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SOCKING IT TO PLAINTIFFS: SUPREME COURT ANTITRUST DECISIONS IN THE 1976-77 TERM

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Those persons who delve into the sometimes esoteric and sometimes shockingly practical world of the antitrust laws have noticed a markedly increased emphasis on both private and public enforcement efforts in recent years. One need look no further than the attacks against groups once thought to be immune,[1] action by Congress,[2] and substantially increased state enforcement[3] to see a vigor-

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1. *See, e.g.*, Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975) (application of antitrust laws to professionals and a state agency).

2. Some of the more important congressional activity during the proceeding three years includes Act of Dec. 21, 1974, Pub. L. No. 93-528, § 3, 88 Stat. 1708 (amending 15 U.S.C. § 1 (1970)), which increased violation of the Sherman Act from a misdemeanor to a felony and penalties from $50,000 to $1,000,000 in the case of a corporation, or $100,000 for other persons and imprisonment from one year to three years; the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, §§ 2-4, 89 Stat. 801 (amending 15 U.S.C. §§ 1, 45(a) (1970)), which repealed authorization for state laws allowing "fair trade" vertical price fixing agreements; and the Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94-435, 90 Stat. 1383. Title I grants the Antitrust Division broad civil precomplaint discovery and investigatory powers. Title II provides that the Antitrust Division and the Federal Trade Commission must be notified of proposed mergers involving companies in which one has net sales or total assets of $100,000,000 or more and the other, $10,000,000 or more. Title III contains the so-called *parens patriae* provisions, which grant to states attorneys general standing to bring suits for Sherman Act violations on behalf of the states' citizens.

For an excellent discussion of antitrust related legislation enacted or considered during the 94th Congress, see Shenefield & Hartwell, *Annual Survey of Antitrust Developments* 1975-76, 34 WASH. & LEE L. REV. 7 (1977).

3. Indications of increased antitrust enforcement efforts at the state level come from many

ous movement to assure that no violation goes unnoticed and unpunished, and that private parties are compensated three-fold for injuries suffered by reason of illegal anticompetitive activity.

If, however, a person unfamiliar with this background did nothing more than examine antitrust cases decided by the Court during its 1976-77 term, he would conclude that antitrust problems should be of little concern. For if a major league batter were to average the same as plaintiffs did in this term, he would find himself back washing cars in his hometown rather quickly. Notwithstanding this, antitrust continues to be one of the most rapidly growing and fastest changing areas of law today.

I. An Overview of the Term

Six cases involving antitrust issues were decided by the Court, and the plaintiff lost the antitrust question in all. Each case was a private action; no enforcement actions by the Department of Justice or Federal Trade Commission were heard. If divided on the basis of the general issue presented for determination, the six cases can be divided conveniently into groups of two. In *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*[4] and *Illinois Brick Co. v. Illinois*,[5] the issue concerned circumstances under which an award of damages is improper, notwithstanding that an antitrust violation was proved and injury was caused. In *Brunswick*, the Court held that an award of damages was not proper where the injury occurred by reason of some factor other than the anticompetitive harm against which the antitrust laws are aimed. *Illinois Brick* determined that indirect purchasers from price fixers may not recoup whatever damages they suffer by reason of the violation.

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sources. Many states, for example, are improving, or enacting for the first time, state antitrust laws. Virginia did this in 1974. *See* VA. CODE ANN. §§ 59.1-9.1 through -9.17 (Cum. Supp. 1977). Both the TRADE REG. REP. (CCH) and ANTITRUST & TRADE REG. REP. (BNA) now report extensively on state antitrust matters. Recently, Congress appropriated substantial funds to be given the states for their antitrust enforcement programs. Crime Control Act of 1976, Pub. L. No. 94-503, § 116, 90 Stat. 2415 (codified at 42 U.S.C. § 3739 (Supp. VI 1976)).

For general discussions of state antitrust enforcement and its proper role, see NATIONAL ASSOCIATION OF ATTORNEYS GENERAL, STATE ANTITRUST LAWS AND THEIR ENFORCEMENT (1974), and Johnson, *The Role of State Antitrust Enforcement in Oregon*, 21 ANTITRUST BULL. 611 (1976).

4. 429 U.S. 477 (1977) (discussed in Part II *infra*).

5. 97 S.Ct. 2061 (1977) (discussed in Part III *infra*).

Two other cases, *Bates v. State Bar of Arizona*[6] and *Vendo Co. v. Lektro-Vend Corp.*,[7] dealt with situations of seeming conflict between federal and state interests. In *Bates*, the court held that the state action exemption protected the State Bar of Arizona where a disciplinary rule promulgated by the Arizona Supreme Court and enforced by the bar was challenged on antitrust grounds.[8] *Vendo* held that in the specific factual circumstances presented, section 16 of the Clayton Act[9] was not an exception to the federal Anti-Injunction Act,[10] and therefore, a federal court acting under section 16 should not have enjoined a state proceeding.

The final two cases involved the standard a plaintiff must meet to prove a *per se* violation of section 1 of the Sherman Act.[11] Both cases involved vertical relationships[12] and, no doubt, will substantially affect the franchising industry. After the Court's decision in *Continental T.V., Inc. v. GTE Sylvania, Inc.*,[13] vertical customer and territorial restraints, some of which had been judged violative of the antitrust laws under the *per se* rule, are not necessarily *per se* illegal. And in *United States Steel Corp. v. Fortner Enterprises, Inc.*,[14] the Court made clear that existence of economic power in the market for the tying product, which is necessary before a tie-in is *per se* illegal, is not a foregone conclusion.

From this brief synopsis, it can be seen that several of the cases

6. 97 S.Ct. 2691 (1977). *Bates* involved a first amendment issue, also. See *infra*, at Part VII.

7. 97 S.Ct. 2881 (1977) (discussed in Part VI *infra*).

8. Although the persons challenging the disciplinary rule were not plaintiffs since the matter was commenced by a bar disciplinary proceeding against them, their argument that the restraint was not protected by the state action exemption usually would be raised by a plaintiff.

9. Section 16 of the Clayton Act, 15 U.S.C. § 26 (1970), confers standing on a person threatened with injury by violation of the antitrust laws to bring an action for injunctive relief.

10. 28 U.S.C. § 2283 (1970). See note 164 *infra*, and accompanying text, at Part VI.

11. Section 1 of the Sherman Act, 15 U.S.C. § 1 (1970), provides in pertinent part that "[e]very 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."

12. A vertical relationship is one between entities at different levels in the chain of distribution, *e.g.*, an agreement between vendor and vendee, as contrasted to a horizontal relationship, which is between competitors.

13. 97 S.Ct. 2549 (1977).

14. 97 S.Ct. 861 (1977) (discussed in Part V *infra*).

will have substantial ramifications on private efforts to assure a competitive economy, and not unimportantly, availability of redress for injuries sustained. It is to these cases and some of their ramifications that we now turn.

II. When Is There An "Injury"?

Section 7 of the Clayton Act[15] proscribes acquisitions, the effect of which "may be substantially to lessen competition, or tend to create a monopoly" in any market. It is an "incipiency" statute, intended to invalidate acquisitions before their anticompetitive harms are felt.[16] Thus, no present actual anticompetitive effects need be shown to prove a violation.[17]

Section 4 of the Clayton Act[18] provides that persons injured by reason of an antitrust violation may sue for three times their actual damages. A seemingly simple question is whether a private plaintiff is entitled to damages before the anticompetitive effects of an acquisition violative of section 7 are felt.

The answer would seem to be an obvious no, because if there are no anticompetitive effects, there is no injury. What, however, if a competitor is injured, not because of any anticompetitive effect of the acquisition, but because of some other factor which would not have occurred but for the illegal acquisition? In fact, assume that at present, the acquisition is procompetitive. Is not the injury still caused by something "forbidden in the antitrust laws," as required by section 4?

This question was the subject of the Court's first antitrust decision of 1977, *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*[19] During the "go-go" years of bowling in the 1950's, Brunswick, one of the two largest manufacturers of bowling equipment in the country, made

15. 15 U.S.C. § 18 (1970).

16. *See, e.g.*, FTC v. Procter & Gamble Co., 386 U.S. 568 (1967).

17. Other antitrust statutes which apply to incipient violations include section 3 of the Clayton Act, 15 U.S.C. § 14 (1970), which prohibits certain exclusive dealing arrangements and tie-in agreements involving the sale of goods; and section 2(a) of the Clayton Act, as amended by the Robinson-Patman Act, 15 U.S.C. § 13(a) (1970), which prohibits certain price discriminations.

18. 15 U.S.C. § 15 (1970).

19. 429 U.S. 477 (1977).

substantial sales of equipment on credit to bowling centers. The balloon burst in the 1960's, however, and when its customers defaulted on their sales contracts, Brunswick acquired a number of them to minimize its losses. Six of the centers acquired by Brunswick were in geographic areas where Treadway Companies, owner of the Pueblo Bowl-O-Mat, operated competing centers.

Treadway, on behalf of the centers operated by it, sued, charging that the acquisitions violated section 7, and requested injunctive relief, divestiture by Brunswick of the acquired centers, and treble damages.[20] The crux of the case centered on the Treadway theory of damages. It argued that but for the acquisitions by Brunswick, the acquired centers would have failed, and the business of Treadway centers would have increased. Thus, it argued that the "mere presence" of Brunswick in the market, a result of the allegedly illegal acquisitions, had injured Treadway's business.[21]

Brunswick argued in defense,[22] first, that the acquisitions were procompetitive, and therefore, could not be violative of section 7; second, that even if the acquisitions were otherwise unlawful, the "failing company" defense was applicable to avoid invalidity;[23] and third, that even if the acquisitions were unlawful, its "mere presence" in the market did not justify damages.

A jury found for Treadway on its section 7 claim, and Brunswick's

20. Treadway also claimed that Brunswick violated section 1 of the Sherman Act by fixing the resale price at which goods sold to Treadway centers were sold to the public, and that it monopolized the bowling center market in violation of section 2. The section 1 claim was abandoned prior to trial; the section 2 claim was tried and lost by Treadway.

21. The facts of the case and theories used by each party are most clearly explained in the Third Circuit's opinion on appeal. NBO Indus. Treadway Co. v. Brunswick Corp., 523 F.2d 262 (3d Cir. 1975).

22. *See* Treadway Co. v. Brunswick Corp., 364 F. Supp. 316 (D.N.J. 1973).

23. The failing company defense holds that an acquisition otherwise illegal is permitted where the acquired corporation is on the brink of bankruptcy with little chance of rehabilitation, and the acquiring firm has attempted to find other purchasers, whose acquisition would not violate section 7. *See, e.g.*, United States v. Greater Buffalo Press, Inc., 402 U.S. 549 (1971).

As Professor Areeda has noted, the Treadway theory of damage, *i.e.*, that but for the acquisitions, the centers would have disappeared, seems inconsistent with a violation of section 7; for if the competitors would have disappeared then the failing company defense would have been proved by the plaintiff itself. Areeda, *Antitrust Violations Without Damage Recoveries*, 89 HARV. L. REV. 1127, 1132-33 n.34 (1976) [hereinafter cited as Areeda]. See note 24 *infra*.

motion for judgment notwithstanding the verdict was overruled.[24] A subsequent order of the court required Brunswick to divest itself of the centers.[25]

The Third Circuit affirmed that section 7 had been violated, and that damages were proper under Treadway's "mere presence" theory. Because, however, of erroneous instructions, the case was remanded;[26] divestiture, it held, was not warranted.[27]

The court held that there was sufficient evidence to support the

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24. 364 F. Supp. at 320. The court also overruled the failing company defense because there was some doubt that the centers would have gone out of business, and there was almost no proof that Brunswick had attempted to find another purchaser.

25. Treadway Co. v. Brunswick Corp., 389 F. Supp. 996 (D.N.J. 1974).

The acquisitions by Brunswick were vertical, *i.e.*, between corporations at different levels in the chain of distribution. The major anticompetitive effect of vertical mergers against which section 7 protects is market foreclosure. Where a manufacturer acquires one of its customers, competitors of the manufacturer may be foreclosed from selling to that customer, and competition in the market for the *manufacturer's product* may be lessened. The potential effect of this may be to increase the price paid for the manufacturer's product. *See, e.g.*, Brown Shoe Co. v. United States, 370 U.S. 294 (1962). A second potentially anticompetitive effect, and that of particular interest here, is the so-called "deep-pocket theory." Simply stated, it holds that where a large, financially strong company acquires one of its customers, it places its resources behind the acquired company and gives the latter a competitive advantage over its competitors. See note 28 *infra*, for further explanation. Considerations of economic efficiencies, however, may dictate the allowance of the merger absent actual or potential predatory conduct, or actual or potential market foreclosure. It was, however, this second alleged anticompetitive effect, *i.e.*, entrance by a "deep pocket," upon which Treadway principally relied to invalidate the merger. Any damages suffered by it under its "mere presence in the market" damage theory, however, were not a result of either of these anticompetitive effects.

Other potentially anticompetitive effects of vertical mergers, none of which are salient here, are discussed in RUSSELL WARREN, ANTITRUST IN THEORY AND PRACTICE 255 (1975) [hereinafter cited as WARREN].

26. 523 F.2d 262 (3d Cir. 1975). The case was remanded because the trial court's instructions with respect to both whether section 7 was violated and measurement of damages under section 4 were erroneous.

27. 523 F.2d at 279. The court found that it would be sufficient only to enjoin "those practices by which a deep pocket market entrant harms competition." *Id.* Drafting an order in conformance therewith would be extremely difficult.

Whether divestiture should be allowed in private section 7 cases has been the subject of great controversy, and the decisions have split. *See* International Tel. & Tel. Corp. v. General Tel. & Elec. Corp., 518 F.2d 913 (9th Cir. 1975) allowing divestiture, and Fuchs Sugars & Syrups, Inc. v. Amstar Corp., 402 F. Supp. 636 (S.D.N.Y. 1975), where divestiture was not allowed. *See generally* ABA ANTITRUST SECTION, MONOGRAPH NO. 1, MERGERS AND THE PRIVATE ANTITRUST SUIT: THE PRIVATE ENFORCEMENT OF SECTION 7 OF THE CLAYTON ACT at 4-7, 61-63 (1977) [hereinafter cited as MONOGRAPH NO. 1].

jury's verdict of liability based upon the "deep pocket" theory[28] and made clear that private actions for damages were proper for violation of section 7.[29] The paramount question was whether compensable "damages were suffered . . . because in the absence of [Brunswick's] illegal presence the acquired centers would have gone out of business thus effectively transferring customers to Treadway's centers."[30] The court rejected Brunswick's claim that an *actual* foreclosure of competitors or an *actual* lessening of competition was necessary before damages were proper, because then the Treadway companies would have to be driven out of business before damages accrued. Also rejected was Brunswick's theory that Treadway was not damaged because the merger, although violative of section 7, was procompetitive. Even if the short-run effect was the enhancement of *competition*, "*[c]ompetitors*, on the other hand, are injured in their business or property in a short-run period of predatory competition."[31]

The Supreme Court unanimously held that Treadway was not entitled to damages based on its "mere presence" theory.[32] Mr. Justice Marshall characterized the problem as attempting to construe

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28. The court's explanation of the "deep pocket" potential for causing harm was as follows:

> The entry of a giant into a market of pygmies certainly suggests the possibility of a lessening of horizontal retail competition [between the centers acquired by Brunswick and the Treadway centers]. This is because such a new entrant has greater ease of entry into the market, can accomplish cost-savings by investing in new equipment, can resort to low or below cost sales to sustain itself against competition for a longer period, and can obtain more favorable credit terms.

523 F.2d at 268.

29. Although at first glance this may seem obvious, there are both legal and policy considerations which lend support to the argument that no private damage action for violation of section 7 should be available. Chief among the arguments is that because section 7 is aimed at *potential* harm, there will seldom be any actual injury. See, e.g., Bailey's Bakery, Ltd. v. Continental Baking Co., 235 F. Supp. 705 (D. Hawaii 1964). It is accepted now, however, that private actions for damages are allowable in proper circumstances where, for example, the threat of injury ripens into reality. *See* Gottesman v. General Motors Corp., 414 F.2d 956 (2d Cir. 1969). *See also* Calnetics Corp. v. Volkswagen of America, 532 F.2d 674 (9th Cir.), *cert. denied*, 429 U.S. 940 (1976). *See generally* ABA MONOGRAPH No. 1, *supra* note 27, at 7-10, 59-61.

30. 523 F.2d at 268. The only evidence offered by Treadway to prove its damages was an expert's opinion of what increased profits Treadway centers would have earned had the centers acquired by Brunswick folded.

31. *Id.* at 272 (emphasis added). This situation may arise under any incipiency statute. The problem with the analysis is that here there was little or no evidence of any predation.

32. 429 U.S. 477 (1977).

a "prophylactic measure" consistently with a "remedial provision."[33] The case presented a conflict between two policies of the antitrust laws: Allowance of the damage action would serve the well-recognized purposes of private enforcement and deterrence. On the other hand, acceptance of the "mere presence" theory would disserve the policy of providing redress for injuries suffered by the anticompetitive effects of the violation.

The Court held that Treadway's damage did not constitute "injury" as used in section 4 because "while [Treadway's] loss occurred 'by reason of' the unlawful acquisitions, it did not occur 'by reason of' that which made the acquisitions unlawful."[34] The injury would have been suffered even if the acquisition had been lawful or if a non-"deep pocket" company had acquired the centers. It held that not only must the plaintiff prove an injury causally linked to a violation, but it also must prove an "*antitrust* injury, which is to say injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts unlawful."[35] Thus, for there to be recovery, the injury must be caused by the anticompetitive effect of the violation or by anticompetitive acts made possible therefrom.[36]

The logic of the decision is sound.[37] Windfall recoveries have no place in antitrust theory. Application of the principle, however, may be more difficult than its statement, not only in section 7 cases, but in cases involving other incipiency statutes as well. The decision also may affect the certification of classes. In *Olmstead v. Amoco Oil Co.*,[38] a proposed class action by gasoline retailers alleging tie-in agreements, the court refused to certify the class because each dealer would have to testify for the court to determine if his injury was an "antitrust injury" under the *Brunswick* standard.[39] We can expect each damage claim to be closely scrutinized to assure that it

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33. *Id.* at 485.
34. *Id.* at 488.
35. *Id.* at 489.
36. The Court upheld the Third Circuit's determination that equitable relief was available, see note 27 *supra*, and found it unnecessary to decide whether the failing company defense was proved. 429 U.S. at 484-85 n.9.
37. *See* Areeda, *supra* note 23, at 1133.
38. [1977-1] TRADE REG. REP. (CCH) ¶ 61,487 (M.D. Fla. June 16, 1977).
39. *Id.* at 71,891.

arose from some harm at which the antitrust laws are aimed. This may lead to much new discussion concerning the purposes and objectives of antitrust enforcement.

The Court has taken a middle ground. On one hand, no actual lessening of competition need be shown to recover, and plaintiff need not be driven from the market before "antitrust injur[ies]" arise.[40] But damages must be the result of the violation's anticompetitive effects before damages are proper.[41]

III. No Recovery Even Where Damages Are Caused by the Anticompetitive Effects

In *Brunswick*, the plaintiff was unsuccessful because its damages were not caused by the anticompetitive effect of the antitrust violations. In the case which, perhaps, is the most devastating to private antitrust enforcement efforts, *Illinois Brick Co. v. Illinois*,[42] damage allegedly suffered by the plaintiff clearly was directly attributable to the classic economic effects of price fixing. Yet recovery of damages was denied.

The State of Illinois charged Illinois Brick Company and other manufacturers of concrete block in the Chicago area with fixing the price of block which subsequently became part of buildings constructed for the state.[43] The block was sold by the alleged price fixers

40. 429 U.S. at 489 n.14. The Court recognized, however, that "the case for relief will be strongest where competition has been diminished." *Id.*

41. The issue presented in *Brunswick* has been compared to the question of who has "standing" under section 4. *See* Areeda, *supra* note 23, at 1134. The Court noted in Hawaii v. Standard Oil Co., 405 U.S. 251, 262-63 n.14 (1972) that "Congress did not intend the antitrust laws to provide a remedy in damages for all injuries that might conceivably be traced to an antitrust violation." The prevalent standing test now, the "target area" test, asks whether the plaintiff is "within that area of the economy which is endangered by a breakdown of competitive conditions in a particular industry," Conference of Studio Unions v. Loew's, Inc., 193 F.2d 51, 55 (9th Cir. 1951), *cert. denied*, 342 U.S. 919 (1952), or whether the plaintiff, if injured, was "aimed at" by the defendant, Karseal Corp. v. Richfield Oil Corp., 221 F.2d 358, 362 (9th Cir. 1955). The difference between the *Brunswick* issue and that in standing cases is that in the latter, injury was a result of the anticompetitive effects against which the antitrust laws were aimed. More closely related to the standing cases, although still not on point, is Illinois Brick Co. v. Illinois, 97 S.Ct. 2061 (1977), discussed in Part III *infra*.

42. 97 S.Ct. 2061 (1977).

43. In April of 1973, the defendants were indicted and subsequently pleaded *nolo contendere* to charges of price fixing. *See* 5 TRADE REG. REP. (CCH) ¶ 45,073 at 53,524. A consent decree terminating the parallel government civil suit was entered in June of 1974.

to masonry contractors who sold it to a general contractor who sold the building, including the block, to the state. The state was, therefore, an "indirect purchaser" of the block from its manufacturer; there were two intermediate purchasers. Even though it did not purchase directly from the alleged price fixers, the state argued that the anticompetitive effect of the alleged price fix, *i.e.*, a noncompetitive overcharge, was "passed-on" through the intermediate purchasers to the state, which bore the brunt of the injury. The question presented was not whether the state met its burden of showing that the price increase was passed-on, but whether it would be given the opportunity to do so, *i.e.*, whether an indirect purchaser is allowed to recover damages passed-on to him.

The starting point in analyzing this question is the Court's 1968 decision in *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*,[44] where the issue of passing-on arose in a somewhat different context. United, a manufacturer of machinery used to produce shoes, had monopolized the market for shoe machinery.[45] Hanover, a manufacturer of shoes and customer of United, brought a private treble damage action, alleging that United's monopolistic practices had caused Hanover to pay higher than competitive prices for shoe machinery. In defense, United argued that any illegal increase in price had been passed-on by Hanover to its customers and that Hanover, therefore, had suffered no "legally cognizable injury."[46]

The Court rejected the passing-on *defense* for two basic reasons. First, the evidentiary problems of proving what amount of damages were passed-on would be almost insurmountable and would unduly protract already complicated antitrust suits.[47] Second, allowance of

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United States v. Ampress Brick Co., [1974-1] TRADE REG. REP. (CCH) ¶ 75,060 (N.D. Ill. 1974) (consent decree).

44. 392 U.S. 481 (1968).

45. *See* United States v. United Shoe Mach. Corp., 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954).

46. 392 U.S. at 487-88. United argued that if Hanover had purchased the machines at a lower price, it would have charged less for the shoes and, thus, made no more profit than it actually did.

47. United argued that where the direct purchaser's customers bear an equal overcharge and where the demand curve for the purchaser's product is almost perfectly inelastic, *i.e.*, a large increase in price would not decrease demand, and therefore, the overcharge could be passed-on in full, the direct purchaser would not be damaged within the meaning of section 4 of the Clayton Act. The Court rejected this theory because of its underlying *ceteris paribus*

the defense would lead to less vigorous private enforcement of the antitrust laws because if the passing-on defense were asserted against each entity in the chain of distribution who sued, the final user, often a consumer, would have too little a stake in the matter to bring an action. The Court did recognize that there could be situations, such as a preexisting cost-plus contract between the violator and his customer, where proof problems would not be so difficult and the defense might be allowed.[48]

Illinois Brick flip-flopped the question presented in *Hanover Shoe* and presented the passing-on theory as an offensive tactic. The question was whether a plaintiff could recover where any damages incurred by it were passed through to it by one or more intermediate purchasers. The answer to this question had been the subject of varying opinions in the circuits.

Analyzing the question as one of standing[49] under section 4 of the Clayton Act, the Ninth Circuit in *In re Western Liquid Asphalt Cases*[50] held that the basic policy consideration in *Hanover Shoe* was to promote strong private enforcement and that this goal would be served best by allowing recovery by indirect purchasers.[51] This pol-

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economic assumptions:

> We are not impressed with the argument that sound laws of economics required recognizing this defense. A wide range of factors influence a company's pricing policies. Normally the impact of a single change in the relevant conditions cannot be measured after the fact; indeed a businessman may be unable to state whether, had one fact been different (a single supply less expensive, general economic conditions more buoyant, or the labor market tighter, for example), he would have chosen a different price. Equally difficult to determine, in the real economic world rather than an economist's hypothetical model, is what effect a change in a company's price will have on its total sales. Finally, costs per unit for a different volume of total sales are hard to estimate. Even if it could be shown that the buyer raised his price in response to, and in the amount of, the overcharge and that his margin of profit and total sales had not thereafter declined, there would remain the nearly insuperable difficulty of demonstrating that the particular plaintiff could not or would not have raised his prices absent the overcharge or maintained the higher price had the overcharge been discontinued.

392 U.S. at 493.

For a discussion of both the legal and economic issues of the passing-on defense, see Schaefer, *Passing-On Theory in Antitrust Treble Damage Actions: An Economic and Legal Analysis*, 16 WM. & MARY L. REV. 883 (1975).

48. 392 U.S. at 494.

49. See note 41 *supra*.

50. 487 F.2d 191 (9th Cir. 1973), *cert. denied*, 415 U.S. 919 (1974).

51. In analyzing *Hanover Shoe*, the court said:

> Clearly the Court's purpose was to preserve the private antitrust suit and promote

icy, and the fact that the plaintiffs were in the area which defendants should have forseen would be harmed by the illegal conspiracy, combined to mandate that the plaintiffs be given standing. The court recognized that in offensive passing-on cases there might be a possibility of multiple recoveries by purchasers at different levels in the chain of distribution.[52] Where, however, purchasers at several levels in the chain of distribution sued, it felt that procedural rules were available to assure that the total overcharge was apportioned or that the defendant would not otherwise pay more than once.[53]

The opposite conclusion was reached by the Third Circuit in *Mangano v. American Radiator & Standard Sanitary Corp.*[54] As might be expected, whereas the Ninth Circuit emphasized that portion of *Hanover Shoe* which discussed the importance of treble damage actions in antitrust enforcement, the court in *American Radiator* emphasized the complex and difficult evidentiary problems which allowing the theory would interject into antitrust proceedings.[55] Although the court recognized that one reason for the *Hanover Shoe* result was fear of negating the efficacy of private

> compensation to those injured. This purpose could not be achieved with the hindrance of a defense, the proof of which it felt would normally present "insuperable difficulty," but the mere allegation of which would often lengthen antitrust litigation beyond reasonable bounds.

Id. at 196.

52. The court paid no more than lip service to *Hanover Shoe*'s concern with the complexity of evidence: "Although [plaintiffs] may have difficulty proving damages, our decision shows that we believe they should have an opportunity to do so." *Id.* at 200.

53. *Id.* at 201. The court specifically mentioned compulsory joinder, consolidation, interpleader and the appointment of a master in complex cases. Other protections, according to the court, include the "short" four year statute of limitations and doctrines of former adjudication.

54. 438 F.2d 1187 (3d Cir. 1971), *aff'g per curiam* Philadelphia Hous. Auth. v. American Radiator & Standard Sanitary Corp., 50 F.R.D. 13 (E.D. Pa. 1970). Because of the *per curiam* nature of affirmance, the discussion here is of the district court's "thorough and well-reasoned opinion." 438 F.2d at 1188.

55. The difficulty was explained as follows:

> Assuming that the price paid by the wholesaler to the manufacturer contained an unlawful overcharge, claims of the present plaintiffs rest, as has been indicated, at the very least on the following additional premises: (a) that the overcharge was then passed on by the wholesaler to the plumbing contractor; (b) that the plumbing contractor then passed the overcharge on to the builder; (c) that the builder passed on the overcharge to the purchasing homeowner; (d) in the case of used houses, each prior homeowner passed the overcharge on to the present plaintiffs. Each of these steps represents activity in a completely new and unrestrained market.

50 F.R.D. at 26.

damage actions, it dismissed this rationale because the Supreme Court "laid little stress on this consideration and discussed it very briefly."[56] No effort was made to interpret the two bases of the *Hanover Shoe* decision in a consistent manner.

In *Illinois Brick*, the district court viewed the issue of offensive passing-on as one of "whether parties more remote than the direct purchaser . . . have standing to sue under section 4 of the Clayton Act."[57] After holding that nothing in *Hanover Shoe* required privity between the plaintiff and defendant and therefore, that the decision did not foreclose *all* indirect purchasers from relief, the court analyzed which indirect purchasers were in the "target area" for standing purposes.[58] Finding the state to be an "ultimate consumer," it held that the state's injury was too remote for it to have standing.[59]

The Seventh Circuit reversed.[60] Placing reliance on the broad language of section 4, *i.e.*, "*[a]ny person* who shall be injured . . . shall recover,"[61] and the *Western Liquid Asphalt* decision, it held that *Hanover Shoe* "did not enshrine privity as a requirement of recovery under the antitrust laws,"[62] and that the state was within the target area for standing purposes. *American Radiator* and *Allis-Chalmers*[63] were distinguished on the ground that in each, the plain-

56. *Id.* at 29.

57. Illinois v. Ampress Brick Co., 67 F.R.D. 461, 464 (N.D. Ill. 1975).

58. The standing test used by the court was the more liberal standard of Twentieth Century Fox Film Corp. v. Goldwyn, 328 F.2d 190 (9th Cir.), *cert. denied*, 379 U.S. 880 (1964), which asks whether the defendant could reasonably forsee that the plaintiff would be affected by the violation.

To determine standing, the court divided indirect purchasers into two groups. An "immediate consumer" was defined as an indirect purchaser who bought the good from the vendor without the good having been altered. An "ultimate consumer" was defined as one who bought the good from the middleman in an altered form. In *Hanover Shoe*, for example, a customer of Hanover's would be an ultimate consumer.

59. On the other hand, the court held that an immediate consumer would have standing.

The denial of standing to the "ultimate consumer" was based on the Seventh Circuit's holding in Commonwealth Edison Co. v. Allis-Chalmers Mfg. Co., 315 F.2d 564 (7th Cir. 1963), one of the famous Electrical Conspiracy Cases. There, Illinois was denied standing when it intervened and sought damages for its citizens in a suit by the utility charging the defendant with fixing the prices of electrical equipment sold to the utility.

60. Illinois v. Ampress Brick Co., 536 F.2d 1163 (7th Cir. 1976).

61. *Id.* at 1165, (emphasis added), *quoting* 15 U.S.C. § 15 (1970).

62. 536 F.2d at 1166.

63. See note 59 *supra*.

tiff simply failed to prove that it was damaged by the alleged violation.[64]

The Supreme Court reversed the Seventh Circuit in a six to three decision.[65] State attorneys general and their staffs, some of whom have instituted *parens patriae* suits, and many of whom are involved in multi-district cases where the state was an indirect purchaser, immediately became concerned and with good reason. The decision will seriously affect the ability of states to enforce vigorously the antitrust laws for the benefit of their citizens, who as consumers may be subjected to price fixing on goods they buy, and as taxpayers must bear the effect of price fixing on goods purchased by the state.

The Court wasted no time in clearing some confusion by putting to rest the theory that the question was one of standing.[66] The issue framed for determination by the Court was whether under section 4 "the overcharged direct purchaser, and not others in the chain of manufacture or distribution, is the party 'injured in his business or property' within the meaning of the section."[67] Finding *Hanover Shoe* to be applicable and meshing the two bases for that decision, a majority of the Court determined that to allow recovery by indi-

64. This distinction seems weak. In neither *American Radiator* nor *Allis-Chalmers* were the plaintiffs even allowed to prove that the violation injured them. Moreover, in *Hanover Shoe* the defense was not allowed, even conceding that portions of the overcharge were passed-on. Thus, the holding in *Hanover Shoe* was that the defendant was not allowed to prove the pass-on, not that he had been given the opportunity and failed.

65. 97 S.Ct. 2061 (1977).

66. 97 S.Ct. at 2066 n.7. Mr. Justice White, speaking for the majority, said:

> Because we find *Hanover Shoe* dispositive here, we do not address the standing issue, except to note, as did the Court of Appeals below, 536 F.2d. at 1166, that the question of which persons have been injured by an illegal overcharge for purposes of § 4 is analytically distinct from the question of which persons have sustained injuries too remote to give them standing to sue for damages under § 4.

67. 97 S.Ct. at 2066. The Court realized that it was creating a legal fiction. For example, its interpretation of *Hanover Shoe* was that the "antitrust defendant is not permitted to introduce evidence that indirect purchasers were *in fact* injured by the illegal overcharge." 97 S.Ct. at 2064 (emphasis added). And the Court phrased the question for determination in *Illinois Brick* as "whether the overcharged direct purchaser *should be deemed* . . . to have suffered the full injury." *Id.* at 2065 (emphasis added). Finally, the majority concluded, "It is true that, in elevating direct purchasers to a preferred position as private attorneys general, the *Hanover Shoe* rule denies recovery to those indirect purchasers who may have been actually injured by antitrust violations." *Id.* at 2075.

rect purchasers would decrease the effectiveness of private actions as a mode of antitrust enforcement.

The result was reached in two steps. First, the majority decided that if passing-on cannot be used as a defense by the defendant, it should not be used offensively by an indirect purchaser. If application were not consistent, the risk of multiple liability would be tremendous; and although procedural rules exist that diminish the problem where indirect and direct purchasers sue concurrently,[68] there remains a possibility of multiple recoveries where the direct purchaser has recovered the full amount of the overcharge before the indirect purchaser sues. The majority refused to adopt the policy of allowing some multiple of treble damages to be recovered and instead decided that the injuries of some persons must go unredressed.[69] Moreover, the difficulty with theoretical economic evidence seen in *Hanover Shoe* "applies with no less force to the assertion of pass-on theories by plaintiffs than to the assertion by defendants,"[70] and, therefore, the same complexities arise — complexities which deter efficient private enforcement of the antitrust laws.[71]

Second, having determined that consistency was necessary whether or not the pass-on theory was to be heard by courts, the question became whether to disallow both offensive and defensive use, or to overrule or modify *Hanover Shoe* and allow use of the theory by both sides. Because it felt that overruling *Hanover Shoe* would seriously erode the effectiveness of the private treble damage action, the majority held that neither offensive nor defensive use

68. See note 53 *supra*. Such mechanisms as consolidation, joinder and interpleader do not solve the problem if defensive use of passing-on is not allowed.

69. If this one seemingly simple policy consideration had not been adopted, the result probably would have been entirely different. This was a point of disagreement between the Court and the Ninth Circuit.

70. 97 S.Ct. at 2068.

71. The majority also rejected Illinois' argument and that of the dissenters that the 1976 *parens patriae* provisions, section 4C of the Clayton Act, 15 U.S.C. § 15C, and its legislative history, conclusively showed that indirect purchasers were entitled to recovery. Although recognizing that Congress *thought*, in considering section 4C, that there was no bar to recovery by indirect purchasers, the legislators made clear that section 4C did no more than confer *standing* on state attorneys general; standing was not the issue in *Illinois Brick*. Moreover, since section 4 was enacted some sixty-two years before section 4C, the legislative history of the latter could not be used to interpret the former. Congress was expressly invited to change the result if it disagreed. 97 S.Ct. at 2068-69 n.14. See note 81 *infra*.

would be allowed. This result was predicated on now familiar factors: First, the attempt to apportion damages between purchasers at different levels in the chain of distribution and the economic evidence which would be necessary would "add whole new dimensions of complexity to treble damage suits."[72] The purely competitive market, upon which is based the elasticity analysis which determines what portion of the overcharge is passed on, simply does not exist.[73] Second, the majority again reiterated its fear of multiple recoveries.[74]

The dissenters[75] adopted the opposite view of every argument put forth by the majority. Where the majority argued that *Hanover Shoe* had to be applied consistently to offensive and defensive use of passing-on, the dissent saw no need for consistency. Emphasizing that part of *Hanover Shoe* which extolled the private action and the incentive for its use, the dissent argued that offensive use of the theory would not allow defendants to escape liability as defensive use would.[76]

The majority's concerns with respect to the complexity which would be introduced, and the potentiality for multiple liability and duplicative recoveries, were dismissed not because these concerns were frivolous, but because the policies underlying private treble damage actions outweighed these costs. Recognizing that complex and difficult problems of economic theories and proof would have to be heard, the dissenters simply noted that the same problem

72. 97 S.Ct. at 2070.

73. See note 47 *supra*. Economic factors also led the majority to reject a middle-ground approach which, even in the case of no preexisting contract, would allow indirect purchasers to sue where a middleman normally adds a percentage markup to the goods. According to the majority, however, since this percentage may differ depending on factors such as the strength of demand, proof of what portion was passed-on would still be difficult. If the Court had wished to play Solomon, this would have been one place to do it; proof of changed markups would not be difficult to obtain, and variation in other economic factors could be dealt with to that degree of specificity required in antitrust cases.

74. The majority noted that it was unlikely that "all potential plaintiffs could or would be joined." 97 S.Ct. at 2072.

75. Brennan, Marshall & Blackmun, JJ. Mr. Justice Blackmun, although joining the dissent, filed a short separate opinion in which he noted that the majority decision would have been different had *Hanover Shoe* not been decided.

76. 97 S.Ct. at 2078-79. The dissent also thought that the legislative history of section 4C made clear the intent of Congress that indirect purchasers could recover under that section, and that this should apply to section 4 as well. See note 71 *supra*.

arose in almost all antitrust trials. More concern was expressed over the majority's fear of duplicative recovery. In only two situations is it possible for the defendant to pay treble damages more than once: where suit is brought in different courts; and where money has been recovered through settlement or judgment in an action and a subsequent suit is filed. Concern over the first situation was negated by procedural mechanisms which allow for inter-district consolidation. In the second, because of the length of most antitrust proceedings, the statute of limitations would probably run for a subsequent suit before judgment was obtained in the first.[77] In any event, however, the possibility of a few duplicative recoveries "does not . . . justify erecting a bar against all recoveries by indirect purchasers without regard to whether the particular case presents a significant danger of double recovery."[78]

Both the majority and dissent asked whether allowing recovery by indirect purchasers would best serve the purposes of private treble damage actions; and after examining the same operative factors, they reached diametrically opposite results. The majority, at least in theory, was wrong. Common sense would dictate that one injured by the anticompetitive results of a violation recover;[79] especially weak is the rationale that a party is denied his day in court because he brings a complex matter for determination. On the other hand, no defendant, notwithstanding his transgressions, should be subjected to paying six or nine times the actual damages caused in the name of "strong antitrust enforcement" or "deterrence"; treble damages are at least adequate.

Illinois Brick, however, was not decided on theoretical grounds. The interpretation given section 4 turned on expediency and practicality: if recovery is allowed, litigation will become more complex or some parties may pay more than once; if not, some persons will be denied their due. What choice do we make? The answer chosen by the majority was the latter.

Perhaps the most cogent criticism of the majority position is that it establishes too hard and fast a rule. A better result may have been

77. Settlement might present a different situation. This was not directly addressed.
78. 97 S.Ct. at 2083.
79. *See Brunswick*, Part II *supra*.

to allow each case to be examined by the trial judge early in the pretrial period to see which, if any, of the factors militating against indirect purchaser recovery were present. As the dissent noted, the possibility of multiple recovery will not be a factor in most cases. The same may be true of the other factors in other situations. Now, however, where an indirect purchaser is a plaintiff, his claim is negated immediately on a motion to dismiss before it is ascertained whether the practicalities of his case demand such a result.[80]

The most interesting question raised by *Illinois Brick* is its effect on the new *parens patriae* provisions. The question is whether "injury" means the same thing in sections 4 and 4C. Supporters of section 4C will argue correctly that Congress clearly intended that indirect purchasers be within those "injured" under 4C. Opponents will argue correctly that 4C was intended to do no more than give state attorneys general standing and created no increased liability. The majority recognized both arguments and weighted the latter more heavily. Adoption of the former view in establishing the status of indirect purchasers was not precluded, however. It may be that Congress will solve the problem by accepting the majority's invitation to reverse the result of the case legislatively.[81]

IV. "We Were Right The First Time"

In *United States v. White Motor Co.*,[82] a district court, sustaining the government's motion for summary judgment, held that vertical customer and territorial restraints were *per se* violative of section 1 of the Sherman Act.[83] The Supreme Court, holding that they did "not know enough of the economic and business stuff out of which

80. *Cf.* Continental T.V., Inc. v. GTE Sylvania, Inc., 97 S.Ct. 2549, 2558 n.16 (1977) *infra*, at Part IV, where the Court sought to avoid "an unintended and undesirable rigidity in the law." Has the majority breached this principle in disallowing recovery to all indirect purchasers?

81. Senator Kennedy and Congressman Rodino have introduced a bill by which any person "injured in fact," either directly or indirectly, may recover. Sections 4, 4A (conferring standing for damages on the United States), and 4C would be amended. *See* 823 Antitrust & Trade Reg. Rep. (BNA) A-3 (July 21, 1977); Wall Street Journal, July 18, 1977, at 3, col. 1. Opinions concerning whether *Hanover Shoe* should be overturned by legislation differ. *See* 830 Antitrust & Trade Reg. Rep. (BNA) A-6 (Sept. 15, 1977).

82. 194 F. Supp. 562 (N.D. Ohio 1961).

83. 15 U.S.C. § 1 (1970).

these arrangements emerge," reversed and remanded the case for trial.[84]

Vertical territorial and customer restrictions, *i.e.*, restraints imposed by a manufacturer on his customers, which in some way limit where or to whom the latter can sell the manufacturer's goods, come in a variety of forms. First, and most restrictive, are closed territory distribution grants, which allow the customer to sell only to persons or designated types of customers within his assigned territory.[85] Under this arrangement, there is no competition among distributors of the manufacturer's product. Second are arrangements which make it unpleasant for the distributor to sell outside his territory. Among these are "areas of primary responsibility"[86] and "profit pass-over" provisions.[87] Third are "location clauses" which allow the distributor to sell to anyone but provide that he may do so from only one or more designated locations.[88] Finally, the manufacturer may grant the distributor an "exclusive territory," with the caveat that at the manufacturer's discretion, another distributor may be put therein when demand necessitates.[89]

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84. White Motor Co. v. United States, 372 U.S. 253, 263 (1963).

85. The restraints in *White Motor* were of this type. Many vertical agreements include some combination of the restraints described herein.

86. The distributor is given a territory in which he is expected to make his primary promotional and sales efforts; however, he may sell to customers without the area. This type of arrangement has been tested under the rule of reason and generally upheld. *See, e.g.*, Colorado Pump & Supply Co. v. Febco, Inc., 472 F.2d 637 (10th Cir.), *cert. denied*, 411 U.S. 987 (1973).

87. Under a profit pass-over arrangement, the distributor, although assigned a specific territory, can sell to anyone. When, however, he sells to customers outside his assigned territory, he must pay some amount to the distributor assigned to that area. These generally have been upheld under the rule of reason. *See, e.g.*, Superior Bedding Co. v. Serta Assoc., 353 F. Supp. 1143 (N.D. Ill. 1972).

88. These, also, are tested under the rule of reason and have been upheld. *See, e.g.*, Salco Corp. v. General Motors Corp., 517 F.2d 567 (10th Cir. 1975).

For a complete discussion of vertical restraints, *see generally* ABA ANTITRUST SECTION MONOGRAPH NO. 2, VERTICAL RESTRICTIONS LIMITING INTRABRAND COMPETITION (1977).

89. The economic effects of vertical restraints are analyzed in conjunction with the discussion of Continental T.V., Inc. v. GTE Sylvania, Inc., 97 S.Ct. 2549 (1977), *infra* notes 115-16.

For the present, suffice it to say that vertical restraints will normally lessen *intrabrand* competition, *i.e.*, competition between distributors selling the same brand. Other manufacturers, of course, may produce a product reasonably interchangeable therewith. The effect of a vertical restraint on *interbrand* competition, *i.e.*, competition between different brands, may be neutral, favorable or unfavorable, depending on the circumstances of the particular case.

The Court's rationale in *White Motor* was simply that it did not know, and could not ascertain from the record, the effect vertical restraints have on competition.[90] The decision was not that the rule of reason was necessarily the proper standard of analysis, but only that it was impossible from the record to ascertain whether the restraints should be placed in the *per se* unreasonable category.

The same effective result was reached by the Court this term in *Continental T.V., Inc. v. GTE Sylvania, Inc.*,[91] but not until the Court unnecessarily overruled a 1967 decision[92] which held that certain vertical restraints are *per se* unreasonable. Prior to 1962, Sylvania marketed its televisions through distributors who sold them to a large number of retailers. Because of a shrinking market share,[93] it ceased using distributors and commenced selling directly to a select group of retailers, each of whom agreed to sell only from the location franchised by Sylvania. An express purpose of this location clause arrangement was to decrease the number of retailers selling Sylvania products to lessen intrabrand competition.[94] Continental T.V., a Sylvania franchisee in San Francisco, determined to establish a store in Sacramento. When it did so, Sylvania terminated the franchise, and Continental brought suit under section 1.[95]

In *United States v. Arnold, Schwinn & Co.*,[96] the Court had been

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Possible rationales for a manufacturer or supplier instituting vertical restraints are discussed in WARREN, *supra* note 31, at 132-36.

90. The case represented the first time vertical restraints had come before the Court, 372 U.S. at 262, and since the question had been decided below on summary judgment, evidence on competitive effect was lacking. The Court concluded that vertical restraints

> . . . may be too dangerous to sanction or they may be allowable protections against aggressive competitors or the only practicable means a small company has for breaking into or staying in business (citations omitted) and within the "rule of reason." 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" (citation omitted) and therefore should be classified as *per se* violations of the Sherman Act. . . .

Id. at 263.

91. 97 S.Ct. 2549 (1977).

92. United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

93. Its share of the national television market was between one and two percent. 97 S.Ct. at 2551-52 n.4.

94. The policy, indeed, increased Sylvania's share of the television market. *Id.* at 2552.

95. The manner in which the case arose is somewhat more complicated than explained here. Continental's action was actually a counterclaim. Because, however, this is immaterial for purposes of analysis, the operative facts are simplified.

96. 388 U.S. 365 (1967).

presented with vertical restraints at two levels in the chain of distribution. Schwinn, a large and strong manufacturer of bicycles, distributed its products in three ways: sales to distributors who, in turn, resold to retailers franchised by Schwinn; sales to franchised retailers pursuant to consignment agreements with distributors; and direct sales to retailers with a commission being paid the distributor taking the order. Distributors, who were assigned territories, could sell only to retailers in their territory and only to retailers franchised by Schwinn. Each franchised retailer could sell only to the public and not to unfranchised retailers. Moreover, each was franchised to sell only from prescribed locations.[97]

Noting that the government did not argue that the restrictions were *per se* illegal, and taking heed of *White Motor*, a majority of the Court held that it must examine "the specifics of the challenged practices and their impact upon the marketplace"[98] to determine whether the methods of distribution were reasonable under section 1. Seeming to quickly discard this cautious approach, the majority, finding that Schwinn was not a newcomer to the market or a failing company, two factors held to be relevant in determining reasonableness in *White Motor*, held the vertical restraints *per se* illegal where the manufacturer had parted with title, risk and, therefore, dominion over the product.[99] Thus, under the plan where Schwinn *sold* to distributors, it could not dictate where or to whom the distributor sold. Moreover, once the retailer took title, whether from Schwinn or from a distributor, Schwinn could not restrict to whom he sold.[100]

In *Sylvania*, the district court instructed the jury in strict conformance with the *Schwinn* rule; if Sylvania parted with dominion over the goods and thereafter attempted to restrict locations, the

97. Thus, the distributors were subjected to the most stringent form of vertical territorial and customer restraints, but the retailers were subject to more relaxed prohibitions; the retailer could sell to any consumer, notwithstanding the customer's place of residence.

98. 388 U.S. at 374.

99. *Id.* at 382.

100. Where title did not pass to the distributor, for example, under a consignment arrangement, Schwinn retained its rights of control.

Surprisingly, when *Schwinn* was sent back to the trial court, it was settled by a consent decree that specifically allowed both areas of primary responsibility and location clauses. United States v. Arnold, Schwinn & Co., 291 F. Supp. 564 (N.D. Ill. 1968).

restraint was *per se* unreasonable. The Ninth Circuit, sitting *en banc*, reversed by a divided vote.[101]

Five factors led the Ninth Circuit to conclude that the Sylvania location clauses should not be held *per se* unreasonable. First, although the language of *Schwinn* was broad enough to invalidate the clauses under the *per se* rule, the language should not be applied literally; each different type of vertical restraint should be examined on its own facts. And since there are significant differences in the degrees of anticompetitive effects under location clauses and under the totally closed Schwinn system, the court held that the *per se* rule did not apply.[102] Second, all precedent testing the validity of location clauses had applied the rule of reason.[103] Third, precedent testing other types of vertical restraints which do not foreclose totally intrabrand competition, including exclusive distributorships,[104] also had applied the rule of reason. Fourth, application of the *per se* rule would harm small business.[105] Finally, since location clauses may be procompetitive because of their effects on interbrand competition, application of the *per se* rule might foil the basic policy of the Sherman Act, that of promoting economic competition.[106] The Ninth Circuit was able, thus, to uphold the location clause without tackling the *Schwinn* rule head-on.

101. GTE Sylvania, Inc. v. Continental T.V., Inc., 537 F.2d 980 (9th Cir. 1976). A panel of the court had affirmed the district court decision, [1974-1] TRADE REG. REP. (CCH) ¶ 75,072 (9th Cir. 1974), but this decision was subsequently withdrawn in order that the case could be reconsidered. [1974-2] TRADE REG. REP. (CCH) ¶ 75,435 (9th Cir. 1974).

102. 537 F.2d at 1000-01. The court saw two major distinctions: First, in *Schwinn*, distributors could not sell to any retailer who resided outside the distributor's territory. Each distributor was totally insulated from competition by other distributors, and therefore, "intrabrand competition . . . was wholly destroyed." *Id.* at 990. Under the location clause, however, the Sylvania retailer could, at least in theory, sell to anyone. Second, Schwinn was a tremendous factor in the market for bicycles, whereas Sylvania was insignificant in the market for televisions. *Id.* at 991.

103. See note 88 *supra*.

104. *See, e.g.*, Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors, Ltd., 416 F.2d 71 (9th Cir. 1969), *cert. denied*, 396 U.S. 1062 (1970). See notes 86 & 87 *supra*.

105. The effect would be particularly devastating on franchising. The small franchisee, supposedly, would spread himself too thin in attempting to sell everywhere rather than concentrating his efforts in one area. If the franchisee grew too large, other franchisees would have trouble competing in their area with the giant. Qualified franchisees would be difficult to obtain. Finally, if franchisees, for any reason, could not endure in the market, the franchisor might be induced to vertically integrate forward to distribute his products.

106. The court notes, incorrectly, that before the *per se* approach is used, the practice must be one that *always* involves an unreasonable restraint. Here, it had not been proved that the

The Supreme Court, in an uncharacteristic move, examined not only the question of location clauses, but the entire plethora of vertical restraints, including those held *per se* unreasonable in *Schwinn*.[107] The Ninth Circuit was upheld, and moreover, *Schwinn* was overruled.[108]

To reach its result, the Court used a two-step approach remarkably similar in some ways to that used in *Illinois Brick*. First, it found that the restrictions held *per se* invalid in *Schwinn* were sufficiently similar to the Sylvania location clauses that the same rules of law should apply. Having done this, the Court left itself the choice of either overruling *Schwinn* or holding, as no circuit court had done, that location clauses were *per se* unreasonable.[109] Second, after examining the proper role of the *per se* rule in antitrust enforcement; noting that there was no reason for distinguishing be-

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decrease in intrabrand competition brought about by the Sylvania practice outweighed the procompetitive effects on interbrand competition:

> We recognize, of course, that in establishing a locations practice, Sylvania did check intrabrand competition to some extent. This was an inevitable incident to Sylvania's attempt to promote and maintain interbrand competition. However, to ignore Sylvania's ultimate purpose to remain in the market as a viable competitor, thereby fostering interbrand competition, and to consider only the fact that its practice slightly limited intrabrand competition, is to overlook the forest while watching the trees. The free market policy of the antitrust laws would not be served by fashioning rules which foster intrabrand competition to the point of extinguishing interbrand competition.

537 F.2d at 1000-01.

107. Continental T.V., Inc. v. GTE Sylvania, Inc., 97 S.Ct. 2549 (1977). The Court's decision to reexamine the *Schwinn* rule, and thus broaden its analysis when it easily could have distinguished the case is unusual because the present Court has seldom gone beyond what was absolutely necessary to decide the particular case before it. In Cantor v. Detroit Edison Co., 428 U.S. 579, 603 (1976), discussed *infra*, at Part VII, this policy was stated explicitly:

> Although it is tempting to try to fashion a rule which would govern the decision of the liability issue and the damage issue in all future cases presenting state action issues, we believe the Court should adhere to its settled policy of giving concrete meaning to the general language of the Sherman Act by a process of case-by-case adjudication of specific controversies.

108. Mr. Justice Powell wrote the opinion for a six-man majority. Mr. Justice White concurred, see notes 119-21 *infra*, and accompanying text, and Mr. Justice Rehnquist took no part in the decision. Marshall and Brennan, JJ., dissented in a one paragraph opinion, simply noting that the *Schwinn* rule should not be overruled, and that the Sylvania location clauses should be held invalid.

109. In *Illinois Brick*, the Court framed the case such that it had the choice of overruling *Hanover Shoe* or precluding the plaintiff from recovering. It chose the latter. In *Sylvania*, the question seen by the Court was whether to overrule *Schwinn* or allow recovery. The Court chose the former. It was a bad term for plaintiffs.

tween sale and nonsale transactions as had been done in *Schwinn*; and finding that vertical restraints were often procompetitive, the Court struck down the *Schwinn* rule of automatic *per se* invalidity.

The major departure of the Court from the Ninth Circuit's decision concerned whether the restraints in *Schwinn* could be distinguished in a legally significant manner from those in *Sylvania*. Focusing only on restraints placed by the two manufacturers on their *retailers*, Mr. Justice Powell, for the majority, found no differences, because in each case the effect was to reduce, but not eliminate, intrabrand competition.[110] The Court also rejected the Ninth Circuit's distinction based on Schwinn's relatively large market share.

The question was then whether location clauses should be declared *per se* unreasonable or whether *Schwinn* should be overruled. Noting the almost unanimous disapproval of the *Schwinn* rule by both courts[111] and commentators,[112] the Court held that the *per se* rule should be examined to determine if its underlying policies justified its application to vertical restraints.

The *per se* rule is a judicial shortcut; it allows a court to dispense with long and complicated proof of a violation's economic effect and thus serves judicial economy.[113] But before the rule is invoked, the

110. This, of course, was true at the retail level. In *Schwinn*, the retailers were bound by location clauses but could sell to anyone except unfranchised retailers. Thus, as in *Sylvania*, intrabrand competition was not eliminated completely. The situation was different at the distributor level in *Schwinn*; but because Sylvania did not use distributors, the restraints placed thereon by Schwinn were not material in comparing the two cases.

Even, however, if it were relevant to compare the restraints on Schwinn distributors and those on Sylvania retailers, the majority noted that its result would have been the same because there was no indication in *Schwinn* that the Court there deemed the *degree* of reduction in intrabrand competition to be pivotal. 97 S.Ct. at 2556 n.12.

111. *See, e.g.*, Adolph Coors Co. v. FTC, 497 F.2d 1178 (10th Cir. 1974). *But see* Adolph Coors Co. v. A&S Wholesalers, Inc., [1977-1] TRADE REG. REP. (CCH) ¶ 61,565 (10th Cir. July 29, 1977), a post-*GTE Sylvania* case upholding vertical territorial and customer restraints.

112. *See, e.g.*, Pollock, *Alternative Distribution Methods After Schwinn*, 63 NW. U. L. REV. 595 (1968).

113. A cost-benefit analysis is necessary:

> The probability that anitcompetitive consequences will result from a practice and the severity of those consequences must be balanced against its pro-competitive 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.

97 S.Ct. at 2558 n.16.

conduct questioned should be "manifestly anti-competitive."[114] The question was whether vertical restraints exhibit the consistent anti-competitive effects necessary for invocation of the *per se* rule. The Court found that in the abstract, the competitive effect of a vertical restraint was indeterminate. Although intrabrand competition would be reduced, interbrand competition might be increased significantly,[115] in which case the overall competitive effect might be positive.[116]

Thus, the automatic application of the *per se* rule to vertical restraints was unjustified. Although there may be certain situations in which the *per se* rule should be applied, the Court held that before the rule is invoked, the practice challenged should exhibit a "demonstrable economic effect," which justifies its use.[117] In all other cases, the standard of reasonableness is proper.[118]

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114. *Id.* at 2558.

115. *Ceteris paribus*, restraints on interbrand competition are more destructive of competition than those which lessen intrabrand competition. As the Court noted, *Id.* at 2559 n.19,

> The extreme example of a deficiency of interbrand competition is monopoly, where there is only one 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.

116. The potential positive effects on interbrand competition seen by the majority were efficiencies which the manufacturer might realize in the distribution of his goods; the incentive to promote the product induced in the distributor by his grant of an exclusive right to sell the product in a certain territory or to certain customers; the disincentive toward forward vertical integration that arises from allowing vertical restraints; the reduction of barriers of entry to new manufacturers by their ability to recruit retailers who, if given exclusive territories, will make the necessary investment to establish outlets; and the offering by retailers of additional services if given some type of exclusivity. *Id.* at 2560.

The last argument is especially interesting in light of the fact that advocates of fair trade laws argued that the high prices often charged for fair traded merchandise were justified to give the retailer a profit cushion which could be used to provide additional services. *See* LEWIS SCHWARTZ, FREE ENTERPRISE AND ECONOMIC ORGANIZATION 959 (4th ed. 1972). Congress, evidently, rejected this rationale. See note 2 *supra*.

117. 97 S.Ct. at 2562. Of course, if an overriding anticompetitive effect must be proved, it seems senseless to denominate the rule as *per se*.

118. The Court also analyzed the *Schwinn* reliance on the distinction between passage of title and agency or consignment arrangements, and properly concluded that "the competitive impact of vertical restrictions is [not] significantly affected by the form of the transaction." *Id.* at 2560. The Court felt it necessary to inject this analysis into the decision because the

In his concurring opinion, Mr. Justice White followed the rationale of the Ninth Circuit and distinguished *Sylvania* from *Schwinn* on the bases of differences in competitive effects and market power. He, moreover, argued that differences of treatment were justified where an agency or consignment distributional method was used as compared to an outright sale. In the former situation, the goods continue to belong to the manufacturer, and "businessmen should have the freedom to dispose of the goods they own as they see fit."[119] Finally, he saw little economic distinction between many types of vertical customer and territorial restraints, and vertical price fixing which long has been condemned under the *per se* rule,[120] noting that the distinction "may be as difficult to justify as that of *Schwinn* under the terms of the majority's analysis."[121]

Thus, the Court has retreated to its position in *White Motor*, and one must wonder with Mr. Justice White whether other practices traditionally classified as unreasonable *per se* will be reexamined.[122]

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form of the transaction, rather than the restraint's effect on competition, was the "pivotal factor" in the *Schwinn* decision. *Id.* at 2559.

119. *Id.* at 2567 (White, J., concurring).

120. *See, e.g.*, Dr. Miles Medical Co. v. John D. Park & Sons, Inc., 220 U.S. 373 (1911). The majority justified the different treatment given to non-price vertical restraints on three questionable grounds. First, vertical price fixing almost always reduces interbrand competition; second, if all manufacturers engage in fair trading, horizontal price fixing is induced; finally, Congress, by repeal of the fair trade exemption, had expressed its approval of *per se* rule application to vertical price fixing.

Because these arguments, taken either singularly or together, seem weak, perhaps the majority should have relied on the overriding importance of price as a competitive variable and simply noted that where a price is fixed, the anticompetitive effect is much more immediate and direct than where customers or territories are allocated and any effect on price is indirect. *See, e.g.*, United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 226 n.59 (1940) (price is the "central nervous system of the economy"). *Cf.* United States v. Nu-Phonics, Inc., 820 ANTITRUST & TRADE REG. REP. (BNA) E-1 (E.D. Mich. June 20, 1977) (practices traditionally classified as indirect price fixing must be shown to be price fixing before *per se* rule applies).

121. 97 S.Ct. at 2568.

122. The court's decision this term in United States Steel Corp. v. Fortner Enterprises, Inc., Part V *infra*, although not destroying the *per se* rule in tie-in analyses, certainly makes the *per se* test more difficult to meet. Moreover, for a number of years, courts have been retreating from the hard and fast rule of Klor's, Inc. v. Broadway-Hale Stores, Inc. 359 U.S. 207 (1959), that group refusals to deal are *per se* illegal. *See, e.g.*, Hatley v. American Quarter Horse Ass'n., [1977-1] TRADE REG. REP. (CCH) ¶ 61,441 (5th Cir. May 19, 1977).

Perhaps the most interesting question is whether the Court will reconsider its decision in United States v. Sealy, Inc., 388 U.S. 350 (1967), and United States v. Topco Assoc., 405 U.S. 596 (1972). Both of these cases involved horizontal market allocations, which have tradition-

Moreover, in the situation where intrabrand competition is completely foreclosed, it is difficult to understand why the *per se* rule should not apply. In other contexts where some restraint is found necessary or justified, the Court has held that the restraint must not only be justified but "even then [restrain] only to the minimum extent necessary."[123] Types of vertical restraints less restrictive than those found in *Schwinn* certainly would result in the benefits to interbrand competition envisioned by the majority.

It would seem that franchisors will be the primary beneficiaries of the *Sylvania* ruling. It can only be hoped that they do not use the decision to increase unreasonably the vertical control exerted over the independent businessmen — the franchisees — who are the backbone of a successful franchising operation.[124] Even if they do, however, a violation of section 1 is going to be difficult to prove.

V. Nine Strikes And You're Out

Perhaps no individual in the history of antitrust litigation has tried so hard and come away with so little as A. B. Fortner, Jr., of Louisville, Kentucky. His case, involving Fortner Enterprises, Inc. ("Fortner"), his corporation, visited the district court three times, a circuit court of appeals three times, and if grants of certiorari are

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ally been classified as *per se* unreasonable. Because, however, the parties to the market allocation scheme were distributors for the same company, the effect of the conspiracy was to reduce *intrabrand* competition. In fact, Topco argued that the agreement was necessary to allow it to compete with its larger competitors, and the district court upheld the allocation under the rule of reason. United States v. Topco Assoc., 319 F.Supp. 1031 (N.D. Ill. 1970). The Court, however, automatically applied the *per se* rule with no analysis. Because the effects on competition of vertical restraints and the Topco agreements are almost identical, it is hard to see how *Topco* can stand in light of the analysis used in *Sylvania*, notwithstanding that *Topco* was cited with seeming approval. 97 S.Ct. at 2562 n.28. If the two cases are considered together, their similarities are striking; arguments and logic rejected in *Topco* were accepted in *Sylvania*.

123. Otter Tail Power Co. v. United States, 410 U.S. 366, 389 (1973) (Stewart, J., dissenting) (whether or not conduct arguably allowed under federal regulatory statute was exempt from antitrust challenge).

124. Some franchisees will welcome the decision because tight vertical control, which leads to fewer competitors, gives them a comfortable feeling. Others, however, who desire that their businesses grow to the fullest extent may be in for a rude awakening when their present franchise agreements expire. Many exclusive territory provisions which completely foreclose intrabrand competition are going to be used.

excluded, the Supreme Court three times; and in the end, fifteen years after suit was filed, it came away with nothing.[125]

Fortner, a real estate development firm, entered into two contracts with United States Steel Homes Credit Corp. ("Credit Corp."), a subsidiary of United States Steel Corp., by which the Credit Corp. agreed to finance land acquisitions and the purchase of prefabricated houses by Fortner, if Fortner agreed to purchase the houses from the Homes Division of U. S. Steel. Fortner was able to borrow substantially more than the purchase price of the houses sold it, on particularly attractive terms.

Subsequent to entering the contracts, Fortner discovered that the houses were defective and priced at a noncompetitive high level. It filed suit against U. S. Steel and the Credit Corp. in 1962, charging violations of sections 1 and 2 of the Sherman Act. The crux of Fortner's complaint was that the contracts were illegal tying agreements,[126] *i.e.*, that the purchase of homes was tied to the granting of favorable credit terms by the Credit Corp.[127]

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125. *See* United States Steel Corp. v. Fortner Enterprises, Inc., 97 S.Ct. 861 (1977).

126. The basic definition of a tie-in is the following:

> A "tie-in" generally may be defined as an arrangement whereby a seller conditions his sale of a product or service (the "tying product") upon a buyer's purchase of a separate product or service (the "tied product") from the seller or from a designated third party.

ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 38 (1975).

127. A complete analysis of the economic effects of tie-ins is beyond the scope of this article. To properly analyze, however, the opinions subsequently discussed, some understanding of both the favorable and unfavorable aspects of tie-ins is helpful.

Tie-ins may lead to three general types of adverse economic consequences. First, they may allow a seller to *create* monopoly power in the market for the *tied product*. This is accomplished by "leverage," *i.e.*, "the use of monopoly power in one market (the market for the tying good) to create monopoly power in a second market (the market for the tied good)." WARREN, *supra* note 25, at 193. It may be accomplished by "foreclosure," where because of the tie, competitors in the tied product are unable to sell to the victim of the tie-in. Foreclosure results not because competitors have an inferior product, but because of some monopoly power in the market for the tying good. *Id.* at 197. Competition in the market for the tied product also may be affected adversely because the tie-in creates barriers to entry, especially when the tying and tied products are complementary, *i.e.*, used together. *See* PETER ASCH, ECONOMIC THEORY AND THE ANTITRUST DILEMMA 348 (1970) [hereinafter cited as ASCH].

Secondly, tie-ins may allow the seller to *exercise* monopoly power in the market for the *tying* product. The arrangement allows the seller to engage in price discrimination. Where different customers have different elasticities of demand for the tying product and if the tied product is complementary, it allows the seller to "meter" use of the tying product, thus giving a rough estimate of elasticity. WARREN, *supra* note 25, at 198-99. The tie-in also may allow

A review of the evolution of standards used to test the legality of tie-ins is helpful in analyzing the questions placed before the courts by Fortner. In *International Business Machines Corp. v. United States*,[128] the Court struck down an IBM practice of leasing its patented tabulating machines only on the condition that the lessee also purchase tabulating cards from IBM. Because its machine was patented and because its only competitor at that time was Remington Rand, IBM had significant power in the market for the tying product, although there was no finding to this effect by the Court. It held simply that the practice was illegal under section 3 of the Clayton Act,[129] because the tie-in "precludes the use of the cards of any

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the seller to "share the risk" of the tying product with the purchaser, thus inducing more demand. Professor Warren, relying on the analysis in Burstein, *A Theory of Full-Line Forcing*, 55 Nw. U. L. Rev. 62 (1960), explains this in the franchising context as follows:

> The firm selling franchises could offer them at a relatively low price to reduce the risk of the prospective franchisee. In return, the franchisor could require that the franchisee purchase all of the product sold in the franchised outlet from him. By offering the franchise at a relatively low price, the franchisor shares the risk with the franchisee, but to compensate the franchisor, he is allowed to share the rewards.

Warren, *supra* note 25, at 201.

Third, tie-ins have a seemingly coercive effect on purchasers. To get one product he wants, the buyer must purchase another which he may not desire. This argument, however, is somewhat fallacious because a purchaser cannot be forced to pay more for the combination than the tying good alone is worth to him. The argument is especially weak when there are plenty of alternatives to the tying good on the market.

All these criticisms are based on the seller having some degree of monopoly power in the market for the tying product. If there is little or no monopoly power, the purchaser, if he does not want the tied product, simply purchases the tying product elsewhere.

There are several arguably favorable consequences of tie-ins which should be mentioned. First, a competitor under some legal or illegal constraint not to lower his price may do so, in effect, by offering a "free" tied good. *See* Asch at 348. Second, the tie-in "may facilitate new entry into fields where established sellers have wedded their customers to them by ties of habit and custom." Fortner Enterprises v. United States Steel, 394 U.S. 495, 514 n.9 (1969) (Fortner I) (White & Harlan, JJ., dissenting); *see also* United States v. Jerrold Electronics Corp., 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961). Third, a tie-in may protect good will or quality control; for example, a franchisor may attempt to require his franchisees to purchase the product sold to the public through him to assure high and uniform quality. Often, however, there are less restrictive ways to accomplish the same objective. *See, e.g.*, Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971), *cert. denied*, 405 U.S. 955 (1972). Finally, if the tying and tied products are functionally related, a tie-in may reduce the combined costs of placing the product on the market because of economic efficiencies of joint production and distribution. *See Fortner I supra*, at 514 n.9.

128. 298 U.S. 131 (1936).

129. 15 U.S.C. § 14 (1970). Where both the tying and tied products are goods as opposed to services, section 3 may be used to challenge the arrangement. Where, however, one of the products is a service, section 3 is inapplicable and section 1 of the Sherman Act is used. Section 3 is an "incipiency" statute similar to section 7. See note 17 *supra*.

competitor. . . ."[130] Thus, the Court was concerned with foreclosure in the market for the tied good, but the degree of foreclosure necessary for a violation was not made clear.[131]

The focus in *International Salt Co. v. United States*[132] was also on foreclosure; a *per se* rule was introduced. International conditioned its lease of machinery using salt on the purchase of salt by customers from it. Again, the tying products were patented and thus, although it was not discussed in the opinion, International clearly had some degree of monopoly power in the market for the tying good.[133] The decision, however, was based on the effect of the tie-in on the market for the tied product. The Court held that "it is unreasonable, *per se*, to foreclose competitors from any substantial market."[134]

Rules for *per se* illegality under both section 3 and section 1 were espoused by the Court in *Times-Picayune Publishing Co. v. United States*.[135] It held that a tie-in is *per se* unreasonable under section 3 where the seller has a monopolistic position in the tying product market *or*, drawing from *International Salt*, a substantial volume of

130. 298 U.S. at 135.

131. *See also* United Shoe Mach. Corp. v. United States, 258 U.S. 451 (1922). The Court, there held that United's 95% share of the market for shoe machinery indicated sufficient power in the market for a tying product to declare the tie-in presented illegal under section 3.

132. 332 U.S. 392 (1947).

133. In Standard Oil Co. v. United States, 337 U.S. 293, 305 (1949), the Court, in analyzing *International Salt*, noted that it was not established that equivalent machines could not be obtained.

134. 332 U.S. at 396. The $500,000 of salt sold for use in the machines in 1944 was held to be "substantial."

In Standard Oil Co. v. United States, 337 U.S. 293 (1949), which examined the legality of requirements contracts under sections 1 and 3, the Court explained the necessity for power in the market for the tying product:

> 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. (Citation omitted). 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.

337 U.S. at 306.

See also the "block booking" cases, *e.g.*, United States v. Paramount Pictures, Inc., 334 U.S. 131 (1948), where it was recognized that copyrights on the tying products produce market power.

135. 345 U.S. 594 (1953).

commerce in the market for the tied good is restrained. If both tests were met, then section 1 was violated.

Although *Times-Picayune* spoke of the necessity for a "monopolistic position" in the market for the tying product, the Court retreated somewhat from this seemingly stringent position in *Northern Pacific Railway v. United States.*[136] The Court held tie-ins *per se* illegal "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."[137] Thus, the "monopolistic position" standard in *Times-Picayune* was interpreted to mean no more than a seller's ability to impose an "appreciable restraint" in the tied product market. In the absence of some other explanation, the fact that a number of tie-ins existed was "compelling evidence" of power in the market for the tying product.[138]

Thus, the degree of market power in the tying product necessary to sustain the *per se* rule was unclear when Fortner filed suit. Early cases appeared either to involve situations where strong market dominance could be inferred because of a grant of patent or copyright, or to state simply that a "monopolistic position" was necessary. *Northern Pacific,* however, could be read to mean that little evidence was necessary to prove the requisite power.[139]

The first time Fortner was before the district court, summary judgment was entered against it; the Sixth Circuit affirmed.[140] Finding that the Credit Corp. had no patent or monopoly on money, that other lenders could meet its attractive credit terms if they so desired, and that, therefore, generous credit terms were not equivalent to market power, the court held that the necessary power in the

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136. 356 U.S. 1 (1958).

137. *Id.* at 6.

138. *Id.* at 7-8.

139. Even Mr. Justice Black's example in *Northern Pacific* of what would *not* constitute sufficient power was comforting to antitrust plaintiffs:

> As a simple example, if one of a dozen food stores in a community were to refuse to sell flour unless the buyer also took sugar it would hardly tend to restrain competition in sugar if its competitors were ready and able to sell flour by itself.

356 U.S. at 6-7.

140. Fortner Enterprises, Inc. v. United States Steel Corp., 293 F. Supp. 762 (W.D. Ky. 1966), *aff'd per curiam,* [1968] TRADE REG. REP. ¶ 72,577 (6th Cir. 1968).

market for the tying product, money, could not be shown. Moreover, since only .00032% of the land in the county was affected by the Fortner contracts, commerce in the tied product was not substantially restrained.[141]

The Supreme Court reversed in 1969,[142] holding that facts had been raised which, if proved, would justify use of the *per se* rule. With respect to the necessary restraint on the tied product, the majority held that the proper measure was the "total volume of sales tied by the sales policy under challenge," which would include not only sales of houses to Fortner, but to all customers pursuant to a tie-in arrangement.[143] Then, in a seeming further liberalization of the lenient standard in *Northern Pacific*, the majority explained that dominance in the market for the tying product was not necessary. The test is "whether the seller has the power to raise prices, or impose other burdensome terms such as a tie-in, with respect to any appreciable number of buyers within the market."[144]

Fortner desired to offer several types of evidence to prove the requisite market power in credit, and the majority felt the issue should be determined at trial. First, Fortner offered to show that competitors of U.S. Steel charged less for comparable houses. This "may suggest," the majority said, power in the market for credit.[145] Second, Fortner argued that the financing was uniquely advantageous. The majority held that such advantageous terms "can reflect" the lender's economic advantage over its competitors.[146] One

141. 293 F. Supp. at 768-69. It is difficult to understand why the court used this as a test.

142. Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495 (1969). The decision was five to four.

143. *Id.* at 502. Fortner alleged that its own purchases were approximately $190,000, which the majority concluded was "not insubstantial."

144. *Id.* at 504.

145. *Id.* The majority said that

> [s]ince in a freely competitive situation buyers would not accept a tying arrangement obligating them to buy a tied product at a price higher than the going market rate, this substantial price differential with respect to the tied product (prefabricated houses) in itself may suggest that [U.S. Steel] had some special economic power in the credit market.

Id.

146. *Id.* at 505. Affidavits showed that no other financial institution in the area would match the Credit Corp. terms. The majority was careful to note, however, that economic power can be inferred from uniqueness only where other creditors could not offer the advantageous terms. Barriers may be legal, physical or economic. Where economic barriers prevent

competitive advantage that U.S. Steel "may well have had" was the nationwide scope of its operations. The majority suggested that if these allegations were proved, the requisite economic power could be inferred.

At this point, Fortner must have been extremely optimistic. The case was remanded for trial, and even the most skeptical person must have thought that proving power in the market for the tying product would not be difficult, especially in light of the majority's comments concerning what types of factors were relevant. On remand, the trial judge directed a verdict for Fortner on liability, and a jury found single damages of $93,200. This was reversed by the Sixth Circuit,[147] which held that the question of power in the market for the tying product should have been sent to the jury.[148] The matter was sent back for trial again.

On remand, jury was waived and the matter was determined by the judge on the previous evidence with supplementation. He found for Fortner again, and this time the Sixth Circuit affirmed.[149] The circuit court held that although an expert had testified that the loan granted Fortner was unique in the area at that time, Fortner had failed to show that either legal barriers or cost advantages had precluded other lenders from offering the same terms. Uniqueness, then, was not proved to the extent necessary to show market power. But Fortner had shown that (1) a substantial amount of business in the tied product was involved; (2) a significant number of buyers had accepted the tie-in; and (3) the houses were sold by U. S. Steel at a price higher than that charged by competitors. Proof of these factors was sufficient to show the requisite power notwithstanding lack of proof on the question of uniqueness.

The Supreme Court unanimously reversed;[150] it analyzed whether the factors discussed by the Sixth Circuit, and the proof on each,

competitors from offering the product, "the uniqueness test . . . is somewhat confusing since the real source of economic power is not the product itself but rather the seller's cost advantage in producing it." *Id.* at 505 n.2.

147. Fortner Enterprises, Inc., v. United States Steel Corp., 452 F.2d 1095 (6th Cir.), *cert. denied*, 406 U.S. 919 (1972).

148. The Supreme Court had determined that the restraint on the tied product was sufficient to meet that part of the *per se* test.

149. 523 F.2d 961 (6th Cir. 1975).

150. United States Steel Corp. v. Fortner Enterprises, Inc., 97 S.Ct. 861 (1977).

were sufficient to prove the necessary power in the market for the tying product.[151]

First, the corporate connection between the credit subsidiary and U. S. Steel Corp. did not appear to provide the former with any competitive advantage over other lenders. Thus, the affiliation was not probative of economic power. Second, although many customers had been subject to the tie-in, there was no evidence of either leverage or price discrimination. Third, the Court noted that even though U. S. Steel houses were more expensive than those sold by others, the financing was less expensive; therefore, the combined price for the package may have been equal to or lower than a competitive price.[152] Finally, it held that the only "uniqueness" about the tying product was that the credit company was willing to accept a greater risk — or a smaller profit — than its competitors, and this led to no inference of economic power. The Court concluded that the evidence "proves nothing more than a willingness to provide cheap financing in order to sell expensive homes."[153] Fortner, therefore, was back where it started in 1962.

Without doubt, the seller must have some degree of monopoly power in the market for the tying product before a violation should be found; for otherwise it is impossible to coerce the buyer into the tie-in. But the degree of power necessary remains a mystery.

Moreover, what must be proved? And how is it proved? The patent and copyright cases seem relatively simple, although it should be expected that even in those, defendants will argue that there are an abundance of reasonably interchangeable substitutes. What

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151. Fortner's evidence, as explained the Court, showed the following:

> (1) petitioners [the Credit Corp. and U.S. Steel's Home Division] were owned by one of the Nation's largest corporations; (2) petitioners entered into tying agreements with a significant number of customers in addition to Fortner; (3) the Home Division charged respondent a noncompetitive price for its prefabricated homes; and (4) the financing provided to Fortner was "unique," primarily because it covered 100% of Fortner's acquisition and development costs.

Id. at 865.

152. *Id.* at 866-67. *But see* WARREN, *supra* note 25, at 194 (this does not negate possibility of leverage). Professor Areeda suggests that at least in computing damages, the fact that the tying product was sold at an unusually low price should be taken into consideration. Areeda, *Antitrust Violations Without Damage Recoveries*, 89 HARV. L. REV. 1127, 1138 (1976).

153. 97 S.Ct. at 868. Clearly, this was the most important of the four factors. The Court specifically stated that uniqueness had to be proved before market power was shown.

about trademarks, especially in the franchising context? Can economic power be inferred from the trademark itself when there are 150 other hamburger franchises which can be obtained?

Will it now be necessary to prove the defendant's market share of the tying product? If so, all the problems of relevant market definition arise. And even then, what size market share exhibits the necessary power? Do concentration ratios become a relevant factor? And if so, in the market for the tying or tied product? Would this depend upon whether the defendant were attempting to create monopoly power in the tied product or exercise power in the market for the tying product?

It may be that all defendants will attempt to prove that the price of their tying products was below the competitive norm.[154] This, of course, will introduce additional problems of proof, and even then, it is not clear that such should be allowed as a defense to liability.

It seems time to stop using the phrase "*per se*" when testing tie-ins. Tie-ins have never been *per se* illegal; their illegality has hinged on economic questions concerning the markets for the tying and tied products. *Per se* means nothing and adds nothing to the analysis. And is the *per se* rule proper in any event? As the Court held in *Sylvania*, a *per se* rule should not be used where the practice may present benefits,[155] and we may well see the *per se* rule reexamined in tie-in cases.

If, however, *Fortner* II makes anything clear, it is that many tie-ins which do adversely affect competition will now pass muster because of the seemingly increased proof necessary to show economic power in the market for the tying product. It will be interesting to see how plaintiffs attempt to prove this economic power after *Fortner* II.

VI. FEDERAL-STATE CONFLICT I — ENJOINING STATE PROCEEDINGS

There are several routes by which anticompetitive state action, or anticompetitive activity by private parties in conjunction with the

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154. Franchisors may argue, for example, that their tie-ins simply indicate "a willingness to sell a cheap franchise in order to sell expensive supplies." Franchising World, May 1977, p. 7, col. 4.

155. See note 113 *supra*, and accompanying text.

state, can come into conflict with the federal antitrust laws. Perhaps the most common situation is that where the defendant claims that he has been commanded by the state to engage in anticompetitive action.[156] In addition, the so-called *Noerr-Pennington* doctrine holds that inducement of government action, even if prompted by anticompetitive motives and otherwise violative of the antitrust laws, is exempt from challenge.[157]

The conflict was presented to the Court this term in a somewhat different context in *Vendo Co. v. Lektro-Vend Corp.*[158] There the question was whether a state court proceeding which allegedly was used to violate federal antitrust law could be enjoined by a federal court under section 16 of the Clayton Act[159] notwithstanding the Anti-Injunction Act.[160] The case is interesting not only for its discussion of federal procedure, but also for the light it sheds on when the *Noerr-Pennington* doctrine is applicable to shield from challenge state court litigation otherwise violative of the antitrust laws.[161]

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156. *See, e.g.*, Parker v. Brown, 317 U.S. 341 (1943). The so-called "state action exemption" is the subject of Part VII *infra*.

157. UMW v. Pennington, 381 U.S. 657 (1965); Eastern R.R. Presidents Conf. v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961).

158. 97 S.Ct. 2881 (1977).

159. 15 U.S.C. § 26 (1970). Section 16 confers standing upon private plaintiffs to seek equitable redress and is analogous to section 4 which confers standing for damages.

160. 28 U.S.C. § 2283 (1970).

161. Because much of the *Vendo* decision involves application of this doctrine, a brief discussion of its background and substance may be helpful. In *Noerr*, the Court held that a publicity campaign by railroads intended to influence a legislature to enact laws unfavorable to truckers was exempt from challenge under the antitrust laws. The decision had two bases: First, a democracy "depends upon the ability of the people to make their wishes known to their representatives." 365 U.S. at 137. Second, the right to petition the government is protected by the first amendment. The Court, however, recognized an exception to this rule where the conspiracy "is a mere sham to cover what is actually nothing more than an attempt to interfere directly with the business relationships of a competitor and the application of the Sherman Act would be justified." *Id.* at 144. The sham exception was presented to the Court in California Motor Transport Co. v. Trucking Unlimited, 404 U.S. 508 (1972) [hereinafter cited as *Trucking Unlimited*], where it was alleged that one group of truckers persistently instituted federal and state legal actions to defeat applications for operating rights filed by another group. The Court held that the principles of *Noerr* applied to solicitation of help from a court. But the judicial process cannot be abused: "[A] pattern of baseless, repetitive claims may emerge which leads the factfinder to conclude that the administrative and judicial processes have been abused." 404 U.S. at 513.

See also Franchise Realty Interstate Corp. v. San Francisco Local Joint Executive Board of Culinary Workers, 542 F.2d 1076 (9th Cir. 1976), *cert. denied*, 97 S.Ct. 1571 (1977).

The Anti-Injunction Act attempts to prevent "needless friction between state and federal courts."[162] It serves as an absolute prohibition against federal court injunctions of state court proceedings except where the proceeding falls within one of the statute's express exceptions:[163] where such an injunction is expressly authorized by Congress; where the injunction is necessary to aid a court in its jurisdiction; and where the injunction is necessary to protect or effectuate the court's judgment.[164]

With respect to the first exception, however, the Court has held several times that "expressly authorized" does not mean that the federal statute must literally state that it authorizes enjoining state proceedings. Such an interpretation would mean that the policies of many federal statutes could be frustrated by state court proceedings.

In *Mitchum v. Foster*,[165] where the question was whether a state civil proceeding could be enjoined in a federal action which charged that the state court action was violating the plaintiff's civil rights,[166] the Court held that the expressly authorized exception was met if "an Act of Congress, clearly creating a federal right or remedy enforceable in a federal court of equity, could be given its intended scope only by the stay of a state court proceeding."[167] The legislative history of the predecessor of section 1983 showed that its purpose was to enforce the fourteenth amendment against state action, especially state judicial action. Since Congress, by enactment of section 1983, had made federal courts into watchdogs over their state counterparts, the Court held that Congress had "expressly authorized" federal courts to enjoin state court proceedings which violate section 1983. The question in *Vendo* was whether Congress had done the same thing under section 16 of the Clayton Act.

Vendo's problems began in 1959, when it purchased a competitor

162. Oklahoma Packing Co. v. Oklahoma Gas & Elec. Co., 309 U.S. 4, 9 (1940).

163. Atlantic Coast Line R.R. v. Brotherhood of Locomotive Eng'rs, 398 U.S. 281 (1970).

164. Even, however, if the state proceeding meets one of the exceptions, the federal court might still refuse to hear the case on grounds of comity or abstention.

165. 407 U.S. 225 (1972).

166. Suit was brought under 42 U.S.C. § 1983 (1970).

167. 407 U.S. at 238. In reviewing its decisions concerning the Act, the Court noted that the federal statute need not expressly mention enjoining state court proceedings but only that the policy of the federal statute could be frustrated if the federal court had no power to enjoin.

and extracted from its former owner, Mr. Stoner, an employment contract and a ten year covenant not to compete in any country where Vendo did business. One specific purpose for the acquisition, and the sole purpose of the covenant not to compete, was to eliminate Stoner as a competitor.

Stoner, however, became involved with a Vendo competitor, Lektro-Vend. Vendo brought suit in state court for breach of the noncompetition agreement; the complaint was amended to include a claim for theft of trade secrets; and subsequently, Vendo increased its damage request. Judgment for over $7,000,000 was entered for Vendo, and the Illinois Supreme Court affirmed.[168] Stoner immediately brought suit in federal court to preliminarily enjoin collection of the judgment under section 16, charging that Vendo had violated both sections 1 and 2 of the Sherman Act.

The district court held that Stoner was likely to prevail on both his claims.[169] Section 1 was violated because the noncompetition covenants were overly broad and the intent of Vendo was the elimination of competition. Section 2 was violated because Vendo exhibited a "dangerous propensity for creation of an actual monopoly," and there was a specific intent to monopolize, *one part* of which was the litigation commenced against Stoner.[170]

The court realized that commercial litigation usually is protected from antitrust challenge under the *Noerr-Pennington* doctrine but held that the exemption is lost where litigation is "used as an integral part of a scheme attempting to monopolize and exclude competition."[171] Finding that there was substantial evidence that Vendo's

168. Vendo Co. v. Stoner, 58 Ill.2d 289, 321 N.E.2d 1 (1974).

169. Lektro-Vend Corp. v. Vendo Co., 403 F. Supp. 527 (N.D. Ill. 1975). Interestingly, the judge was Richard W. McLaren, former Assistant Attorney General in charge of the Antitrust Division.

170. 403 F. Supp. at 534.

171. *Id.* The Court held:

> [I]f plaintiffs can prove that Vendo's state court litigation against the Stoner interests was not a genuine attempt to use the adjudicative process legitimately, antitrust liability in the instant case under section 2 of the Sherman Act would follow.

Id.

It is important to note that the court did not hold that baseless litigation itself would be a violation. The litigation would be only one factor probative of an attempt to monopolize. Baseless litigation brought by one entity without more does not seem to meet the substantive standards for violation of any antitrust law.

suit was an attempt to use the adjudicative process illegitimately, the court held that this was an element of the section 2 offense.

Vendo's claim that the Anti-Injunction Act precluded the federal court from enjoining collection of the state court judgment was rejected. The Court held that section 16 was an exception to the Act because the "expressly authorized" standards of *Mitchum* were met. The antitrust laws could be given their "intended scope" only by staying the state court proceedings.[172] The Seventh Circuit affirmed, noting that Vendo was seeking "to thwart a federal antitrust suit by the enforcement of state court judgments which are alleged to be the very object of antitrust violations."[173]

The Supreme Court reversed in an interesting decision.[174] Three members of the Court held that section 16 is not an exception to the Anti-Injunction Act;[175] two held that in some circumstances, it is an exception;[176] and four said that section 16 was an exception on the facts presented.[177]

A plurality, finding that section 16 is not an exception, relied almost exclusively on *Mitchum*. Although they recognized that the first test for the "expressly authorized" exception was met, *i.e.*, "[t]he private action for damages conferred by the Clayton Act is a 'uniquely federal right or remedy,' "[178] the second test was not. Section 16 is not a federal statute which can be given its intended scope only by enjoining state court actions. In *Mitchum*, although the statute involved did not expressly authorize enjoining state actions, the legislative history made manifestly clear that such was necessary for the statute to work. The legislative history of section 16 showed simply that Congress intended to give a private right for equitable relief; not that it thought state court litigation would be used to violate the antitrust laws.

172. No explanation was given for this conclusion.

173. 545 F.2d 1050, 1057 (7th Cir. 1976). The case, however, shows no affirmative effort by Vendo to use its state court proceeding specifically to affect the antitrust suit. While Vendo's suit may have been brought for an anticompetitive purpose, it was filed before the federal action.

174. 97 S.Ct. 2881 (1977).

175. Rehnquist, Stewart & Powell, JJ.

176. Burger, C.J., & Blackmun, J.

177. Stevens, Brennan, White & Marshall, JJ.

178. 97 S.Ct. at 2887. The Court seemed to confuse sections 4 and 16. This suit involved equitable relief, not damages.

The Chief Justice and Mr. Justice Blackmun concurred, but their decision was based on much narrower grounds. They argued that whether section 16 could be given its intended scope without staying state court proceedings would depend on the use which had been made of the state court. An injunction could issue against a state court proceeding if the proceedings were part of a pattern of baseless and repetitive claims under the *Trucking Unlimited* standard or there was "some equivalent showing of grave abuse of the state courts."[179] In *Vendo*, however, there was a single state court proceeding; and moreover, Vendo was found to have a good cause of action. Thus, it was not shown that Vendo had used litigation in state court as an anticompetitive mechanism in and of itself.[180]

The dissent held that Vendo's state court litigation violated the Sherman Act and should, therefore, be enjoined. Noting that litigation in state courts can violate the antitrust laws[181] and that section 16 is used to enjoin antitrust violations, the dissent found that the injunction was expressly authorized.[182] Rejected was the plurality's stand that if the state court proceeding was illegal under the *Trucking Unlimited* standard, *future* state court proceedings could be enjoined. This rule, the dissent argued, would mean that the victim would be driven out of business before any remedy would be available, a result Congress could not have intended.[183]

The Chief Justice and Mr. Justice Blackmun were chastized by the dissenters for their belief that a multiplicity of lawsuits could be enjoined but that one proceeding could not. After citing several

179. *Id.* at 2893 n.1.

180. The opinion seems to hold that if the state court proceedings, in and of themselves, violate the antitrust laws, they can be enjoined.

181. 97 S.Ct. at 2897-98. The plurality read *Noerr* and *Trucking Unlimited* to mean that if a pattern of sham litigation itself constituted a violation, *future* state proceedings could be enjoined. *Id.* at 2889 n.6.

182. *Id.* at 2898-900. The plurality felt that this argument confused jurisdiction over the subject matter in antitrust cases, which section 16 gives to federal courts, with whether a court with jurisdiction has been expressly authorized under section 2283 to issue the injunction. *Id.* at 2890 n.8.

183. The dissent noted:

> It would demean the legislative process to construe the eloquent rhetoric which accompanied the enactment of the antitrust laws as implicitly denying federal courts the power to restrain illegal state court litigation simply because it was filed before the federal case was concluded.

Id. at 2900.

examples given in *Trucking Unlimited* where single abuses of government agencies had been held violative of the antitrust laws,[184] they noted that the "baseless and repetitive claims" mentioned in the decision was not meant to be exclusive. Finally, the dissent held that although the Illinois court found Vendo's claim meritorious, this did not mean that there was no violation of federal antitrust laws. The Illinois decision on the merits merely highlighted the fact that "state and federal courts apply significantly different standards in evaluating contracts in restraint of trade."[185]

What is the rule of the case? A majority of the Court felt that section 16 is an "expressly authorized" exception to the Anti-Injunction Act in certain circumstances. Thus, the concurring and dissenting members of the Court would hold that where the state court proceeding was itself violative of the antitrust laws, it could be enjoined. Their differences centered on what frequency of state court litigation was necessary to violate the Sherman Act. A number of baseless and repetitive claims would be required by the concurrence under the *Trucking Unlimited* rule. The dissent interpreted the same case as holding that a single action could be sufficient.

Some persons, no doubt, will interpret the dissent to mean that any sort of state court litigation which has an anticompetitive motive or effect can be enjoined. This interpretation plays havoc with principles of federalism. Many perfectly legitimate state court actions, whether prosecuted successfully or not, have anticompetitive effects, and one must hope that the dissent is not used to increase litigation time by the filing of federal injunction suits under section 16.

Perhaps the importance of *Vendo* is not the effect it may have on pending state litigation, but the effect it may have on the *Noerr-Pennington* doctrine in general.[186] The doctrine grew in response to

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184. *Id.* at 2902. The examples included perjury, commercial bribery of a government purchasing agent, fraud on the patent office, and conspiracy with a licensing authority to eliminate a competitor; in short, no situation analogous to that presented in the instant case.

185. *Id.* at 2903.

186. Suits in a state court by which a defendant seeks to enjoin that action on federal antitrust grounds are infrequent. If that were the Court's sole concern, it is difficult to understand why certiorari was even granted. More prevalent are cases where there is no state court action which is sought to be enjoined, but a federal antitrust suit is simply defended

groups attempting to solicit certain action by government agencies. Its rationale, the first amendment, is the basic right of persons to petition their government. Of course, "[i]t is well settled that First Amendment rights are not immunized from regulation when they are used as an integral part of conduct which violates a valid statute."[187] Certainly no policy of the first amendment protects attempts to abuse government agencies through such practices as commercial bribery or fraud on the patent office. Use of the state courts, however, even in an anticompetitive manner, to present an arguably meritorious claim presents a different situation, especially when the plaintiff's claim is meritorious. Perhaps a clearly anticompetitive reason for bringing suit might be evidence of a more broad-based violation; but seldom, if ever, should one suit be held within the "sham" exception to *Noerr*.

Fortunately, a majority of the Court agrees. The concurring opinion would require a pattern of claims or some other showing of "grave abuse" before a violation is proved and pending state court litigation could be enjoined. The plurality would seem to require the same for violation before future state court litigation could be enjoined. Thus, although *Vendo* taken as a whole may expand somewhat the *Trucking Unlimited* sham exception rule, the expansion does not seem particularly worrisome.

VII. Federal-State Conflict II — The State Action Exemption

Without doubt, the area of antitrust law which has been in the greatest flux during the past several years has been that of when the "state action" doctrine[188] applies to exempt from illegality conduct otherwise violative of the antitrust laws. Consider, for example, that in each of the Court's last three terms, a decision involving proper application of this doctrine has been announced.[189] Moreover, the

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on *Noerr-Pennington* grounds. *See, e.g.*, Kurek v. Pleasure Driveway and Park Dist., [1977-1] Trade Reg. Rep. (CCH) ¶ 61,448 (7th Cir. May 26, 1977).

187. *Trucking Unlimited*, *supra* note 161, 404 U.S. at 514.

188. The doctrine is variously called the "state action defense," the "state action immunity," the "state action exemption," and the "nonapplicability of antitrust laws" doctrine. For convenience, it will be referred to here as the "state action exemption."

189. Bates v. State Bar of Arizona, 97 S.Ct. 2691 (1977); Cantor v. Detroit Edison Co., 428 U.S. 579 (1976); Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975).

same issue will occupy the Court's time during its next term.[190]

Generally, the state action exemption doctrine provides that where the challenged anticompetitive activity "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," the activity is protected from federal antitrust challenge.[191] This statement, of course, is skeletal, and questions abound.

The basic conflict of policies which has caused the controversy is clear. On the one hand, the Court has recognized that the Sherman Act is the Magna Carta of economic freedom.[192] On the other, principles of federalism might dictate that the policies of the antitrust laws give way to the state's judgment that competition is not the "summum bonum"[193] in a given situation. It will be seen that the Court has taken a middle ground.

After the Court's 1943 decision in the seminal case, *Parker v. Brown*,[194] the state action exemption was not presented to the Court again until 1962,[195] and then, in its 1975 *Goldfarb* decision.[196] The facts of *Goldfarb* are well known, and only a brief synopsis is necessary here. Suit was brought against the Virginia State Bar, "the

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190. City of Lafayette v. Louisiana Power & Light Co., 532 F.2d 431 (5th Cir. 1976), *cert. granted*, 97 S.Ct. 1577 (1977).

191. Parker v. Brown, 317 U.S. 341, 350 (1943). The doctrine can be traced back to at least 1904 when the Court decided Olsen v. Smith, 195 U.S. 332 (1904). There, against both constitutional and antitrust challenges, the right of Texas to confer a monopoly on pilots in the port of Galveston was upheld. To hold the practice violative of the antitrust laws, the Court said, would be tantamount to denying the right of Texas to regulate pilotage. "[I]t must follow that no monopoly or combination in a legal sense can arise from the fact that the duly authorized agents of the State are alone allowed to perform the duties devolving upon them by law." 195 U.S. at 345.

In *Parker*, a suit against state officials, the Court held that Congress did not intend the Sherman Act to restrain state or official action; the intent was to prohibit only certain individual action. The Court was careful to caution, however, that the state cannot give immunity to private persons by declaring their conduct lawful or by authorizing it. The particular facts before it did not present a case where the state had become a participant in a private combination in restraint of trade. 317 U.S. at 351-52.

192. *See* United States v. Topco Assocs., 405 U.S. 596 (1972); Northern Pac. Ry. v. United States, 356 U.S. 1 (1958).

193. George R. Whitten, Jr., Inc. v. Paddock Pool Builders, Inc., 424 F.2d 25, 30 (1st Cir. 1970).

194. See note 191 *supra*.

195. Continental Ore Co. v. Union Carbide & Carbon Corp., 370 U.S. 690 (1962).

196. 421 U.S. 773 (1975).

administrative agency through which the Virginia Supreme Court regulates the practice of law,"[197] and a private local bar association, charging that the promulgation of a minimum fee schedule by the private group, in conjunction with condonation and ethical opinions in support thereof by the state bar, constituted a price fixing agreement.

After holding that the challenged conduct constituted price fixing, the Court considered whether the state bar's conduct was exempt from challenge under the state action exemption. The "threshold inquiry" was whether the "activity is state action of the type the Sherman Act was not meant to proscribe," *i.e.*, "whether the activity is required by the State acting as sovereign."[198] Although the Supreme Court of Virginia apparently had granted power to the state bar to issue ethical opinions, no statute or court rule "required the anticompetitive activities of either respondent."[199] The challenged activity must be "compelled," not simply prompted.

Noting that the state bar was a state agency for some limited purposes, the Court held that it could not expect to be protected when engaging in anticompetitive activity for its own members' benefit. The state bar had "voluntarily joined in what is essentially a private anticompetitive activity,"[200] and therefore, could not claim *Parker v. Brown* protection.

Goldfarb appeared to be a narrowing of the state action exemption, and although its ramifications were unclear, several general principles appeared[9] A state agency can violate the Sherman Act; the challenged activity itself must have been mandated;[201] a suffi-

197. 421 U.S. at 776 (footnote omitted).

198. *Id.* at 790.

199. *Id.*

200. *Id.* at 792.

201. Lower court decisions subsequent to *Goldfarb*, at least where some government entity subordinate to the state raised the exemption, have interpreted the requirement more liberally:

> We read *Goldfarb* as holding that, absent state authority which demonstrates that it is the intent of the state to restrain competition in a given area, *Parker*-type immunity or exemption may not be extended to anticompetitive government activities. Such an intent may be demonstrated by explicit language in state statutes, or may be inferred from the nature of the powers and duties given to a particular government entity.

cient mandate may come from either the legislature or the judiciary;[202] and a state agency cannot expect to be protected if it joins with private entities to effect the restraint. The major question left unanswered was whether, if the conduct is compelled, any further analysis is necessary, *i.e.*, whether a command is both necessary and sufficient to sustain the exemption. Unfortunately, because of an intervening case between *Goldfarb* and this term's case, *Bates v. State Bar of Arizona*,[203] the answer still is not completely clear. This intervening case, *Cantor v. Detroit Edison Co.*,[204] is one of the most confusing cases ever to come from the Court.

In *Cantor*, the Michigan Public Service Commission had approved a tariff provision by which Detroit Edison exchanged the burnt-out light bulbs of its customers for new ones at no cost.[205] The tariff had been drafted and submitted for approval by the utility; no state law required it to furnish bulbs,[206] and the Court concluded that Michigan had expressed no interest in regulating the market for light bulbs. Cantor, a retailer who sold bulbs, sued the utility, charging that the arrangement foreclosed him from selling light bulbs in violation of the antitrust laws.

A plurality of the Court[207] read *Parker* narrowly to apply only where the state or some state official was sued.[208] The *Parker* Court

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Duke & Co. v. Foerster, 521 F.2d 1277, 1280 (3d Cir. 1975). *Accord*, City of Lafayette v. Louisiana Power & Light Co., 532 F.2d 431 (5th Cir. 1976), *cert. granted*, 97 S.Ct. 1577 (1977); City of Fairfax v. Fairfax Hosp. Ass'n, [1976-2] TRADE REG. REP. (CCH) ¶ 60,999 (E.D. Va. 1976), *rev'd*, [1977-2] TRADE REG. REP. (CCH) ¶ 61,598 (4th Cir. Aug. 22, 1977).

202. Hirschkop v. Virginia State Bar, No. 76-629-A (E.D. Va. March 8, 1976). *See City of Lafayette*, 532 F.2d at 434 n.7.

203. 97 S.Ct. 2691 (1977).

204. 428 U.S. 579 (1976).

205. The plurality, see note 207 *infra*, seemed particularly careful in its statement of facts to emphasize that the tariff was "approved" by the commission. In Part I of the opinion, 428 U.S. at 582-85, "approval" or "approved" is used to describe the commission's action at least six times. Nowhere is it said that the action was a command or mandate. Of course, even if there were a mandate, it would have come not from the legislature or judiciary, but rather from a subordinate state agency. If, however, there were no proper mandate, under *Goldfarb* the analysis would stop. This is only one of many confusing aspects of the *Cantor* decision.

206. The utility was required, however, to continue the practice until a tariff not containing the program was approved by the commission.

207. Stevens, Brennan, White & Marshall, JJ.

208. *Goldfarb* teaches that state officials are not always protected. *See* notes 196-200 *supra*, and accompanying text.

had "carefully selected language which plainly limited the Court's holding to official action taken by state officials."[209]

Having determined that *Parker* was inapplicable, the plurality had to decide whether some new doctrine related to the *Parker* holding protected the utility. Two arguments might be made in favor of protection: First, it would be "unfair" to hold a private entity responsible where it did no more than obey a command of the state.[210] Second, where a state is already regulating a certain practice, it can be argued that Congress did not intend the antitrust laws to apply as a second, sometimes conflicting, regulatory scheme.

The majority[211] rejected the first argument because the utility did not simply follow a state command; it played an active role in drafting and having the anticompetitive scheme approved. "[T]he option to have, or not to have, such a program is primarily [the utility's], not the Commission's."[212] The second argument was rejected for three reasons: First, as a general principle, state regulation and the antitrust laws do not always conflict. They can live together in many factual settings. Second, even where there is a conflict, the federal interest may be supreme.[213] Third, where the market under scrutiny, such as light bulbs, is unregulated by the state, then the antitrust laws should have full play.[214]

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209. 428 U.S. at 591.

210. *Id.* at 592. This is not to say, however, that the practice could not be enjoined, and such exemplifies a problem with the plurality's first conclusion, *i.e.*, that *Parker* is applicable or inapplicable depending on the status of the party sued. If a person desires to destroy the state program, he simply sues a private party rather than the state. There is little logic to this.

211. *Id.* at 594-95. The Chief Justice concurred in this portion of the plurality opinion. *Id.* at 603. Thus, this part is the law of the case.

212. *Id.* at 594 (footnote omitted). A majority made crystal clear that simple "state authorization, approval, encouragement, or participation in restrictive private conduct confers no antitrust immunity." *Id.* at 592-93 (footnote omitted).

213. *Id.* at 595. Some have suggested that a traditional preemption analysis is the proper mode of determining when the state action exemption should apply. *See, e.g.*, Note, *Parker v. Brown: A Preemption Analysis*, 84 YALE L. J. 1164 (1975).

214. 428 U.S. at 595. The plurality (the Chief Justice did not concur) also emphasized that because of *Goldfarb's* "threshold inquiry" language, it should not be inferred that compliance by a private party with any state requirement will sustain the exemption. *Id.* at 600. This statement can be interpreted in several ways. It may mean that there must be more than a simple requirement, *i.e.*, there must be an absolute *command* from some sovereign branch of the state. On the other hand, it may mean that an absolute command may be necessary but not sufficient. In light of *Bates*, where the Court did not go behind the command to

The Chief Justice and Mr. Justice Blackmun concurred in the result. The former, in a short and direct opinion, simply noted that the state had no business approving tariffs which affected a market which was normally not subject to regulation. Mr. Justice Blackmun used a different analysis. First he held that the Sherman Act "generally preempts inconsistent state laws."[215] The more difficult question was in what situations preemption occurs. He espoused a "rule of reason" approach where, although "state *sanctioned* activities"[216] would be presumptively valid, potential harms and benefits would be weighed. Finding no justification for the light bulb exchange program, Mr. Justice Blackmun concurred.[217]

It is interesting that some members of the Court felt it necessary to perform all types of gyrations to reach the desired result. Assuming that the utility's program was not deserving of an exemption, it would have been easy enough simply to find an insufficient command by the state; or, perhaps it could have been argued that the regulation of the market for light bulbs by a subordinate state agency had not been "contemplated" by any sovereign branch of

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question its wisdom, the former interpretation is probably correct.

215. 428 U.S. at 605.

216. *Id.* at 609 (emphasis added).

217. *Id.* at 612-64. The dissent by Stewart, Powell & Rehnquist, JJ., is the most lucid and logical analysis in the decision whether one agrees with its result or not. Rejected was the plurality's narrow interpretation of *Parker* that it applied only when state officials were sued because such would "trivialize that case to the point of overruling it." *Id.* at 616 (footnote omitted). The issue in *Parker* was whether the *restraint* was exempt from challenge; the pivotal factor is whether the restraint, notwithstanding the status of the defendant, is the result of state action. The "fairness test" was rejected because participation in the decision-making process by private parties is protected under the *Noerr-Pennington* doctrine. See note 161 *supra*, Part VI.

The dissenters argued that Congress simply did not intend the antitrust laws to apply to state action. As the scope of the commerce clause expanded, however, some doctrine had to be invented to fulfill this intent. *Parker v. Brown* was the answer:

> *Parker's* basic holding — that the Sherman Act did not intend to displace restraints imposed by the State acting as sovereign — coincides with the expressed legislative goal not to "invade the legislative authority of the several States. . . ." *Goldfarb* clarified *Parker* by holding that private conduct, if it is to come within the state-action exemption, must be not merely "prompted" but "compelled" by state action. Thus refined, the doctrine performs the salutary function of isolating those areas of state regulation where the State's sovereign interest is, by the State's own judgment, at its strongest, and limits the exemption to those areas.

428 U.S. at 637.

state government.[218] In any event, the best that can be said of the decision is that it is impossible to apply in factual situations other than that in which it arose.[219]

The Court in *Cantor* again narrowed the scope of the state action exemption; the question was how much. Although the rule of the case is unclear, it appears that a majority of the Court held that approval from some group subordinate to the legislature or judiciary, in and of itself, is not sufficient to sustain the exemption. Indeed this is consistent with *Goldfarb*, where the "command," if any, came from the state bar rather than the supreme court.

Although the Court's most recent venture into this area of the law does not solve all the problems raised by the *Cantor* and *Goldfarb* decisions, it does seem to express a clear rule in certain circumstances. In *Bates v. State Bar of Arizona*,[220] the Court unanimously held that a disciplinary rule promulgated by the Arizona Supreme Court and enforced by the state bar, which prohibited certain attorney advertising, was exempt from challenge under section 1 of the Sherman Act.[221]

Bates claimed that the prohibition on advertising constituted a price fixing agreement, *per se* illegal under section 1. The Arizona Supreme Court disagreed, but held that even if such were the case, the state action exemption applied.[222]

The Court, in affirming this portion of the Arizona court's opin-

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218. Kurek v. Pleasure Driveway and Park Dist., [1977-1] TRADE REG. REP. (CCH) ¶ 61,448 (7th Cir. May 26, 1977).

219. *But see* Litton Systems, Inc. v. Southwestern Bell Tel. Co., 539 F.2d 418 (5th Cir. 1976); Almeda Mall, Inc. v. Houston Lighting & Power Co., [1977-1] TRADE REG. REP. (CCH) ¶ 61,485, 71,884 (S.D. Tex. April 29, 1977) (similar facts).

See also Boddicker v. Arizona Dental Ass'n, 549 F.2d 626 (9th Cir. 1977); Surety Title Ins. Agency, Inc. v. Virginia State Bar, 431 F.Supp. 298 (E.D.Va. 1977), *appeal docketed*, No. 77-1703 (4th Cir. Apr. 26, 1977) (not discussed herein because the Virginia State Bar is represented by the Virginia Office of Attorney General, the writer's employer).

220. 97 S.Ct. 2691 (1977).

221. *Id.* at 2696-98. The Court's discussion of Sherman Act applicability was a relatively minor part of the opinion. By a five to four vote, the Court held that price advertising for some relatively standardized legal services is protected by the first amendment.

222. Matter of Bates, 113 Ariz. 394, 555 P.2d 640 (1976). Although the result is correct, the reasoning was unsatisfactory: "The regulation of the State Bar by the Supreme Court is an activity of the State of Arizona acting as sovereign and exempt by the very provisions of the Sherman Act." 113 Ariz. at ___, 555 P.2d at 643.

ion, held that "*Goldfarb* and *Cantor* . . . are distinguishable, and their reasoning supports our conclusion here."[223] *Goldfarb* was distinguished easily on the ground that the illegal activity there had not been compelled by the state. In *Bates*, however, the restraint was an "affirmative command of the Arizona Supreme Court," the "ultimate body wielding the State's power over the practice of law."[224]

Bates, however, argued that the case was more akin to *Cantor*. He argued that the American Bar Association, from which the disciplinary rule came, was a private group analogous to the utility in *Cantor*. The Arizona court, in approving the rule, played the part of the public service commission. The Court, however, noted "that the context in which *Cantor* arose is crucial."[225] Three factors in *Cantor* were critically distinct from the case at bar: First, in *Cantor* no public official or agency was sued; here, however, the Arizona Supreme Court was the real party in interest. Second, in *Cantor* the state had expressed no interest in regulating the market involved. On the other hand, the activities of attorneys are of great interest to the state and traditionally have been regulated. "Finally, the light bulb program in *Cantor* was instigated by the utility with only the acquiescence of the state regulatory commission."[226] The disciplinary rule, according to the Court, showed the state's policy, *i.e.*, advertising by attorneys is not in the public interest. Moreover, the alleged restraint could be reexamined by the policymaker, the Arizona Supreme Court; this weakened the argument that if the rule were exempted from challenge, federal policy would be subordinated to that of the state.[227]

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223. 97 S.Ct. at 2696.

224. *Id.* at 2697. If the Court had stopped here, the law would be clear. A command from a sovereign branch of government would be both necessary and sufficient for applicability of the state action exemption. The analysis would stop.

225. *Id.* Does this mean that *Cantor* is an anomoly?

226. *Id.* at 2698. Is the Court's concern that there was no command, *i.e.*, only "acquiescence," or that any command there was came from the commission and not the legislature? The former seems more probable; but if that is the case, why not simply cite *Goldfarb*?

227. It is difficult to understand why this is so. There is no reason to expect that the sovereign branches of the state will pay any more heed to federal antitrust policy than will a state regulatory commission. The Court's argument would bear more credence if *Cantor* had involved action by some self-regulating board. Surely someone could have appealed the tainted tariff.

Although *Bates* does not answer all questions which might arise under the state action exemption, it does seem to bring the doctrine's narrowing to a screeching halt. It can be read as a bright line case which holds that where there is a specific command by a sovereign branch of the state government, notwithstanding the wisdom of the command, a state agency if acting within the perimeters of the command is protected from antitrust liability. It appears from *Bates* that the Court is not going to engage in substantive due process analysis to determine if the exemption applies; under their first amendment analysis, a majority of the Court determined that some degree of attorney advertising was warranted. It would also seem that the decision holds that the Sherman Act does not preempt inconsistent state legislation.[228]

There are, however, at least two questions which *Bates* does not answer. First, what happens when private parties are sued and they are acting pursuant to a command of the type found in *Bates*? For example, if private attorneys had been sued, would the result have been the same? Second, what happens to a state agency when it is not acting within the command itself but is implementing the command in a reasonable manner.[229] With respect to the first question, the fairness test of *Cantor* simply seems unworkable. With respect to the second, we may see the Court determine "reasonableness" itself or use the "contemplation" test which has been adopted by lower courts.

VIII. CONCLUSION

It is difficult to disagree strenuously with the Court's results this

228. The argument and retort were couched in the following terms:

> [Bates] also assert[s] that the interest embodied in the Sherman Act must prevail over the state interest in regulating the bar.
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> . . . .
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> . . .Our concern that federal policy is being unnecessarily and inappropriately subordinated to state policy is reduced in such a situation; we deem it significant that the state policy is so clearly and affirmatively expressed and that the State's supervision is so active.

97 S.Ct. at 2697-98.

229. This is an especially important consideration to local governments which are usually granted extremely general powers by the state. The question should be answered next term in City of Lafayette v. Louisiana Power & Light Co., 532 F.2d 431 (5th Cir. 1976), *cert. granted*, 97 S.Ct. 1577 (1977).

term except that in *Illinois Brick*; a blanket denial of recovery by indirect purchasers simply cannot be justified. If the decision cannot be reversed by Congress, the Court should examine this question again after the decision's adverse effects on antitrust enforcement become clear. By seemingly increasing the burden of proof in tie-in cases and rejecting the *per se* rule in vertical restraints cases, the Court is turning more and more to economics as the lodestar in antitrust cases; and this is how it should be. To encourage, however, more economic analysis and complexity in some areas but to deny recovery for indirect purchasers for the very same reasons seems inconsistent at best.

Although private plaintiffs were consistently unsuccessful, none of the decisions this term will have significant effects on government enforcement of the antitrust laws, with the exception of government attempts to recover damages for itself and perhaps, in *parens patriae* actions, where states attempt to recover for their citizens. There will be a strong move in Congress to reverse the case, and even if this is unsuccessful, it is not clear that the Court's interpretation of section 4 is applicable to section 4C.

The ramifications of the decisions obviously will be felt by private litigants, those "private attorneys general" who are depended upon so heavily to supplement the government's antitrust enforcement efforts. If, however, the doors have been closed to some extent on private litigants and incentives to sue have been lessened, those who would engage in illegal conduct should take little solace. A number of "sleeping giants" are now awakening. Indeed, in the years to come it may be that the states became a primary factor in the nation's overall efforts to assure a competitive marketplace.