possibility of exercise by Tampa Electric of the option reserved to it to build oil-burning units at Gannon

was too remote. Found to be equally remote was the possibility of Tampa's conversion of existing oil-burning units at its other stations to the use of coal which would not be covered by the contract with respondents. It followed, both courts found, that the "line of commerce" on which the restraint was to be tested was coal—not boiler fuels. Both courts compared the estimated coal tonnage as to which the contract pre-empted competition for 20 years, namely 1,000,000 tons a year in 1961, with the previous annual consumption of peninsular Florida, 700,000 tons. Emphasizing that fact as well as the contract value of the coal covered by the 20-year term, *i.e.*, \$128,000,000, they held that such volume was not "insignificant or insubstantial" and that the effect of the contract would "be to substantially lessen competition," in violation of the Act. Both courts were of the opinion that in view of the executory nature of the contract, judicial enforcement of any portion of it could not be granted without directing a violation of the Act itself, and enforcement was, therefore, denied.

APPLICATION OF SECTION 3 OF THE CLAYTON ACT

In the almost half century since Congress adopted the Clayton Act, this Court has been called upon 10 times, including the present, to pass upon questions arising under Section 3.³ . . .

In practical application, even though a contract is found to be an exclusive-dealing arrangement, it does not violate the section unless the court believes it probable that performance of the contract will foreclose competition in a substantial share of the line of commerce affected. Following the guidelines of earlier decisions, certain considerations must be taken. *First*, the line of commerce, *i.e.*, the type of goods, wares, or merchandise, etc., involved must be determined, where it is in controversy, on the basis of the facts peculiar to the case. *Second*, the area of effective competition in the known line of commerce must be charted by careful selection of the market area in which the seller operates, and to which the purchaser can practicably turn for supplies. In short, the threatened foreclosure of competition must be in relation to the market affected. . . .

Third, and last, the competition foreclosed by the contract must be found to constitute a substantial share of the relevant market. That is to say, the opportunities for other traders to enter into or remain in that market must be significantly limited. . . .

To determine substantiality in a given case, it is necessary to weight the probable effect of the contract on the relevant area of effective competition, taking into account the relative strength of the parties, the proportionate volume of commerce involved in relation to the total volume of

³ A detailed discussion of the *Standard Fashion*, *United Shoe*, *International Salt* and *Standard Oil of California* cases followed. IMS.

commerce in the relevant market area, and the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein. It follows that a mere showing that the contract itself involves a substantial number of dollars is ordinarily of little consequence.

THE APPLICATION OF SECTION 3 HERE

In applying these considerations to the facts of the case before us, it appears clear that both the Court of Appeals and the District Court have not given the required effect to a controlling factor in the case—the relevant competitive market area. This omission, by itself, requires reversal, for, as we have pointed out, the relevant market is the prime factor in relation to which the ultimate question, whether the contract forecloses competition in a substantial share of the line of commerce involved, must be decided. For the purposes of this case, therefore, we need not decide two threshold questions passed by Tampa Electric. They are whether the contract in fact satisfies the initial requirement of Section 3, *i.e.*, whether it is truly an exclusive-dealing one, and, secondly, whether the line of commerce is boiler fuels, including coal, oil and gas, rather than coal alone.⁴ We, therefore, for the purposes of this case, assume, but do not decide, that the contract is an exclusive-dealing arrangement within the compass of Section 3, and that the line of commerce is bituminous coal.

RELEVANT MARKET OF EFFECTIVE COMPETITION

Neither the Court of Appeals nor the District Court considered in detail the question of the relevant market. They do seem, however, to have been satisfied with inquiring only as to competition within "Peninsular Florida." It was noted that the total consumption of peninsular Florida was 700,000 tons of coal per year, about equal to the estimated 1959 requirements of Tampa Electric. It was also pointed out that coal accounted for less than 6% of the fuel consumed in the entire State.⁵ The District Court concluded that though the respondents were only one of 700 coal producers who could serve the same market, peninsular Florida, the contract for a period of 20 years excluded competitors from a substantial amount of trade. Respondents contend that the coal tonnage covered by the contract must be weighed against either the total consumption of coal in peninsular Florida, or all of Florida, or the Bituminous

⁴ In support of these contentions petitioner urges us to consider that it remains free to convert existing oil-burning units at its other plants to coal-burning units, the fuel for which it would be free to purchase from any seller in the market; also that just as it is permitted to use oil at its other plants, so, too it may construct all future Gannon units as oil burners; and that in any event it is free to draw a maximum of 15% of its Gannon fuel requirements from by-products of local customers. Petitioner further argues that its novel reliance upon coal in fact created new fuel competition in an area that theretofore relied almost exclusively upon oil and, to a lesser extent, upon natural gas.

⁵ Oil and, to a lesser extent, natural gas are the primary fuels consumed in Florida.

Coal Act area comprising peninsular Florida and the Georgia "finger," or, at most, all of Florida and Georgia. If the latter area were considered the relevant market, Tampa Electric's proposed requirements would be 18% of the tonnage sold therein. Tampa Electric says that both courts and respondents are in error, because the "700 coal producers who could serve" it, as recognized by the trial court and admitted by respondents, operated in the Appalachian coal area and that its contract requirements were less than 1% of the total marketed production of these producers; that the relevant effective area of competition was the area in which these producers operated, and in which they were willing to compete for the consumer potential.

We are persuaded that on the record in this case, neither peninsular Florida, nor the entire State of Florida, nor Florida and Georgia combined constituted the relevant market of effective competition. We do not believe that the pie will slice so thinly. By far the bulk of the overwhelming tonnage marketed from the same producing area as serves Tampa is sold outside of Georgia and Florida, and the producers were "eager" to sell more coal in those States.⁶ While the relevant competitive market is not ordinarily susceptible to a "metes and bounds" definition, cf. *Times-Picayune Pub. Co. v. United States*, 345 U.S. 594, 611, it is of course the area in which respondents and the other 700 producers effectively compete. . . . The record shows that, like the respondents, they sold bituminous coal "suitable for [Tampa's] requirements," mined in parts of Pennsylvania, Virginia, West Virginia, Kentucky, Tennessee, Alabama, Ohio and Illinois. We take notice of the fact that the approximate total bituminous coal (and lignite) product in the year 1954 from the districts in which these 700 producers are located was 359,289,000 tons, of which some 290,567,000 tons were sold on the open market. Of the latter amount some 78,716,000 tons were sold to electric utilities. We also note that in 1954 Florida and Georgia combined consumed at least 2,304,000 tons, 1,100,000 of which were used by electric utilities, and the sources of which were mines located in no less than seven States. We take further notice that the production and marketing of bituminous coal (and lignite) from the same districts, and assumedly equally available to Tampa on a commercially feasible basis, is currently on a par with prior years. In point of statistical fact, coal consumption in the combined Florida-Georgia area has increased significantly since 1954. In 1959 more than 3,775,000 tons were there consumed, 2,913,000 being used by electric utilities including, presumably, the coal used by the petitioner. The coal continued to come from at least seven States. From these statistics it clearly appears that the proportionate volume of the total relevant coal

⁶ Peabody Coal Company offered to supply petitioner with coal from its mines in western Kentucky, for use in the units at another of its Florida stations, and that offer prompted a renegotiation of the price petitioner was paying for the oil then being consumed at that station.

product as to which the challenged contract pre-empted competition, less than 1%, is, conservatively speaking, quite insubstantial. A more accurate figure, even assuming pre-emption to the extent of the maximum anticipated total requirements, 2,250,000 tons a year, would be .77%.

EFFECT ON COMPETITION IN THE RELEVANT MARKET

It may well be that in the context of antitrust legislation protracted requirements contracts are suspect, but they have not been declared illegal *per se*. Even though a single contract between single traders may fall within the initial broad proscription of the section, it must also suffer the qualifying disability, tendency to work a substantial—not remote—lessening of competition in the relevant competitive market. It is urged that the present contract pre-empts competition to the extent of purchases worth perhaps \$128,000,000 and that this “is, of course, not insignificant or insubstantial.” While \$128,000,000 is a considerable sum of money, even in these days, the dollar volume, by itself, is not the test, as we have already pointed out.

The remaining determination, therefore, is whether the pre-emption of competition to the extent of the tonnage involved tends to substantially foreclose competition in the relevant coal market. We think not. That market sees an annual trade in excess of 250,000,000 tons of coal and over a billion dollars—multiplied by 20 years it runs into astronomical figures. There is here neither a seller with a dominant position in the market as in *Standard Fashions, supra*; nor myriad outlets with substantial sales volume, coupled with an industry-wide practice of relying upon exclusive contracts, as in *Standard Oil, supra*; nor a plainly restrictive tying arrangement as in *International Salt, supra*. On the contrary, we seem to have only that type of contract which “may well be of economic advantage to buyers as well as to sellers.” *Standard Oil Co. v. United States, supra*. . . . In the case of the buyer it “may assure supply,” while on the part of the seller it “may make possible the substantial reduction of selling expenses, give protection against price fluctuations, and . . . offer the possibility of a predictable market.” *Id.* . . . The 20-year period of the contract is singled out as the principal vice, but at least in the case of public utilities the assurance of a steady and ample supply of fuel is necessary in the public interest. Otherwise consumers are left unprotected against service failures owing to shutdowns; and increasingly unjustified costs might result in more burdensome rate structures eventually to be reflected in the consumer’s bill. The compelling validity of such considerations has been recognized fully in the natural gas public utility field. This is not to say that utilities are immunized from Clayton Act proscriptions, but merely that, in judging the term of a requirements contract in relation to the substantiality of the foreclosure of competition, particularized considerations of the parties’ operations are not irrelevant.

In weighing the various factors, we have decided that in the competitive bituminous coal marketing area involved here the contract sued upon does not tend to foreclose a substantial volume of competition.

We need not discuss the respondents’ further contention that the contract also violates Section 1 and Section 2 of the Sherman Act, for if it does not fall within the broader proscription of Section 3 of the Clayton Act it follows that it is not forbidden by those of the former. *Times-Picayune Pub. Co. v. United States*. . . .

The judgment is reversed and the case remanded to the District Court for further proceedings not inconsistent with this opinion.

It is so ordered.

MR. JUSTICE BLACK and MR. JUSTICE DOUGLAS are of the opinion that the District Court and the Court of Appeals correctly decided this case and would therefore affirm their judgments.

11

Other Vertical Restrictions

As the chapter's title implies, the cases included herein have involved practices whose effects cannot neatly be categorized. In the *General Motors*, *Schwinn*, *Topco*, *GTE Sylvania*, and *Monsanto* cases, the courts have sought to define the limits which suppliers can impose upon their customers. Until recently (per *Schwinn*), once title to the product passed from the hands of the seller to the buyer, the courts took a very dim view of the imposition of restrictions on the buyer's freedom to dispose of the product as he saw fit. However, in *GTE Sylvania*, the Supreme Court explicitly rejected this position, holding instead that, absent pricing restrictions, vertical restrictions henceforth will be subject to a rule-of-reason analysis, with its attendant evaluation of relative costs and benefits.

The *Chicken Delight* case typifies the continuing controversy surrounding the practice of franchising. Again, the courts appear to be seeking a means by which to strike a balance between the right of the franchisor to protect the economic integrity of his franchise, and the freedom of the franchisee to operate in his own best interests.

United States v. General Motors Corporation

384 U.S. 127 (1966)

MR. JUSTICE FORTAS delivered the opinion of the Court.

This is a civil action brought by the United States to enjoin the appellees from participating in an alleged conspiracy to restrain trade in violation of §1 of the Sherman Act. The United States District Court for the Southern District of California concluded that the proof failed to establish the alleged violation, and entered judgment for the defendants. . . . We reverse.

I

The appellees are the General Motors Corporation, which manufactures, among other things, the Chevrolet line of cars and trucks, and three associations of Chevrolet dealers in and around Los Angeles, California. All of the Chevrolet dealers in the area belong to one or more of the appellee associations.

Chevrolets are ordinarily distributed by dealers operating under a franchise from General Motors. The dealers purchase the cars from the manufacturer, and then retail them to the public. The relationship between manufacturer and dealer is incorporated in a comprehensive uniform Dealer Selling Agreement. This agreement does not restrict or define those to whom the dealer may sell. Nor are there limitations as to the territory within which the dealer may sell. Compare *White Motor Co. v. United States*, 372 U.S. 253. The franchise agreement does, however, contain a clause (hereinafter referred to as the "location clause") which prohibits a dealer from moving to or establishing "a new or different location, branch sales office, branch service station, or place of business including any used car lot or location without the prior written approval of Chevrolet."

Beginning in the late 1950s, "discount houses" engaged in retailing consumer goods in the Los Angeles area and "referral services" began offering to sell new cars to the public at allegedly bargain prices. Their sources of supply were the franchised dealers. By 1960 a number of individual Chevrolet dealers, without authorization from General Motors, had developed working relationships with these establishments. A customer would enter one of these establishments and examine the literature and price lists for automobiles produced by several manufacturers. In some instances, floor models were available for inspection. Some of the establishments negotiated with the customer for a trade-in of his old car, and provided financing for his new-car purchase.

The relationship with the franchised dealer took various forms. One arrangement was for the discounter to refer the customer to the dealer. The car would then be offered to him by the dealer at a price previously agreed upon between the dealer and the discounter. In 1960, a typical referral agreement concerning Chevrolets provided that the price to the customer was not to exceed \$250 over the dealer's invoiced cost. For its part in supplying the customer, the discounter received \$50 per sale.

Another common arrangement was for the discounter itself to negotiate the sale, the dealer's role being to furnish the car and to transfer title to the customer at the direction of the discounter. One dealer furnished Chevrolets under such an arrangement, charging the discounter \$85 over its invoiced cost, with the discounter getting the best price it could from its customer.

These were the principal forms of trading involved in this case, al-

though within each there were variations, and there were schemes which fit neither pattern.¹ By 1960 these methods for retailing new cars had reached considerable dimensions. Of the 100,000 new Chevrolets sold in the Los Angeles area in that year, some 2,000 represented discount house or referral sales. One Chevrolet dealer attributed as much as 25% of its annual sales to participation in these arrangements, while another accounted for between 400 and 525 referral sales in a single year.

Approximately a dozen of the 85 Chevrolet dealers in the Los Angeles area were furnishing cars to discounters in 1960. As the volume of these sales grew, the nonparticipating Chevrolet dealers located near one or more of the discount outlets began to feel the pinch. Dealers lost sales because potential customers received, or thought they would receive,² a more attractive deal from a discounter who obtained his Chevrolets from a distant dealer. The discounters vigorously advertised Chevrolets for sale, with alluring statements as to price savings. The discounters also advertised that all Chevrolet dealers were obligated to honor the new-car warranty and to provide the free services contemplated therein; and General Motors does indeed require Chevrolet dealers to service Chevrolet cars, wherever purchased, pursuant to the new-car warranty and service agreement. Accordingly, nonparticipating dealers were increasingly called upon to service, without compensation, Chevrolets purchased through discounters. Perhaps what grated most was the demand that they "precondition" cars so purchased—make the hopefully minor adjustments and do the body and paint work necessary to render a factory-fresh car both customer- and road-worthy.

On June 28, 1960, at a regular meeting of the appellee Losor Chevrolet Dealers Association, member dealers discussed the problem and resolved to bring it to the attention of the Chevrolet Division's Los Angeles zone manager, Robert O'Connor. . . . O'Connor promised he would speak to the offending dealers. When no help was forthcoming . . . [t]he member

¹ At least one discount house actually purchased its cars from cooperative dealers, then resold them to its customers. In this situation, which in the trade is referred to as "bootlegging," the customer does not receive a new-car warranty. General Motors, while disapproving of the practice, does not assert that it violates the "location clause." In those arrangements against which General Motors and the associations did direct their efforts, title to the new car passed directly from dealer to retail customer, who thus obtained a new-car warranty and service agreement.

There must also be distinguished the ubiquitous practice of using "bird dogs"—informal sources who steer occasional customers toward a particular dealer, in return for relatively small fees—often a bottle of liquor. This practice is not only deemed by General Motors not to violate the "location clause," but has the corporation's endorsement as a desirable sales device.

² There is evidence in the record that discount sales undercut the prices at which franchised dealers were able to, or chose to compete. . . . Moreover, the discounters advertised and actually provided auto loans at interest rates substantially lower than those offered by G.M.A.C., General Motors' financing subsidiary. . . .

dealers . . . agreed . . . to flood General Motors and the Chevrolet Division with letters and telegrams asking for help. Salesmen, too, were to write.

Hundreds of letters and wires descended upon Detroit—with telling effect. Within a week Chevrolet's O'Connor was directed to furnish his superiors in Detroit with "a detailed report of the discount house operations . . . as well as what action we in the Zone are taking to curb such sales."

By mid-December General Motors had formulated its response. . . .

General Motors personnel proceeded to telephone all area dealers, both to identify those associated with the discounters and to advise non-participants that General Motors had entered the lists. The principal offenders were treated to unprecedented individual confrontations with [Roy] Cash, the regional manager [of the Chevrolet Division]. These brief meetings were wholly successful in obtaining from each dealer his agreement to abandon the practices in question. Some capitulated during the course of the four- or five-minute meeting, or immediately thereafter. One dealer, who met not with Cash but with the city sales manager for Chevrolet, put off decision for a week "to make sure that the other dealers, or most of them, had stopped their business dealings with the discount houses."³

There is evidence that unanimity was not obtained without reference to the ultimate power of General Motors. . . .

By mid-January General Motors had elicited from each dealer a promise not to do business with the discounters. But such agreements would require policing—a fact which had been anticipated. General Motors earlier had initiated contacts with firms capable of performing such a function. This plan, unilaterally to police the agreements, was displaced, however, in favor of a joint effort between General Motors, the three appellee associations, and a number of individual dealers.

. . . Early in 1961, the three associations agreed jointly to finance the "shopping" of the discounters to assure that no Chevrolet dealer continued to supply them with cars. Each of the associations contributed \$5,000, and a professional investigator was hired. He was instructed to try to

³ According to Francis Bruder, a dealer who had been doing business with the discounters since 1957, "Cash told me that he felt certain that the other dealers would discontinue dealing with discount houses and referral services as well. I left this meeting with the impression that every dealer who had been doing business with a discount house or referral service would soon quit."

This was precisely the impression General Motors had intended to implant. As was explained in an inter-office memorandum to the general sales manager of General Motors' Chevrolet Division, "[All dealers were talked to] in order that every dealer with whom the subject was discussed would know that a similar discussion was being held with all other dealers so that, if certain dealers should elect to discontinue their cooperation with a discount house, we might be able to discourage some other dealer who might be solicited from starting the practice."

purchase new Chevrolets from the proscribed outlets, to tape-record the transactions, if any, and to gather all the necessary documentary evidence—which the associations would then lay “at the doorstep of Chevrolet.” These joint associational activities were both preceded and supplemented by similar “shopping” activities by individual dealers and by appellee Losor Chevrolet Dealers Association.

General Motors collaborated with these policing activities. There is evidence that zone manager O'Connor and a subordinate, Jere Faust, actively solicited the help of individual dealers in uncovering violations. . . .

By the spring of 1961, the campaign to eliminate the discounters from commerce in new Chevrolet cars was a success. Sales through the discount outlets seem to have come to a halt. Not until a federal grand jury commenced an inquiry into the matters which we have sketched does it appear that any Chevrolet dealer resumed its business association with the discounters.

II

On these basic facts, the Government first proceeded criminally. A federal grand jury in the Southern District of California returned an indictment. After trial, the defendants were found not guilty. The present civil action, filed shortly after return of the indictment, was then brought to trial.

Both the government and the appellees urge the importance, for purposes of decision, of the “location clause” in the Dealer Selling Agreement which prohibits a franchised dealer from moving to or establishing “a new or different location, branch sales office, branch service station, or place of business . . . without the prior written approval of Chevrolet.” . . .

We need not reach . . . questions concerning the meaning, effect, or validity of the “location clause” or of any other provision in the Dealer Selling Agreement, and we do not. We do not decide whether the “location clause” may be construed to prohibit a dealer, party to it, from selling through discounters, or whether General Motors could by unilateral action enforce the clause, so construed. We have here a classic conspiracy in restraint of trade: joint, collaborative action by dealers, the appellee associations, and General Motors to eliminate a class of competitors by terminating business dealings between them and a minority of Chevrolet dealers and to deprive franchised dealers of their freedom to deal through discounters if they so choose. Against this fact of unlawful combination, the “location clause” is of no avail. . . .

The District Court decided otherwise. It concluded that the described events did not add up to a combination or conspiracy violative of the antitrust laws. . . .

The trial court attempted to justify its conclusion on the following reasoning: That each defendant and alleged co-conspirator acted to pro-

mote its own self-interest; that General Motors, as well as the defendant associations and their members, has a lawful interest in securing compliance with the “location clause” and in thus protecting the franchise system of distributing automobiles—business arrangements which the court deemed lawful and proper; and that in seeking to vindicate these interests the defendants and their alleged co-conspirators entered into no “agreements” among themselves, although they may have engaged in “parallel action.”

These factors do not justify the result reached. It is of no consequence, for purposes of determining whether there has been a combination or conspiracy under §1 of the Sherman Act, that each party acted in its own lawful interest. . . . [I]t has long been settled that explicit agreement is not a necessary part of a Sherman Act conspiracy—certainly not where, as here, joint and collaborative action was pervasive in the initiation, execution, and fulfillment of the plan. *United States v. Parke, Davis & Co.*, *supra*, at 43; *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707, 722-723; *Federal Trade Comm'n v. Beech-Nut Packing Co.*, 257 U.S. 441, 455.

Neither individual dealers nor the associations acted independently or separately. The dealers collaborated, through the associations and otherwise, among themselves and with General Motors, both to enlist the aid of General Motors and to enforce the dealers' promises to foresake the discounters. The associations explicitly entered into a joint venture to assist General Motors in policing the dealers' promises, and their joint proffer of aid was accepted and utilized by General Motors.

As Parke Davis had done, General Motors sought to elicit from all the dealers' agreements, substantially interrelated and interdependent, that none of them would do business with the discounters. These agreements were hammered out in meetings between nonconforming dealers and officials of General Motors' Chevrolet Division, and in telephone conversations with other dealers. It was acknowledged from the beginning that substantial unanimity would be essential if the agreements were to be forthcoming. And once the agreements were secured, General Motors both solicited and employed the assistance of its alleged co-conspirators in helping to police them. What resulted was a fabric interwoven by many strands of joint action to eliminate the discounters from participation in the market, to inhibit the free choice of franchised dealers to select their own methods of trade and to provide multilateral surveillance and enforcement. This process for achieving and enforcing the desired objective can by no stretch of the imagination be described as “unilateral” or merely “parallel.” . . .

There can be no doubt that the effect of the combination or conspiracy here was to restrain trade and commerce within the meaning of the Sherman Act. Elimination, by joint collaborative action, of discounters from access to the market is a *per se* violation of the Act.

. . . This [is] . . . not new doctrine, for it [has] . . . long been rec-

ognized that "there are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use," and that group boycotts are of this character. *Northern Pac. R. Co. v. United States*, 356 U.S. 1, 5. See also *Fashion Originators' Guild of America, Inc. v. Federal Trade Comm'n*, 312 U.S. 457, and *Eastern States Retail Lumber Dealers' Assn. v. United States*, 234 U.S. 600, 613-614, neither of which involved price-fixing.

The principle of these cases is that where businessmen concert their actions in order to deprive others of access to merchandise which the latter wish to sell to the public, we need not inquire into the economic motivation underlying their conduct. . . . Exclusion of traders from the market by means of combination or conspiracy is so inconsistent with the free-market principles embodied in the Sherman Act that it is not to be saved by reference to the need for preserving the collaborators' profit margins or their system for distributing automobiles, any more than by reference to the allegedly tortious conduct against which a combination or conspiracy may be directed—as in *Fashion Originators' Guild of America, Inc. v. Federal Trade Comm'n*, *supra*, at 468.

We note, moreover, that inherent in the success of the combination in this case was a substantial restraint upon price competition—a goal unlawful *per se* when sought to be effected by combination or conspiracy. *E.g.*, *United States v. Parke, Davis & Co.*, 362 U.S. 29, 47; *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223. And the *per se* rule applies even when the effect upon prices is indirect. *Simpson v. Union Oil Co.*, 377 U.S. 13, 16-22; *Socony-Vacuum Oil Co.*, *supra*.

There is in the record ample evidence that one of the purposes behind the concerted effort to eliminate sales of new Chevrolet cars by discounters was to protect franchised dealers from real or apparent price competition. The discounters advertised price savings. . . . Some purchasers found and others believed that discount prices were lower than those available through the franchised dealers. . . . Certainly, complaints about price competition were prominent in the letters and telegrams with which the individual dealers and salesmen bombarded General Motors in November 1960. . . . And although the District Court found to the contrary, there is evidence in the record that General Motors itself was not unconcerned about the effect of discount sales upon general price levels.⁴

⁴ In an inter-office memorandum, circulated among General Motors officials immediately prior to formulation of corporate policy *vis-à-vis* the discounters, it was stated that "It would appear that one of the real hazards of condoning this type of operation is that discounted prices are freely quoted to a large portion of the public." Moreover, we note that some discounters advertised that they would finance new-car purchases at an interest rate of 5¼%, a rate substantially lower than that available at franchised Chevrolet dealers through G.M.A.C., a subsidiary of General Motors Corporation. . . . Finally, it is conceded that

The protection of price competition from conspiratorial restraint is an object of special solicitude under the antitrust laws. We cannot respect that solicitude by closing our eyes to the effect upon price competition of the removal from the market, by combination or conspiracy, of a class of traders. Nor do we propose to construe the Sherman Act to prohibit conspiracies to fix prices at which competitors may sell, but to allow conspiracies or combinations to put competitors out of business entirely.

Accordingly, we reverse and remand to the United States District Court for the Southern District of California in order that it may fashion appropriate equitable relief. . . .

It is so ordered.

United States v. Arnold, Schwinn & Co.

388 U.S. 365 (1967)

MR. JUSTICE FORTAS delivered the opinion of the Court.

The United States brought this appeal to review the judgment of the District Court in a civil antitrust case alleging violations of §1 of the Sherman Act. . . . The complaint charged a continuing conspiracy since 1952 between defendants and other alleged co-conspirators involving price fixing, allocation of exclusive territories to wholesalers and jobbers, and confinement of merchandise to franchised dealers. Named as defendants were Arnold, Schwinn & Company ("Schwinn"), the Schwinn Cycle Distributors Association ("SCDA"), and B. F. Goodrich Company ("B. F. Goodrich").¹ . . .

Appellee Schwinn is a family-owned business which for many years has been engaged in the manufacture and sale of bicycles and some limited bicycle parts and accessories. Appellee SCDA is an association of distributors handling Schwinn bicycles and other products. The challenged marketing program was instituted in 1952. In 1951 Schwinn had the largest single share of the United States bicycle market—22.5%. In 1961 Schwinn's share of market had fallen to 12.8% although its dollar and unit sales had risen substantially. In the same period, a competitor, Murray Ohio Manufacturing Company, which is now the leading United States bicycle producer, increased its market share from 11.6% in 1951 to 22.8% in 1961. Murray sells primarily to Sears, Roebuck & Company and other mass merchandisers. By 1962 there were nine bicycle producers in the

General Motors is intensely concerned that each of its dealers has an adequate "profit opportunity" . . . , a concern which necessarily involves consideration of the price realized by dealers.

¹ B. F. Goodrich negotiated a consent decree with the Government prior to trial, and dropped out of the case.

through local advertising and merchandising efforts than they will have such reason to promote any other generally available brands.

The issues presented by the antitrust cases reaching this Court are rarely simple to resolve under the rule of reason; they do indeed frequently require us to make difficult economic determinations. We should not for that reason alone, however, be overly zealous in formulating new *per se* rules, for an excess of zeal in that regard is both contrary to the policy of the Sherman Act and detrimental to the welfare of consumers generally. Indeed, the economic effect of the new rule laid down by the Court today seems clear: unless Congress intervenes, grocery staples marketed under private-label brands with their lower consumer prices will soon be available only to those who patronize the large national chains.

*Continental T.V., Inc., et al. v.
GTE Sylvania Inc.*

433 U.S. 36 (1977)

MR. JUSTICE POWELL delivered the opinion of the Court.

Franchise agreements between manufacturers and retailers frequently include provisions barring the retailers from selling franchised products from locations other than those specified in the agreements. This case presents important questions concerning the appropriate antitrust analysis of these restrictions under §1 of the Sherman Act, . . . and the Court's decision in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967).

I

Respondent GTE Sylvania Inc. (Sylvania) manufactures and sells television sets through its Home Entertainment Products Division. Prior to 1962, like most other television manufacturers, Sylvania sold its televisions to independent or company-owned distributors who in turn resold to a large and diverse group of retailers. Prompted by a decline in its market share to a relatively insignificant 1 percent to 2 percent of national television sales,¹ Sylvania conducted an intensive reassessment of its marketing strategy, and in 1962 adopted the franchise plan challenged here. Sylvania phased out its wholesale distributors and began to sell its televisions directly to a smaller and more select group of franchised retailers. An acknowledged purpose of the change was to decrease the number of competing Sylvania retailers in the hope of attracting the more aggressive and competent retailers thought necessary to the improvement of the company's market position. . . . To this end, Sylvania limited the number of franchises granted for any given area and required each fran-

chisee to sell his Sylvania products only from the location or locations at which he was franchised.² A franchise did not constitute an exclusive territory, and Sylvania retained sole discretion to increase the number of retailers in an area in light of the success or failure of existing retailers in developing their market. The revised marketing strategy appears to have been successful during the period at issue here, for by 1965 Sylvania's share of national television sales had increased to approximately 5 percent, and the company ranked as the Nation's eighth largest manufacturer of color television sets.

This suit is the result of the rupture of a franchiser-franchisee relationship that had previously prospered under the revised Sylvania plan. Dissatisfied with its sales in the city of San Francisco,³ Sylvania decided in the spring of 1965 to franchise Young Brothers, an established San Francisco retailer of televisions, as an additional San Francisco retailer. The proposed location of the new franchise was approximately a mile from a retail outlet operated by petitioner Continental T.V., Inc. (Continental), one of the most successful Sylvania franchisees. . . . Continental protested that the location of the new franchise violated Sylvania's marketing policy, but Sylvania persisted in its plans. . . .

During this same period, Continental expressed a desire to open a store in Sacramento, California, a desire Sylvania attributed at least in part to Continental's displeasure over the Young Brothers decision. Sylvania believed that the Sacramento market was adequately served by the existing Sylvania retailers and denied the request.⁴ In the face of this denial, Continental advised Sylvania in early September 1965, that it was in the process of moving Sylvania merchandise from its San Jose, California warehouse to a new retail location that it had leased in Sacramento. . . . Shortly thereafter, Sylvania terminated Continental's franchises. . . .

The antitrust issues before us originated in cross-claims brought by Continental against Sylvania and Maguire [a finance company that handled the credit arrangements between Sylvania and its retailers]. Most important for our purposes was the claim that Sylvania had violated §1 of the Sherman Act by entering into and enforcing franchise agreements that prohibited the sale of Sylvania products other than from specified locations.⁵ . . . Relying on this Court's decision in *United States v. Arnold, Schwinn & Co.*, *supra*, the District Court . . . [gave the jury the following instruction]:

² Sylvania imposed no restrictions on the right of the franchisee to sell the products of competing manufacturers.

³ Sylvania's market share in San Francisco was approximately 2.5 percent—half its national and northern California average.

⁴ Sylvania had achieved exceptional results in Sacramento, where its market share exceeded 15 percent in 1965.

⁵ Although Sylvania contended in the District Court that its policy was unilaterally enforced, it now concedes that its location restriction involved understandings or agreements with the retailers.

¹ RCA at that time was the dominant firm with as much as 60 percent to 70 percent of national television sales in an industry with more than 100 manufacturers.

Therefore, if you find by a preponderance of the evidence that Sylvania entered into a contract, combination or conspiracy with one or more of its dealers pursuant to which Sylvania exercised dominion or control over the products sold to the dealer, after having parted with title and risk to the products, you must find any effort thereafter to restrict outlets or store locations from which its dealers resold the merchandise which they had purchased from Sylvania to be a violation of Section 1 of the Sherman Act, regardless of the reasonableness of the location restrictions.

In answers to special interrogatories, the jury found that Sylvania had engaged "in a contract, combination or conspiracy in restraint of trade in violation of the antitrust laws with respect to location restrictions alone." . . .

On appeal, the Court of Appeals for the Ninth Circuit, sitting en banc, reversed by a divided vote. The court acknowledged that there is language in *Schwinn* that could be read to support the District Court's instruction but concluded that *Schwinn* was distinguishable on several grounds. Contrasting the nature of the restrictions, their competitive impact, and the market shares of the franchisers in the two cases, the court concluded that Sylvania's location restriction had less potential for competitive harm than the restrictions invalidated in *Schwinn* and thus should be judged under the "rule of reason" rather than the per se rule stated in *Schwinn*. . . .

We granted Continental's petition for certiorari to resolve this important question of antitrust law.

II

A

We turn first to Continental's contention that Sylvania's restriction on retail locations is a per se violation of §1 of the Sherman Act as interpreted in *Schwinn*. The restrictions at issue in *Schwinn* were part of a three-tier distribution system comprising, in addition to Arnold, Schwinn & Co. (Schwinn), 22 intermediate distributors and a network of franchised retailers. Each distributor had a defined geographic area in which it had the exclusive right to supply franchised retailers. Sales to the public were made only through franchised retailers, who were authorized to sell Schwinn bicycles only from specified locations. In support of this limitation, Schwinn prohibited both distributors and retailers from selling Schwinn bicycles to nonfranchised retailers. At the retail level, therefore, Schwinn was able to control the number of retailers of its bicycles in any given area according to its view of the needs of that market.

The Court . . . [on appeal by the United States] stated that the resolution of the case would require an examination of "the specifics of the challenged practices and their impact upon the marketplace in order to make a judgment as to whether the restraint is or is not 'reasonable' in the special sense in which §1 of the Sherman Act must be read for purposes of

this type of inquiry." . . . Despite this description of its task, the Court proceeded to articulate the following "bright line" per se rule of illegality for vertical restrictions: "Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it." . . . But the Court expressly stated that the rule of reason governs when "the manufacturer retains title, dominion, and risk with respect to the product and the position and function of the dealer in question are, in fact, indistinguishable from those of an agent or salesman of the manufacturer." . . .

B

In the present case, it is undisputed that title to the televisions passed from Sylvania to Continental. Thus, the *Schwinn* per se rule applies unless Sylvania's restriction on locations falls outside *Schwinn*'s prohibition against a manufacturer's attempting to restrict a "retailer's freedom as to where and to whom it will resell the products." . . . As the Court of Appeals conceded, the language of *Schwinn* is clearly broad enough to apply to the present case. Unlike the Court of Appeals, however, we are unable to find a principled basis for distinguishing *Schwinn* from the case now before us.

Both Schwinn and Sylvania sought to reduce but not to eliminate competition among their respective retailers through the adoption of a franchise system. . . . These restrictions allowed Schwinn and Sylvania to regulate the amount of competition among their retailers by preventing a franchisee from selling franchised products from outlets other than the one covered by the franchise agreement. To exactly the same end, the Schwinn franchise plan included a companion restriction, apparently not found in the Sylvania plan, that prohibited franchised retailers from selling Schwinn products to nonfranchised retailers. In *Schwinn* the Court expressly held that this restriction was impermissible under the broad principle stated there. In intent and competitive impact, the retail-customer restriction in *Schwinn* is indistinguishable from the location restriction in the present case. In both cases the restrictions limited the freedom of the retailer to dispose of the purchased products as he desired. The fact that one restriction was addressed to territory and the other to customers is irrelevant to functional antitrust analysis and, indeed, to the language and broad thrust of the opinion in *Schwinn*.⁶ As MR. CHIEF JUSTICE HUGHES stated in *Appalachian Coals, Inc. v. United States*,

⁶ The distinctions drawn by the Court of Appeals and endorsed in MR. JUSTICE WHITE's separate opinion have no basis in *Schwinn*. The intrabrand competitive impact of the restrictions at issue in *Schwinn* ranged from complete elimination to mere reduction; yet, the Court did not even hint at any distinction on this ground. Similarly, there is no suggestion that the per se rule was applied because of Schwinn's prominent position in its industry. . . . Although Schwinn did hint at preferential treatment for new entrants and failing firms, the District Court below did not even submit Sylvania's claim that it was failing to the jury. . . .

288 U.S. 344, 360, 377 (1933): "Realities must dominate the judgment. . . . The Antitrust Act aims at substance."

III

Sylvania argues that if *Schwinn* cannot be distinguished, it should be reconsidered. Although *Schwinn* is supported by the principle of *stare decisis*, . . . we are convinced that the need for clarification of the law in this area justifies reconsideration. *Schwinn* itself was an abrupt and largely unexplained departure from *White Motor Co. v. United States*, 372 U.S. 253 (1963), where only four years earlier the Court had refused to endorse a per se rule for vertical restrictions. Since its announcement, *Schwinn* has been the subject of continuing controversy and confusion, both in the scholarly journals and in the federal courts. The great weight of scholarly opinion has been critical of the decision,⁷ and a number of the federal courts confronted with analogous vertical restrictions have sought to limit its reach.⁸ In our view, the experience of the past ten years should be brought to bear on this subject of considerable commercial importance.

The traditional framework of analysis under §1 of the Sherman Act is familiar and does not require extended discussion. Section 1 prohibits "[e]very contract, combination. . . , or conspiracy, in restraint of trade or commerce." Since the early years of this century a judicial gloss on this statutory language has established the "rule of reason" as the prevailing standard of analysis. . . . Under this rule, the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.⁹ Per se rules of illegality are appropriate only when they relate to conduct that is manifestly anticompetitive. As the Court explained in *Northern Pac. R. Co. v. United States*, 356 U.S. 1, 5 (1958), "there are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreason-

⁷ A former assistant attorney general in charge of the Antitrust Division has described *Schwinn* as "an exercise in barren formalism" that is "artificial and unresponsive to the competitive needs of the real world." Baker, "Vertical Restraints in Times of Change: From *White* to *Schwinn* to Where?," 44 *Antitrust L. J.* 537 (1975). . . .

⁸ Indeed, as one commentator has observed, many courts "have struggled to distinguish or limit *Schwinn* in ways that are a tribute to judicial ingenuity." Robinson . . . ["Recent Antitrust Developments: 1974," 75 *Colum. L. Rev.* 243 (1975)], n. 13, at 272. . . .

⁹ One of the most frequently cited statements of the rule of reason is that of JUSTICE BRANDEIS in *Chicago Board of Trade v. United States* 246 U.S. 231, 238 (1918):

"The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of the intent may help the court to interpret facts and to predict consequences."

able and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."¹⁰

In essence, the issue before us is whether *Schwinn's* per se rule can be justified under the demanding standards of *Northern Pac. R. Co.* The Court's refusal to endorse a per se rule in *White Motor Co.* was based on its uncertainty as to whether vertical restrictions satisfied those standards. Addressing this question for the first time, the Court stated:

We need to know more than we do about the actual impact of these arrangements on competition to decide whether they have such a "pernicious effect on competition and lack . . . any redeeming virtue" . . . and therefore should be classified as per se violations of the Sherman Act 372 U.S., at 263.

Only four years later the Court in *Schwinn* announced its sweeping per se rule without even a reference to *Northern Pac. R. Co.* and with no explanation of its sudden change in position.¹¹ We turn now to consider *Schwinn* in light of *Northern Pac. R. Co.*

The market impact of vertical restrictions¹² is complex because of their potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition.¹³ Significantly, the Court in

¹⁰ Per se rules thus require the Court to make broad generalizations about the social utility of particular commercial practices. The probability that anticompetitive consequences will result from a practice and the severity of those consequences must be balanced against its procompetitive consequences. Cases that do not fit the generalization may arise, but a per se rule reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them. Once established, per se rules tend to provide guidance to the business community and to minimize the burdens on litigants and the judicial system of the more complex rule of reason trials . . . but those advantages are not sufficient in themselves to justify the creation of per se rules. If it were otherwise, all of antitrust law would be reduced to per se rules, thus introducing an unintended and undesirable rigidity in the law.

¹¹ After *White Motor Co.*, the courts of appeals continued to evaluate territorial restrictions according to the rule of reason . . .

¹² As in *Schwinn*, we are concerned here only with nonprice vertical restrictions. The per se illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy. As MR. JUSTICE WHITE notes, post, . . . some commentators have argued that the manufacturer's motivation for imposing vertical price restrictions may be the same as for nonprice restrictions. There are, however, significant differences that could easily justify different treatment. In his concurring opinion in *White Motor Co.*, MR. JUSTICE BRENNAN noted that, unlike nonprice restrictions, "[r]esale price maintenance is not designed to, but almost invariably does in fact, reduce price competition not only among sellers of the affected product, but quite as much between that product and competing brands." 372 U.S. at 268. . . . Furthermore, Congress recently has expressed its approval of a per se analysis of vertical price restrictions by repealing those provisions of the Miller-Tydings and McGuire Acts allowing fair trade pricing at the option of the individual States. . . . No similar expression of congressional intent exists for nonprice restrictions.

¹³ Interbrand competition is the competition among the manufacturers of the same generic product—television sets in this case—and is the primary concern of antitrust law. The extreme example of a deficiency of interbrand competition is monopoly, where there is only one manufacturer. In contrast, intrabrand competition is the competition between the distributors—wholesale or retail—of the product of a particular manufacturer. (Cont.)

Schwinn did not distinguish among the challenged restrictions on the basis of their individual potential for intrabrand harm or interbrand benefit. Restrictions that completely eliminated intrabrand competition among *Schwinn* distributors were analyzed no differently from those that merely moderated intrabrand competition among retailers. The pivotal factor was the passage of title: all restrictions were held to be per se illegal where title had passed, and all were evaluated and sustained under the rule of reason where it had not. The location restriction at issue here would be subject to the same pattern of analysis under *Schwinn*.

It appears that this distinction between sale and nonsale transactions resulted from the Court's effort to accommodate the perceived intrabrand harm and interbrand benefit of vertical restrictions. The per se rule for sale transactions reflected the view that vertical restrictions are "so obviously destructive" of intrabrand competition . . . that their use would "open the door to exclusivity of outlets and limitation of territory further than prudence permits." . . .¹⁴ Conversely, the continued adherence to the traditional rule of reason for nonsale transactions reflected the view that the restrictions have too great a potential for the promotion of interbrand competition to justify complete prohibition.¹⁵ The Court's opinion

The degree of intrabrand competition is wholly independent of the level of interbrand competition confronting the manufacturer. Thus, there may be fierce intrabrand competition among the distributors of a product produced by a monopolist and no intrabrand competition among the distributors of a product produced by a firm in a highly competitive industry. But when interbrand competition exists, as it does among television manufacturers, it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product.

¹⁴ The Court also stated that to impose vertical restrictions in sale transactions would "violate the ancient rule against restraints on alienation." 388 U.S., at 380. This isolated reference has provoked sharp criticism from virtually all of the commentators on the decision, most of whom have regarded the Court's apparent reliance on the "ancient rule" as both a misreading of legal history and a perversion of antitrust analysis. . . .

We are similarly unable to accept Judge Browning's interpretation of *Schwinn*. In his dissent below he argued that the decision reflects the view that the Sherman Act was intended to prohibit restrictions on the autonomy of independent businessmen even though they have no impact on "price, quality, and quantity of goods and services." . . . This view is certainly not explicit in *Schwinn*, which purports to be based on an examination of the "impact [of the restrictions] upon the marketplace." . . . Competitive economies have social and political as well as economic advantages, . . . but an antitrust policy divorced from market considerations would lack any objective benchmarks. . . .

¹⁵ In that regard, the Court specifically stated that a more complete prohibition "might severely hamper smaller enterprises resorting to reasonable methods of meeting the competition of giants and of merchandising through independent dealers." . . . The Court also broadly hinted that it would recognize additional exceptions to the per se rule for new entrants in an industry and for failing firms, both of which were mentioned in *White Motor* as candidates for such exceptions. . . . The Court might have limited the exceptions to the per se rule to these situations, which present the strongest arguments for the sacrifice of intrabrand competition for interbrand competition. Significantly, it chose instead to create the more extensive exception for nonsale transactions which is available to all businesses, regardless of their size, financial health, or market share. This broader exception demonstrates even more clearly the Court's awareness of the "redeeming virtues" of vertical restrictions.

provides no analytical support for these contrasting positions. Nor is there even an assertion in the opinion that the competitive impact of vertical restrictions is significantly affected by the form of the transaction. Nonsale transactions appear to be excluded from the per se rule, not because of a greater danger of intrabrand harm or a greater promise of interbrand benefit, but rather because of the Court's unexplained belief that a complete per se prohibition would be too "inflexible." . . .

Vertical restrictions reduce intrabrand competition by limiting the number of sellers of a particular product competing for the business of a given group of buyers. Location restrictions have this effect because of practical constraints on the effective marketing area of retail outlets. Although intrabrand competition may be reduced, the ability of retailers to exploit the resulting market may be limited both by the ability of consumers to travel to other franchised locations and perhaps more importantly, to purchase the competing products of other manufacturers. None of these key variables, however, is affected by the form of the transaction by which a manufacturer conveys his products to the retailers.

Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. These "redeeming virtues" are implicit in every decision sustaining vertical restrictions under the rule of reason. Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers. . . .¹⁶ For example, new manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer. Established manufacturers can use them to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products. Service and repair are vital for many products, such as automobiles and major household appliances. The availability and quality of such services affect a manufacturer's good will and competitiveness of his product. Because of market imperfections such as the so-called free-rider effect, these services might not be provided by retailers in a purely competitive situation, despite the fact that each retailer's benefit would be greater if all provided the services than if none did. . . .

Economists also have argued that manufacturers have an economic interest in maintaining as much intrabrand competition as is consistent

¹⁶ Marketing efficiency is not the only legitimate reason for a manufacturer's desire to exert control over the manner in which his products are sold and serviced. As a result of statutory and common law developments, society increasingly demands that manufacturers assume direct responsibility for the safety and quality of their products. . . . The legitimacy of these concerns has been recognized in cases involving vertical restrictions. . . .

with the efficient distribution of their products. . . .¹⁷ Although the view that the manufacturer's interest necessarily corresponds with that of the public is not universally shared, even the leading critic of vertical restrictions concedes that *Schwinn's* distinction between sale and nonsale transactions is essentially unrelated to any relevant economic impact. Comanor, "Vertical Territorial and Customer Restrictions: *White Motor* and Its Aftermath," 81 *Harv. L. Rev.* 1419, 1422 (1968).¹⁸ Indeed, to the extent that the form of the transaction is related to interbrand benefits, the Court's distinction is inconsistent with its articulated concern for the ability of smaller firms to compete effectively with larger ones. Capital requirements and administrative expenses may prevent smaller firms from using the exception for nonsale transactions. . . .¹⁹

We conclude that the distinction drawn in *Schwinn* between sale and nonsale transactions is not sufficient to justify the application of a per se rule in one situation and a rule of reason in the other. The question remains whether the per se rule stated in *Schwinn* should be expanded to include nonsale transactions or abandoned in favor of a return to the rule of reason. We have found no persuasive support for expanding the per se rule. . . .

We revert to the standard articulated in *Northern Pac. R. Co.*, and reiterated in *White Motor*, for determining whether vertical restrictions must be "conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." . . . Such restrictions, in varying forms, are widely used in our free market economy. As indicated above, there is substantial scholarly and judicial authority supporting their economic utility. There is relatively little authority to the contrary.²⁰ Certainly,

¹⁷ "Generally a manufacturer would prefer the lowest retail price possible, once its price to dealers has been set, because a lower retail price means increased sales and higher manufacturer revenues." Note, 88 *Harv. L. Rev.* 636, 641 (1975). In this context, a manufacturer is likely to view the difference between the price at which it sells to its retailers and their price to the consumer as its "cost of distribution," which it would prefer to minimize. . . .

¹⁸ Professor Comanor argues that the promotional activities encouraged by vertical restrictions result in product differentiation and, therefore, a decrease in interbrand competition. This argument is flawed by its necessary assumption that a large part of the promotional efforts resulting from vertical restrictions will not convey socially desirable information about product availability, price, quality, and services. Nor is it clear that a per se rule would result in anything more than a shift to less efficient methods of obtaining the same promotional effects.

¹⁹ We also note that per se rules in this area may work to the ultimate detriment of the small businessmen who operate as franchisees. To the extent that a per se rule prevents a firm from using the franchise system to achieve efficiencies that it perceives as important to its successful operation, the rule creates an incentive for vertical integration into the distribution system, thereby eliminating to that extent the role of independent businessmen. . . .

²⁰ There may be occasional problems in differentiating vertical restrictions from horizontal restrictions originating in agreements among the retailers. There is no doubt that restrictions in the latter category would be illegal per se, . . . but we do not regard the problems of proof as sufficiently great to justify a per se rule.

there has been no showing in this case, either generally or with respect to Sylvania's agreements, that vertical restrictions have or are likely to have a "pernicious effect on competition" or that they "lack . . . any redeeming virtue." . . .²¹ Accordingly, we conclude that the per se rule stated in *Schwinn* must be overruled. . . . In so holding we do not foreclose the possibility that particular applications of vertical restrictions might justify per se prohibition under *Northern Pac. R. Co.* But we do make clear that departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than—as in *Schwinn*—upon formalistic line drawing.

In sum, we conclude that the appropriate decision is to return to the rule of reason that governed vertical restrictions prior to *Schwinn*. When anticompetitive effects are shown to result from particular vertical restrictions they can be adequately policed under the rule of reason, the standard traditionally applied for the majority of anticompetitive practices challenged under §1 of the Act. Accordingly, the decision of the Court of Appeals is affirmed.

MR. JUSTICE REHNQUIST took no part in the consideration or decision of this case.

MR. JUSTICE WHITE, concurring in the judgment.

Although I agree with the majority that the location clause at issue in this case is not a per se violation of the Sherman Act and should be judged under the rule of reason, I cannot agree that this result requires the overruling of *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967). In my view this case is distinguishable from *Schwinn* because there is less potential for restraint of intrabrand competition and more potential for stimulating interbrand competition. As to intrabrand competition, Sylvania, unlike *Schwinn*, did not restrict the customers to whom or the territories where its purchasers could sell. As to interbrand competition, Sylvania, unlike *Schwinn*, had an insignificant market share at the time it adopted its challenged distribution practice and enjoyed no consumer preference that would allow its retailers to charge a premium over other brands. . . . To reach out to overrule one of this Court's recent interpretations of the Sherman Act, after such a cursory examination of the necessity for doing so, is surely an affront to the principle that considera-

²¹ The location restriction used by Sylvania was neither the least nor the most restrictive provision that it could have used. . . . But we agree with the implicit judgment in *Schwinn* that a per se rule based on the nature of the restriction is, in general, undesirable. Although distinctions can be drawn among the frequently used restrictions, we are inclined to view them as differences of degree and form. . . . We are unable to perceive significant social gain from channeling transactions into one form or another. Finally, we agree with the Court in *Schwinn* that the advantages of vertical restrictions should not be limited to the categories of new entrants and failing firms. Sylvania was faltering, if not failing, and we think it would be unduly artificial to deny it the use of valuable competitive tools.

tions of *stare decisis* are to be given particularly strong weight in the area of statutory construction. . . .

One element of the system of interrelated vertical restraints invalidated in *Schwinn* was a retail-customer restriction prohibiting franchised retailers from selling Schwinn products to nonfranchised retailers. The Court rests its inability to distinguish *Schwinn* entirely on this retail-customer restriction, finding it "[i]n intent and competitive impact . . . indistinguishable from the location restriction in the present case," because "[i]n both cases the restrictions limited the freedom of the retailer to dispose of the purchased products as he desired." . . . The customer restriction may well have, however, a very different "intent and competitive impact" than the location restriction: it prevents discount stores from getting the manufacturer's product and thus prevents intrabrand price competition. Suppose, for example, that interbrand competition is sufficiently weak that the franchised retailers are able to charge a price substantially above wholesale. Under a location restriction, these franchisers are free to sell to discount stores seeking to exploit the potential for sales at prices below the prevailing retail level. One of the franchised retailers may be tempted to lower its price and act in effect as a wholesaler for the discount house in order to share in the profits to be had from lowering prices and expanding volume. . . .

Under a retail customer restriction, on the other hand, the franchised dealers cannot sell to discounters, who are cut off altogether from the manufacturer's product and the opportunity for intrabrand price competition. This was precisely the theory on which the Government successfully challenged Schwinn's customer restrictions in this Court. . . .

It is true that, as the majority states, Sylvania's location restriction inhibited to some degree "the freedom of the retailer to dispose of the purchased products" by requiring the retailer to sell from one particular place of business. But the retailer is still free to sell to any type of customer—including discounters and other unfranchised dealers—from any area. I think this freedom implies a significant difference for the effect of a location clause on intrabrand competition. The District Court on remand in *Schwinn* evidently thought so as well, for after enjoining Schwinn's customer restrictions as directed by this Court it expressly sanctioned location clauses, permitting Schwinn to "designat[e] in its retailer franchise agreements the location of the place or places of business for which the franchise is issued." . . .

An additional basis for finding less restraint of intrabrand competition in this case, emphasized by the Ninth Circuit en banc, is that *Schwinn* involved [territorial] restrictions on competition among distributors at the wholesale level. . . . Moreover, like its franchised retailers, Schwinn's distributors were absolutely barred from selling to nonfranchised retailers, further limiting the possibilities of intrabrand price competition.

The majority apparently gives no weight to the Court of Appeals' re-

liance on the difference between the competitive effects of Sylvania's location clause and Schwinn's interlocking "system of vertical restraints affecting both wholesale and retail distribution." . . .

Just as there are significant differences between *Schwinn* and this case with respect to intrabrand competition, there are also significant differences with respect to interbrand competition. Unlike Schwinn, Sylvania clearly had no economic power in the generic product market. At the time they instituted their respective distribution policies, Schwinn was "the leading bicycle producer in the Nation," with a national market share of 22.5 percent, . . . whereas Sylvania was a "faltering, if not failing" producer of television sets, with "a relatively insignificant 1 percent to 2 percent" share of the national market in which the dominant manufacturer had a 60 percent to 70 percent share. . . . Moreover, the Schwinn brand name enjoyed superior consumer acceptance and commanded a premium price as, in the District Court's words, "the Cadillac of the bicycle industry." . . . This premium gave Schwinn dealers a margin of protection from interbrand competition and created the possibilities for price cutting by discounters that the Government argued were forestalled by Schwinn's customer restrictions. . . . Thus, judged by the criteria economists use to measure market power—product differentiation and market share . . . —Schwinn enjoyed a substantially stronger position in the bicycle market than did Sylvania in the television market. This Court relied on Schwinn's market position as one reason not to apply the rule of reason to the vertical restraints challenged there. "Schwinn was not a newcomer, seeking a break into or a stay in the bicycle business. It was not a 'failing company.' On the contrary, at the initiation of these practices, it was the leading bicycle producer in the Nation." . . . And the Court of Appeals below found "another significant distinction between our case and *Schwinn*" in Sylvania's "precarious market share," which "was so small when it adopted its locations practice that it was threatened with expulsion from the television market." . . .

In my view there are at least two considerations, both relied upon by the majority to justify overruling *Schwinn*, that would provide a "principled basis" for instead refusing to extend *Schwinn* to a vertical restraint that is imposed by a "faltering" manufacturer with a "precarious" position in a generic product market dominated by another firm. The first is that, as the majority puts it, "when interbrand competition exists, as it does among television manufacturers, it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product." . . . Second is the view, argued forcefully in the economic literature cited by the majority, that the potential benefits of vertical restraints in promoting interbrand competition are particularly strong where the manufacturer imposing the restraints is seeking to enter a new market or to

expand a small market share. . . . The majority even recognizes that *Schwinn* "hinted" at an exception for new entrants and failing firms from its per se rule. . . .

In other areas of antitrust law, this Court has not hesitated to base its rules of per se illegality in part on the defendant's market power. . . . I see no doctrinal obstacle to excluding firms with such minimal market power as Sylvania's from the reach of the *Schwinn* rule.²²

I have, moreover, substantial misgivings about the approach the majority takes to overruling *Schwinn*. The reason for the distinction in *Schwinn* between sale and nonsale transactions was not, as the majority would have it, "the Court's effort to accommodate the perceived intra-brand harm and interbrand benefit of vertical restrictions. . . ." ; the reason was rather, as Judge Browning argued in dissent below, the notion in many of our cases involving vertical restraints that independent businessmen should have the freedom to dispose of the goods they own as they see fit. . . .

After summarily rejecting this concern, reflected in our interpretations of the Sherman Act for "the autonomy of independent businessmen," . . . the majority not surprisingly finds "no justification" for *Schwinn*'s distinction between sale and nonsale transactions because the distinction is "essentially unrelated to any relevant economic impact." . . . But while according some weight to the businessman's interest in controlling the terms on which he trades in his own goods may be anathema to those who view the Sherman Act as directed solely to economic efficiency, . . . this principle is without question more deeply embedded in our cases than the notions of free-rider effects and distributional efficiencies borrowed by the majority from the "new economics of vertical relationships." . . . Perhaps the Court is right in partially abandoning this principle and in judging the instant nonprice vertical restraints solely by their "relevant economic impact"; but the precedents which reflect this principle should not be so lightly rejected by the Court. . . .

I have a further reservation about the majority's reliance on "relevant economic impact" as the test for retaining per se rules regarding vertical restraints. It is common ground among the leading advocates of a purely economic approach to the question of distribution restraints that the economic arguments in favor of allowing vertical nonprice restraints generally apply to vertical price restraints as well.²³ Although the majority

²² . . . The majority's failure to use the market share of *Schwinn* and Sylvania as a basis for distinguishing these cases is the more anomalous for its reliance. . . . on the economic analysis of those who distinguish the anticompetitive effects of distribution restraints on the basis of the market shares of the distributors. . . .

²³ Professor Posner writes, for example: "There is no basis for choosing between [price fixing and market division] on social grounds. If resale price maintenance is like dealer price fixing, and therefore bad, a manufacturer's assignment of exclusive sales territories is like market division, and therefore bad too. . . ."

asserts that "the per se illegality of price restrictions . . . involves significantly different questions of analysis and policy," . . . I suspect this purported distinction may be as difficult to justify as that of *Schwinn* under the terms of the majority's analysis. . . . Indeed, the Court has already recognized that resale price maintenance may increase output by inducing "demand-creating activity" by dealers (such as additional retail outlets, advertising and promotion, and product servicing) that outweighs the additional sales that would result from lower prices brought about by dealer price competition. . . . These same output-enhancing possibilities of nonprice vertical restraints are relied upon by the majority as evidence of their "social utility and economic soundness," . . . and as a justification for judging them under the rule of reason. The effect, if not the intention, of the Court's opinion is necessarily to call into question the firmly established per se rule against price restraints.

Although the case law in the area of distributional restraints has perhaps been less than satisfactory, the Court would do well to proceed more deliberately in attempting to improve it. . . . In order to decide this case, the Court need only hold that a location clause imposed by a manufacturer with negligible economic power in the product market has a competitive impact sufficiently less restrictive than the *Schwinn* restraints to justify a rule-of-reason standard, even if the same weight is given here as in *Schwinn* to dealer autonomy. I therefore concur in the judgment.

MR. JUSTICE BRENNAN, with whom MR. JUSTICE MARSHALL joins, dissenting.

I would not overrule the per se rule stated in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), and would therefore reverse the decision of the Court of Appeals for the Ninth Circuit.

Siegel v. Chicken Delight, Inc.

448 F.2d 43 (9th Cir. 1971)

cert. denied 405 U.S. 955 (1972)

MERRILL, Circuit Judge

I. FACTUAL BACKGROUND

Over its eighteen years' existence, Chicken Delight has licensed several hundred franchisees to operate home delivery and pick-up food stores. It charged its franchisees no franchise fees or royalties. Instead, in exchange for the license granting the franchisees the right to assume its

"[If helping new entrants break into a market] is a good justification for exclusive territories, it is an equally good justification for resale price maintenance, which as we have seen is simply another method of dealing with the free-rider problem. . . . In fact, any argument that can be made on behalf of exclusive territories can also be made on behalf of resale price maintenance." Posner, *supra*, n. 7, at 292-293. (Footnote omitted.) . . .

identity and adopt its business methods and to prepare and market certain food products under its trade-mark, Chicken Delight required its franchisees to purchase a specified number of cookers and fryers and to purchase certain packaging supplies and mixes exclusively from Chicken Delight. . . . The prices fixed for these purchases were higher than, and included a percentage markup which exceeded that of, comparable products sold by competing suppliers.

II. THE EXISTENCE OF AN UNLAWFUL TYING ARRANGEMENT

. . . In order to establish that there exists an unlawful tying arrangement plaintiffs must demonstrate *First*, that the scheme in question involves two distinct items and provides that one (the tying product) may not be obtained unless the other (the tied product) is also purchased. . . . *Second*, that the tying product possesses sufficient economic power appreciably to restrain competition in the tied product market. . . . *Third*, that a "not insubstantial" amount of commerce is affected by the arrangement. . . . Chicken Delight concedes that the third requirement has been satisfied. It disputes the existence of the first two. Further it asserts that, even if plaintiffs should prevail with respect to the first two requirements, there is a *fourth* issue: whether there exists a special justification for the particular tying arrangement in question. . . .

A. Two Products

. . . The hallmark of a tie-in is that it denies competitors free access to the tied product market, not because the party imposing the arrangement has a superior product in that market, but because of the power or leverage exerted by the tying product. . . . Rules governing tying arrangements are designed to strike, not at the mere coupling of physically separable objects, but rather at the use of a dominant desired product to compel the purchase of a second, distinct commodity. . . . In effect, the forced purchase of the second, tied product is a price exacted for the purchase of the dominant, tying product. By shutting competitors out of the tied product market, tying arrangements serve hardly any purpose other than the suppression of competition. . . .

Chicken Delight urges us to hold that its trade-mark and franchise licenses are not items separate and distinct from the packaging, mixes, and equipment, which it says are essential components of the franchise system. . . . To treat the combined sale of all these items as a tie-in for antitrust purposes, Chicken Delight maintains, would be like applying the antitrust rules to the sale of a car with its tires or a left shoe with the right. Therefore, concludes Chicken Delight, the lawfulness of the arrangement should not be measured by the rules governing tie-ins. We disagree.

. . . In determining whether an aggregation of separable items should

be regarded as one or more items for tie-in purposes in the normal cases of sales of products the courts must look to the function of the aggregation. . . . Consideration is given to such questions as whether the amalgamation of products resulted in cost savings apart from those reductions in sales expenses and the like normally attendant upon any tie-in, and whether the items are normally sold or used as a unit with fixed proportions.¹

Where one of the products sold as part of an aggregation is a trademark or franchise license, new questions are injected. In determining whether the license and the remaining ("tied") items in the aggregation are to be regarded as distinct items which can be traded in distinct markets consideration must be given to the function of trade-marks.

The historical conception of a trade-mark as a strict emblem of source of the product to which it attaches has largely been abandoned. The burgeoning business of franchising has made trade-mark licensing a widespread commercial practice and has resulted in the development of a new rationale for trade-marks as representations of product quality. . . . This is particularly true in the case of a franchise system set up not to distribute the trade-marked goods of the franchisor, but, as here, to conduct a certain business under a common trade-mark or trade name. . . . Under such a type of franchise, the trade-mark simply reflects the goodwill and quality standards of the enterprise which it identifies. As long as the system of operation of the franchisees lives up to those quality standards and remains as represented by the mark so that the public is not misled, neither the protection afforded the trade-mark by law nor the value of the trade-mark to the licensee depends upon the source of the components.

This being so, it is apparent that the goodwill of the Chicken Delight trade-mark does not attach to the multitude of separate articles used in the operation of the licensed system or in the production of its end product. It is not what is used, but how it is used and what results that have given the system and its end product their entitlement to trade-mark protection. It is to the system and the end product that the public looks with the confidence that established goodwill has created.

. . . Thus, sale of a franchise license, with the attendant rights to operate a business in the prescribed manner and to benefit from the goodwill of the trade name, in no way requires the forced sale by the franchisor of some or all of the component articles. Just as the quality of a

¹ It should be readily apparent that, measured against these tests, the package sales here in question are quite different from the sale of an automobile and its tires or a left shoe and the right. In particular, there are several factors in this case which other courts have deemed sufficient to find a tie-in. Undisputed testimony at trial established that other franchisors in fast food businesses similar to that of Chicken Delight sold their licenses separate from the essential supplies. The various supplies sold here were sold individually and in differing amounts, rather than in a preassembled package, and the franchisees were billed accordingly. At no time were the franchisees required to purchase all their various supplies from Chicken Delight. Chicken Delight did not itself manufacture the tied items.

copyrighted creation cannot by a tie-in be appropriated by a creation to which the copyright does not relate, . . . so here attempts by tie-in to extend the trade-mark protection to common articles (which the public does not and has no reason to connect with the trade-mark) simply because they are said to be essential to production of that which is the subject of the trade-mark, cannot escape antitrust scrutiny.

. . . Chicken Delight's assertions that only a few essential items were involved in the arrangement does not give us cause to reach a different conclusion. The relevant question is not whether the items are essential to the franchise, but whether it is essential to the franchise that the items be purchased from Chicken Delight. This raises not the issue of whether there is a tie-in but rather the issue of whether the tie-in is justifiable, a subject to be discussed below.

We conclude that the District Court was not in error in ruling as matter of law that the arrangement involved distinct tying and tied products.

B. Economic Power

. . . Under the *per se* theory of illegality, plaintiffs are required to establish not only the existence of a tying arrangement but also that the tying product possesses sufficient economic power to appreciably restrain free competition in the tied product markets. . . .

Chicken Delight points out that while it was an early pioneer in the fast food franchising field, the record establishes that there has recently been a dramatic expansion in this area, with the advent of numerous firms, including many chicken franchising systems, all competing vigorously with each other. Under the circumstances, it contends that the existence of the requisite market dominance remained a jury question.

The District Court ruled, however, that Chicken Delight's unique registered trade-mark, in combination with its demonstrated power to impose a tie-in, established as matter of law the existence of sufficient market power to bring the case within the Sherman Act.

We agree. . . .

It can hardly be denied that the Chicken Delight trade-mark is distinctive; that it possesses goodwill and public acceptance unique to it and not enjoyed by other fast food chains.

. . . It is now clear that sufficient economic power is to be presumed where the tying product is patented or copyrighted. . . .

Just as the patent or copyright forecloses competitors from offering the distinctive product on the market, so the registered trade-mark presents a legal barrier against competition. It is not the nature of the public interest that has caused the legal barrier to be erected that is the basis for the presumption, but the fact that such a barrier does exist. Accordingly we see no reason why the presumption that exists in the case of the patent and copyright does not equally apply to the trade-mark. . . .

Thus we conclude that the District Court did not err in ruling as matter of law that the tying product—the license to use the Chicken Delight

trade-mark—possessed sufficient market power to bring the case within the Sherman Act.

C. Justification

Chicken Delight maintains that, even if its contractual arrangements are held to constitute a tying arrangement, it was not an unreasonable restraint under the Sherman Act. Three different bases for justification are urged.

. . . First, Chicken Delight contends that the arrangement was a reasonable device for measuring and collecting revenue. There is no authority for justifying a tying arrangement on this ground. Unquestionably, there exist feasible alternative methods of compensation for the franchise licenses, including royalties based on sales volume or fees computed per unit of time, which would neither involve tie-ins nor have undesirable anticompetitive consequences.²

. . . Second, Chicken Delight advances as justification the fact that when it first entered the fast food field in 1952 it was a new business and was then entitled to the protection afforded by *United States v. Jerrold Electronics Corp.*, . . . 187 F. Supp. 545 (E.D. Pa. 1960). As to the period here involved—1963 to 1970—it contends that transition to a different arrangement would be difficult if not economically impossible.

We find no merit in this contention. Whatever claim Chicken Delight might have had to a new business defense in 1952—a question we need not decide—the defense cannot apply to the 1963–70 period. To accept Chicken Delight's argument would convert the new business justification into a perpetual license to operate in restraint of trade. *See Id.*, 187 F. Supp. at 558, 561.

The third justification Chicken Delight offers is the “marketing identity” purpose, the franchisor's preservation of the distinctiveness, uniformity and quality of its product.

. . . In the case of a trade-mark this purpose cannot be lightly dismissed. Not only protection of the franchisor's goodwill is involved. The licensor owes an affirmative duty to the public to assure that in the hands of his licensee the trade-mark continues to represent that which it purports to represent. For a licensor, through relaxation of quality control, to permit inferior products to be presented to the public under his licensed mark might well constitute a misuse of the mark. . . .

However, to recognize that such a duty exists is not to say that every means of meeting it is justified. Restraint of trade can be justified only in the absence of less restrictive alternatives. In cases such as this, where the alternative of specification is available,³ the language used in *Stan-*

² It bears noting that Chicken Delight's competitors in the fast food franchising business did not find it necessary to use tie-ins.

³ There may, of course, be cases where some extraordinary condition forecloses specification, e.g., where it would divulge a trade secret.

dard Oil Co. v. United States, . . . 337 U.S. at 306 (1949), . . . in our view states the proper test, applicable in the case of trade-marks as well as in other cases:

. . . the protection of the good will of the manufacturer of the tying device—fails in the usual situation because specification of the type and quality of the product to be used in connection with the tying device is protection enough. . . . The only situation, indeed, in which the protection of good will may necessitate the use of tying clauses is where specifications for a substitute would be so detailed that they could not practicably be supplied. . . .

The District Court found factual issues to exist as to whether effective quality control could be achieved by specification in the case of the cooking machinery and the dip and spice mixes. These questions were given to the jury under instructions; and the jury, in response to special interrogatories, found against *Chicken Delight*. . . .

As to the paper packaging, the court ruled as matter of law that no justification existed. It stated, 311 F. Supp. at page 851:

Defendants' showing on paper packaging is nothing more than a recitation of the need for distinctive packaging to be used uniformly by all franchisees in identifying the hot foods. This was not contested. However, the admissions in evidence clearly demonstrate that the tied packaging was easily specifiable. In fact, the only specifications required were printing and color. Moreover, defendants have admitted that any competent manufacturer of like products could consistently and satisfactorily manufacture the packaging products if defendants furnished specifications. Those suppliers could have sold to the franchisees through normal channels of distribution.

We agree. One cannot immunize a tie-in from the antitrust laws by simply stamping a trade-mark symbol on the tied product—at least where the tied product is not itself the product represented by the mark.

We conclude that the District Court was not in error in holding as matter of law (and upon the limited jury verdict) that *Chicken Delight's* contractual requirements constituted a tying arrangement in violation of §1 of the Sherman Act. Upon this aspect of the case, judgment is affirmed. . . .

Monsanto Co. v. Spray-Rite Service Corp.

104 U.S. 1464 (1984)

JUSTICE POWELL delivered the opinion of the Court:

This case presents a question as to the standard of proof required to find a vertical price-fixing conspiracy in violation of Section 1 of the Sherman Act.

I

Petitioner Monsanto Company manufactures chemical products, including agricultural herbicides. By the late 1960s, the time at issue in this case, its sales accounted for approximately 15% of the corn herbicide market and 3% of the soybean herbicide market. In the corn herbicide market, the market leader commanded a 70% share. In the soybean herbicide market, two other competitors each had between 30% and 40% of the market. Respondent Spray-Rite Service Corporation was engaged in the wholesale distribution of agricultural chemicals from 1955 to 1972. Spray-Rite was essentially a family business, whose owner and president, Donald Yapp, was also its sole salaried salesman. Spray-Rite was a discount operation, buying in large quantities and selling at a low margin.

Spray-Rite was an authorized distributor of Monsanto herbicides from 1957 to 1968. In October 1967, Monsanto announced that it would appoint distributors for one-year terms, and that it would renew distributors according to several new criteria. Among the criteria were: (i) whether the distributor's primary activity was soliciting sales to retail dealers; (ii) whether the distributor employed trained salesmen capable of educating its customers on the technical aspects of Monsanto's herbicides; and (iii) whether the distributor could be expected "to exploit fully" the market in its geographical area of primary responsibility. . . .¹

In October 1968, Monsanto declined to renew Spray-Rite's distributorship. At that time, Spray-Rite was the 10th largest out of approximately 100 distributors of Monsanto's primary corn herbicide. Ninety percent of Spray-Rite's sales volume was devoted to herbicide sales, and 16 percent of its sales were of Monsanto products. After Monsanto's termination, Spray-Rite continued as a herbicide dealer until 1972. It was able to purchase some of Monsanto's products from other distributors, but not as much as it desired or as early in the season as it needed. Monsanto introduced a new corn herbicide in 1969. By 1972, its share of the corn herbicide market had increased to approximately 28%. Its share of the soybean herbicide market had grown to approximately 19%.

Spray-Rite brought this action under Section 1 of the Sherman Act. . . . It alleged that Monsanto and some of its distributors conspired to fix the resale prices of Monsanto herbicides. Its complaint further alleged that Monsanto terminated Spray-Rite's distributorship, adopted compensation programs and shipping policies, and encouraged distributors to boycott Spray-Rite in furtherance of this conspiracy. Monsanto denied the allegations of conspiracy, and asserted that Spray-Rite's

¹ These areas of primary responsibility were not exclusive territorial restrictions. Approximately 10 to 20 distributors were assigned to each area, and distributors were permitted to sell outside their assigned area.

Does Regulation Make a Difference?

The cases presented in this chapter serve two purposes. First, they supplement the recent merger decisions set forth in Chapter 5 and are of interest as merger cases alone. Second, they illustrate a development in antitrust which continues to generate a substantial amount of controversy among both students and policymakers—attempts to reconcile the methods used by regulators with those favored by antitrust enforcement officials.

Parker v. Brown

338 U.S. 341 (1943)

MR. CHIEF JUSTICE STONE delivered the opinion of the Court.

The questions for our consideration are whether the marketing program adopted for the 1940 raisin crop under the California Agricultural Prorate Act is rendered invalid (1) by the Sherman Act, or (2) by the Agricultural Marketing Agreement Act of 1937, as amended, . . . or (3) by the Commerce Clause of the Constitution.¹

Appellee, a producer and packer of raisins in California brought this suit in the district court to enjoin appellants—the State Director of Agriculture, Raisin Proration Zone No. 1, the members of the State Agricultural Prorate Advisory Commission and of the Program Committee for Zone No. 1, and others charged by the statute with the administration of the Prorate Act—from enforcing, as to appellee, a program for marketing the 1940 crop of raisins produced in “Raisin Proration Zone No. 1.” . . .

As appears from the evidence and from the findings of the district

¹ We include here only that portion of the opinion relating to (1). IMS.

court, almost all of the raisins consumed in the United States, and nearly one-half of the world crop, are produced in Raisin Proration Zone No. 1. Between 90 and 95 percent of the raisins grown in California are ultimately shipped in interstate or foreign commerce. . . .

The California Agricultural Prorate Act authorizes the establishment, through action of state officials, of programs for the marketing of agricultural commodities produced in the state, so as to restrict competition among the growers and maintain prices in the distribution of their commodities to packers. The declared purpose of the Act is to "conserve the agricultural wealth of the State" and to "prevent economic waste in the marketing of agricultural products" of the state. . . .

Upon the petition of ten producers for the establishment of a prorate marketing plan for any commodity within a defined production zone . . . , and after a public hearing . . . , and after making prescribed economic findings . . . showing that the institution of a program for the proposed zone will prevent agricultural waste and conserve agricultural wealth of the state without permitting unreasonable profits to producers, the Commission is authorized to grant the petition. The Director, with the approval of the Commission, is then required to select a program committee from among nominees chosen by the qualified producers within the zone, to which he may add not more than two handlers or packers who receive the regulated commodity from producers for marketing. . . .

The program committee is required . . . to formulate a proration marketing program for the commodity produced in the zone, which the Commission is authorized to approve after a public hearing and a "finding that the program is reasonably calculated to carry out the objectives of the Act." The Commission may, if so advised, modify the program and approve it as modified. If the proposed program, as approved by the Commission, is consented to by 65 percent in number of producers in the zone owning 51 percent of the acreage devoted to production of the regulated crop, the Director is required to declare the program instituted. . . .

Authority to administer the program, subject to the approval of the Director of Agriculture, is conferred on the program committee. . . . Section 22.5 declares that it shall be a misdemeanor . . . for any producer to sell or any handler to receive or possess without proper authority any commodity for which a proration program has been instituted. . . . Section 25 imposes a civil liability of \$500 "for each and every violation" of any provision of a proration program.

The seasonal proration marketing program for raisins, with which we are now concerned, became effective on September 7, 1940. This provided that the program committee should classify raisins as "standard," "substandard," and "inferior"; "inferior" raisins are those which are unfit for human consumption, as defined in the Federal Food, Drug and Cosmetic Act. . . . The committee is required to establish receiving sta-

tions within the zone to which every producer must deliver all raisins which he desires to market. The raisins are graded at these stations. All inferior raisins are to be placed in the "inferior raisin pool," to be disposed of by the committee "only for assured by-product and other diversion purposes." All substandard raisins, and at least 20 percent of the total standard and substandard raisins produced, must be placed in a "surplus pool." Raisins in this pool may also be disposed of only for "assured by-product and other diversion purposes," except that under certain circumstances the program committee may transfer standard raisins from the surplus pool to the stabilization pool. Fifty percent of the crop must be placed in a "stabilization pool."

Under the program the producer is permitted to sell the remaining 30 percent of his standard raisins, denominated "free tonnage," through ordinary commercial channels, subject to the requirement that he obtain a "secondary certificate" authorizing such marketing and pay a certificate fee of \$2.50 for each ton covered by the certificate. Certification is stated to be a device for controlling "the time and volume of movement" of free tonnage into such ordinary commercial channels. Raisins in the stabilization pool are to be disposed of by the committee "in such manner as to obtain stability in the market and to dispose of such raisins," but no raisins (other than those subject to special lending or pooling arrangements of the Federal Government) can be sold by the committee at less than the prevailing market price for raisins of the same variety and grade on the date of sale. . . .

Appellee's bill of complaint challenges the validity of the proration program as in violation of the Commerce Clause and the Sherman Act; in support of the decree of the district court he also urges that it conflicts with and is superseded by the Federal Agricultural Marketing Agreement Act of 1937. The complaint alleges that he is engaged within the marketing zone both in producing and in purchasing and packing raisins for sale and shipment interstate; that before the adoption of the program he had entered into contracts for the sale of 1940 crop raisins; that, unless enjoined, appellants will enforce the program against appellee by criminal prosecutions and will prevent him from marketing his 1940 crop, from fulfilling his sales contracts, and from purchasing for sale and selling in interstate commerce raisins of that crop. . . .

VALIDITY OF THE PRORATE PROGRAM UNDER THE SHERMAN ACT

Section 1 of the Sherman Act, 15 U.S.C. §1, makes unlawful "every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States." And, 15 U.S.C. §2, makes it unlawful to "monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States." We may assume for present pur-

poses that the California prorate program would violate the Sherman Act if it were organized and made effective solely by virtue of a contract, combination or conspiracy of private persons, individual or corporate. . . .

But it is plain that the prorate program here was never intended to operate by force of individual agreement or combination. It derived its authority and its efficacy from the legislative command of the state and was not intended to operate or become effective without that command. We find nothing in the language of the Sherman Act or in its history which suggests that its purpose was to restrain a state or its officers or agents from activities directed by its legislature. In a dual system of government in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an unexpressed purpose to nullify a state's control over its officers and agents is not lightly to be attributed to Congress.

The Sherman Act makes no mention of the state as such, and gives no hint that it was intended to restrain state action or official action directed by a state. The Act is applicable to "persons" including corporations . . . , and it authorizes suits under it by persons and corporations. . . .

There is no suggestion of a purpose to restrain state action in the Act's legislative history. The sponsor of the bill which was ultimately enacted as the Sherman Act declared that it prevented only "business combinations." . . . That its purpose was to suppress combinations to restrain competition and attempts to monopolize by individuals and corporations, abundantly appears from its legislative history. . . .

True, a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful, . . . and we have no question of the state or its municipality becoming a participant in a private agreement or combination by others for restraint of trade. . . . Here the state command to the Commission and to the program committee of the California Prorate Act is not rendered unlawful by the Sherman Act since, in view of the latter's words and history, it must be taken to be a prohibition of individual and not state action. It is the state which has created the machinery for establishing the prorate program. Although the organization of a prorate zone is proposed by producers, and a prorate program, approved by the Commission, must also be approved by referendum of producers, it is the state, acting through the Commission, which adopts the program and which enforces it with penal sanctions, in the execution of a governmental policy. The prerequisite approval of the program upon referendum by a prescribed number of producers is not the imposition by them of their will upon the minority by force of agreement or combination which the Sherman Act prohibits. The state itself exercises its legislative authority in making the regulation and in prescribing the conditions of its application. The required vote on the referendum is one of these conditions. . . .

The state in adopting and enforcing the prorate program made no con-

tract or agreement and entered into no conspiracy in restraint of trade or to establish monopoly but, as sovereign, imposed the restraint as an act of government which the Sherman Act did not undertake to prohibit. . . .

Reversed.

.

Note: In two subsequent cases, *Washington Gas Light Co. v. Virginia Electric and Power Co.*, 438 F.2d 248 (4th Cir. 1971) and *Gas Light Co. of Columbus v. Georgia Power Co.*, 440 F.2d 1135 (5th Cir. 1971), the courts have held that promotional practices of electric utilities which have been approved (either expressly or tacitly) by state regulatory commissions are entitled to antitrust immunity under the *Parker* rule. The former was settled out of court; the latter was denied certiorari by the Supreme Court.

*California Retail Liquor Dealers Association v.
Midcal Aluminum, Inc., et al.*

445 U.S. 97 (1980)

MR. JUSTICE POWELL delivered the opinion of the Court:

In a state-court action, respondent Midcal Aluminum, Inc., a wine distributor, presented a successful antitrust challenge to California's resale price maintenance and price posting statutes for the wholesale wine trade. The issue in this case is whether those state laws are shielded from the Sherman Act by either the "state action" doctrine of *Parker v. Brown*, 317 U.S. 341 (1943), or §2 of the 21st Amendment.

I

Under §24866(b) of the California Business and Professions Code, all wine producers, wholesalers, and rectifiers must file with the State fair trade contracts or price schedules. . . . If a wine producer has not set prices through a fair trade contract, wholesalers must post a resale price schedule for that producer's brands. *Id.*, §24866(a). No state-licensed wine merchant may sell wine to a retailer at other than the price set "either in an effective price schedule or in an effective fair trade contract. . . ." *Id.*, §24862 (West Supp. 1979).

The State is divided into three trading areas for administration of the wine pricing program. A single fair trade contract or schedule for each brand sets the terms for all wholesale transactions in that brand within a given trading area. *Id.*, §§24862, 24864-24865 (West Supp. 1979). Similarly, state regulations provide that the wine prices posted by a single wholesaler within a trading area bind all wholesalers in that area. . . . A licensee [selling] below the established prices faces fines, license suspension, or outright license revocation. Cal. Bus. & Prof. Code

relationship between the 1950 amendment and previous judicial decisions. . . .

. . . [T]he legislative history demonstrates that it was the asset-acquisition provision that was designed to plug the loophole created by *Thatcher, Swift, and Arrow*. . . .

I do not mean to suggest, of course, that Section 7 of the Clayton Act is thereby rendered applicable only to ordinary commercial and industrial corporations and not to firms in any "regulated" sector of the economy. . . . Rather, the absence of any mention of banks in the legislative history of the 1950 amendment, viewed in light of the prior congressional treatment of banking as a distinctive area with special characteristics and needs, compels the conclusion that bank mergers were simply not then regarded as part of the loophole to be plugged.

This conclusion is confirmed by a number of additional considerations. It was not until *after* the passage of the 1950 amendment of Section 7 that Representative Celler, its co-sponsor, requested the staff of the Antitrust Subcommittee of the House Committee on the Judiciary "to prepare a report indicating the concentration existing in our banking system." . . . It is also worth noting that in 1956 Representative Celler himself introduced another amendment to Section 7, explaining that "all the bill [H. R. 5948] does is plug a loophole in the present law dealing with bank mergers. . . . This loophole exists because Section 7 of the Clayton Act prohibits bank mergers . . . only if such mergers are accomplished by stock acquisition." . . . The amendment passed the House but was defeated in the Senate.

For all these reasons, I think the conclusion is inescapable that Section 7 of the Clayton Act does not apply to the PNB-Girard merger. The Court's contrary conclusion seems to me little better than a *tour de force*.¹³

Memorandum of MR. JUSTICE GOLDBERG.

I agree fully with my Brother HARLAN that Section 7 of the Clayton Act has no application to bank mergers of the type involved here, and I therefore join in the conclusions expressed in his opinion on that point. However, while I thus dissent from the Court's holding with respect to the applicability of the Clayton Act to this merger, I wish to make clear that I do not necessarily dissent from its judgment invalidating the merger. To do so would require me to conclude in addition that on the record as it stands the government has failed to prove a violation of the Sherman Act, which is fully applicable to the commercial banking business. In my opinion there is a substantial Sherman Act issue in this case, but since the

¹³ Since the Court does not reach the Sherman Act aspect of this case, it would serve no useful purpose for me to do so.

Court does not reach it and since my views relative thereto would be superfluous in light of today's disposition of the case, I express no ultimate conclusion concerning it. . . .

Note: In the case of *United States v. Phillipsburg National Bank and Trust Co.*, 399 U.S. 350 (1970), the principles set forth above were emphatically reaffirmed. Indeed, in a lengthy dissent, Justice Harlan declared that "[a]fter today's opinion the legality of every merger of two directly competing banks—no matter how small—is placed in doubt. . . ." (*Id.* at p. 374.) However, cf. *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602 (1974).

Otter Tail Power Co. v. United States

410 U.S. 366 (1973)

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MR. JUSTICE DOUGLAS delivered the opinion of the Court.

In this civil antitrust suit brought by appellee against Otter Tail Power Co. (Otter Tail), an electric utility company, the District Court found that Otter Tail had attempted to monopolize and had monopolized the retail distribution of electric power in its service area in violation of §2 of the Sherman Act. . . . The District Court found that Otter Tail had attempted to prevent communities in which its retail distribution franchise had expired from replacing it with a municipal distribution system. The principal means employed were (1) refusals to sell power at wholesale to proposed municipal systems in the communities where it had been retailing power; (2) refusals to "wheel" power to such systems, that is to say, to transfer by direct transmission or displacement electric power from one utility to another over the facilities of an intermediate utility; (3) the institution and support of litigation designed to prevent or delay establishment of those systems; and (4) the invocation of provisions in its transmission contracts with several other power suppliers for the purpose of denying the municipal systems access to other suppliers by means of Otter Tail's transmission systems.

Otter Tail sells electric power at retail in 465 towns in Minnesota, North Dakota, and South Dakota. The District Court's decree enjoins it from refusing to sell electric power at wholesale to existing or proposed municipal electric power systems in the areas serviced by Otter Tail, from refusing to wheel electric power over the lines from the electric power suppliers to existing or proposed municipal systems in the area, from entering into or enforcing any contract which prohibits use of Otter Tail's lines to wheel electric power to municipal electric power systems, or from entering into or enforcing any contract which limits the customers to

whom and areas in which Otter Tail or any other electric power company may sell electric power.

The decree also enjoins Otter Tail from instituting, supporting, or engaging in litigation, directly or indirectly, against municipalities and their officials who have voted to establish municipal electric power systems for the purpose of delaying, preventing, or interfering with the establishment of a municipal electric power system. . . .

In towns where Otter Tail distributes at retail, it operates under municipally granted franchises which are limited from 10 to 20 years. Each town in Otter Tail's service area generally can accommodate only one distribution system, making each town a natural monopoly market for the distribution and sale of electric power at retail. The aggregate of towns in Otter Tail's service area is the geographic market in which Otter Tail competes for the right to serve the towns at retail.¹ That competition is generally for the right to serve the entire retail market within the composite limits of a town, and that competition is generally between Otter Tail and a prospective or existing municipal system. These towns number 510 and of those Otter Tail serves 91%, or 465.

Otter Tail's policy is to acquire, when it can, existing municipal systems within its service areas. It has acquired six since 1947. . . . Proposed municipal systems have great obstacles; they must purchase the electric power at wholesale. To do so they must have access to existing transmission lines. The only ones available² belong to Otter Tail. . . .

The antitrust charge against Otter Tail does not involve the lawfulness of its retail outlets, but only its methods of preventing the towns it served from establishing their own municipal systems when Otter Tail's franchises expired. The critical events centered largely in four towns—Elbow Lake, Minnesota; Hankinson, North Dakota; Colman, South Dakota; and Aurora, South Dakota. When Otter Tail's franchise in each of these towns terminated, the citizens voted to establish a municipal distribution system. Otter Tail refused to sell the new systems energy at wholesale and refused to agree to wheel power from other suppliers of wholesale energy.

Colman and Aurora had access to other transmission. Against them, Otter Tail used the weapon of litigation.

¹ Northern States Power Co. also supplies some towns in Otter Tail's area with electric power at retail. But the District Court excluded these towns from Otter Tail's area because the two companies do not compete in the towns served by each other. Of the 615 remaining towns in the area, 465 are served at retail by Otter Tail, 45 by municipal systems, and 105 by rural electric cooperatives. The cooperatives are barred by §4 of the Rural Electrification Act of 1936, 49 Stat. 1365, as amended, 7 U.S.C. §904, from borrowing federal funds to provide power to towns already receiving central station service. For this and related reasons, the District Court excluded the rural cooperatives from the relevant market.

² Subtransmission lines, with voltages from 34.5 kv to 69 kv are used for moving power from the bulk supply lines to points of local distribution. Of Otter Tail's basic subtransmission system in this area, two-thirds of those lines are 41.6 kv subtransmission lines.

As respects Elbow Lake and Hankinson, Otter Tail simply refused to deal, although according to the findings it had the ability to do so. Elbow Lake, cut off from all sources of wholesale power, constructed its own generating plant. Both Elbow Lake and Hankinson requested the Bureau of Reclamation and various cooperatives to furnish them with wholesale power; they were willing to supply it if Otter Tail would wheel it. But Otter Tail refused, relying on provisions in its contracts which barred the use of its lines for wheeling power to towns which it had served at retail. Elbow Lake after completing its plant asked the Federal Power Commission, under §202(b) of the Federal Power Act . . . to require Otter Tail to interconnect with the town and sell it power at wholesale. The Federal Power Commission ordered first a temporary . . . and then a permanent connection. . . . Hankinson tried unsuccessfully to get relief from the North Dakota Commission and then filed a complaint with the federal commission seeking an order to compel Otter Tail to wheel. While the application was pending, the town council voted to withdraw it and subsequently renewed Otter Tail's franchise.

It was found that Otter Tail instituted or sponsored litigation involving four towns in its service area which had the effect of halting or delaying efforts to establish municipal systems. Municipal power systems are financed by the sale of electric revenue bonds. Before such bonds can be sold, the town's attorney must submit an opinion which includes a statement that there is no pending or threatened litigation which might impair the value or legality of the bonds. The record amply bears out the District Court's holding that Otter Tail's use of litigation halted or appreciably slowed the efforts for municipal ownership. . . .

I

Otter Tail contends that by reason of the Federal Power Act it is not subject to antitrust regulation with respect to its refusal to deal. We disagree with that position.

. . . Activities which come under the jurisdiction of a regulatory agency nevertheless may be subject to scrutiny under the antitrust laws. . . .

The District Court determined that Otter Tail's consistent refusals to wholesale or wheel power to its municipal customers constituted illegal monopolization. Otter Tail maintains here that its refusals to deal should be immune from antitrust prosecution because the Federal Power Commission has the authority to compel involuntary interconnections of power pursuant to §202(b) of the Federal Power Act. The essential thrust of §202, however, is to encourage voluntary interconnections of power. . . . Only if a power company refuses to interconnect voluntarily may the Federal Power Commission, subject to limitations unrelated to antitrust considerations, order the interconnection. The standard which gov-

erns its decision is whether such action is "necessary or appropriate in the public interest." Although antitrust considerations may be relevant, they are not determinative.

There is nothing in the legislative history which reveals a purpose to insulate electric power companies from the operation of the antitrust laws. . . .

Thus, there is no basis for concluding that the limited authority of the Federal Power Commission to order interconnections was intended to be a substitute for, or to immunize Otter Tail from, antitrust regulation for refusing to deal with municipal corporations.

II

The decree of the District Court enjoins Otter Tail from "[r]efusing to sell electric power at wholesale to existing or proposed municipal electric power systems in cities and towns located in [its service area]" and from refusing to wheel electric power over its transmission lines from other electric power lines to such cities and towns. But the decree goes on to provide:

The defendant shall not be compelled by the Judgment in this case to furnish wholesale electric service or wheeling service to a municipality except at rates which are compensatory and under terms and conditions which are filed with and subject to approval by the Federal Power Commission.

So far as wheeling is concerned, there is no authority granted the Commission under Part II of the Federal Power Act to order it. . . . Insofar as the District Court ordered wheeling to correct anticompetitive and monopolistic practices of Otter Tail, there is no conflict with the authority of the Federal Power Commission.

As respects the ordering of interconnections, there is no conflict on the present record. Elbow Lake applied to the Federal Power Commission for an interconnection with Otter Tail and, as we have said, obtained it. Hankinson renewed Otter Tail's franchise. So the decree of the District Court, as far as the present record is concerned, presents no actual conflict between the federal judicial decree and an order of the Federal Power Commission. The argument concerning the pre-emption of the area by the Federal Power Commission concerns only instances which may arise in the future, if Otter Tail continues its hostile attitude and conduct against "existing or proposed municipal electric power systems." The decree of the District Court has an open end by which that court retains jurisdiction "necessary or appropriate" to carry out the decree or "for the modification of any of the provisions." It also contemplates that future disputes over interconnections and the terms and conditions governing those interconnections will be subject to Federal Power Commission perusal. It will be time enough to consider whether the antitrust remedy may override the power of the Commission under §202(b) as, if, and when the Commission

denies the interconnection and the District Court nevertheless undertakes to direct it. At present, there is only a potential conflict, not a present concrete case or controversy concerning it.

III

The record makes abundantly clear that Otter Tail used its monopoly power in the towns in its service area to foreclose competition or gain a competitive advantage, or to destroy a competitor, all in violation of the antitrust laws. See *United States v. Griffith*, 334 U.S. 100, 107. The District Court determined that Otter Tail has "a strategic dominance in the transmission of power in most of its service area" and that it used this dominance to foreclose potential entrants into the retail area from obtaining electric power from outside sources of supply. 331 F. Supp., at 60. Use of monopoly power "to destroy threatened competition" is a violation of the "attempt to monopolize" clause of §2 of the Sherman Act. *Lorain Journal v. United States*, 342 U.S. 143, 154; *Eastman Kodak Co. v. Southern Photo Materials Co.*, 273 U.S. 359, 375. So are agreements not to compete, with the aim of preserving or extending a monopoly. *Schine Chain Theatres v. United States*, 334 U.S. 110, 119. In *Associated Press v. United States* 326 U.S. 1, a cooperative news association had bylaws that permitted member newspapers to bar competitors from joining the association. We held that that practice violated the Sherman Act, even though the transgressor "had not yet achieved a complete monopoly." *Id.*, at 13.

When a community serviced by Otter Tail decides not to renew Otter Tail's retail franchise when it expires, it may generate, transmit, and distribute its own electric power. We recently described the difficulties and problems of those isolated electric power systems. See *Gainesville Utilities v. Florida Power Corp.*, 402 U.S. 515, 517-520. Interconnection with other utilities is frequently the only solution. *Id.*, at 519 n. 3. That is what Elbow Lake in the present case did. There were no engineering factors that prevented Otter Tail from selling power at wholesale to those towns that wanted municipal plants or wheeling the power. The District Court found—and its findings are supported—that Otter Tail's refusals to sell at wholesale or to wheel were solely to prevent municipal power systems from eroding its monopolistic position.

Otter Tail relies on its wheeling contracts with the Bureau of Reclamation and with cooperatives which it says relieve it of any duty to wheel power to municipalities served at retail by Otter Tail at the time the contracts were made. The District Court held that these restrictive provisions were "in reality, territorial allocation schemes," 331 F. Supp., at 63, and were *per se* violations of the Sherman Act, citing *Northern Pacific R. Co. v. United States*, 356 U.S. 1. Like covenants were there held to "deny defendant's competitors access to the fenced-off market on the same terms as the defendant." *Id.*, at 12. We recently re-emphasized the

vice under the Sherman Act of territorial restrictions among potential competitors. *United States v. Topco Associates*, 405 U.S. 596, 608. The fact that some of the restrictive provisions were contained in a contract with the Bureau of Reclamation is not material to our problem for, as the Solicitor General says, "government contracting officers do not have the power to grant immunity from the Sherman Act." Such contracts stand on their own footing and are valid or not, depending on the statutory framework within which the federal agency operates. The Solicitor General tells us that these restrictive provisions operate as a "hindrance" to the Bureau and were "agreed to by the Bureau only at Otter Tail's insistence," as the District Court found. The evidence supports that finding.

IV

The District Court found that the litigation sponsored by Otter Tail had the purpose of delaying and preventing the establishment of municipal electric systems "with the expectation that this would preserve its predominant position in the sale and transmission of electric power in the area." . . . 331 F. Supp., at 62. . . . On that phase of the order, we vacate and remand for consideration in light of our intervening decision in *California Motor Transport Co.*

V

Otter Tail argues that, without the weapons which it used, more and more municipalities will turn to public power and Otter Tail will go downhill. . . .

The . . . Sherman Act . . . assumes that an enterprise will protect itself against loss by operating with superior service, lower costs, and improved efficiency. Otter Tail's theory collided with the Sherman Act as it sought to substitute for competition anticompetitive uses of its dominant economic power.³

The fact that three municipalities which Otter Tail opposed finally got their municipal systems does not excuse Otter Tail's conduct. That fact does not condone the antitrust tactics which Otter Tail sought to impose. Moreover, the District Court repeated what we said in *FTC v. National Lead Co.*, 352 U.S. 419, 431, "those caught violating the Act must expect some fencing in." The proclivity for predatory practices has always been a consideration for the District Court in fashioning its antitrust decree. See *United States v. Crescent Amusement Co.*, 323 U.S. 173, 190.

We do not suggest, however, that the District Court, concluding that Otter Tail violated the antitrust laws, should be impervious to Otter Tail's

³ The Federal Power Commission said in *Elbow Lake v. Otter Tail Power Co.*, 46 F.P.C., at 678:

"The public interest is far broader than the economic interest of a particular power supplier. . . . The private company's lack of enthusiasm for the arrangement cannot deter us, so long as the public interest requires it."

assertion that compulsory interconnection or wheeling will erode its integrated system and threaten its capacity to serve adequately the public. As the dissent properly notes, the Commission may not order interconnection if to do so "would impair [the utility's] ability to render adequate service to its customers." 16 U.S.C. §824a(b). The District Court in this case found that the "pessimistic view" advanced in Otter Tail's "erosion study" "is not supported by the record." Furthermore, it concluded that "it does not appear that Bureau of Reclamation power is a serious threat to the defendant nor that it will be in the foreseeable future." Since the District Court has made future connections subject to Commission approval and in any event has retained jurisdiction to enable the parties to apply for "necessary or appropriate" relief and presumably will give effect to the policies embodied in the Federal Power Act, we cannot say under these circumstances that it has abused its discretion.

Except for the provision of the order discussed in part IV of this opinion, the judgment is

Affirmed.

MR. JUSTICE BLACKMUN and MR. JUSTICE POWELL took no part in the consideration or decision of this case.

MR. JUSTICE STEWART, with whom THE CHIEF JUSTICE and MR. JUSTICE REHNQUIST join, concurring in part and dissenting in part. . . .

The Court in this case has followed the District Court into a misapplication of the Sherman Act to a highly regulated, natural-monopoly industry wholly different from those that have given rise to ordinary antitrust principles. In my view, Otter Tail's refusal to wholesale power through interconnection or to perform wheeling services was conduct entailing no antitrust violation.

. . . The District Court . . . mechanically applied the familiar Sherman Act formula: since Otter Tail possessed monopoly power⁴ and had acted to preserve that power, it was guilty of an antitrust violation. Nowhere did the District Court come to grips with the significance of the Federal Power Act, either in terms of the specific regulatory apparatus it

⁴ The District Court looked to Otter Tail's service area, and measured market dominance in terms of the number of towns within that area served by Otter Tail. Computed this way, Otter Tail provides 91% of the retail market. 331 F. Supp. 54, 59. As the appellant points out, however, these towns vary in size from more than 29,000 to 20 inhabitants. If Otter Tail's size were measured by actual retail sales, its market share would be only 28.9% of the electricity sold at retail within its geographic market area. It is important to note that another reasonable geographical market unit might be each individual municipality. Viewed this way, whichever power company sells electricity at retail in a town has a complete monopoly. [Footnote relocated. IMS.]

established or the policy considerations that moved the Congress to enact it. Yet it seems to me that these concerns are central to the disposition of this case.

. . . In the face of natural monopolies at retail and similar economies of scale in the subtransmission of power, Congress was forced to address the very problem raised by this case—use of the lines of one company by another. One obvious solution would have been to impose the obligations of a common carrier upon power companies owning lines capable of the wholesale transmission of electricity. . . . Yet, after substantial debate . . . the Congress declined to follow this path. . . .

This legislative history, especially when viewed in the light of repeated subsequent congressional refusals to impose common carrier obligations in this area . . . indicates a clear congressional purpose to allow electric utilities to decide for themselves whether to wheel or sell at wholesale as they see fit. This freedom is qualified by a grant of authority to the Commission to order interconnection (but not wheeling) in certain circumstances. But the exercise of even that power is limited by a consideration of the ability of the regulated utility to function. The Commission may not order interconnection where this would entail an “undue burden” on the regulated utility. In addition, the Commission has

no authority to compel the enlargement of generating facilities for such purposes, nor to compel such public utility to sell or exchange energy when to do so would impair its ability to render adequate service to its customers. 16 U.S.C. §824a(b).

As the District Court found, Otter Tail is a vertically integrated power company. But the bulk of its business—some 90% of its income—derives from sales of power at retail. Left to its own judgment in dealing with its customers, it seems entirely predictable that Otter Tail would decline wholesale dealing with towns in which it had previously done business at retail. If the purpose of the congressional scheme is to leave such decisions to the power companies in the absence of a contrary requirement imposed by the Commission, it would appear that Otter Tail’s course of conduct in refusing to deal with the municipal system at Elbow Lake and in refusing to promise to deal with the proposed system at Hankinson, was foreseeable within the zone of freedom specifically created by the statutory scheme.⁵ As a retailer of power, Otter Tail asserted a legitimate

⁵ The District Court was persuaded that the restrictions on wheeling contained in Otter Tail’s contracts with the Bureau of Reclamation were “in reality, territorial allocation schemes.” 331 F. Supp., at 63. I think this finding was clearly erroneous. Territorial allocation arrangements that have run afoul of the antitrust laws have traditionally been horizontal, and have involved the elimination of competition between two enterprises that were similarly situated in the market. *United States v. Topco Associates*, 405 U.S. 596; *Timken Roller Bearing Co. v. United States*, 341 U.S. 593; cf. *White Motor Co. v. United States*, 372 U.S. 253, 261–264. Otter Tail and the Bureau of Reclamation stand in a vertical, not a horizontal, relationship. Furthermore, though Otter Tail refused to wheel power to towns

business interest in keeping its lines free for its own power sales and in refusing to lend a hand in its own demise by wheeling cheaper power from the Bureau of Reclamation to municipal consumers which might otherwise purchase power at retail from Otter Tail itself.

The opinion of the Court emphasizes that Otter Tail’s actions were not simple refusals to deal—they resulted in Otter Tail’s maintenance of monopoly control by hindering the emergence of municipal power companies . . . [But] a monopoly is sure to result either way. If the consumers of Elbow Lake receive their electric power from a municipally owned company or from Otter Tail, there will be a monopoly at the retail level, for there will in any event be only one supplier. The very reason for the regulation of private utility rates—by state bodies and by the Commission—is the inevitability of a monopoly that requires price control to take the place of price competition. Antitrust principles applicable to other industries cannot be blindly applied to a unilateral refusal to deal on the part of a power company, operating in a regime of rate regulation and licensed monopolies.

The Court’s opinion scoffs at Otter Tail’s defense of business justification. . . . This question-begging disregard of the economic health of Otter Tail is wholly at odds with the congressional purpose in specifying the conditions under which interconnections can be required.

This is not to say that Otter Tail’s financial health is paramount in all instances, . . . or that the electric power industry as regulated by the Commission is *per se* exempt from the antitrust laws. In the absence of a specific statutory immunity, cf. *Hughes Tool Co. v. Trans World Airlines*, 409 U.S. 363, such exemptions are not lightly to be implied, *United States v. Philadelphia National Bank*, 374 U.S. 321. Furthermore, no sweeping antitrust exemption is warranted, as it has been in cases involving certain pervasively regulated industries, under the doctrine of “primary jurisdiction.”⁶ . . .

With respect to decisions by regulated electric utilities as to whether or not to provide nonretail services, I think that in the absence of horizontal conspiracy, the teaching of the “primary jurisdiction” cases argues for leaving governmental regulation to the Commission instead of the invari-

whose consumers it formerly served at retail, it did not exact from the Bureau a promise that the latter would not provide power to such towns by alternative means. Hence, I cannot see how these contracts operate as territorial-allocation schemes. If Otter Tail had demanded that the Bureau not sell to former Otter Tail customers, or if Otter Tail had combined with other retailers of electricity and undertaken mutual noncompetition agreements, this would be a different case.

⁶ . . . [T]he considerable freedom allowed to electric utilities with respect to coordination of service persuades me that the antitrust laws apply to the extent they are not repugnant to specific features of the regulatory scheme. For this reason . . . a genuine territorial allocation agreement might be prohibited under the Sherman Act. . . . Were it not for the legislative history noted above, a consistent refusal to deal with municipally owned power companies might also be impermissible under the Sherman Act. For me, however, the legislative history with respect to wheeling and interconnection is dispositive.

ably less sensitive and less specifically expert process of antitrust litigation. I believe this is what Congress intended by declining to impose common carrier obligations on companies like Otter Tail, and by entrusting the Commission with the burden of "assuring an abundant supply of electric energy throughout the United States" and with the power to order interconnections when necessary in the public interest. This is an area where "sporadic action by federal courts" can "work mischief." Cf. *United States v. Radio Corp. of America*, 358 U.S., at 350. . . .

Both because I believe Otter Tail's refusal to wheel or wholesale power was conduct exempt from the antitrust laws and because I believe the District Court's decree improperly pre-empted the jurisdiction of the Federal Power Commission, I would reverse the judgment before us.

Silver v. New York Stock Exchange

373 U.S. 341 (1963)

MR. JUSTICE GOLDBERG delivered the opinion of the Court.

We deal here today with the question, of great importance to the public and the financial community, of whether and to what extent the federal antitrust laws apply to securities exchanges regulated by the Securities Exchange Act of 1934. More particularly, the question is whether the New York Stock Exchange is to be held liable to a nonmember broker-dealer under the antitrust laws or regarded as impliedly immune therefrom when, pursuant to rules the Exchange has adopted under the Securities Exchange Act of 1934, it orders a number of its members to remove private direct telephone wire connections previously in operation between their offices and those of the nonmember, without giving the nonmember notice, assigning him any reason for the action, or affording him an opportunity to be heard.

I

The facts material to resolution of this question are not in dispute. Harold J. Silver, who died during the pendency of this action, entered the securities business in Dallas, Texas, in 1955, by establishing the predecessor of petitioner Municipal Securities (Municipal) to deal primarily in municipal bonds. The business of Municipal having increased steadily, Silver, in June 1958, established petitioner Municipal Securities, Inc. (Municipal, Inc.), to trade in corporate over-the-counter securities. Both firms are registered broker-dealers and members of the National Association of Securities Dealers, Inc. (NASD); neither is a member of the respondent Exchange.

Instantaneous communication with firms in the mainstream of the securities business is of great significance to a broker-dealer not a member of the Exchange, and Silver took steps to see that this was established for

his firms. Municipal obtained direct private telephone wire connections with the municipal bond departments of a number of securities firms (three of which were members of the Exchange) and banks, and Municipal, Inc., arranged for private wires to the corporate securities trading departments of ten member firms of the Exchange, as well as to the trading desks of a number of nonmember firms.

Pursuant to the requirements of the Exchange's rules, all but one of the member firms which had granted private wires to Municipal, Inc., applied to the Exchange for approval of the connections. . . . During the summer of 1958 the Exchange granted "temporary approval" for these, as well as for a direct teletype connection to a member firm in New York City and for stock ticker service to be furnished to petitioners directly from the floor of the Exchange.

On February 12, 1959, without prior notice to Silver, his firms, or anyone connected with them, the Exchange's Department of Member Firms decided to disapprove the private wire and related applications. Notice was sent to the member firms involved, instructing them to discontinue the wires, a directive with which compliance was required by the Exchange's Constitution and rules. These firms in turn notified Silver that the private wires would have to be discontinued, and the Exchange advised him directly of the discontinuance of the stock ticker service. The wires and ticker were all removed by the beginning of March. By telephone calls, letters, and a personal trip to New York, Silver sought an explanation from the Exchange of the reason for its decision but was repeatedly told it was the policy of the Exchange not to disclose the reasons for such action. . . .

Petitioners contend that their volume of business dropped substantially thereafter and that their profits fell, due to a combination of forces all stemming from the removal of the private wires—their consequent inability to obtain quotations quickly, the inconvenience to other traders in calling petitioners, and the stigma attaching to the disapproval. As a result of this change in fortunes, petitioners contend, Municipal, Inc., soon ceased functioning as an operating business organization, and Municipal has remained in business only on a greatly diminished scale. . . .

II

The fundamental issue confronting us is whether the Securities Exchange Act has created a duty of exchange self-regulation so pervasive as to constitute an implied repealer of our antitrust laws, thereby exempting the Exchange from liability in this and similar cases.

A

It is plain, to begin with, that removal of the wires by collective action of the Exchange and its members would, had it occurred in a context free from other federal regulation, constitute a per se violation of §1 of the

any other in this general area the problem of framing an adequate decree—one which prevents future antitrust violations without unnecessarily impinging on the patent right.

United States v. General Electric Company

272 U.S. 476 (1926)

MR. CHIEF JUSTICE TAFT delivered the opinion of the Court.

This is a bill in equity brought by the United States in the District Court for the Northern District of Ohio to enjoin the General Electric Company, the Westinghouse Electric and Manufacturing Company, and the Westinghouse Lamp Company from further violation of the Anti-Trust Act of July 2, 1890. . . . The bill made two charges, one that the General Electric Company in its business of making and selling incandescent electric lights had devised and was carrying out a plan for their distribution throughout the United States by a number of so-called agents, exceeding 21,000, to restrain interstate trade in such lamps and to exercise a monopoly of the sale thereof; and, second, that it was achieving the same illegal purpose through a contract of license with the defendants, the Westinghouse Electric and Manufacturing Company and the Westinghouse Lamp Company.¹ . . .

The second question in the case involves the validity of a license granted March 1, 1912, by the Electric Company to the Westinghouse Company to make, use and sell lamps under the patents owned by the former. It was charged that the license in effect provided that the Westinghouse Company would follow prices and terms of sales from time to time fixed by the Electric Company and observed by it, and that the Westinghouse Company would, with regard to lamps manufactured by it under the license, adopt and maintain the same conditions of sale as observed by the Electric Company in the distribution of lamps manufactured by it. . . .

The Electric Company is the owner of . . . patents . . . [which] cover completely the making of the modern electric lights with the tungsten filaments, and secure to the Electric Company the monopoly of their making, using and vending.

The total business in electric lights for the year 1921 was \$68,300,000, and the relative percentages of business done by the companies were, Electric, 69 percent, Westinghouse, 16 percent, other licensees, 8 percent, and manufacturers not licensed, 7 percent.

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¹ For present purposes we focus upon the second of the two charges; the first raises issues that are peripheral to the subject of this chapter. IMS.

. . . Had the Electric Company, as the owner of the patents entirely controlling the manufacture, use and sale of the tungsten incandescent lamps, in its license to the Westinghouse Company, the right to impose the condition that its sales should be at prices fixed by the licensor and subject to change according to its discretion? . . .

The owner of a patent may assign it to another and convey, (1) the exclusive right to make, use and vend the invention throughout the United States, or, (2) an undivided part or share of that exclusive right, or (3) the exclusive right under the patent within and through a specific part of the United States. But any assignment or transfer short of one of these is a license, giving the licensee no title in the patent and no right to sue at law in his own name for an infringement. . . . Conveying less than title to the patent, or part of it, the patentee may grant a license to make, use and vend articles under the specifications of his patent for any royalty or upon any condition the performance of which is reasonably within the reward which the patentee by the grant of the patent is entitled to secure. It is well settled, . . . that where a patentee makes the patented article and sells it, he can exercise no future control over what the purchaser may wish to do with the article after his purchase. It has passed beyond the scope of the patentee's rights. . . . But the question is a different one which arises when we consider what a patentee who grants a license to one to make and vend the patented article may do in limiting the licensee in the exercise of the right to sell. The patentee may make and grant a license to another to make and use the patented articles, but withhold his right to sell them. The licensee in such a case acquires an interest in the articles made. He owns the material of them and may use them. But if he sells them, he infringes the right of the patentee, and may be held for damages and enjoined. If the patentee goes further, and licenses the selling of the articles, may he limit the selling by limiting the method of sale and the price? We think he may do so, provided the conditions of sale are normally and reasonably adapted to secure pecuniary reward for the patentee's monopoly. One of the valuable elements of the exclusive right of a patentee is to acquire profit by the price at which the article is sold. The higher the price, the greater the profit, unless it is prohibitory. When the patentee licenses another to make and vend, and retains the right to continue to make and vend on his own account, the price at which his licensee will sell will necessarily affect the price at which he can sell his own patented goods. It would seem entirely reasonable that he should say to the licensee, "Yes, you may make and sell articles under my patent, but not so as to destroy the profit that I wish to obtain by making them and selling them myself." He does not thereby sell outright to the licensee the articles the latter may make and sell, or vest absolute ownership in them. He restricts the property and interest the licensee has in the goods he makes and proposes to sell.

[MR. JUSTICE TAFT then reviewed several earlier cases, including those which involved the setting of prices of unpatented materials used in conjunction with a patented article. He concluded that they were not relevant to the present case since "[the] price at which a patented article sells is certainly a circumstance having a more direct relation, and is more germane to the rights of the patentee, than the unpatented material with which the patented article may be used. Indeed, . . . price fixing is usually the essence of that which secures proper reward to the patentee."]

Nor do we think that the decisions of this Court holding restrictions as to price of patented articles invalid, apply to a contract of license like the one in this case. . . . These cases really are only instances of the application of the principle of *Adams v. Burke*, 17 Wall. 453, 456, . . . that a patentee may not attach to the article made by him, or with his consent, a condition running with the article in the hands of purchasers, limiting the price at which one who becomes its owner for full consideration shall part with it. They do not consider or condemn a restriction put by a patentee upon his licenses as to the prices at which the latter shall sell articles which he makes and only can make legally under the license. . . .

For the reasons given, we sustain the validity of the license granted by the Electric Company to the Westinghouse Company. The decree of the District Court dismissing the bill is

Affirmed.

Note: In 1973, General Electric's agency marketing system was adjudged a *per se* violation of Section 1 of the Sherman Act on the grounds that the Company's patents were no longer controlling and, hence, no longer immune from the reach of the antitrust laws. *U.S. v. General Electric Company* 358 F. Supp. 731.

Hartford-Empire Company v. United States

323 U.S. 386 (1945)

MR. JUSTICE ROBERTS delivered the opinion of the Court.

These are appeals from a decree awarding an injunction against violations of Sections 1 and 2 of the Sherman Act, as amended, and Section 3 of the Clayton Act. Two questions are presented. Were violations proved? If so, are the provisions of the decree right?

The complaint named as defendants . . . the leaders in automatic glass-making machinery and in the glassware industry. The charge is that all the defendants agreed, conspired, and combined to monopolize, and did monopolize and restrain interstate and foreign commerce by acquiring patents covering the manufacture of glassmaking machinery, and by excluding others from a fair opportunity freely to engage in commerce in

such machinery and in the manufacture and distribution of glass products. The gravamen of the case is that the defendants have cooperated in obtaining and licensing patents covering glassmaking machinery, have limited and restricted the use of the patented machinery by a network of agreements, and have maintained prices for unpatented glassware. . . .

In 1919 the Glass Container Association of America was formed. . . . The court below, on sufficient evidence, has found that the association, through its statistical committee, assigned production quotas to its members and that they and Hartford were zealous in seeing that these were observed.

In summary, the situation brought about in the glass industry, and existing in 1938, was this: Hartford, with the technical and financial aid of others in the conspiracy, had acquired, by issue to it or assignment from the owners, more than 600 patents. These, with over 100 Corning controlled patents, over 60 Owens patents, over 70 Hazel patents, and some 12 Lynch patents, had been, by cross-licensing agreements, merged into a pool which effectually controlled the industry. This control was exercised to allot production in Corning's field¹ to Corning, and that in restricted classes within the general container field to Owens, Hazel, Thatcher, Ball, and such other smaller manufacturers as the group agreed should be licensed. The result was that 94% of the glass containers manufactured in this country on feeders and formers were made on machinery licensed under the pooled patents.

The District Court found that invention of glassmaking machinery had been discouraged, that competition in the manufacture and sale or licensing of such machinery had been suppressed, and that the system of restricted licensing had been employed to suppress competition in the manufacture of unpatented glassware and to maintain prices of the manufactured product. The findings are full and adequate and are supported by evidence, much of it contemporary writings of corporate defendants or their officers and agents. . . .

We affirm the District Court's findings and conclusions that the corporate appellants combined in violation of the Sherman Act, that Hartford and Lynch contracted in violation of the Clayton Act, and that the individual appellants with exceptions to be noted participated in the violations in their capacities as officers and directors of the corporations. . . .

I. Little need be said concerning the legal principles which vindicate the District Court's findings and conclusions. . . .

. . . It is clear that, by cooperative arrangements and binding agreements, the appellant corporations, over a period of years, regulated and suppressed competition in the use of glassmaking machinery and employed their joint patent position to allocate fields of manufacture and to maintain prices of unpatented glassware.

¹ The pressed and blown glass, or noncontainer field. IMS.

The explanations offered by the Appellants are unconvincing. It is said, on behalf of Hartford, that its business, in its inception, was lawful and within the patent laws; and that, in order to protect its legitimate interests as holder of patents for automatic glass machinery, it was justified in buying up and fencing off improvement patents, the grant of which, while leaving the fundamental inventions untouched, would hamper their use unless tribute were paid to the owners of the so-called improvements which, of themselves, had only a nuisance value.

The explanation fails to account for the offensive and defensive alliance of patent owners with its concomitant stifling of initiative, invention, and competition.

Nor can Owens' contention prevail that it long ago abandoned any cooperation with the other corporate defendants and has been free of any trammel to unrestricted competition either in the machinery or glass field. Owens remained active in the association. It remained dominant in the suction field. In continued in close touch with Hartford and with other large manufacturers of glassware who were parties to the conspiracy. The District Court was justified in finding that the mere cancellation of the written word was not enough, in the light of subsequent conduct, to acquit Owens of further participation in the conspiracy. . . .

II. The Government sought the dissolution of Hartford. The court, however, decided that a continuance of certain of Hartford's activities would be of advantage to the glass industry and denied, for the time being, that form of relief. The court was of opinion, however, that the long series of transactions and the persistent manifestations of a purpose to violate the antitrust statutes required the entry of a decree which would preclude the resumption of unlawful practices. It was faced, therefore, with the difficult problem of awarding an injunction which would insure the desired end without imposing punishments or other sanctions for past misconduct, a problem especially difficult in view of the status and relationship of the parties.

At the trial the Government stated that in this suit it was not attacking the validity of any patent or claiming any patent had been awarded an improper priority.

At the time of the District Court's decision, Hartford had reduced the royalties of all its licensees to its then schedule of standard royalties so that all stood on an equal basis so far as license fees were concerned. Government counsel did not assert, or attempt to prove, that these royalties were not reasonable in amount.

Owens, as respects suction invention licenses, had removed all restrictive clauses; Hartford had done the same with respect to all its glass machinery licenses and so had Hartford and Lynch with respect to forming machine licenses. . . .

The association had ceased to allot quotas amongst the glass manufacturers or to furnish advance information or make recommendations to its

members. The licensing system of Hartford remained that of leasing machinery built for it embodying the patented inventions. Rentals consisted of standard royalties on production. Under this system Hartford rendered a service in the repair, maintenance, and protection of the machines, which is valuable, if not essential, to the users. This was the status with which the court had to deal.

The applicable principals are not doubtful. The Sherman Act provides criminal penalties for its violation, and authorizes the recovery of a penal sum in addition to damages in a civil suit by one injured by violation. It also authorizes an injunction to prevent continuing violations by those acting contrary to its proscriptions. The present suit is in the last named category and we may not impose penalties in the guise of preventing future violations. This is not to say that a decree need deal only with the exact type of acts found to have been committed or that the court should not, in framing its decree, resolve all doubts in favor of the Government, or may not prohibit acts which in another setting would be unobjectionable. But, even so, the court may not create, as to the defendants, new duties, prescription of which is the function of Congress, or place the defendants, for the future, "in a different class than other people," as the Government has suggested. The decree must not be "so vague as to put the whole conduct of the defendants' business at the peril of a summons for contempt"; enjoin "all possible breaches of the law"; or cause the defendants hereafter not "to be under the protection of the law of the land." With these principles in mind we proceed to examine the terms of the decree entered. . . .

The court appointed a receiver for Hartford *pendente lite*. By paragraphs 10 to 20 of the final decree it continued him in office and gave directions as to his administration of Hartford's affairs, including certain actions to be taken to effectuate features of the decree affecting Hartford's business and licenses, which will later be described, and meantime to continue the receipt of royalties under existing licenses, these to be repaid to the licensees on the decree becoming final. . . .

. . . [T]he receivership and the impounding of funds were not necessary to the prescription of appropriate relief. The receivership should be wound up and the business returned to Hartford. The royalties paid to the receiver by Hartford's lessees may, unless the District Court finds that Hartford has, since the entry of the receivership decree, violated the antitrust laws, or acted contrary to the terms of the final decree as modified by this opinion, be paid over to Hartford. . . .

Paragraphs 21, 22, and 23 . . . forbid any disposition or transfer of possession of such machinery by any means other than an outright sale, and require Hartford to offer in writing to sell each of the present lessees all the machinery now under lease to such lessee at a reasonable price. . . .

All of the appellants attack these provisions. . . .

. . . The Government replies that the injunction is intended only to prevent them from again setting up a patent pool and monopolizing the patented inventions. . . . But the decree as entered requires that each of the defendants must hereafter forever abstain from leasing a patented machine, no matter what the date of the invention, and compels each of them if he desires to distribute patented machinery to sell the machine which embodies the patent to everyone who applies, at a price to be fixed by the court. The injunction as drawn is not directed at any combination, agreement or conspiracy. It binds every defendant forever irrespective of his connection with any other or of the independence of his action. . . .

[Paragraph 24 requires defendants to license all present and future patents on a royalty-free basis.]

Since the provisions of paragraphs 21 to 24 inclusive, in effect confiscate considerable portions of the appellants' property we think they go beyond what is required to dissolve the combination and prevent future combinations of like character. It is to be borne in mind that the Government has not, in this litigation, attacked the validity of any patent or the priority ascribed to any by the Patent Office, nor has it attacked, as excessive or unreasonable, the standard royalties heretofore exacted by Hartford. Hartford has reduced all of its royalties to a uniform scale and has waived and abolished and agreed to waive and abolish all restrictions and limitations in its outstanding leases so that every licensee shall be at liberty to use the machinery for the manufacture of any kind of quantity of glassware comprehended within the decree. Moreover, if licenses or assignments by any one of the corporate defendants to any other still contain any offensive provision, such provision can, by appropriate injunction, be cancelled, so that the owner of each patent will have unrestricted freedom to use and to license, and every licensee equally with every other will be free of restriction as to the use of the leased or licensed machinery, method or process, or the articles manufactured thereon or thereunder.

It is suggested that there is not confiscation since Hartford might, with the later consent of the court, sell its patents. Under the decree as entered below nothing can be obtained by Hartford for the use of its patents and we cannot speculate as to what might be the ultimate adjustments made by the trial court in the decree.

If, as suggested, some of Hartford's patents were improperly obtained, or if some of them were awarded a priority to which the invention was not entitled, avenues are open to the Government to raise these questions and to have the patents cancelled. But if, as we must assume on this record, a defendant owns valid patents, it is difficult to say that, however much in the past such defendant has abused the rights thereby conferred, it must now dedicate them to the public.

That a patent is property, protected against appropriation both by individuals and by government, has long been settled. In recognition of this quality of a patent the courts, in enjoining violations of the Sherman Act

arising from the use of patent licenses, agreements, and leases, have abstained from action which amounted to a forfeiture of the patents. . . .

Since paragraphs 21 to 24(a) inclusive are to be eliminated, this paragraph, which is ancillary to them, should also be deleted from the decree, but in view of the nature of the conspiracy found, an injunction should go against the further prosecution of all infringement suits pending at the date this suit was brought. Hartford and the other corporate defendants mentioned in paragraph 24 should be required to lease or license glass making machinery of the classes each now manufacturers to any who may desire to take licenses, (under patents on such machinery or on improvements, methods or processes applicable thereto), at standard royalties and without discrimination or restriction, and if at the time of entry of the decree there are any alleged infringers who are willing to take such licenses they should be released, and the patent owner deprived of all damages and profits which it might have claimed for past infringement. The decree should, however, be without prejudice to the future institution of any suit or suits for asserted infringements against persons refusing to take licenses under any of the presently licensed inventions arising out of their use after the date of the decree. The decree should not forbid any defendant from seeking recovery for infringement, occurring after the date of the final decree, of patents not covering feeders, formers, stackers, lehrs, or processes or methods applicable to any of them.

Paragraph 27 cancels all outstanding agreements between corporate appellants. . . .

In view of what we have already said about these earlier paragraphs, the license agreements as modified by the parties and in accordance with the views here expressed, should be allowed to stand. . . .

Paragraph 28 orders cancellation of all Hartford machinery leases now outstanding and requires that each lessee be offered a new license (without royalty, pursuant to paragraph 24) and offered the right to purchase all of the machinery now held under lease (as required by paragraph 23). In view of what has been said this provision should not stand.

Paragraph 29 enjoins the insertion or enforcement of any provision in any agreement heretofore or hereafter made by any of the appellants which (a) directly or indirectly limits or restricts (1) the type or kind of product, whether glassware or any other, which can be produced on machines or equipment or by processes embodying inventions licensed under patents or patent applications, (2) the use of the product so produced, (3) the character, weight, color, capacity, or composition of the product, (4) the quantity, (5) the market, either as to territory or customers in or to which the product may be sold or distributed, (6) the price or terms of sale or other disposition of the product, or (7) the use of the machinery or equipment distributed or the inventions licensed in connection with any other machinery or equipment, or the use of it in any

specified plant or locality; (b) authorizes termination of the license for unauthorized use; (c) provides that the licensee shall not contest the validity of any patent or patents of the licensor; (d) provides that improvements by the licensee on machinery leased and sold shall become the property of the lessor; (e) provides that rights to improvements and inventions covering licensed machinery or processes or methods shall become the exclusive property of the lessor or vendor; or (f) grants to any licensee a preferential position by lower rates of royalty, by different provisions of licensing, leasing, or sale, by exclusive licensing, rebate, discounts or requiring a share in net or gross income, or by any other means.

The paragraph now covers every kind of invention and every patent, present or future, in any field if owned or controlled or distributed by an appellant.

The injunction will stop all inventions or acquirement of patents in any field by any appellant unless for its own use in its business, for it sets such limitations upon the reward of a patent as to make it practically worthless except for use by the owner. It is unlimited in time. It is not limited to any joint action or conspiracy violative of the antitrust laws; it covers inventions in every conceivable field.

The Government now agrees that this injunction should be limited to glassmaking machinery and glassware as defined in paragraph 1 of the decree of the District Court. . . .

Paragraph 31 requires court approval of "any agreement between any of the defendants" and "of any license agreement made pursuant to this judgment." This is too sweeping. The provision is without limit of time and not terminable upon fulfillment of any condition. . . . This paragraph, if retained, should be restricted in application to lease or license agreements and agreements respecting patents and trade practices, production and trade relations.

By paragraph 33 each of the individual defendants is enjoined from "holding, controlling, directly or indirectly, or through corporations, agents, trustees, representatives, or nominees, any of the issued and outstanding capital stock, bonds, or other evidences of indebtedness of more than one corporation engaged either in the manufacture and sale of glassware or in the manufacture or distribution of machinery used in the manufacture of glassware or in both. . . ." . . . The purpose of dealing with stock ownership is to prevent aggregation of control to the end of establishing a monopoly or stifling competition. The ownership of a few, or even a few hundred, shares of stock of a glass manufacturing company not in competition with the company of which a defendant happens to be a director or officer can have no tendency towards such a result. . . .

Moreover, the injunction is against ownership of bonds of any such company. It is difficult to see how such ownership in any reasonable amount by any of the individuals in question could tend towards a violation of the Sherman Act. . . .

The decree should be modified to prohibit acquisition of stocks or bonds of any corporate appellant by any other such appellant, and to prohibit only the acquisition of a measure of control through ownership of stocks or bonds or otherwise, by any individual in a company competing with that with which he is officially connected or a subsidiary or affiliate of such competing company. . . .

Paragraphs 37 to 39 are directed at the Glass Containers Association. . . .

The injunctions entered in paragraphs 37 to 39, inclusive, compel the association to abolish its statistical committee and to refrain from establishing any committee with similar functions. . . .

We think the injunction as respects the association, while leaving it in existence, practically destroys its functioning, even as an innocent trade association for what have been held lawful ends. The association has undoubtedly been an important instrument of restraint and monopoly. It may be made such again, and detection and prevention and punishment for such resumption of violations of law may be difficult if not impossible. In the light of the record, we think it better to order its dissolution, and to provide that the corporate defendants be restrained for a period of five years from forming or joining any such trade association. . . .

Paragraph 52 deals with the problem of suppressed or unworked patents. Much is said in the opinion below, and in the briefs, about the practice of the appellants in applying for patents to "block off" or "fence in" competing inventions. In the cooperative effort of certain of the appellants to obtain dominance in the field of patented glassmaking machinery, many patents were applied for to prevent others from obtaining patents on improvements which might, to some extent, limit the return in the way of royalty on original or fundamental inventions. The decree should restrain agreements and combinations with this object. But it is another matter to restrain every defendant, for the indefinite future, from attempting to patent improvements of machines or processes previously patented and then owned by such defendant. This paragraph is, in our judgment, too broad. In effect it prohibits several of the corporate defendants from applying for patents covering their own inventions in the art of glassmaking. For reasons elsewhere elaborated it cannot be sustained. . . .

A patent owner is not in the position of a quasi-trustee for the public or under any obligation to see that the public acquires the free right to use the invention. He has no obligation either to use it or to grant its use to others. If he discloses the invention in his application so that it will come into the public domain at the end of the 17-year period of exclusive right he has fulfilled the only obligation imposed by the statute. . . .

[The judgment of the District Court was reversed in part and affirmed in part, and the decree was vacated and remanded. JUSTICES DOUGLAS, MURPHY and JACKSON took no part in the consideration or

decision of the case. JUSTICES BLACK and RUTLEDGE each separately dissented in part.]

International Salt Co., Inc. v. United States

332 U.S. 392 (1947)

MR. JUSTICE JACKSON delivered the opinion of the Court.

The Government brought this civil action to enjoin the International Salt Company, appellant here, from carrying out provisions of the leases of its patented machines to the effect that lessees would use therein only International's salt products. The restriction is alleged to violate Section 1 of the Sherman Act, and Section 3 of the Clayton Act. . . .

It was established . . . that the International Salt Company is engaged in interstate commerce in salt, of which it is the country's largest producer for industrial uses. It also owns patents on two machines for utilization of salt products. . . . The principal distribution of each of these machines is under leases which, among other things, require the lessees to purchase from appellant all unpatented salt and salt tablets consumed in the leased machines. . . .

. . . In 1944, appellant sold approximately 119,000 tons of salt, for about \$500,000, for use in these machines.

The appellant's patents, confer a limited monopoly of the invention they reward. From them appellant derives a right to restrain others from making, vending or using the patented machines. But the patents confer no right to restrain use of, or trade in, unpatented salt. By contracting to close this market for salt against competition, International has engaged in a restraint of trade for which its patents afford no immunity from the antitrust laws. . . .

Appellant contends, however, that summary judgment was unauthorized because it precluded trial of alleged issues of fact as to whether the restraint was unreasonable within the Sherman Act or substantially lessened competition or tended to create a monopoly in salt within the Clayton Act. We think the admitted facts left no genuine issue. Not only is price-fixing unreasonable, *per se*, *United States v. Socony-Vacuum Oil Co.* . . . ; *United States v. Trenton Potteries Co.* . . . , but also it is unreasonable, *per se*, to foreclose competitors from any substantial market. . . . The volume of business affected by these contracts cannot be said to be insignificant or insubstantial and the tendency of the arrangement to accomplishment of monopoly seems obvious. Under the law, agreements are forbidden which "tend to create a monopoly," and it is immaterial that the tendency is a creeping one rather than one that proceeds at full gallop; nor does the law await arrival at the goal before condemning the direction of the movement. . . .

Appellant also urges that since under the leases it remained under an obligation to repair and maintain the machines, it was reasonable to confine their use to its own salt because its high quality assured satisfactory functioning and low maintenance cost. . . .

Of course, a lessor may impose on a lessee reasonable restrictions designed in good faith to minimize maintenance burdens and to assure satisfactory operation. . . . But it is not pleaded, nor is it argued, that the machine is allergic to salt of equal quality produced by anyone except International. If others cannot produce salt equal to reasonable specifications for machine use, it is one thing; but it is admitted that, at times, at least, competitors do offer such a product. They are, however, shut out of the market by a provision that limits it, not in terms of quality, but in terms of a particular vendor. Rules for use of leased machinery must not be disguised restraints of free competition, though they may set reasonable standards which all suppliers must meet. . . .

Judgment affirmed.

[MR. JUSTICE FRANKFURTER, joined by MR. JUSTICE REED and MR. JUSTICE BURTON, dissented in part.]

Appendix

Excerpts from Antitrust Statutes

SHERMAN ACT, 1890

Sec. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding \$5,000, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Sec. 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding \$5,000, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

ANTITRUST PROCEDURES AND PENALTIES ACT, 1974, AMENDING SECTIONS 1 AND 2 OF THE SHERMAN ACT

Sec. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony and, on conviction thereof, shall be punished by fine not exceeding \$1 million if a corporation, or, if any other person, \$100,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

Sec. 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to

monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$1 million if a corporation, or, if any other person, \$100,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

CLAYTON ACT, 1914

Sec. 2. That it shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities, which commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, where the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly in any line of commerce: *Provided*, That nothing herein contained shall prevent discrimination in price between purchasers of commodities on account of differences in the grade, quality, or quantity of the commodity sold, or that makes only due allowance for differences in the cost of selling or transportation, or discrimination in price in the same or different communities made in good faith to meet competition: *And provided further*, That nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade.

ROBINSON-PATMAN ACT, 1936, AMENDING SECTION 2 OF THE CLAYTON ACT

Sec. 2. (a) That it shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them: *Provided*, That nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered: *Provided, however*, That the Federal Trade Commission may, after due in-

vestigation and hearing to all interested parties, fix and establish quantity limits, and revise the same as it finds necessary, as to particular commodities or classes of commodities, where it finds that available purchasers in greater quantities are so few as to render differentials on account thereof unjustly discriminatory or promotive of monopoly in any line of commerce; and the foregoing shall then not be construed to permit differentials based on differences in quantities greater than those so fixed and established: *And provided further*, That nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade: *And provided further*, That nothing herein contained shall prevent price changes from time to time where in response to changing conditions affecting the market for or the marketability of the goods concerned, such as but not limited to actual or imminent deterioration of perishable goods, obsolescence of seasonal goods, distress sales under court process, or sales in good faith in discontinuance of business in the goods concerned.

(b) Upon proof being made, at any hearing on a complaint under this section, that there has been discrimination in price or services or facilities furnished, the burden of rebutting the prima-facie case thus made by showing justification shall be upon the person charged with a violation of this section, and unless justification shall be affirmatively shown, the Commission is authorized to issue an order terminating the discrimination: *Provided, however*, That nothing herein contained shall prevent a seller rebutting the prima-facie case thus made by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor, or the services or facilities furnished by a competitor.

(c) That it shall be unlawful for any person engaged in commerce, in the course of such commerce, to pay or grant, or to receive or accept, anything of value as a commission, brokerage, or other compensation, or any allowance or discount in lieu thereof, except for services rendered in connection with the sale or purchase of goods, wares, or merchandise, either to the other party to such transaction or to an agent, representative, or other intermediary therein where such intermediary is acting in fact for or in behalf, or is subject to the direct or indirect control, of any party to such transactions other than the person by whom such compensation is so granted or paid.

(d) That it shall be unlawful for any person engaged in commerce to pay or contract for the payment of anything of value to or for the benefit of a customer of such person in the course of such commerce as compensation or in consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale, or offering for sale of any products or commodities manufactured, sold, or

offered for sale by such person, unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products or commodities.

(e) That it shall be unlawful for any person to discriminate in favor of one purchaser against another purchaser or purchasers of a commodity bought for resale, with or without processing, by contracting to furnish or furnishing, or by contributing to the furnishing of, any services or facilities connected with the processing, handling, sale, or offering for sale of such commodity so purchased upon terms not accorded to all purchasers on proportionally equal terms.

(f) That it shall be unlawful for any person engaged in commerce, in the course of such commerce, knowingly to induce or receive a discrimination in price which is prohibited by this section.

CLAYTON ACT, 1914

Sec. 3. That it shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodity of a competitor or competitors of the lessor seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

FEDERAL TRADE COMMISSION ACT, 1914

Sec. 5. That unfair methods of competition in commerce are hereby declared unlawful.

CLAYTON ACT, 1914

Sec. 7. That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of another corporation engaged also in commerce where the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition or to restrain such commerce in any section or community or tend to create a monopoly of any line of commerce.

No corporation shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of two or more corporations en-

gaged in commerce where the effect of such acquisition or the use of such stock by the voting or granting of proxies or otherwise may be to substantially lessen competition between such corporations, or any of them, whose stock or other share capital is so acquired, or to restrain such commerce in any section or community or tend to create a monopoly of any line of commerce.

CELLER-KEFAUVER ACT, 1950, AMENDING SECTION 7 OF THE CLAYTON ACT

Sec. 7. That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

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