

## 16.8: Cases

### Horizontal Restraints of Trade

National Society of Professional Engineers v. United States

435 U.S. 679 (1978)

MR. JUSTICE STEVENS delivered the opinion of the Court.

This is a civil antitrust case brought by the United States to nullify an association's canon of ethics prohibiting competitive bidding by its members. The question is whether the canon may be justified under the Sherman Act, 15 U.S. c. § 1 et seq. (1976 ed.), because it was adopted by members of a learned profession for the purpose of minimizing the risk that competition would produce inferior engineering work endangering the public safety. The District Court rejected this justification without making any findings on the likelihood that competition would produce the dire consequences foreseen by the association. The Court of Appeals affirmed. We granted certiorari to decide whether the District Court should have considered the factual basis for the proffered justification before rejecting it. Because we are satisfied that the asserted defense rests on a fundamental misunderstanding of the Rule of Reason frequently applied in antitrust litigation, we affirm.

Engineering is an important and learned profession. There are over 750,000 graduate engineers in the United States, of whom about 325,000 are registered as professional engineers. Registration requirements vary from State to State, but usually require the applicant to be a graduate engineer with at least four years of practical experience and to pass a written examination. About half of those who are registered engage in consulting engineering on a fee basis. They perform services in connection with the study, design, and construction of all types of improvements to real property—bridges, office buildings, airports, and factories are examples. Engineering fees, amounting to well over \$2 billion each year, constitute about 5% of total construction costs. In any given facility, approximately 50% to 80% of the cost of construction is the direct result of work performed by an engineer concerning the systems and equipment to be incorporated in the structure.

The National Society of Professional Engineers (Society) was organized in 1935 to deal with the nontechnical aspects of engineering practice, including the promotion of the professional, social, and economic interests of its members. Its present membership of 69,000 resides throughout the United States and in some foreign countries. Approximately 12,000 members are consulting engineers who offer their services to governmental, industrial, and private clients. Some Society members are principals or chief executive officers of some of the largest engineering firms in the country.

The charges of a consulting engineer may be computed in different ways. He may charge the client a percentage of the cost of the project, may charge fixed rates per hour for different types of work, may perform an assignment for a specific sum, or he may combine one or more of these approaches....This case...involves a charge that the members of the Society have unlawfully agreed to refuse to negotiate or even to discuss the question of fees until after a prospective client has selected the engineer for a particular project. Evidence of this agreement is found in § II(c) of the Society's Code of Ethics, adopted in July 1964.

The District Court found that the Society's Board of Ethical Review has uniformly interpreted the "ethical rules against competitive bidding for engineering services as prohibiting the submission of any form of price information to a prospective customer which would enable that customer to make a price comparison on engineering services." If the client requires that such information be provided, then § II(c) imposes an obligation upon the engineering firm to withdraw from consideration for that job.

[P]etitioner argues that its attempt to preserve the profession's traditional method of setting fees for engineering services is a reasonable method of forestalling the public harm which might be produced by unrestrained competitive bidding. To evaluate this argument it is necessary to identify the contours of the Rule of Reason and to discuss its application to the kind of justification asserted by petitioner.

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The test prescribed in *Standard Oil* is whether the challenged contracts or acts "were unreasonably restrictive of competitive conditions." Unreasonableness under that test could be based either (1) on the nature or character of the contracts, or (2) on surrounding circumstances giving rise to the inference or presumption that they were intended to restrain trade and enhance prices. Under either branch of the test, the inquiry is confined to a consideration of impact on competitive conditions.

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Price is the “central nervous system of the economy,” *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 226 n. 59, and an agreement that “interfere[s] with the setting of price by free market forces” is illegal on its face, *United States v. Container Corp.*, 393 U.S. 333, 337. In this case we are presented with an agreement among competitors to refuse to discuss prices with potential customers until after negotiations have resulted in the initial selection of an engineer. While this is not price fixing as such, no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement. It operates as an absolute ban on competitive bidding, applying with equal force to both complicated and simple projects and to both inexperienced and sophisticated customers. As the District Court found, the ban “impedes the ordinary give and take of the market place,” and substantially deprives the customer of “the ability to utilize and compare prices in selecting engineering services.” On its face, this agreement restrains trade within the meaning of § 1 of the Sherman Act.

The Society’s affirmative defense confirms rather than refutes the anticompetitive purpose and effect of its agreement. The Society argues that the restraint is justified because bidding on engineering services is inherently imprecise, would lead to deceptively low bids, and would thereby tempt individual engineers to do inferior work with consequent risk to public safety and health. The logic of this argument rests on the assumption that the agreement will tend to maintain the price level; if it had no such effect, it would not serve its intended purpose. The Society nonetheless invokes the Rule of Reason, arguing that its restraint on price competition ultimately inures to the public benefit by preventing the production of inferior work and by insuring ethical behavior. As the preceding discussion of the Rule of Reason reveals, this Court has never accepted such an argument.

It may be, as petitioner argues, that competition tends to force prices down and that an inexpensive item may be inferior to one that is more costly. There is some risk, therefore, that competition will cause some suppliers to market a defective product. Similarly, competitive bidding for engineering projects may be inherently imprecise and incapable of taking into account all the variables which will be involved in the actual performance of the project. Based on these considerations, a purchaser might conclude that his interest in quality—which may embrace the safety of the end product—outweighs the advantages of achieving cost savings by pitting one competitor against another. Or an individual vendor might independently refrain from price negotiation until he has satisfied himself that he fully understands the scope of his customers’ needs. These decisions might be reasonable; indeed, petitioner has provided ample documentation for that thesis. But these are not reasons that satisfy the Rule; nor are such individual decisions subject to antitrust attack.

The Sherman Act does not require competitive bidding; it prohibits unreasonable restraints on competition. Petitioner’s ban on competitive bidding prevents all customers from making price comparisons in the initial selection of an engineer, and imposes the Society’s views of the costs and benefits of competition on the entire marketplace. It is this restraint that must be justified under the Rule of Reason, and petitioner’s attempt to do so on the basis of the potential threat that competition poses to the public safety and the ethics of its profession is nothing less than a frontal assault on the basic policy of the Sherman Act.

The Sherman Act reflects a legislative judgment that ultimately competition will produce not only lower prices, but also better goods and services. “The heart of our national economic policy long has been faith in the value of competition.” *Standard Oil Co. v. FTC*, 340 U.S. 231, 248. The assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain—quality, service, safety, and durability—and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers. Even assuming occasional exceptions to the presumed consequences of competition, the statutory policy precludes inquiry into the question whether competition is good or bad.

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In sum, the Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable. Such a view of the Rule would create the “sea of doubt” on which Judge Taft refused to embark in *Addyston*, 85 F. 271 (1898), at 284, and which this Court has firmly avoided ever since.

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The judgment of the Court of Appeals is affirmed.

### Case Questions

1. What kinds of harms are likely if there is unrestrained competitive bidding among engineering firms?
2. By what other means (i.e., *not* including deliberate nondisclosure of price information up to the time of contracting) could the National Society of Professional Engineers protect the public from harm?

## More Horizontal Restraints of Trade

State Oil Company v. Barkat U Khan and Khan & Associates

522 U.S. 3 (1997)

Barkat U. Khan and his corporation entered into an agreement with State Oil Company to lease and operate a gas station and convenience store owned by State Oil. The agreement provided that Khan would obtain the station's gasoline supply from State Oil at a price equal to a suggested retail price set by State Oil, less a margin of 3.25 cents per gallon. Under the agreement, respondents could charge any amount for gasoline sold to the station's customers, but if the price charged was higher than State Oil's suggested retail price, the excess was to be rebated to State Oil. Respondents could sell gasoline for less than State Oil's suggested retail price, but any such decrease would reduce their 3.25 cents-per-gallon margin.

About a year after respondents began operating the gas station, they fell behind in lease payments. State Oil then gave notice of its intent to terminate the agreement and commenced a state court proceeding to evict respondents. At State Oil's request, the state court appointed a receiver to operate the gas station. The receiver operated the station for several months without being subject to the price restraints in respondents' agreement with State Oil. According to respondents, the receiver obtained an overall profit margin in excess of 3.25 cents per gallon by lowering the price of regular-grade gasoline and raising the price of premium grades.

Respondents sued State Oil in the United States District Court for the Northern District of Illinois, alleging in part that State Oil had engaged in price fixing in violation of § 1 of the Sherman Act by preventing respondents from raising or lowering retail gas prices. According to the complaint, but for the agreement with State Oil, respondents could have charged different prices based on the grades of gasoline, in the same way that the receiver had, thereby achieving increased sales and profits. State Oil responded that the agreement did not actually prevent respondents from setting gasoline prices, and that, in substance, respondents did not allege a violation of antitrust laws by their claim that State Oil's suggested retail price was not optimal.

The District Court entered summary judgment for State Oil on this claim, [finding] that [Khan's allegations, if true]...did not establish the sort of "manifestly anticompetitive implications or pernicious effect on competition" that would justify per se prohibition of State Oil's conduct. The Seventh Circuit reversed. The Court of Appeals for the Seventh Circuit reversed the District Court's grant of summary judgment for State Oil on the basis of *Albrecht v. Herald Co.*, 390 U.S. 14 (1968). 93 F.3d 1358 (1996). The court first noted that the agreement between respondents and State Oil did indeed fix maximum gasoline prices by making it "worthless" for respondents to exceed the suggested retail prices. After reviewing legal and economic aspects of price fixing, the court concluded that State Oil's pricing scheme was a per se antitrust violation under *Albrecht v. Herald Co.*, supra. Although the Court of Appeals characterized *Albrecht* as "unsound when decided" and "inconsistent with later decisions" of this Court, it felt constrained to follow that decision. The Supreme Court granted certiorari.

Justice Sandra Day O'Connor

We granted certiorari to consider two questions, whether State Oil's conduct constitutes a *per se* violation of the Sherman Act and whether respondents are entitled to recover damages based on that conduct.

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Although the Sherman Act, by its terms, prohibits every agreement "in restraint of trade," this Court has long recognized that Congress intended to outlaw only unreasonable restraints. See, e.g., *Arizona v. Maricopa County Medical Soc.*, U.S. Supreme Court (1982). As a consequence, most antitrust claims are analyzed under a "rule of reason," according to which the finder of fact must decide whether the questioned practice imposes an unreasonable restraint on competition, taking into account a variety of factors, including specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint's history, nature, and effect.

Some types of restraints, however, have such predictable and pernicious anticompetitive effect, and such limited potential for pro-competitive benefit, that they are deemed unlawful *per se*. *Northern Pacific R. Co. v. United States*, U.S. Supreme Court (1958). *Per se* treatment is appropriate "once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Maricopa County* (1982). Thus, we have expressed reluctance to adopt *per se* rules with regard to "restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious." *FTC v. Indiana Federation of Dentists*, U.S. Supreme Court (1986).

A review of this Court's decisions leading up to and beyond *Albrecht* is relevant to our assessment of the continuing validity of the *per se* rule established in *Albrecht*. Beginning with *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, U.S. Supreme Court (1911), the Court recognized the illegality of agreements under which manufacturers or suppliers set the minimum resale prices to be

charged by their distributors. By 1940, the Court broadly declared all business combinations “formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce” illegal *per se*. *United States v. Socony-Vacuum Oil Co.*, U.S. Supreme Court (1940). Accordingly, the Court condemned an agreement between two affiliated liquor distillers to limit the maximum price charged by retailers in *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, U.S. Supreme Court (1951), noting that agreements to fix maximum prices, “no less than those to fix minimum prices, cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment.”

In subsequent cases, the Court’s attention turned to arrangements through which suppliers imposed restrictions on dealers with respect to matters other than resale price. In *White Motor Co. v. United States*, U.S. Supreme Court (1963), the Court considered the validity of a manufacturer’s assignment of exclusive territories to its distributors and dealers. The Court determined that too little was known about the competitive impact of such vertical limitations to warrant treating them as *per se* unlawful. Four years later, in *United States v. Arnold, Schwinn & Co.*, U.S. Supreme Court (1967), the Court reconsidered the status of exclusive dealer territories and held that, upon the transfer of title to goods to a distributor, a supplier’s imposition of territorial restrictions on the distributor was “so obviously destructive of competition” as to constitute a *per se* violation of the Sherman Act. In *Schwinn*, the Court acknowledged that some vertical restrictions, such as the conferral of territorial rights or franchises, could have pro-competitive benefits by allowing smaller enterprises to compete, and that such restrictions might avert vertical integration in the distribution process. The Court drew the line, however, at permitting manufacturers to control product marketing once dominion over the goods had passed to dealers.

*Albrecht*, decided [a year after *Schwinn*], involved a newspaper publisher who had granted exclusive territories to independent carriers subject to their adherence to a maximum price on resale of the newspapers to the public. Influenced by its decisions in *Socony-Vacuum*, *Kiefer-Stewart*, and *Schwinn*, the Court concluded that it was *per se* unlawful for the publisher to fix the maximum resale price of its newspapers. The Court acknowledged that “maximum and minimum price fixing may have different consequences in many situations,” but nonetheless condemned maximum price fixing for “substituting the perhaps erroneous judgment of a seller for the forces of the competitive market.”

Nine years later, in *Continental T. V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 53 L. Ed. 2d 568, 97 S. Ct. 2549 (1977), the Court overruled *Schwinn*, thereby rejecting application of a *per se* rule in the context of vertical nonprice restrictions. The Court acknowledged the principle of *stare decisis*, but explained that the need for clarification in the law justified reconsideration of *Schwinn*:

“Since its announcement, *Schwinn* has been the subject of continuing controversy and confusion, both in the scholarly journals and in the federal courts. The great weight of scholarly opinion has been critical of the decision, and a number of the federal courts confronted with analogous vertical restrictions have sought to limit its reach. In our view, the experience of the past 10 years should be brought to bear on this subject of considerable commercial importance.”

The Court then reviewed scholarly works supporting the economic utility of vertical nonprice restraints....The Court concluded that, because “departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than—as in *Schwinn*—upon formalistic line drawing,” the appropriate course would be “to return to the rule of reason that governed vertical restrictions prior to *Schwinn*.” *Sylvania* (1977)

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Subsequent decisions of the Court...have hinted that the analytical underpinnings of *Albrecht* were substantially weakened by *Sylvania*. We noted in *Maricopa County* that vertical restraints are generally more defensible than horizontal restraints...and that decisions such as *Sylvania* “recognize the possibility that a vertical restraint imposed by a *single* manufacturer or wholesaler may stimulate interbrand competition even as it reduces intrabrand competition.”

[I]n *Atlantic Richfield Co. v. USA Petroleum Co. (ARCO)*, U.S. Supreme Court (1990), although *Albrecht*’s continuing validity was not squarely before the Court, some disfavor with that decision was signaled by our statement that we would “assume, *arguendo*, that *Albrecht* correctly held that vertical, maximum price fixing is subject to the *per se* rule.” More significantly, we specifically acknowledged that vertical maximum price fixing “may have procompetitive interbrand effects,” and pointed out that, in the wake of *GTE Sylvania*, “the procompetitive potential of a vertical maximum price restraint is more evident...than it was when *Albrecht* was decided, because exclusive territorial arrangements and other nonprice restrictions were unlawful *per se* in 1968.”

Thus, our reconsideration of *Albrecht*’s continuing validity is informed by several of our decisions, as well as a considerable body of scholarship discussing the effects of vertical restraints. Our analysis is also guided by our general view that the primary purpose of the antitrust laws is to protect interbrand competition. See, e.g., *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S.

717, 726, 99 L. Ed. 2d 808, 108 S. Ct. 1515 (1988). “Low prices,” we have explained, “benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition.” *ARCO, supra*, at 340. Our interpretation of the Sherman Act also incorporates the notion that condemnation of practices resulting in lower prices to consumers is “especially costly” because “cutting prices in order to increase business often is the very essence of competition.”

So informed, we find it difficult to maintain that vertically-imposed maximum prices could harm consumers or competition to the extent necessary to justify their *per se* invalidation. As Chief Judge Posner wrote for the Court of Appeals in this case:

As for maximum resale price fixing, unless the supplier is a monopsonist he cannot squeeze his dealers’ margins below a competitive level; the attempt to do so would just drive the dealers into the arms of a competing supplier. A supplier might, however, fix a maximum resale price in order to prevent his dealers from exploiting a monopoly position.... Suppose that State Oil, perhaps to encourage...dealer services...has spaced its dealers sufficiently far apart to limit competition among them (or even given each of them an exclusive territory); and suppose further that Union 76 is a sufficiently distinctive and popular brand to give the dealers in it at least a modicum of monopoly power. Then State Oil might want to place a ceiling on the dealers’ resale prices in order to prevent them from exploiting that monopoly power fully. It would do this not out of disinterested malice, but in its commercial self-interest. The higher the price at which gasoline is resold, the smaller the volume sold, and so the lower the profit to the supplier if the higher profit per gallon at the higher price is being snared by the dealer.” 93 F.3d at 1362.

We recognize that the *Albrecht* decision presented a number of theoretical justifications for a *per se* rule against vertical maximum price fixing. But criticism of those premises abounds. The *Albrecht* decision was grounded in the fear that maximum price fixing by suppliers could interfere with dealer freedom. 390 U.S. at 152. In response, as one commentator has pointed out, “the ban on maximum resale price limitations declared in *Albrecht* in the name of ‘dealer freedom’ has actually prompted many suppliers to integrate forward into distribution, thus eliminating the very independent trader for whom *Albrecht* professed solicitude.” 7 P. Areeda, *Antitrust Law*, P1635, p. 395 (1989). For example, integration in the newspaper industry since *Albrecht* has given rise to litigation between independent distributors and publishers.

The *Albrecht* Court also expressed the concern that maximum prices may be set too low for dealers to offer consumers essential or desired services. 390 U.S. at 152-153. But such conduct, by driving away customers, would seem likely to harm manufacturers as well as dealers and consumers, making it unlikely that a supplier would set such a price as a matter of business judgment.... In addition, *Albrecht* noted that vertical maximum price fixing could effectively channel distribution through large or specially-advantaged dealers. 390 U.S. at 153. It is unclear, however, that a supplier would profit from limiting its market by excluding potential dealers. See, e.g., *Easterbrook, supra*, at 905-908. Further, although vertical maximum price fixing might limit the viability of inefficient dealers, that consequence is not necessarily harmful to competition and consumers.

Finally, *Albrecht* reflected the Court’s fear that maximum price fixing could be used to disguise arrangements to fix minimum prices, 390 U.S. at 153, which remain illegal *per se*. Although we have acknowledged the possibility that maximum pricing might mask minimum pricing, see *Maricopa County*, 457 U.S. at 348, we believe that such conduct—as with the other concerns articulated in *Albrecht*—can be appropriately recognized and punished under the rule of reason.... After reconsidering *Albrecht*’s rationale and the substantial criticism the decision has received, however, we conclude that there is insufficient economic justification for *per se* invalidation of vertical maximum price fixing.

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Despite what Chief Judge Posner aptly described as *Albrecht*’s “infirmities, [and] its increasingly wobbly, moth-eaten foundations,” there remains the question whether *Albrecht* deserves continuing respect under the doctrine of *stare decisis*. The Court of Appeals was correct in applying that principle despite disagreement with *Albrecht*, for it is this Court’s prerogative alone to overrule one of its precedents.... We approach the reconsideration of decisions of this Court with the utmost caution. *Stare decisis* reflects “a policy judgment that ‘in most matters it is more important that the applicable rule of law be settled than that it be settled right.’” *Agostini v. Felton*, U.S. Supreme Court (1997).

But “*stare decisis* is not an inexorable command.” *Payne v. Tennessee*, U.S. Supreme Court (1991). In the area of antitrust law, there is a competing interest, well-represented in this Court’s decisions, in recognizing and adapting to changed circumstances and the lessons of accumulated experience.

...With the views underlying *Albrecht* eroded by this Court’s precedent, there is not much of that decision to salvage.... [W]e find its conceptual foundations gravely weakened. In overruling *Albrecht*, we of course do not hold that all vertical maximum price fixing is *per se* lawful. Instead, vertical maximum price fixing, like the majority of commercial arrangements subject to the antitrust laws, should be evaluated under the rule of reason.



## Case Questions

1. What does Judge Posner of the Seventh Circuit mean when he uses the term *monopsonist*? Is he referring to the respondent (Khan and Associates) or to the State Oil Company?
2. Explain why State Oil Company would want to set a maximum price. What business benefit is it for State Oil Company?
3. The court clearly states that setting maximum price is no longer a per se violation of the Sherman Act and is thus a rule of reason analysis in each case. What about setting minimum prices? Is setting minimum prices per se illegal, illegal if it does not pass the rule of reason standard, or entirely legal?

## Acquiring and Maintaining a Monopoly

United States v. Aluminum Company of America

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

### JUDGE LEARNED HAND

It does not follow because “Alcoa” had such a monopoly that it “monopolized” the ingot market: it may not have achieved monopoly; monopoly may have been thrust upon it. If it had been a combination of existing smelters which united the whole industry and controlled the production of all aluminum ingot, it would certainly have “monopolized” the market....We may start therefore with the premise that to have combined ninety percent of the producers of ingot would have been to “monopolize” the ingot market; and, so far as concerns the public interest, it can make no difference whether an existing competition is put an end to, or whether prospective competition is prevented....

Nevertheless, it is unquestionably true that from the very outset the courts have at least kept in reserve the possibility that the origin of a monopoly may be critical in determining its legality; and for this they had warrant in some of the congressional debates which accompanied the passage of the Act....This notion has usually been expressed by saying that size does not determine guilt; that there must be some “exclusion” of competitors; that the growth must be something else than “natural” or “normal”; that there must be a “wrongful intent,” or some other specific intent; or that some “unduly” coercive means must be used. At times there has been emphasis upon the use of the active verb, “monopolize,” as the judge noted in the case at bar.

A market may, for example, be so limited that it is impossible to produce at all and meet the cost of production except by a plant large enough to supply the whole demand. Or there may be changes in taste or in cost which drive out all but one purveyor. A single producer may be the survivor out of a group of active competitors, merely by virtue of his superior skill, foresight, and industry. In such cases a strong argument can be made that, although the result may expose the public to the evils of monopoly, the Act does not mean to condemn the resultant of those very forces which it is its prime object to foster: *finis opus coronal*. The successful competitor, having been urged to compete, must not be turned upon when he wins.

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[As] Cardozo, J., in *United States v. Swift & Co.*, 286 U.S. 106, p. 116, 52 S. Ct. 460, 463, 76 L.Ed. 999,...said, “Mere size...is not an offense against the Sherman Act unless magnified to the point at *which* it amounts to a monopoly...but size carries with it an opportunity for abuse that is not to be ignored when the opportunity is proved to have been utilized in the past.” “Alcoa’s” size was “magnified” to make it a “monopoly”; indeed, it has never been anything else; and its size not only offered it an “opportunity for abuse,” but it “utilized” its size for “abuse,” as can easily be shown.

It would completely misconstrue “Alcoa’s” position in 1940 to hold that it was the passive beneficiary of a monopoly, following upon an involuntary elimination of competitors by automatically operative *economic* forces. Already in 1909, when its last lawful monopoly ended, it sought to strengthen its position by unlawful practices, and these concededly continued until 1912. In that year it had two plants in New York, at which it produced less than 42 million pounds of ingot; in 1934 it had five plants (the original two, enlarged; one in Tennessee; one in North Carolina; one in Washington), and its production had risen to about 327 million pounds, an increase of almost eight-fold. Meanwhile not a pound of ingot had been produced by anyone else in the United States. This increase and this continued and undisturbed control did not fall undesigned into “Alcoa’s” lap; obviously it could not have done so. It could only have resulted, as it did result, from a persistent determination to maintain the control, with which it found itself vested in 1912. There were at least one or two abortive attempts to enter the industry, but “Alcoa” effectively anticipated and forestalled all competition, and succeeded in holding the field alone. True, it stimulated demand and opened new uses for the metal, but not without making sure that it could supply what it had evoked. There is no dispute as to this; “Alcoa” avows it as evidence of the skill, energy and initiative with which it has always conducted its business: as a reason why, having won its way by fair means, it should be commended, and not dismembered. We need charge it with no moral derelictions after 1912; we may assume that all its

claims for itself are true. The only question is whether it falls within the exception established in favor of those who do not seek, but cannot avoid, the control of a market. It seems to us that that question scarcely survives its statement. It was not inevitable that it should always anticipate increases in the demand for ingot and be prepared to supply them. Nothing compelled it to keep doubling and redoubling its capacity before others entered the field. It insists that it never excluded competitors; but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connections and the elite of personnel. Only in case we interpret “exclusion” as limited to maneuvers not honestly industrial, but actuated solely by a desire to prevent competition, can such a course, indefatigably pursued, be deemed not “exclusionary.” So to limit it would in our judgment emasculate the Act; would permit just such consolidations as it was designed to prevent.

We disregard any question of “intent.” Relatively early in the history of the Act—1905—Holmes, J., in *Swift & Co. v. United States*, explained this aspect of the Act in a passage often quoted. Although the primary evil was monopoly, the Act also covered preliminary steps, which, if continued, would lead to it. These may do no harm of themselves; but if they are initial moves in a plan or scheme which, carried out, will result in monopoly, they are dangerous and the law will nip them in the bud....In order to fall within § 2, the monopolist must have both the power to monopolize, and the intent to monopolize. To read the passage as demanding any “specific,” intent, makes nonsense of it, for no monopolist monopolizes unconscious of what he is doing. So here, “Alcoa” meant to keep, and did keep, that complete and exclusive hold upon the ingot market with which it started. That was to “monopolize” that market, however innocently it otherwise proceeded. So far as the judgment held that it was not within § 2, it must be reversed.

### Case Questions

1. Judge Learned Hand claims there would be no violation of the Sherman Act in any case where a company achieves monopoly through “natural” or “normal” operation of the market.
  1. What language in the Sherman Act requires the plaintiff to show something more than a company’s monopoly status?
  2. What specifics, if any, does Judge Hand provide that indicate that Alcoa not only had market dominance but sought to increase its dominance and to exclude competition?
2. Can you think of a single producer in a given product or geographic market that has achieved that status because of “peer skill, foresight, and industry”? Is there anything wrong with Alcoa’s selling the concept of aluminum products to an ever-increasing set of customers and then also ensuring that it had the capacity to meet the increasing demand?
3. To stimulate interbrand competition, would you recommend that Congress change Section 2 so that any company that had over 80 percent of market share would be “broken up” to ensure competition? Why is this a bad idea? Or why do you think it is a good idea?

### Innovation and Intent to Monopolize

*Berkey Photo, Inc. v. Eastman Kodak Company*

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

IRVING R. KAUFMAN, CHIEF JUDGE

To millions of Americans, the name Kodak is virtually synonymous with photography....It is one of the giants of American enterprise, with international sales of nearly \$6 billion in 1977 and pre-tax profits in excess of \$1.2 billion.

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

The two firms thus stand in a complex, multifaceted relationship, for Kodak has been Berkey’s competitor in some markets and its supplier in others. In this action, Berkey claims that every aspect of the association has been infected by Kodak’s monopoly power in the film, color print paper, and camera markets, willfully acquired, maintained, and exercised in violation of § 2 of the Sherman Act, 15 U.S.C. § 2....Berkey alleges that these violations caused it to lose sales in the camera and photofinishing markets and to pay excessive prices to Kodak for film, color print paper, and photofinishing equipment.

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[T]he jury found for Berkey on virtually every point, awarding damages totalling \$37,620,130. Judge Frankel upheld verdicts aggregating \$27,154,700 for lost camera and photofinishing sales and for excessive prices on film and photofinishing equipment.... Trebled and supplemented by attorneys' fees and costs pursuant to § 4 of the Clayton Act, 15 U.S.C. § 15, Berkey's judgment reached a grand total of \$87,091,309.47, with interest, of course, continuing to accrue.

Kodak now appeals this judgment.

The principal markets relevant here, each nationwide in scope, are amateur conventional still cameras, conventional photographic film, photofinishing services, photofinishing equipment, and color print paper.

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

Kodak has long been the dominant firm in the market thus defined. Between 1954 and 1973 it never enjoyed less than 61% of the annual unit sales, nor less than 64% of the dollar volume, and in the peak year of 1964, Kodak cameras accounted for 90% of market revenues. Much of this success is no doubt due to the firm's history of innovation.

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

\* \* \*

One must comprehend the fundamental tension—one might almost say the paradox—that is near the heart of § 2....

The conundrum was indicated in characteristically striking prose by Judge Hand, who was not able to resolve it. Having stated that Congress "did not condone 'good trusts' and condemn 'bad' ones; it forbade all," he declared with equal force, "The successful competitor, having been urged to compete, must not be turned upon when he wins."...We must always be mindful lest the Sherman Act be invoked perversely in favor of those who seek protection against the rigors of competition.

\* \* \*

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

\* \* \*

As Kodak had hoped, the 110 system proved to be a dramatic success. In 1972—the system's first year—the company sold 2,984,000 Pocket Instamatics, more than 50% of its sales in the amateur conventional still camera market. The new camera thus accounted in large part for a sharp increase in total market sales, from 6.2 million units in 1971 to 8.2 million in 1972....

Berkey's Keystone division was a late entrant in the 110 sweepstakes, joining the competition only in late 1973. Moreover, because of hasty design, the original models suffered from latent defects, and sales that year were a paltry 42,000. With interest in the 126 dwindling, Keystone thus suffered a net decline of 118,000 unit sales in 1973. The following year, however, it recovered strongly, in large part because improvements in its pocket cameras helped it sell 406,000 units, 7% of all 110s sold that year.

Berkey contends that the introduction of the 110 system was both an attempt to monopolize and actual monopolization of the camera market.

\* \* \*

It will be useful at the outset to present the arguments on which Berkey asks us to uphold its verdict: Kodak, a film and camera monopolist, was in a position to set industry standards. Rivals could not compete effectively without offering products similar to Kodak's. Moreover, Kodak persistently refused to make film available for most formats other than those in which it made cameras. Since cameras are worthless without film, this policy effectively prevented other manufacturers from introducing cameras in new formats. Because of its dominant position astride two markets, and by use of its film monopoly to distort the camera market, Kodak



forfeited its own right to reap profits from such innovations without providing its rivals with sufficient advance information to enable them to enter the market with copies of the new product on the day of Kodak's introduction. This is one of several "predisclosure" arguments Berkey has advanced in the course of this litigation.

\* \* \*

Through the 1960s, Kodak followed a checkered pattern of predisclosing innovations to various segments of the industry. Its purpose on these occasions evidently was to ensure that the industry would be able to meet consumers' demand for the complementary goods and services they would need to enjoy the new Kodak products. But predisclosure would quite obviously also diminish Kodak's share of the auxiliary markets. It was therefore, in the words of Walter Fallon, Kodak's chief executive officer, "a matter of judgment on each and every occasion" whether predisclosure would be for or against Kodak's self-interest. Kodak decided not to release advance information about the new film and format. The decision was evidently based on the perception of Dr. Louis K. Eilers, Kodak's chief executive officer at that time, that Kodak would gain more from being first on the market for the sale of all goods and services related to the 110 system than it would lose from the inability of other photofinishers to process Kodacolor II.

Judge Frankel did not decide that Kodak should have disclosed the details of the 110 to other camera manufacturers prior to introduction. Instead, he left the matter to the jury....We hold that this instruction was in error and that, as a matter of law, Kodak did not have a duty to predisclose information about the 110 system to competing camera manufacturers.

As Judge Frankel indicated, and as Berkey concedes, a firm may normally keep its innovations secret from its rivals as long as it wishes, forcing them to catch up on the strength of their own efforts after the new product is introduced. It is the possibility of success in the marketplace, attributable to superior performance, that provides the incentives on which the proper functioning of our competitive economy rests....

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

\* \* \*

Moreover, enforced predisclosure would cause undesirable consequences beyond merely encouraging the sluggishness the Sherman Act was designed to prevent. A significant vice of the theory propounded by Berkey lies in the uncertainty of its application. Berkey does not contend, in the colorful phrase of Judge Frankel, that "Kodak has to live in a goldfish bowl," disclosing every innovation to the world at large. However predictable in its application, such an extreme rule would be insupportable. Rather, Berkey postulates that Kodak had a duty to disclose limited types of information to certain competitors under specific circumstances. But it is difficult to comprehend how a major corporation, accustomed though it is to making business decisions with antitrust considerations in mind, could possess the omniscience to anticipate all the instances in which a jury might one day in the future retrospectively conclude that predisclosure was warranted. And it is equally difficult to discern workable guidelines that a court might set forth to aid the firm's decision. For example, how detailed must the information conveyed be? And how far must research have progressed before it is "ripe" for disclosure? These inherent uncertainties would have an inevitable chilling effect on innovation. They go far, we believe, towards explaining why no court has ever imposed the duty Berkey seeks to create here.

\* \* \*

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

Clearly, then, the policy considerations militating against predisclosure requirements for monolithic monopolists are equally applicable here. The first firm, even a monopolist, to design a new camera format has a right to the lead time that follows from its success. The mere fact that Kodak manufactured film in the new format as well, so that its customers would not be offered worthless cameras, could not deprive it of that reward.

\* \* \*

## Conclusion

We have held that Kodak did not have an obligation, merely because it introduced film and camera in a new format, to make any predisclosure to its camera-making competitors. Nor did the earlier use of its film monopoly to foreclose format innovation by those competitors create of its own force such a duty where none had existed before. In awarding Berkey \$15,250,000, just \$828,000 short of the maximum amount demanded, the jury clearly based its calculation of lost camera profits on Berkey's central argument that it had a right to be "at the starting line when the whistle blew" for the new system. The verdict, therefore, cannot stand.

## Case Questions

1. Consider patent law. Did Kodak have a legal monopoly on the 110 system (having invented it) for seventeen years? Did it have any legal obligation to share the technology with others?
2. Might it have been better business strategy to give predisclosure to Berkey and others about the necessary changes in film that would come about with the introduction of the 110 camera? How so, or why not? Is there any way that some sort of predisclosure to Berkey and others would maintain or sustain good relations with competitors?

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