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# Federal Antiturst, Economic Freedom, and the Uncertain Conduct Requirement in Section 2 of the Sherman Antitrust Act: Toward a More Objective Approach

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# COMMENTS

# FEDERAL ANTITRUST, ECONOMIC FREEDOM, AND THE UNCERTAIN CONDUCT REQUIREMENT IN SECTION 2 OF THE SHERMAN ANTITRUST ACT: TOWARD A MORE OBJECTIVE APPROACH

## I. INTRODUCTION

Following the Civil War in the United States, American industry embarked upon a period of "truly remarkable economic growth."[1] In several respects economic expansion was beneficial to the general population, as commerce spread to new frontiers through development of canal and railroad systems.[2]

Concurrently, however, rapid economic growth by the late 1880's brought popular objection to large business enterprises and their ability to devour local businesses and manipulate merger schemes.[3] Trusts[4] had become anathema well before Congress considered any legislative remedy.[5]

The Sherman Antitrust Act[6] was one response to public opinion[7] that was increasingly adverse to large business conglomerates.[8] With little

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1. R. SHERMAN, ANTITRUST POLICIES AND ISSUES 32 (1978).

2. *Id.*

3. *Id.*

4. Professor Sherman outlines the history of the use of the term "trust" in order to make a fundamental and salient semantical distinction: "Not surprisingly, in popular use the word 'trust' came to mean monopoly. Of course large business enterprise and monopoly are not the same thing, for monopoly power to set price and deny entry does not require, or necessarily accompany, large scale business enterprise." *Id.* at 2.

5. The initiative for a new federal law to address the trust problem began with President Harrison's election. R. BORK, THE ANTITRUST PARADOX 19 (1978).

6. 15 U.S.C. (1976).

7. Public opinion forced Congress to consider legislation affecting other areas of the economy, as well. In 1890, for example, three important measures dealing with big business, currency, and the tariff were enacted. *See generally* T. WILLIAMS, A HISTORY OF THE UNITED STATES SINCE 1865 287-91 (3d ed. 1969).

8. In the late eighteen eighties, Americans suddenly became aware of the existence of "bigness" in business organizations, and of the appearance of trusts and monopolies on the national scene. H. MERRILL, BOURBON LEADER: GROVER CLEVELAND AND THE DEMOCRATIC PARTY 318-19 (1957). Their attention was excited not only by the sheer physical presence of the industrial giants, but also by the com-

debate and by almost unanimous consent of Congress,[9] the Act became law in July, 1890.[10]

Section Two[11] deems it illegal for any person[12] to monopolize any part of the "trade or commerce among the states or with foreign nations."[13] That section does not, however, either define "monopolize"[14] or delineate what types of conduct are indicative of monopolistic behavior. Those tasks have been left to the courts.[15]

With certain specific and rather narrow exceptions,[16] there exists

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plaints from farmers, workers, and small businessmen that big business was crushing small capitalists; and by warnings from Populist and labor leaders that monopolies were taking over the economy and government. So staunch a conservative as Grover Cleveland announced that corporations "were becoming the people's masters." *Id.*

9. *See* W. SCHULTZ & M. CAINE, FINANCIAL DEVELOPMENT, THE UNITED STATES (1937).

10. *Id.*

11. 15 U.S.C. § 2 (1976).

12. "Person" as used in the Act should be read to include corporations, associations, and other business organizations "existing under the laws of the United States, of any state, or foreign country." 15 U.S.C. § 7 (1976); *See also* Union Pac. Coal Co. v. United States, 173 F. 737 (8th Cir. 1909).

13. Section Two provides:

> 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 a fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars or by imprisonment not exceeding three years or by both said punishments, in the discretion of the court.

15 U.S.C. § 2 (1976).

14. As recently as 1978, one author suggested that "no entirely unambiguous definition of monopoly yet exists." R. SHERMAN, ANTITRUST POLICIES 35 (1978) [hereinafter cited as SHERMAN].

15. *Id.*; *see also* A. NEALE, THE ANTITRUST LAWS OF THE UNITED STATES OF AMERICA: A STUDY OF COMPETITION ENFORCED BY LAW 93 (1970).

16. Certain practices such as boycotts, vertical intergration and exclusive dealings with contracts, tying arrangements, and reciprocal buying are so well established as unlawful that any enterprise engaging in such activities would be doing so at its own risk. *See, e.g.*, Fashion Orignators Guild of America v. Federal Trade Comm'n, 312 U.S. 457 (1949) (boycotts); Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495 (1969) (tying arrangements and reciprocal buying); Federal Trade Comm'n v. Brown Shoe Co., 384 U.S. 316 (1966) (vertical integration and exclusive dealings contracts); *see also* A. NEALE, THE ANTITRUST LAWS 127-53 [hereinafter cited as NEALE].

It will be assumed for purposes of this comment that the reasonable businessman is aware of judicial condemnation of these practices, and that he will, therefore, seek to compete within the boundaries of Section Two. Some decisions indicate, however, that determining those boundaries is no mean feat. Some courts have held illegal certain practices which are, in other contexts, acceptable and lawful business behavior. The cases are legion and are set out by Professor Cooper. Cooper, *Attempts and Monopolization: A Mildly Expansionary Answer to the Prophylactic Riddle of Section Two,* 72 MICH. L. REV. 373, 445-48 (1974).

little definite statement as to what constitutes unlawful or monopolistic conduct under Section Two.[17] Professor Sullivan has articulated three concerns which he believes should be addressed when forming any test of unlawful conduct:

> First, [the test] should discriminate between conduct which is harmful in some economic sense, and conduct which is not; second, it ought to discriminate between alternative courses of action in the market in a manner which would be meaningful to an actor there . . .; third, it should not ban conduct which is no more than the rational response of a business manager seeking to maximize profits, sales, or revenues.[18]

Professor Sullivan emphasizes, therefore, criteria which focus on the requirements and goals of any actor within the market.[19] Also, the criteria outlined above gives rise to a more objective ("reasonable business manager") test for analyzing a particular firm's response to

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17. Despite its Populist roots, the Sherman Act was also a response to economic analysis that tended to reveal that monopolies were the antithesis of a free market. That is, monopolistic behavior is often compared unfavorably with examples of the "perfect" of "pure" competition model. *See, e.g.,* E. SINGER, ANTITRUST ECONOMICS AND LEGAL ANALYSIS 15-45 (1981) [hereinafter cited as SINGER]. The typical competitor is one of so many producers of an identical good that he faces a practically horizontal ("infinitely elastic") *dd* curve, even though the industry's much larger *DD* curve can be much more inelastic. A fuller explanation of this concept is set out in the Appendix.

If there is free entry and exit of well-informed firms which can replicate the cost conditions of any other firm, no excess profit over competitive costs will be involved. *See* P. SAMUELSON, ECONOMICS (9th ed. 1973). Society is, thereby, getting its total output more efficiently; and it is not forcing out of existing firms any output that could be maintained more cheaply by adding new firms. *Id.*

This is compared to the "deadweight" loss due to monopoly. When a monopoly raises price to maximize profit, the consumers lose more than the monopolists profit. *Id.*; SHERMAN, ANTITRUST POLICIES 18-22; J. VAN CISE, THE FEDERAL ANTITRUST LAWS 17-18 (1975) [hereinafter cited as VAN CISE].

Also, some commentators urge that economic reasons alone were not the basis of America's distrust of large business organizations. R. HEILBRONER, THE WORLDLY PHILOSOPHERS 66-69 (4th ed. 1972). An historical basis can be discerned for the contention that monopolies were the "great enemy" of the free enterprise system cogently defended by Adam Smith. *Id.* Nevertheless, even these historians agree that economics is the key to understanding antitrust: "[t]he trouble with [monopolies] is not that they are morally reprehensible in themselves — they are, after all, only the inevitable consequence of man's self interest — they also impede the fluid working of the market." *Id.*

For a somewhat unique approach to the "moral reprehensibility" of monopolies *see* VAN CISE, FEDERAL ANTITRUST LAWS 20-22.

18. L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 100 (1977).

19. Professor Sullivan's failure to distinguish enterprises on the basis of size is significant. It may indicate support for the proposition that "our legal system should encourage the defense of economic liberties, and insure the right for all companies to match a lawful competitive price, regardless of size or cost structure of the company." Singer, *supra* note 17, at 80.

the practical demands of the market. Inherent in such an analysis is a necessity to distinguish between normal aggressive[20] conduct that does not violate Section Two from that sort of conduct which does.[21]

This comment will examine judicial decisions wherein conduct violations of Section Two have been alleged. This examination and analysis will necessarily be at least as economic as it will be legal.[22] Next, the comment will outline what may be perceived as a subtle shift towards a more objective approach by the courts in certain antitrust actions.[23] Finally, the comment will present a test that addresses the concerns outlined by Professor Sullivan.

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20. It is important to point out that this comment will assume that competition is the *sine qua non* of any free enterprise system. *See* SHERMAN, *supra* note 14, at 16; *but see* K. ELZINGA, THE GOALS OF ANTITRUST: OTHER THAN COMPETITION AND EFFICIENCY, WHAT ELSE COUNTS, 125 U. PENN. L. REV. 1191-1213 (1977). In fact, competition is claimed as an advantage by both those favoring a more "strict" or literal reading and enforcement of Section Two as well as those urging a broader "open-textured" approach. *See, e.g.,* 3 P. AREEDA & D. TURNER, ANTITRUST LAW ¶608(e) (1978) (strict or "no conduct" theory); NEALE, *supra* note 16, at 1-2 stated:

> Competition between firms is, after all, accounted a [*sic*] principle virtue of private economic activity, operating as a stimulus to improved methods and as a safeguard against the indifference to the wishes of consumers. It would seem inconsistent [with such a system], therefore, to allow competition to be freely impaired, even eliminated, by private agreements between firms of by the acquisition of private monopoly power.

*See also* R. POSNER, ANTITRUST LAW 8-22 (1976).

21. A selection of the most important cases evidences to some degree the problem of discernment. United States v. Griffith, 334 U.S. 100 (1948) (the use of monopoly power, however lawfully acquired, in an effort to foreclose competition, gain a competitive advantage, or destroy a competitor violates Section Two); United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945) (to violate Section Two, the monopolist must have intention to monopolize); Otter Tail Power Co. v. United States, 410 U.S. 366 (1973) (defendant's use of its dominance to foreclose potential entrants is an attempt to monopolize); United States v. International Harvester Co., 274 U.S. 693 (1927) (mere size not an offense if it is not coupled with an unlawful use of that size and power); United States v. United States Steel Corp., 251 U.S. 417 (1920) (size alone is not an offense); United States v. American Tobacco Co., 221 U.S. 106 (1911) (wrongful purpose must be established as an element of a Section Two offense); Standard Oil Co. of N.J. v. United States, 211 U.S. 1 (1911) (Section Two encompasses all attempts to restrain trade by attempts to monopolize or by actual monopolization).

22. "One of the most interesting developments in American higher education over the past decade has been the emerging recognition by lawyers that an understanding of elementary economic principles is a vital component in their professional equipment." BUCHANAN, GOOD ECONOMICS — BAD LAW, 60 VIRGINIA L. REV. 483 (1974). Antitrust is an area of law that is particularly given to economic analysis due to its concern with control of the market. So inexorable and fundamental is the interaction between law and economics that it is often difficult, indeed, detrimental to analyze one without the aid of the other in the context of this comment's topic. B. SEIGAN, THE INTERACTION BETWEEN ECONOMICS AND THE LAW 8-10 (1977). Also, virtually every authority that addresses antitrust problems does so with at least a cursory examination of elementary economic principles. *Id.*; SINGER, *supra* note 17.

## II. Historical Background

The United States Supreme Court has set forth a two-pronged test that a plaintiff must meet in order to prove a monopolization offense. The test was announced in *United States v. Grinnell Corp.*,[24] and holds that a plaintiff must demonstrate (1) that the defendant possessed actual monopoly power, and (2) that the power was used or acquired in ways "other than by superior product, business accumen, or historical accident."[25] Before it adopted this test, however, the Court had embraced a form of a test used by Judge Learned Hand.[26]

### A. *ALCOA and the "Deliberateness Test"*

In *United States v. American Aluminum Co. of America.*[27] the defendant was charged with monopolizing the virgin aluminum ingot market.[28] Judge Hand,[29] based upon earlier Supreme Court precedent,[30] set out to answer two questions. First, "whether intent to monopolize could be provded only by overt acts of exploitation or predation;"[31] and, second, how wide a departure from "normal methods of industrial development must be shown to disclose an intent to monopolize."[32]

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23. Any system of competitive markets is essentially a communication and information system whereby consumers tell suppliers exactly what to produce. SHERMAN, *supra* note 14, at 16. To the extent that they communicate with these firms, consumers may also benefit from any change in Section Two's interpretation that operates to instigate competition.

24. 388 U.S. 563 (1966).

25. *Id.* 570-71.

26. In *United States v. E.I. DuPont de Nemours & Co.*, the Supreme Court faced the issue of whether DuPont had monopolized the cellophane market in violation of the monopolization provision of Section Two. The Court employed a form of the "deliberateness test." 351 U.S. 377 (1956).

27. 148 F.2d 416 (2d Cir. 1945).

28. Defendant was charged with originally monopolizing the following markets: bauxite, water power, alumina, virgin aluminum (pig and ignot), castings, cooking utensils, pistons, extrusions, structural shapes, foil, sheet, and cable. SINGER, *supra* note 17, at 54.

29. The *Alcoa* case fell into Judge Hand's court under unusual circumstances. Because four Supreme Court Justices had participated in earlier litigation of the case, they disqualified themselves from hearing the appeal, leaving the Court without its required quorum of six. Thus, the Court of Appeals for the Second Circuit was sitting as the court of last resort. *Id.*; SHERMAN, *supra* note 14, at 53.

30. Since the end of World War II, the law under Section Two had been developed largely along the lines laid down by Chief Justice White in 1911. *See* Standard Oil Co. of N.J. v. United States, 221 U.S. 1 (1911). Chief Justice White insisted upon intent and purpose as the main test for deciding whether monopoly power had been accumulated. NEALE, *supra* note 15, at 107.

31. NEALE, *supra* note 15, at 106.

32. United States v. Aluminum Co. of America, 148 F.2d 416, 431 (2d Cir. 1945).

Judge Hand concluded that Alcoa was indeed in a position of power in the American aluminum market.[33] Further, Alcoa had violated the Act "by proceeding to embrace each new opportunity as it opened, and to face every newcomer with a new capacity already geared to a great organization."[34] To restrict a definition of unlawful conduct to that which was specifically directed towards preventing competition would "emasculate the Act."[35]

The court in the *Alcoa* case employed a rule that holds "monopolization" occurs when a firm achieves or maintains a monopoly through a course of deliberate market conduct.[36] Deliberate

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33. *Id.*

34. *Id.*

35. *Id.* at 432; The court elaborated. Judge Hand believed that Congress was not motivated by economic reasons alone in passing the Sherman Act. *Id.* at 427. Political and social concerns "form a major part of our aversion to monopolies, for concentration in the hands of the few obstructs opportunities for the rest." *Id.*; *see also* F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 13-19 (1970); L. SULLIVAN, HANDBOOK OF ANTITRUST (1977).

36. "Deliberate market conduct" would be that which has a tendency to preclude other firms which might otherwise have done so from entering or expanding a particular market. NEALE, *supra* note 15, at 109-10. In a sense, however, all conduct that seeks legitimate business goals is deliberate. For example, when Firm A researches and develops a better mousetrap, that action is obviously deliberate. Firm A engages in conduct with the overt intention of gaining a greater share of the mousetrap market; that is, a share greater than Firms B, C, and D. Thus, one must examine the extent to which the deliberateness test would hold Firm A as possessing the requisite intent to monopolize through its successful marketing of an innovative device.

Analysis of *Alcoa* and the deliberateness test has led some courts to conclude that Judge Hand was actually looking towards a much more restrictive view of "monopolization." *See, e.g.,* Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263 (1979), *cert. denied,* 44 U.S. 1093 (1980) (the cryptic *Alcoa* decision [as] a litigant's wishing-well).

Other courts have criticized Judge Hand for failing to foresee possible abuses of Section Two by weak firms to protect themselves "from the rigors of competition." Buffalo Courier-Express, Inc. v. Buffalo Evening News, Inc., 601 F.2d 48, 50 (2d Cir. 1979).

The logic of the deliberateness test could *pro tanto* provide the basis for a "no-conduct" approach whereby Section Two would outlaw monopolies without any inquiry as to intent or purpose. This approach is quite restrictive, and is basically inconsistent with the Act's function. The Act does not prohibit monopoly *simpliciter.* J. VON KALINOWSKI, ANTITRUST LAWS AND REGULATION ¶ 802(3), at 8-41 (1979). The approach is too restrictive because it is based upon an assumption that is of questionable practical and theoritcal validity. Judge Hand assumed that if Alcoa had restrained expansion of its operations, others would have entered a market in which demand was quickly outpacing supply. The deliberteness test would force firms to restrain themselves in such circumstances. Demanding this sort of behavior raises substantial questions of just how realistic any test is which so restricts established firms. The test fails to provide the firm that wishes to obey the law with rational guides for conduct. SULLIVAN, *supra* note 15, at 96.

One other aspect of *Alcoa* merits examination. Though the court noted that the conduct must be evidenced by a firm's behavior under the facts and circumstances of each case. In *Alcoa,* the defendant's deliberate conduct was manifested by its "positive drive"[37] to control the market. Judge Hand, therefore, created a test that had as its cornerstone deliberate market conduct.[38]

### B. *UNITED SHOE and the "Exclusionary Test"*

Approximately nine years following *Alcoa,* another major attempt was made to define unlawful conduct under Section Two in *United States v. United Shoe Mach. Co.*.[39] Although Judge Wyzanski had at least two other tests from which to choose,[40] he found it unnecessary to do so.[41] Instead he set out to answer the question of whether United Shoe had simply made "a better mousetrap," or whether its conduct was to some degree purposefully exclusionary.[42]

Applying the standard of "purposeful exclusion" to the case before him, Judge Wyzanski found evidence of illegal conduct. For

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defendants had actually assisted competitors instead of discouraging them, it decided that the company had not done enough. 148 F.2d 416, 431 (2d Cir. 1945). In so doing, the court was at least giving its implied approval to a large firm's affirmative obligation to assist other less fortunate firms. Imposition of this duty could give rise to an obligation on the part of large firms to disclose advances made by them which would not be discoverable through ordinary means. For example, Firm A is a large firm on the threshold of an important innovation which will probably increase its sales and broaden its mousetrap market. Firm B, on the other hand, is a small concern, and has not yet even considered the type of research that led to Firm A's innovation. If a duty of predisclosure were imposed upon Firm A, it is conceivable that Firm A would be forced to disclose much of the information to Firm B which made the innovation possible. Further, this disclosure would have to take place before Firm A marketed the new mousetrap.

Predisclosure, however, has been unequivocally rejected by the Supreme Court. United States v. National Lead Co., 332 U.S. 319 (1947) (an attempt by the government to throw the field of technical knowledge wide open would reduce the competitive level and discourage rather than encourage competitive research). Also, predisclosure would have possible adverse consequences beyond merely encouraging economic slothfulness. *See* ICL Peripherals Leasing Corp. v. IBM Corp., 458 F. Supp. 423 (N.D. Cal. 1978).

37. NEALE, *supra* note 15, at 109.

38. 148 F.2d 416, 429-30 (1945).

39. 110 F. Supp. 295 (D.C. Mass. 1953), *affirmed per curiam,* 347 U.S. 521 (1954).

40. Judge Wyzanski contemplated accepting either the *Alcoa* "deliberateness" test or the "classic" exclusionary test. SULLIVAN, *supra* note 18; Standard Oil Co. v. United States, 221 U.S. 1 (1911) (abnormal methods of industrial development undertaken with the intent and purpose to restrain trade); United States v. American Tobacco Co., 221 U.S. 106 (1911) (engaging in or threatening to commit tortious conduct violates Section Two).

41. Judge Wyzanski believed that the result in the case would be the same in either test. NEALE, *supra* note at, at 109.

42. *Id.*

instance, United engaged in practices such as acquisition of competing firms, "lease-only" managements, and long-term lease contracts.[43] Judge Wyzanski found that while these practices were "honestly industrial," they:

> are not practices which can be properly described as the inevitable consequences of ability, natural forces, or law. They represent something more than the use of accessible resources, the process of invention and innovation, and the employment of those techniques of employment, financing, production, and distribution, which a competitive society must foster. They are contacts, arrangements, and policies which, instead of encouraging competition based on pure merit, further the dominance of a particular firm. In this sense, they are unnatural barriers; they are unnecessary to exclude actual and potential competition; they restrict a free market . . . The violation with which United is now charged depends not on moral considerations, but solely on economic considerations. United is denied the right to exercise effective control of the market by business policies that are not the inevitable consequences of its capacities or its natural advantages.[44]

In essence, Judge Wyzanski required a higher standard of conduct for a company possessing a monopoly or dominant market position than for a company in a more competitive market structure.[45] The record of United's performance in terms of efficient service, exceptional innovation, and absence of predatory conduct, however, was outstanding.[46] The company spent over $3 million dollars annually on research and development alone.[47] United's market power did not rest on predatory practices, and, as the District Court concluded, "probably few monopolies could produce a record so free . . . of wrongdoing."[48]

Nevertheless, United was found to have engaged in practices which tended to exclude competition. These practices would have been legally permissible if practiced by a firm in a competitive market structure, but illegal when employed by a company maintaining market control.

43. 110 F. Supp. 295, 343-45.

44. *Id.*

45. SINGER, *supra* note 17, at 59.

46. For a detailed economic analysis of the case, *see* C. KAYSEN, UNITED STATES V. UNITED MACHINE CORPORATION, HARVARD ECONOMIC STUDIES (1956); L. KEYES, THE SHOE MACHINERY CASE AND THE PROBLEM OF THE GOOD TRUST, QUARTERLY JOURNAL OF ECONOMICS (1954).

47. 110 F. Supp. 295, 345.

48. *Id.*

## III. The Dilemma: Aggressive Competition or Illegal Conduct?

The industrialist is justifiably bewildered when he is threatened with loss of intergrity and property for failing to conform his conduct to uncertain legislative and judicial standards defining the monopolization offense.[49] These standards have varied in application and implication as changes have taken place with respect to the economic and legal philosophies underlying those standards.[50] It is as a result of this uncertain conduct element of Section Two that the reasonable businessman is confronted with a dilemma. On the one hand, a firm must proceed aggressively in order to survive and prosper within a free market. On the other hand, courts have held, in Judge Wyzanski's words, "honestly industrial"[51] behavior unlawful if it operates to exclude other firms. A sampling of several cases will sharpen the horns of the dilemma.

One early example was a case brought by the federal government against Dayton entrepreneur John H. Patterson.[52] In *Patterson v. United States,*[53] National Cash Register (NCR) engaged in allegedly unlawful conduct including abuse of the legal process, bribing, and attempting to destroy the credit of competitors.[54] The court described the essence of Section Two "monopolization" as exclusion.[55] Although the court found NCR and Patterson guilty of antitrust violations, it was careful to emphasize that, in its opinion, "monopolizing by efficiency in producing and marketing a better and cheaper article" was not prohibited by Section Two.[56] Nevertheless, no attempt was made to distinguish between legally competitive conduct and that which was "plainly unlawful."[57]

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49. Van Cise, *supra* note 17, at 59.

50. United States v. Aluminum Co. of America, 91 F. Supp. 333, 340 (S.D.N.Y. 1950); *c.f.* Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320 (1961).

51. Note 44 *supra.*

52. Patterson acquired a controlling interest in National Manufacturing Company (later, in 1884, the National Cash Register Company) in 1883. His competitive methods were so aggressive that he was supreme in his field but he was repeatedly subject to attacks by government agencies. *See generally* S. Crowther, John H. Patterson, Pioneer of Industrial Welfare (1923).

53. 222 F. 599 (6th Cir. 1914), *cert. denied,* 238 U.S. 635 (1915).

54. *Id.* at 612-13.

55. *Id.* at 619.

56. *Id.*

57. Such a distinction is vital to resolution of any particular case through employment of the exclusionary test, inasmuch as all business practices are literally exclusionary. Professors Areeda and Turner reflect this concern:

Successful competition is 'exclusionary' in a literal sense. Building a better

The distinction between legally competitive conduct and illegal acts was examined by the Supreme Court in *Schine Chain Theatres, Inc. v. United States.*[58] Again, the Court had to confront a situation in which the defendant's conduct, though perhaps reprehensible, was not intrinsically unlawful. For example, the Court noted the defendant's threats to open or close theatres in order to prevent entry of independent operators, negotiations of long-term agreements not to compete, and its capacity to obtain more favorable film rental concessions from distributors.[59] The Court concluded, however, that the Sherman Act was "not restricted to unlawfully obtained monopolies."[60] Almost parenthetically, the Court noted that much of Schine's behavior was possible solely as a result of its great size and buying power.[61]

The size and scope of a particular company's advertising and product development programs may also raise signficiant conduct questions. In *Bailey's Bakery, Ltd. v. Continental Baking Co.,*[62] the Federal District Court of Hawaii found large-scale advertising and product development illegal within the Section Two conduct requirement.[63] Continental had acquired an interest in Love's Hawaii (Love's) which controlled approximately 83 percent of the bread market in Honolulu.[64] The complaint charged that Love's had carried on extensive advertising campaigns which were proportional to its market share.[65] Acknowledging the truism of antitrust law that mere

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> mousetrap, responding more effectively than rivals to change in consumer tastes, offering higher quality or better service, adopting cost-saving innovations - all competitive moves that enhance one's position vis-a-vis his rivals - exclude those rivals; the greater the success the greater the exclusion.

3 P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 608e (1978); *see also* note 36 *supra.*

58. 334 U.S. 110 (1948).

59. *Id.* at 116.

60. *Id.* at 130.

61. *Id.* at 115; The Court's emphasis on Shine's size raises an interesting point. Frequently, courts have asserted that mere size and power will not constitute violations of Section Two. *See, e.g.*, United States v. United States Steel Corp., 251 U.S. 417, 451 (1920); United States v. International Harvester Company, 274 U.S. 693 (1927). Despite those assertions, however, cases such as *Schine* indicate that large and powerful firms may have great difficulty surmounting the at least implied presumption operating against them. Such "veiled attacks on size and growth without legislative mandate present a clear situation which the lawyer will find impossible to explain to a thoughtful client." Gasell, PROBLEMS IN MONOPOLY, ANTITRUST LAW SYMPOSIUM 59, at 71 (1958).

62. 235 F. Supp. 705 (D. Hawaii 1964), aff'd. 401 F.2d 182 (9th Cir. 1968), *cert. denied* 393 U.S. 1086 (1969).

63. *Id.* at 710.

64. *Id.*

65. *Id.*

size alone is not an offense,[66] the court searched the pleadings[67] for some manifestation of an intent or purpose by the defendant to exclude. Love's' extensive advertising and its introduction of new products were viewed by the court as "basically predatory and aimed at restraining or destroying competition."[68]

One business which sought to expand in the face of a growing market found itself defending an antitrust suit in *Philadelphia World Hockey Club, Inc. v. Philadelphia Hockey, Inc.*.[69] In that case, the defendant National Hockey League (NHL) expanded in an effort to facilitate a growing market. The court inferred from that expansion, however, an intent by the NHL to monopolize professional hockey.[70] Arguably, the expansion was aimed at facilitating a growing market. From its admittedly established position, the NHL sought to compete vigorously with the new World Hockey League.[71] The court imposed a duty similar to that imposed by Judge Wyzanski upon large firms to leave part of "the market unsupplied in order to encourage competitors."[72] Expanding as fast as the market grew was, therefore, indicative of the NHL's wrongful intent to monopolize professional hockey.[73]

The above examples indicate how bewildering judicial decisions regarding the Section Two "monopolization" offense could be to the average businessman. Some have a justifiable belief that the government's actions have rewarded the most successful firms with legal liability.[74] A proposal must, therefore, reconcile the practical demands of the free market with the legitimate concerns obviated through enforcement of the Sherman Act.

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66. *Id.*
67. *Id.* at 723.
68. *Id.*
69. 351 F. Supp. 462 (E.D. Pa. 1972).
70. *Id.* at 512.
71. *Id.* at 511.
72. *See* note 45 *supra*.
73. 351 F. Supp. 462, 512; *see also* Note, *The Super Bowl and the Sherman Act: Professional Team Sports and the Antitrust Laws,* 81 HARV. L. REV. 418, 431 (1967).
74. Handler, *Some Unresolved Problems of Antitrust,* 62 COLUM. L. REV. 930, 934-935 (1962); Mr. Chief Justice Jackson illustrated the problem in his dissent from the Court in *Standard Oil of California v. United States:* "If the courts are to apply the lash of the antitrust laws to the backs of businessmen to make them compete, we cannot in fairness apply the lash whenever they hit upon a successful method of competing." 337 U.S. 293, 324 (1949); *see also* P. SAMUELSON, ECONOMICS (9th ed. 1973).

## IV. A Modest Proposal

The recent decision in *Telex Corp. v. International Business Machine Corp.*[75] emphasized that "technical attainments were not intended to be penalized or prohibited . . . by Section 2."[76] Innovation, success, growth, and efficiency are legitimate business goals, and as such, should not be muted by the Sherman Act.[77] Those kinds of activities . . . "should so far as possible be controlled exclusively by the impersonal mechanism of the free competition between individuals in an open market."[78]

Section Two should not, therefore, be employed as a device for protecting competitors from their more energetic and efficient rivals. As seen above,[79] a test has not yet been devised which is at once objective in terms of a firm's size and also responsive to the practical and rational demands of the marketplace. There exists some reason to believe that courts are moving towards a more rational approach. A recent case provides an example.

The decision in *California Computer Products, Inc. v. IBM, Corp.*[80] utilized an approach which emphasized rational business behavior as a basis upon which to judge the challenged activities. The plaintiff (CalComp) had manufactured various peripheral devices, primarily disk drives,[81] which were compatible to IBM computers.[82]

75. 510 F.2d 894 (1975), *cert. dismissed,* 423 U.S. 802 (1975).

76. *Id.* at 927.

77. "There must be some room to move for a defendant who sees his market share by research and innovation being eroded by those who market copies of his products." *Id.*

78. R. Stewart, "Language, Liberty and Morals," The Intercollegiate Review 122 (1981); *see also* F. Meyer, In Defense of Freedom 150-51 (1962); F. Hayek, The Constitution of Liberty 220-33 (1960).

79. *See* notes 19 and 36 *supra.*

80. [1979-1] Trade Reg. Rep. (CCH) ¶ 62, at 713 (9th Cir. 1979); Other cases are characterized by this objective approach. *See, e.g.,* Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263 (2d Cir. 1979), *cert. denied,* 444 U.S. 1093 (1980); Greyhound Computer Corp. v. IBM, Corp., 559 F.2d 488 (9th Cir. 1977), *cert. denied,* 434 U.S. 1040 (1978); Transamerica Computer Co. v. IBM, Corp., No. C 73-1832 (N.D. Cal., Oct. 18, 1979); Memorex Corp. v. IBM, Corp., Nos. 78-350, 78-3236 (9th Cir. Aug. 1, 1979).

81. Disk drives are devices used to control, record, and store information. IBM introduced its System 370 Model 145 in 1970. It announced then that the 2319A was the standard disk drive for use with the 145. The control function for the new IBM disk drive was partially integrated into the CPU, whereas earlier disk drives themselves housed the central control function. California Computer Prods. Inc. v. IBM, Corp., [1979-1] Trade Reg. Rep. (CCH) ¶ 62,713 (9th Cir. 1979).

82. *Id.*

IBM subsequently altered the specifications of its disk drive system to require new peripheral interfaces which differed significantly from previous configurations.[83] CalComp characterized these design changes as "technical manipulation" that failed to improve performance.[84]

The court, however, did not agree with the plaintiff's characterization, as it found the new model to be a lower cost alternative and, therefore, a superior product.[85] The court's conclusion that IBM's development of the product was a lawful attempt to compete aggressively resulted in a finding that no Section Two "monopolization" violation had occured.[86]

*CalComp* employed an objective approach. For example, the court emphasized that IBM's innovation resulted in a profit.[87] Further, the new interfaces also improved performance.[88] IBM had, therefore, demonstrated to the court's satisfaction that two rational and acceptable business objectives were accomplished by its actions. Although the court did not articulate any precise test, its more objective approach provides the core of the proposal that follows. It will be essentially a three-part test, and may be outlined in this way:

1. The plaintiff must demonstrate that the defendant possessed actual monopoly power which had been attained through means other than by superior product, business accumen, or historical accident.[89]
2. The plaintiff must prove that the defendant employed that power with either the intent or the effect of inhibiting competition with respect to that plaintiff or other similar firms.
3. The defendant should be required, by way of an affirmative defense, to prove that its conduct had a strong rational basis in the accepted standards of business behavior in the particular relevant market.

Before pointing out the proposal's advantages, it should be noted that any notion of eliminating the conduct requirement from Section Two, as some commentators have suggested,[90] is unequivocally re-

83. *Id.*
84. *Id.*
85. CalComp's allegations were also rejected because IBM was not shown to have acted unreasonably to restrict competition. *Id.* at 77,983.
86. *Id.*
87. *Id.*
88. *Id.*
89. Note 25 *supra.*
90. *See, e.g.,* Statement of John J. Flynn, *Proposed Elimination of the Court Requirement for Proving Monopolization Under Section 2,* 48 ANTITRUST L.J. 843 (1980). Professor Flynn proposed a statute that read in part:

> Every person who possesses monopoly power in any revelant market shall be subject to proceedings to be brought by the United States Department of Justice or

jected by this proposal. Many of the "no-conduct" proposals trace their roots to Judge Hand's *Alcoa* opinion. Neither Congress[91] nor the Supreme Court[92] have demonstrated, however, any inclination to adopt such a reading of Section Two. To this extent then, the "no-conduct" reading seems to be a quixotic idea at best.

The proposed three-part test attempts to approximate the rational business approach that characterizes Professor Sullivan's concerns outlined above.[93] It has several advantages. First, the exceptions in *Grinnell* are preserved. These are reasonable exceptions, and have never been seriously questioned.[94]

Second, the prososed test recognizes that monopoly power is not inherently unlawful and injurious. If, as Chief Justice White suggested in *Standard Oil of N.J. v. United States,*[95] the Sherman Act was directed at the monopolist's ability to fix prices, limit production, and reduce product quality,[96] then a violation should not be found unless some action and affirmative behavior is demonstrated by the plaintiff. It is not enough for the plaintiff to show that monopoly power existed, and that, therefore, harmful and anti-competitive intent was "in the air."

Third, economic theory also supports a requirement that the monopolist's power be used to be deemed unlawful.[97] Most of the

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> the Federal Trade Commission. . .Upon finding that a person possesses monopoly power, the [chosen forum] shall order the parties to the proceeding to propose remedies for the dissipation and elimination of the monopoly power found.

*Id.* at 861-62; Professors Areeda and Turner contend that courts, though speaking of intent, actually rely on anticompetitive conduct to establish violations. 3 P. AREEDA & D. TURNER, ANTITRUST LAW 40 (1978), note 21 *supra.* They also believe that the requisite intent to exclude has generally been inferred from an objective assessment of conduct. Note 21 *supra.*

91. No-conduct proposals have been introduced on at least two occasions, and Congress has rejected them. *See* MONOPOLIZATION REFORM ACT, S. 3429, 94th Con., 2d Sess. (1976); INDUSTRIAL RECOGNITION ACT, S. 1167, 92nd Cong. 2d Sess. (1971).

92. *See* United States v. Griffith, 334 U.S. 100 (1948). Arguably, the Court could have adopted the then recent decision in *Alcoa* in its broadest terms.

93. *See* note 18 and accompanying text *supra.*

94. Singer, *supra* note 17, 80-83; *see* R. BORK, THE ANTITRUST PARADOX (1978).

95. 221 U.S. 1 (1911).

96. *Id.* at 46.

97. The fundamental objection to monopolies is that they utilize the plant capable of producing long-run equilibrium output at the lowest per unit cost. *See* C. FERGUSON & S. MAURICE, ECONOMIC ANALYISIS: THEORY AND APPLICATION, (3d ed. 1978), Chap. 8. For example, under certain circumstances, a monopoly might charge a price below that at which profit is maximized, and, thereby, produce and sell an output greater than that at which marginal revenue equals marginal cost. The monopoly's price, of course, is lower than the maximum; but, a rival's entry could lower profit even more. *Id.*; *See* Appendix.

economic objections to monopolies singularly require that something be done by the monopoly. The monopolist's actions are harmful because they in some way threaten the market. The proposal's second requirement, therefore, seems to embody the notion that antitrust violations only follow from those cases in which the defendant undertook some affirmative behavior to restrict competition.[98]

Finally, the proposed test requires the defendant to put forth evidence of the rationality of its behavior in terms of legitimate business goals such as maximizing sales, profits, or revenues through a structured process of research and development. Innovation would be vindicated under the proposal so long as the defendant firm could prove that its expansion or achievement was the result of planning and responding to the demands of the market.[99]

## V. CONCLUSION

Courts have struggled to define precisely the type of conduct which would constitute "monopolization" under Section Two of the Sherman Antitrust Act. Previous efforts to articulate a standard that would simultaneously permit a free market to operate and maintain the legitimate goals of the Act have tended to pose a dilemma for the businessman. He could elect to remain within the strict letter of the Act and judicial decisions, or compete aggressively with the other firms in the market employing their methods. Pursuing the former course could lead to economic hardship. Competing aggressively, on the other hand, may risk violation of Section Two to the extent that application

98. Professors Bork and Bowman suggest that the three "evils" at which the Sherman act was aimed were outlined by Chief Justice White:

1. the power of monopolies to fix prices;
2. power to limit production;
3. power to deteriorate the quality of products.

Bork & Bowman, *The Goals of Antitrust: A Dialogue on Policy,* 65 COLUM. L. REV. 363 (1965); Standard Oil Co. of N.J. v. United States, 221 U.S. 1, 52 (1911).

99. *See, e.g.,* Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263 (1979), *cert. denied,* 444 U.S. 1093 (1980). Berkey had argued that Kodak violated Section Two by introducing the new Kodacolor II film simultaneously with the new Pocket Instamatic camera. This is known in the trade as "systems selling." The court rejected Berkey's claim, and viewed Kodak's behavior as an attempt to develop a superior product. *Id.* at 286. An alternative holding might have been that Kodak employed a selling technique that was free for other competitors to use as well.

This concept may also be applied to standards of conduct for advertising. A monopolist would not be, under the proposed test, forbidden from publicizing its product unless the "extent of this activity is so unwarranted by the *competitive exigencies* as to constitute an entrance barrier." Borden, Inc., 3 TRADE REG. REP. (CCH) ¶ 21,490 at 21,491 (emphasis added).

of the standards for monopolization have tended to vary with respect to the economic and legal philosophies underlying those standards.

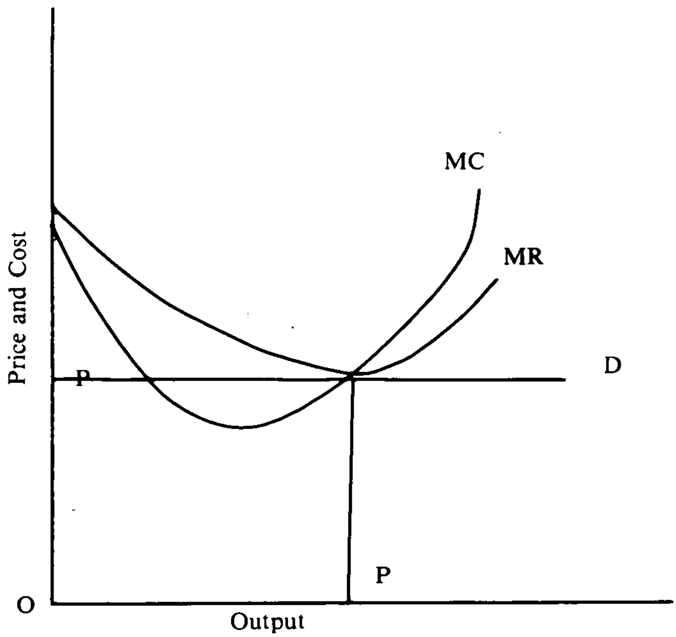
It is necessary, therefore, for a test to be developed which would, at once, reconcile the practical demands of the market with the legitimate goals of the Sherman Act. The proposal outlined in this comment conforms with certain developing case law in tending to judge challenged activities of any particular enterprise upon a basis of rational business behavior.

*Charles R. Corbin, Jr.*

## *APPENDIX*

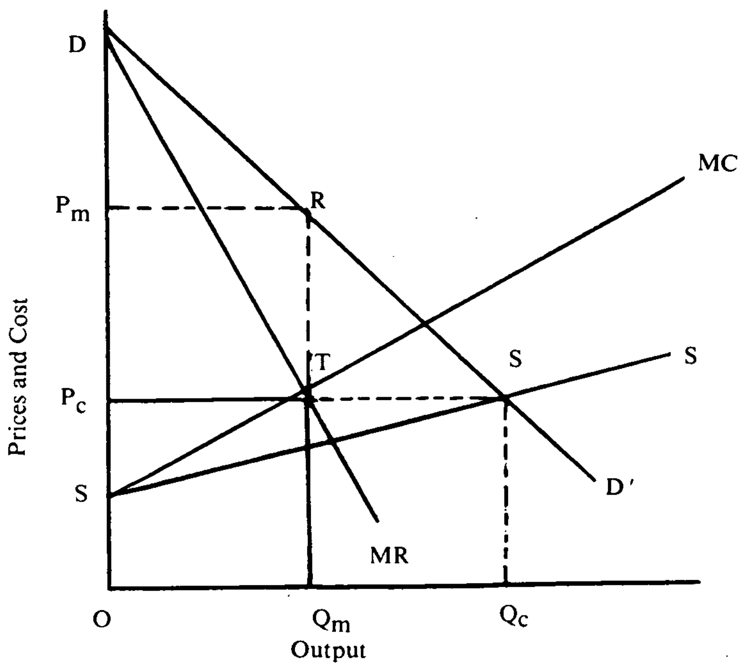
Often economic analysis of monopolies tends to proceed from a basis by which the model of pure competition is compared and contrasted with the model of pure monopoly. Although some commentators have pointed out that such a comparison often neglects other factors, the comparison remains vital to any understanding of the foremost goal of the Sherman Antitrust Act.

The economic model of pure competition is a market structure with many buyers and sellers, a standardized product, freedom of entry and exit, and absence of any collusion. Most importantly, the pure competition model assumes an inability on the part of any one buyer or seller to influence price.



The graph depicts the firm in pure competition where P = MC = MR. In pure competition a firm can sell at the going market price as many units as it produces. Its demand curve (D) is at a height corresponding to the going market price (P). In the graph, the equilibrium output for the competitive firm is at OM, where the marginal cost curve (MC) is rising and intersects the horizontal demand curve (D) at the going market price (P). The demand curve coincides with the marginal revenue curve and, P = MC = MR. The competitive firm will continue to increase its output and sell at the going market rate until the total cost of producing an additional unit (MC) is equal to the revenue (MR = P) derived from its sale. In time, freedom of entry into and exit out of the market will result in the average cost curve's being tangent at its minimium point to the demand curve. Thus, the competitive firm will achieve a normal return, which is the minimum renumeration necessary to remain in business.

The economic model of pure monopoly is, on the other hand, a market structure of one firm which faces neither the threat of entry of other firms into its industry nor the competition of substitute products. The pure monopolist controls a complete industry, and, therefore, "competes" only in the limited sense of vying with all other firms in the economy for the limited resources of consumers.



The monopolist, unlike the purely competitive firm, cannot sell all of its output at a going market price. As a monopolist increases output, the market price for its product can be expected to decline.

Thus, the monopolist faces a downward sloping demand curve (D). The monopolist will maximize profits by increasing its output to $Q_m$, where its marginal revenue curve (MR) intersects its marginal cost curve (MC). As a consequence of the downward sloping demand curve (DD '), the price charged by the monopolist ($OP_m$) will be greater than the marginal revenue ($OP_c$) at the profit maximizing output ($Q_m$).