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# ANTITRUST: MARKET DEFINITION, THE SECTION 2 OFFENSES AND LITERALISM

MARK R. LEE\*

Four major antitrust disputes reached the Seventh Circuit during the 1979-80 term. They raised difficult questions relating to market definition and section 2 offenses. The court resolved the disputes, of course, but it fundamentally failed to come to grips with the difficult questions they raised. It had the power to do the former, but lacked the clear conception of the antitrust laws needed to do the latter.

## DEFINING THE RELEVANT MARKET: *UNITED STATES V. HOUSEHOLD FINANCE CORP.*

In late 1978, Household Finance Corporation,<sup>1</sup> the nation's largest independent consumer finance company, agreed to acquire one of its lesser rivals, the American Investment Company.<sup>2</sup> Shortly thereafter, the Department of Justice filed suit to enjoin the merger as violative of section 7 of the Clayton Act.<sup>3</sup> The government claimed that the relevant product market ("line of commerce" in section 7 terms) in which to gauge the effects of the merger was the making of direct cash loans by finance companies in various cities in which both HFC and AIC did business.<sup>4</sup> It further claimed that the likely effect of the merger, so gauged, would be to substantially reduce competition.<sup>5</sup> HFC challenged only the first claim. The parties stipulated that if the court were persuaded to adopt the Government's definition of the market, the merger was to be enjoined; if the court were persuaded to reject the Government's definition, the suit was to be dismissed.<sup>6</sup>

\* Assistant Professor of Law, Southern Illinois University Law School. The author gratefully acknowledges the thorough editing of Elaine D. Edelman. Portions of the article may still lack clarity, but that is due solely to the author's stubborn refusal to follow her advice.

1. Hereinafter referred to as HFC.

2. Hereinafter referred to as AIC.

3. 15 U.S.C. § 18 (1976). Section 7 provides, in pertinent part:  
No corporation engaged in commerce shall acquire . . . the stock . . . of another corporation . . . where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

4. Complaint, Appendix on Appeal at 14, *United States v. Household Fin. Corp.*, 602 F.2d 1255 (7th Cir. 1979), *cert. denied*, 444 U.S. 1044 (1980).

5. *Id.*

6. Stipulation, Appendix on Appeal at 29-30, *United States v. Household Fin. Corp.*, 602 F.2d 1255 (7th Cir. 1979), *cert. denied*, 444 U.S. 1044 (1980).

At trial the Government's efforts were directed at establishing the existence of a group of credit applicants, sharing particular financial characteristics, who would be accepted by finance companies but rejected, as too risky, by credit unions,<sup>7</sup> commercial banks, savings and loan associations and major credit-granting retailers.<sup>8</sup> The Government apparently presumed that this group of higher-risk applicants was accepted by finance companies because the companies were permitted to charge and, in fact, did charge higher interest rates than the other suppliers of consumer credit.<sup>9</sup> By virtue of the existence of this group, argued the government, finance companies were insulated from what would otherwise have been their competition. The selling of consumer credit, it contended, was "risk segmented." Therefore, the Government concluded, direct cash loans by finance companies constituted the relevant product market.

The trial judge, Frank J. McGarr, was not persuaded.<sup>10</sup> He found that the interest rates and credit practices of consumer finance companies were sharply constrained by the need to compete with other suppliers of consumer credit.<sup>11</sup> They were particularly constrained by credit unions, which had expanded their membership dramatically in the preceding decade,<sup>12</sup> and commercial banks, which were offering borrowers credit cards and overdraft privileges on checking accounts as well as conventional loans.<sup>13</sup> He perceived no significant risk segmentation.<sup>14</sup> Indeed, Judge McGarr seemed to think that finance companies were not so much insulated from the competition as they were succumbing to it.<sup>15</sup> The relevant product market, he concluded, was

7. The Government also contended that many higher-risk credit applicants were ineligible for credit union membership. Brief for Appellant at 18, *United States v. Household Fin. Corp.*, 602 F.2d 1255 (7th Cir. 1979), *cert. denied*, 444 U.S. 1044 (1980). The Government's contention was based on the fact that only 50% of the adult population of the United States belonged to credit unions. From this fact the Government inferred, erroneously, that 50% of all consumer credit customers—including, presumably, many higher-risk credit applicants—lack access to a credit union. The Government erred by assuming that all adults were consumer credit customers. It also erred by assuming that those who were not credit union members were ineligible for membership.

8. Complaint, Appendix on Appeal at 10-11, *United States v. Household Fin. Corp.*, 602 F.2d 1255 (7th Cir. 1979), *cert. denied*, 444 U.S. 1044 (1980).

9. *Id.* The higher rates, in the Government's view, permitted the finance companies to bear the higher costs of loaning money to higher-risk credit applicants.

10. Findings of Fact and Conclusions of Law 1-19, *United States v. Household Fin. Corp.*, No. 79 C 80 (N.D. Ill. Mar. 22, 1979).

11. *Id.* at 4-5, 7-8, 10-14, 16.

12. *Id.* at 10-11.

13. *Id.* at 10.

14. *Id.* at 13-14.

15. *Id.* at 7-8.

consumer installment credit.<sup>16</sup> Accordingly, he dismissed the suit with prejudice in accordance with the parties' stipulation.

The Seventh Circuit reversed.<sup>17</sup> After studying the Government's rather weak evidence,<sup>18</sup> the court was somehow persuaded of the existence of the group of higher-risk credit applicants.<sup>19</sup> It did not pause over the trial judge's findings, which it considered largely correct,<sup>20</sup> but

16. *Id.* at 16-17.

17. 602 F.2d 1255 (7th Cir. 1979), *cert. denied*, 444 U.S. 1044 (1980).

18. To prove its contention that there existed a group of higher-risk credit customers served only by finance companies, the Government introduced studies which purportedly showed (1) that 20% to 50% of all finance company customers were ineligible for commercial bank loans; (2) that finance companies experienced higher delinquency and charge-off rates than commercial banks; and (3) that finance company borrowers had a lower average income and were more likely to hold blue-collar jobs than commercial bank borrowers. 602 F.2d at 1263-65.

These studies had limited probative value. The eligibility studies could not support strong inferences about all finance company customers because they were based on non-representative surveys. For example, one of them was based on a survey of the customers at a one-office finance company located in rural Pennsylvania which had loans outstanding in the amount of only \$1 million. *Id.* at 1264; Appellant's Supp. Appendix 4a (testimony of William Whitesell), *United States v. Household Fin. Corp.*, 602 F.2d 1255 (7th Cir. 1979), *cert. denied*, 444 U.S. 1044 (1980).

The studies of comparative delinquency and charge-off rates did little to bolster the Government's case since the Government failed to show that the rate differences they revealed were (a) statistically significant and (b) explainable only in terms of the existence of a group of higher-risk credit customers served only by finance companies. *See generally* Finkelstein, *Regression Models in Administrative Proceedings*, 86 HARV. L. REV. 1442 (1973). (The exercise of differing judgments by commercial bank and finance company loan officers, influenced no doubt by different regulatory environments, for example, could have produced the rate differences.) Moreover, these studies generated data inconsistent with that generated by studies performed by the defendants. The defendants' studies showed that finance companies experienced identical delinquency rates and marginally higher charge-off rates than did commercial banks. *Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit 11, n.1, United States v. Household Fin. Corp.*, 602 F.2d 1255 (7th Cir. 1979), *cert. denied*, 444 U.S. 1044 (1980).

The demographic studies of borrower income and job characteristics did not advance the Government's position at all since the Government did not show, and probably could not have shown, that such characteristics were related to risk. A relatively high-income executive who has purchased substantial commodity futures on a margin account could represent a greater loan risk than a relatively low-income assembly line worker who holds significant equity in his house and is otherwise free of debt. Besides, the studies showed that commercial banks served more total customers in every income and job group than did finance companies. *Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit 30, United States v. Household Fin. Corp.*, 602 F.2d 1255 (7th Cir. 1979), *cert. denied*, 444 U.S. 1044 (1980).

Even if all the studies introduced by the Government were granted more weight than they deserved, they would tend to show merely that there existed a group of higher-risk credit customers served by finance companies who could not obtain ordinary commercial bank loans. That group of customers might have been able to obtain credit from commercial banks, through overdraft privileges on checking accounts or bank credit cards, or from credit unions, savings and loan associations, and major credit-granting retailers. The Government thus failed to prove its contention, but the Seventh Circuit accepted it anyway.

19. 602 F.2d at 1265.

20. *Id.* at 1260. The only two findings which the Seventh Circuit deemed unsupported were (1) "that a significant percentage of finance company customers are eligible for or actually have non-mortgage loans at banks" and (2) "that a majority of the customers of consumer finance companies have bank credit cards." *Id.* at 1263. As to the first finding, the court was clearly wrong. *See* note 29 *infra*. As to the second finding, the court admitted that there was some supporting evidence. It was simply persuaded by the contrary evidence. 602 F.2d at 1263. Moreover,

essentially irrelevant.<sup>21</sup> In fact, in the court's view, those findings actually supported the proposition that such a group existed.<sup>22</sup> Judge McGarr erred, opined the court, by failing to appreciate the controlling importance of that fact.<sup>23</sup> The mere existence of the group, held the Seventh Circuit, proved that the relevant product market was direct cash loans made by finance companies.<sup>24</sup>

The court's holding was economically naive and legally unsound. It revealed not only the Seventh Circuit's inability to grasp the concept of the relevant market, but also the court's poor understanding of the function of the antitrust laws since that concept and function are intimately related. Moreover, the decision practically invited the Department of Justice to pursue a merger policy far too restrictive for the well-being of the consuming public.

To see where the court went wrong, one must understand the concept of the relevant market in the context of antitrust litigation. Antitrust litigation is ultimately about the predicted and observed effects of all sorts of business activities on the production and consumption decisions of others. It is only by assessing such effects that a court can determine whether a particular business activity will, on balance, frustrate or promote the purpose of the antitrust laws. The purpose of those laws, put simply, is to secure for the general public the benefits of competition: the highest output and lowest prices consistent with optimal resource allocation.<sup>25</sup> In any given case, however, the court cannot practically consider all the effects of the activity challenged. It must

there certainly was evidence that a majority of the customers of consumer finance companies were eligible for bank credit cards. Defendant's Supplemental Appendix on Appeal at 11. One of the Government's own witnesses, John Reed, then a vice-president of Citicorp, testified that he thought about 80% of the customers of Citicorp's consumer finance subsidiary, Nationwide Finance Co., would be eligible for a VISA or MasterCard card. *Id.*

21. 602 F.2d at 1260, 1263.

22. *Id.* at 1260-63, 1265. As the court put it, "[t]he thrust of the [trial judge's] conclusion, thus, is that although concededly some customers are uniquely served by finance companies, the number of such customers is insignificant." *Id.* at 1260. That was a misrepresentation. The trial judge assumed, *arguendo*, that some customers were uniquely served by finance companies. He did not determine whether there were many or few such customers. Their number had little significance for the purpose of defining the market. See notes 26-40 and accompanying text *infra*.

23. "We think, however, that whether the group of customers uniquely served by finance companies is significant enough to constitute a line of commerce within § 7 is a legal question." 602 F.2d at 1260 n.7. "The issue, however, is not whether there is a total division between the types of customers of banks and finance companies but whether, notwithstanding any overlap in customer bases, finance companies service some customers unable to obtain bank credit." *Id.* at 1264 n.12. "Indeed, even if these customers constituted a far lesser percent [less than 15%] of the finance company clientele, we would still find that group significant." *Id.* at 1265.

24. *Id.* at 1265.

25. R. BORK, *THE ANTITRUST PARADOX* 50-90 (1978) [hereinafter cited as BORK]; R. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* 8-22 (1976) [hereinafter cited as POSNER]. See *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 53 n.21 (1977). *But see* Blake &

limit the scope of its inquiry to some manageable portion of the economy. That manageable portion is, for antitrust purposes, the relevant market.

Defining the relevant market is critical to principled decision-making in antitrust cases. If the market is defined too narrowly or too broadly, the effects of the challenged activity are likely to be misperceived. The defendant's capacity for doing antitrust mischief will appear either too great or too small and a court may be misled into preventing useful business activity or permitting the pernicious kind. How one chooses between segments of the economy which should be considered and those which can safely be ignored depends on the effects about which one is most concerned. The choice is, in the final analysis, a matter of policy. The antitrust laws dictate that one be most concerned about output restrictions coupled with price increases. The relevant market should be defined, therefore, so that it includes all participants in the economic system who may exert a substantial check on the defendant's ability to bring about just such effects.<sup>26</sup>

The definition of the relevant market was all important in the trial of *United States v. Household Finance Corp.* since the parties had agreed that the outcome of the case would turn on it. Thus, the real issue was whether institutions offering alternative sources of consumer credit exerted a substantial check on the power of finance companies to restrict credit and raise interest rates for the group of higher-risk credit applicants, assuming it existed.

The trial judge apparently resolved that issue in the negative when he found no *significant* risk segmentation among alternative sources of consumer credit.<sup>27</sup> Substantial evidence, uncontested for the most part, buttressed his finding. First, two studies specifically designed to test the risk segmentation hypothesis showed that, on the basis of information upon which credit worthiness is usually determined, it was quite difficult to predict which borrowers would become bank patrons and which finance company customers.<sup>28</sup> Second, an analysis of the credit "scor-

Jones, *In Defense of Antitrust*, 65 COLUM. L. REV. 377 (1965); Blake & Jones, *Toward a Three-Dimensional Antitrust Policy*, 65 COLUM. L. REV. 422 (1965).

26. POSNER, *supra* note 25, at 125-30; Telex Corp. v. International Business Machines Corp., 510 F.2d 894, 914-19 (10th Cir. 1975), *cert. dismissed*, 423 U.S. 802 (1975). See generally Brown Shoe Co. v. United States, 370 U.S. 294, 325 and n.42 (1962); United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 392-93 (1956).

27. Findings of Fact and Conclusions of Law at 14, United States v. Household Fin. Corp., No. 79 C 80 (N.D. Ill. Mar. 22, 1979).

28. 602 F.2d at 1261. One of the studies was published. See Boczar, *Competition Between Banks and Finance Companies: A Cross Section Study of Personal Loan Debtors*, 33 J. FINANCE 245 (1978).

ing" system of banks and finance companies revealed little difference between the two.<sup>29</sup> Third, evaluations of the loan applications of would-be finance company customers demonstrated that many, if not most, of those individuals had obtained credit or were eligible to obtain it from other institutions.<sup>30</sup> Fourth, official reports about the consumer installment credit market indicated that commercial banks, credit unions, and savings and loan associations had been expanding their share largely at the expense of finance companies.<sup>31</sup> Fifth, and finally, a comparison of banks and finance companies showed that their interest rates were converging and their credit practices becoming more alike.<sup>32</sup> Unfortunately, the trial judge did not explain how these five items supported his finding that there was no significant risk segmentation. He did not explain how they proved that institutions offering alternative sources of consumer credit did exert a substantial check on the power

29. Findings of Fact and Conclusions of Law at 14, *United States v. Household Fin. Corp.*, 79 C 80 (N.D. Ill. Mar. 22, 1979); 602 F.2d at 1262. The credit scoring systems of HFC, Security Pacific Bank and the VISA Division of the First National Bank of Chicago were analyzed by comparing the actual disposition of loan applications at an HFC office with the dispositions which would have been made at the offices of the other two institutions. Defendant's Supplemental Appendix on Appeal at 220-30. The HFC office actually accepted 40% of the applications. The Security Pacific Bank's office would have accepted 56% of them (including 49% of those HFC rejected) and the VISA Division of First National Bank of Chicago's office would have accepted 35% of them.

The Seventh Circuit badly misconstrued this analysis. The court seemed to think that the acceptance rates of Security Pacific Bank and the VISA Division of First National Bank of Chicago measured the number of loan applications they would have accepted of those already accepted by HFC. 602 F.2d at 1262.

30. Findings of Fact and Conclusions of Law at 14, *United States v. Household Fin. Corp.*, 79 C 80 (N.D. Ill. Mar. 22, 1979). For example, HFC studied the loan applications submitted by would-be borrowers at one of its offices during a period shortly preceding the trial of this case. Defendant's Supplemental Appendix on Appeal at 188-91, *United States v. Household Fin. Corp.*, 602 F.2d 1255 (7th Cir. 1979), *cert. denied*, 444 U.S. 1044 (1980). Many applicants were *then in debt* to other financial institutions, but the majority were not. *Id.* On the basis of this study, the Seventh Circuit concluded that a majority of finance company customers *could not obtain credit* from other financial institutions. 602 F.2d at 1263.

31. Findings of Fact and Conclusions of Law at 5-8, *United States v. Household Fin. Corp.*, 79 C 80 (N.D. Ill. Mar. 22, 1979). The following table illustrates the trend:

	Percentage of Consumer Installment Credit Held by Various Institutions	
	1967	Oct., 1978
Commercial Banks	41.7%	49.9%
Finance Companies	30.9	19.6
Credit Unions	11.3	16.8
Retailers	14.5	8.5
Others	1.5	5.2

*Id.* at 6.

32. Findings of Fact and Conclusions of Law at 13, *United States v. Household Fin. Corp.*, 79 C 80 (N.D. Ill. Mar. 22, 1979).

of finance companies to restrict credit and raise interest rates for the group of higher-risk credit applicants.

The relevance of the supporting evidence becomes clearer if we engage in an intellectual simulation. Suppose that the local HFC/AIC office is the only finance company outlet in a particular metropolitan area. Its exclusivity will be preserved for the foreseeable future by government-erected barriers to entry. No finance company, therefore, could be in any better position to extract supracompetitive interest rates from the customer group of which the Department of Justice made so much in *United States v. Household Finance Corp.* Of course, even such a well-situated office would not "exploit" that group unless doing so were profitable. So let us further suppose that that group's demand for finance company loans is elastic enough at competitive interest rates so that "exploitation" would pay.<sup>33</sup> Now consider the rate setting strategies theoretically available to the profit-maximizing manager. There are two.

The manager could attempt to charge higher-risk credit applicants an interest rate which exceeded the rate he charged other customers by proportionately more than the difference in the costs of servicing the two groups.<sup>34</sup> The problem with this "discrimination strategy" lies in the discriminating. The manager would have to identify higher-risk credit applicants at the time they applied. The evidence of record suggests that he might not be able to do that. The results of the two studies designed to test the risk segmentation hypothesis suggest that effective discrimination may be impossible. It may be inferred, at least, that the practice is far too costly to be profitable since no financial institution apparently engages in it. No evidence was introduced to show that banks engage in it and finance companies use the same credit scoring "systems" as banks do. Indeed a survey of finance company offices in St. Louis, Missouri, and Carbondale, Illinois, conducted by the author and his brother unearthed not one finance company which sets different interest rates for customers with different risk-related characteristics.

If discrimination were not feasible, the manager could try the al-

33. Elasticity of demand may be defined as the percentage change in the quantity demanded of a good or service in response to a one percent change in the price of that good or service. Unless the group's demand for finance company loans was elastic enough at competitive interest rates, raising the interest rate for that group would not pay since its demand would decline by proportionately more than the rate rise.

34. If the difference in rates was proportional to the difference in costs, then the higher rate would be no more supracompetitive than the lower. See generally Dam, *The Economics and Law of Price Discrimination: Herein of Three Regulatory Schemes*, 31 U. CHI. L. REV. 1 (1963).



ternative strategy of setting a supracompetitive interest rate for all his customers. The problem with this “exorbitant rate strategy” is that it might not pay. Some potential customers belonging to the lower-risk group might curtail their borrowing or, more likely, take their business elsewhere. If enough of them did, the revenues foregone as a result of reduced lending might exceed the revenues generated by charging each borrower more. Whether the “exorbitant rate strategy” would pay would depend on the elasticity of demand for finance company loans and the size of each risk group. The evidence of record relating to those two factors suggests that it would not pay. It is clear from the credit experience and eligibility of finance company loan applicants that members of the lower-risk group have alternative sources of credit readily available to them. Judging from the steady erosion in the share of the consumer installment credit market held by finance companies, it appears that they have been turning to those sources with increasing frequency. It therefore seems reasonable to infer that this group’s demand for finance company loans is strongly inelastic. Moreover, the credit experience and eligibility data indicate that the lower-risk group is relatively large, and the market share data leaves the impression that the group is growing. The bigger the lower-risk group and the more inelastic its demand, the greater would be the reduction in lending associated with the “exorbitant rate strategy.” The greater the reduction in lending, of course, the less likely it is that setting a supracompetitive interest rate for all customers would pay.

The evidence seems to show that neither “exploitation” strategy theoretically available to our manager would work. If they would not work for him, they would certainly not work for the manager of a finance company less ideally situated than the one in our simulation. Discrimination apparently would be impractical. More importantly for the purposes of this analysis, setting an exorbitant interest rate seemingly would not pay, primarily because of the availability of alternative sources of credit. What that demonstrates is that banks, credit unions, savings and loan associations and major credit-granting retailers do exert a substantial check on the ability of finance companies to restrict credit and raise interest rates for the higher-risk customer group.

As the evidence in light of the simulation therefore shows, finance companies did belong in the same market with the other financial institutions. All of them competed. That was borne out by the convergence of their interest rates and the similarity of their credit practices.<sup>35</sup> If

35. The Seventh Circuit noted that the Supreme Court had stated in *United States v. Phila-*

any risk segmentation existed it was certainly not significant for the purposes of section 7. As in any line of commerce, the competition among firms was for the marginal customers, in this instance lower-risk credit applicants. Absent discrimination, that competition protected the customers with more elastic demands from "exploitation."<sup>36</sup>

The Seventh Circuit ignored this entire line of analysis. In fact, it never addressed the real issue in the case. For it, the existence of the higher-risk group served only by finance companies marked the end rather than beginning of the inquiry into the relevant market.<sup>37</sup> If the group existed—and the court was clearly persuaded that it did—then finance companies belonged in a separate market.<sup>38</sup>

This holding cannot be squared with the decisions of the Supreme Court in leading market definition cases. For example, in *United States v. E.I. du Pont de Nemours & Co.*,<sup>39</sup> the justices found that the product market in which to gauge the defendant's power was flexible wrapping materials rather than cellophane, even though some wrap users such as cigarette manufacturers used the relatively expensive cellophane almost exclusively.<sup>40</sup> Unmoved by such precedent the Seventh Circuit maintained that it was simply following the "rule" that: "a financial institution comprises a separate product market if it offers to a 'significant' number of consumers a 'cluster of products and services' that competing financial institutions do not."<sup>41</sup> This "rule," believed the court, had been established by the Supreme Court in a series of bank merger cases, *United States v. Philadelphia National Bank*,<sup>42</sup> *United States v. Phillipsburg National Bank*,<sup>43</sup> and *United States v. Connecticut National Bank*.<sup>44</sup> A close reading of the opinions in those cases, however, reveals that the court was mistaken; there was no such "rule." It also reveals that the court's holding was quite erroneous.

delphia Nat'l Bank, 374 U.S. 321, 356-57 (1963) and in *United States v. Phillipsburg Nat'l Bank*, 399 U.S. 350, 361 n.4 (1970) that banks did not compete with finance companies. 602 F.2d at 1259-60. But that was factual dicta and it was based on data decades old. It should not have been considered controlling.

36. See generally M. HANDLER, H. BLAKE, R. PITOFKY & H. GOLDSCHMID, CASES AND MATERIALS ON TRADE REGULATION 283-86 (1975).

37. 602 F.2d at 1260 n.7, 1265.

38. *Id.* at 1265.

39. 351 U.S. 377 (1956).

40. *Id.* at 399-401. See also *United States v. Continental Can Co.*, 378 U.S. 441 (1964). In that case, which was otherwise poorly decided, the Supreme Court held that although glass and metal containers were used exclusively for some different purposes, both were part of the same market. *Id.* at 450.

41. 602 F.2d at 1258.

42. 374 U.S. 321 (1963).

43. 399 U.S. 350 (1970).

44. 418 U.S. 656 (1974).

The *Philadelphia Bank* case arose out of the merger of the second and third largest commercial banks in metropolitan Philadelphia. The Government challenged the merger under section 7 as likely to substantially reduce competition in commercial banking. In defense the banks argued, *inter alia*, that the Government had exaggerated the negative impact of the merger by defining the relevant market too narrowly. The banks contended that they were locked in economic battle with all kinds of other financial institutions, ranging from savings and loan associations to insurance companies. Siding with the Government on this issue, the trial judge found that commercial banks offered a distinct cluster of products and services, including checking and trust administration, which no other financial institutions offered.<sup>45</sup> It is useful to note that, in sharp contrast, the trial judge in *United States v. Household Finance Corp.* found that finance companies offered the same product, consumer installment credit, as did a number of other firms, albeit under somewhat different conditions, on somewhat different terms, and at somewhat different interest rates.<sup>46</sup>

On appeal in *Philadelphia Bank* the Supreme Court agreed with the trial judge's disposition of the relevant market issue.<sup>47</sup> It did not, however, announce a special rule for determining the boundaries of the market in section 7 cases involving financial institutions. The Justices made it quite clear that they were simply applying standard market-definition tests<sup>48</sup> which are responsive to the need to control output restrictions coupled with price increases.<sup>49</sup> Thus, the finding that commercial banks offered a distinct cluster of products and services which other financial institutions did not offer was not independently significant. It was significant only in that it indicated that other financial institutions did not exert a substantial check on the power of commercial banks to restrict their banking activities and increase the average price of the cluster of products and services that they offered. Commercial banks, therefore, belonged in a separate market. Recall that when the same standard tests were applied to the facts of *United States v.*

45. *United States v. Philadelphia Nat'l Bank*, 201 F. Supp. 348, 360-63 (E.D. Pa. 1962).

46. The Seventh Circuit incorrectly perceived those differences as indicia of separate markets. It failed to appreciate that a "market is composed of products that have reasonable interchangeability (credit is perhaps the most interchangeable of products) for the purposes for which they are produced—*price, use and qualities considered.*" *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 404 (1956) (emphasis added).

47. 374 U.S. 321, 356 (1963). The Supreme Court disagreed with the trial judge's determination that § 7 was inapplicable, his definition of the geographic market, and his prediction about the likely effects of the merger. It, therefore, reversed. *Id.* at 357-72.

48. *Id.* at 355-56.

49. See note 26 *supra*.

*Household Finance Corp.*, it became clear that finance companies did not belong in a separate market.

Similar market definition issues were raised in the *Phillipsburg Bank* and *Connecticut Bank* cases. Each arose out of a merger between commercial banks that the Government challenged on the same theory that it had successfully used in *Philadelphia Bank*. The banks pressed the same “we-compete-with-other-financial-institutions” argument that had been rejected in *Philadelphia Bank*. Each contended for its own reasons that the argument should be accepted in its case. In the *Phillipsburg Bank* case, the banks marshalled evidence to prove that their operations were much more akin to those of savings and loan associations than were the operations of the banks involved in *Philadelphia Bank*.<sup>50</sup> The Supreme Court nonchalantly dismissed the evidence,<sup>51</sup> drawing a withering dissent from Justice Harlan.<sup>52</sup> For the purpose of this analysis, however, the opinion contained nothing of importance.

In the *Connecticut Bank* case, the banks pointed out that signal changes in the regulations limiting the types of services financial institutions could offer had dramatically altered the competitive environment since *Philadelphia Bank*.<sup>53</sup> Again, the Supreme Court was not persuaded, although it acknowledged the changes pointed out by the banks. The key fact, as far as the Court was concerned, was that the banks still offered to commercial customers a distinct cluster of services which other financial institutions did not offer.<sup>54</sup> For example, under the applicable state statute, only banks could offer checking to such customers.<sup>55</sup> Reliance on this fact, however, did not reflect a special rule for determining whether a particular kind of financial institution belonged in a market all by itself. Rather, it showed that the Supreme Court was once again applying standard market-definition tests. This fact was important because it indicated that, if banks could readily differentiate between commercial and non-commercial customers, their power to “exploit” the commercial customers would not be limited by other financial institutions. Obviously, differentiating between commercial and non-commercial customers, unlike differentiating between “higher-risk” and “lower-risk” credit applicants, was not only possible,

50. 399 U.S. at 380-81 (Harlan, J., dissenting in part & concurring in part).

51. *Id.* at 359-60.

52. *Id.* at 373-82 (Harlan, J., dissenting in part & concurring in part).

53. 418 U.S. at 661-63.

54. *Id.* at 664.

55. *Id.* at 665, 665 n.6.

but probably easy. It followed, therefore, that commercial banks, unlike finance companies, belonged in a separate market.

In short, the "rule" that the Seventh Circuit applied in *United States v. Household Finance Corp.* was one of its own invention. Had it carefully examined the cases which it believed established the "rule," it would have arrived at a contrary holding.

The result of the Seventh Circuit's erroneous holding was that a merger which should have been permitted was prevented. Even if the parties had not stipulated that the outcome of the case would turn on the definition of the market, the same result would probably have been reached because of the judicial gloss given section 7 in the *Philadelphia Bank* case.

In that case, the Supreme Court held:

[A] [horizontal] merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.<sup>56</sup>

What that means in practice is easy to discern. If, in a section 7 case, the Government persuades the trial judge to define the market narrowly enough, the emerged firm and the resulting increase in concentration will appear sizeable. The merger will then almost surely be enjoined because the defendants will probably be unable to rebut the *Philadelphia Bank* presumption. They will probably be unable to do so because it is so difficult to prove what the effects of a horizontal merger are likely to be.<sup>57</sup>

The reason that this is so difficult to prove is that horizontal mergers may have so many effects. Horizontal mergers always reduce the number of competitors in a market by one. That reduction may make it somewhat easier for the remaining firms to collude, expressly or tacitly, to restrict output and raise prices. That danger is the one at which section 7 is directed.<sup>58</sup> If that were the only effect of horizontal mergers, all of them would be illegal. But horizontal mergers may have the opposite effect. Emerging firms may be more efficient, effective competitors than their corporate predecessors by virtue of either economies of scale or superior management. Finally, to add to the complexity,

56. 374 U.S. at 363.

57. It is difficult, but not impossible. See *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974); *United States v. International Harvester Co.*, 564 F.2d 769 (7th Cir. 1977).

58. POSNER, *supra* note 25, at 96-97.

horizontal mergers may have no net effect on consumer welfare. Rather, their principal effect may be on the balance sheet of those who promoted them or on the tax returns of the acquired firm's shareholders.

Since it is arduous work to persuade the trier of fact which effects are likely to predominate, the outcome in any particular case will depend largely on which side bears the burden of doing so. That burden normally rests with the Government. *Philadelphia Bank*, however, places that burden on the defendants once the Government makes a statistical showing regarding the size of the emerged firm and the resulting increase in concentration. The narrower the market definition the easier it is for government lawyers to make that statistical showing and win their cases.

The Seventh Circuit's decision in *United States v. Household Finance Corp.* will make it far easier for government lawyers to secure improperly narrow market definitions. It will therefore encourage them to pursue an overly restrictive merger policy. That policy will deter or undo mergers likely to promote consumer welfare. The irony, unfortunately, is manifest.

## SECTION 2 OFFENSES: THE REQUISITE CONDUCT AND "INTENT"

A monopolist, as any first-semester economics student can tell you, will find it profitable to raise his price above and restrict his output below levels that would prevail in his industry if it were competitively structured.<sup>59</sup> The impact of this strategy on the welfare of consumers is all too predictable. Consider the high price first. Some consumers will balk at the monopolist's price and do without his product even though they would be quite willing to pay a price equal to, or even somewhat in excess of, the marginal cost of meeting their demand.<sup>60</sup> Now consider the restriction of output, the impact of which will be less direct but probably more significant. Since the monopolist will be producing less, he will need fewer resources. The unneeded resources will either lie idle or they will be employed in another industry to produce a good or service of less marginal value to consumers than that which the monopolist might have produced.<sup>61</sup> In either event, they will yield less total satisfaction than they otherwise would, much to the detriment of

59. See F. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 13-19 (1970).

60. BORK, *supra* note 25, at 98-101.

61. *Id.* "Value" refers to what consumers are willing to pay. *Id.*

the consuming public. This inefficiency in allocation is one of the evils against which section 2 of the Sherman Act is directed.<sup>62</sup>

Yet courts have been reluctant to interpret section 2 as prohibiting "monopoly in the concrete."<sup>63</sup> That reluctance has been based in part, no doubt, on the language of the statute, which speaks of "[e]very person who shall monopolize, or attempt to monopolize,"<sup>64</sup> and its legislative history.<sup>65</sup> Primarily, however, courts have been reluctant to interpret section 2 as prohibiting "monopoly in the concrete" because they have recognized that such an interpretation would have the perverse effect of discouraging efficiency in production.<sup>66</sup> A relatively large, successful firm would have to avoid producing too efficiently lest it grow and thereby transgress section 2. The resulting injury to the consuming public could be just as great as that caused by a monopolist's pricing/output strategy.

In response to this conundrum, courts have interpreted section 2 as condemning only those monopolists and would-be monopolists who behave "badly."<sup>67</sup> Distinguishing "bad" business behavior from "good," unfortunately, has proved no simple task. Even the most learned judges, like Hand and Wyzanski, have stumbled.<sup>68</sup> The Supreme Court's hackneyed formulations, like "the willful acquisition or maintenance of [monopoly] power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident,"<sup>69</sup> have provided little guidance.<sup>70</sup> Nor has characterizing the defendant's "specific intent," generally said to be a sepa-

62. See *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 53 n.21 (1977). *But see* Blake & Jones, *In Defense of Antitrust*, 65 COLUM. L. REV. 377 (1965); Blake & Jones, *Toward a Three-Dimensional Antitrust Policy*, 65 COLUM. L. REV. 422 (1965).

63. *Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1, 62 (1911); *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 273 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980).

64. 15 U.S.C. § 2 (1976).

65. See Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J. LAW & ECON. 7 (1966).

66. 603 F.2d at 273; *In re E.I. duPont de Nemours & Co.*, F.T.C. No. 9108, ANTITRUST & TRADE REG. REP. (BNA) No. 987 (Oct. 30, 1980) F-1, F-9, F-11; *United States v. Aluminium Co. of America*, 148 F.2d 416, 427 (2d Cir. 1945). See BORK, *supra* note 25, at 90-106.

67. 603 F.2d at 273-76; *Telex Corp. v. International Business Machines Corp.*, 510 F.2d 894, 919 (10th Cir.), *cert. dismissed*, 423 U.S. 802 (1975).

68. See BORK, *supra* note 25, at 164-75; *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945) (Hand, J.); *United States v. United Shoe Machinery Corp.*, 110 F. Supp. 295 (D. Mass. 1953) (Wyzanski, J.), *aff'd per curiam*, 347 U.S. 521 (1954).

69. *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966).

70. See, e.g., *Telex Corp. v. International Business Machines Corp.*, 367 F. Supp. 258 (N.D. Okla. 1973), *rev'd*, 510 F.2d 894 (10th Cir.), *cert. dismissed*, 423 U.S. 802 (1975); *In re E.I. duPont de Nemours & Co.*, F.T.C. No. 9108, ANTITRUST & TRADE REG. REP. (BNA) No. 987 (Oct. 30, 1980) F-1, F-7.

rate element of attempting to monopolize,<sup>71</sup> proved particularly helpful in evaluating business behavior. It has not been helpful for three reasons. First, evaluating a defendant's business behavior on the basis of his "specific intent" involves blatant bootstrapping because the latter is almost always inferred from the former. Second, the metaphysics of ascribing a state of mind to a corporation is problematic.<sup>72</sup> Third, and most importantly, it is not at all clear what a defendant might "specifically intend" to do that should be considered wrongful. After all, every competitively energetic firm intends to prevail over its actual or potential rivals.<sup>73</sup>

Perhaps these analytical difficulties were inevitable. By focusing on conduct and, to some extent "specific intent," judges have not so much solved the section 2 conundrum as they have recast it in the language of traditional Anglo-American jurisprudence. They must still be concerned about economics. Indeed, no principled judge could determine what a firm may or may not do under section 2, without reference to the effects of its conduct on allocative and productive efficiency. That is why Professor Bork has argued that "bad" business behavior be defined as behavior which could not be profit-maximizing unless the firm engaging in it expected that by doing so it would (1) drive its rivals from the market, leaving it with a share sufficient to command monopoly profits or (2) chasten its rivals into abandoning their competitive behavior.<sup>74</sup>

In any event, when a court classifies particular business behavior as "bad" or "predatory," it reveals the extent of its understanding of the purpose of section 2. That is exactly what the Seventh Circuit did in *Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.*,<sup>75</sup> *City of Mishawaka v. American Electric Power Co.*,<sup>76</sup> and *Photovest Corp. v. Fotomat Corp.*<sup>77</sup> Let us consider them seriatim.

71. *Swift & Co. v. United States*, 196 U.S. 375 (1905); *Cooper, Attempts and Monopolization: A Mildly Expansionary Answer to the Prophylactic Riddle of Section Two*, 72 MICH. L. REV. 373 (1974).

72. See generally *State v. Adjustment Dept. Credit Bureau, Inc.*, 94 Ida. 156, 483 P.2d 687 (1971); *Commonwealth v. Beneficial Fin. Co.*, 360 Mass. 188, 275 N.E.2d 33 (1971), cert. denied, 407 U.S. 914 (1972); Model Penal Code § 2.07 (Proposed Official Draft 1962).

73. P. AREEDA & D. TURNER, 3 ANTITRUST LAW 76 (1978) [hereinafter cited as AREEDA & TURNER]. See *Telex Corp. v. International Business Machines Corp.*, 510 F.2d 894, 925-26 (10th Cir.), cert. dismissed, 423 U.S. 802 (1975).

74. BORK, *supra* note 25, at 144. Complaint counsel in *In re E.I. duPont de Nemours & Co.*, apparently adopted Professor Bork's definition. ANTITRUST & TRADE REG. REP. (BNA) No. 987 (Oct. 30, 1980) F-1, F-5.

75. 615 F.2d 427 (7th Cir. 1980).

76. 616 F.2d 976 (7th Cir. 1980).

77. 606 F.2d 704 (7th Cir. 1979), cert. denied, 100 S. Ct. 1278 (1980).



*Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.*:  
"Predatory Pricing"

For some time prior to spring, 1973, Martin Marietta Corporation had encountered little competition in the Chillicothe, Illinois, market for "CA-6," a coarse, unwashed gravel used primarily in the construction of roads, parking lots and driveways.<sup>78</sup> It was then that the Chillicothe Sand & Gravel Company ("CS&G") opened for business. During the first two years of its existence, CS&G captured an ever-growing share of the market by underpricing Martin Marietta. When Martin Marietta finally responded, the two firms entered into a prolonged price-cutting war which did not end until early 1977. The following table illustrates the ebb and flow of the battle.<sup>79</sup>

	SALES IN TONS		SALES IN DOLLARS		AVG. PRICE	
	MM	CS&G	MM	CS&G	MM	CS&G
1973	196,600	48,365	\$311,700	\$ 72,342	\$1.59	\$1.50
1974	132,400	83,980	248,300	138,266	1.88	1.65
1975	132,100	110,449	241,700	206,391	1.83	1.87
1976	201,900	188,259	337,200	323,522	1.67	1.72
1977	196,400	132,329	316,200	202,455	1.61	1.53
1978	331,700	56,143	593,700	110,405	1.79	1.97

Clearly, Martin Marietta emerged the victor.

Nursing its financial wounds, CS&G decided to try to win in the courtroom what it had lost in the marketplace. Shortly after the price-cutting war ended, it filed an antitrust suit against its chief rival, claiming, *inter alia*, that Martin Marietta had monopolized or attempted to monopolize the local CA-6 market by selling CA-6 at unreasonably low prices.<sup>80</sup>

Price-cutting itself, of course, is hardly predatory. Indeed, it is the quintessence of competition: a firm finds itself underpriced, it responds with a price reduction, and its rivals respond in kind. In a market populated by many buyers and sellers, this process will tend to keep price hovering around marginal cost. Marginal cost pricing is usually considered desirable from an antitrust point of view. It practically guarantees that every consumer willing to pay the cost of meeting his

78. 615 F.2d at 429 & n.1.

79. *Id.* at 430 n.3.

80. CS&G also complained that Martin Marietta had (1) underpriced CS&G on several occasions only after it was advised of CS&G's price; (2) quoted prices for CA-6 and other products on the understanding that the prices were firm only if a contractor's requirements for both were purchased from it; and (3) disparaged CS&G's product. The court treated these complaints as part of the section 2 claim, but found them meritless. 615 F.2d at 433.

demand will be supplied and that resources will be put to their most effective use.<sup>81</sup> Since the antitrust laws are designed to secure just such benefits, it would seem anomalous to hold that they generally forbid a firm from lowering its price.

Cutting price below marginal cost, however, would be suspect because it would turn every sale into a loss. Aside from promotional effects, a firm could not hope to maximize profits by engaging in such a practice unless it expected that by doing so it would (1) drive its rivals from the market, leaving it with a share of the market sufficient to command monopoly profits or (2) chasten its rivals into abandoning their competitive behavior. In Bork's terms, cutting price below marginal cost, at least for long periods, seems predatory.<sup>82</sup>

Professors Areeda and Turner have suggested, in fact, that predatory pricing be defined as cutting price below short-run marginal cost, or its accounting surrogate, average variable costs.<sup>83</sup> Their suggestion has been heeded by the United States Courts of Appeals for the Fifth, Ninth, and Tenth Circuits,<sup>84</sup> but it has been roundly criticized by other academicians, particularly Professors Posner and Williamson.<sup>85</sup> Posner contended that Areeda and Turner mistakenly emphasized the short-run perspective and ignored the importance of "intent."<sup>86</sup> He has suggested that predatory pricing be defined as cutting price below long-run marginal cost, or its accounting surrogate, average total cost, with the "intent" to exclude.<sup>87</sup> Williamson took Areeda and Turner to task for failing to account for the possible untoward effects of a dominant firm's strategic behavior.<sup>88</sup> He argued that cutting price by a dominant firm

81. BORK, *supra* note 25, at 92-98.

82. *Id.* at 144. Bork himself, however, would prefer that there be no rule against predatory pricing. *Id.* at 155. He reasons that the benefits of a rule would be small since firms are unlikely to engage in the practice, and the costs of a rule would be large since courts are likely to mistake competitive pricing for predatory pricing. *Id.*

83. Areeda & Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975).

84. Janich Bros., Inc. v. American Distilling Co., 570 F.2d 848 (9th Cir. 1977), *cert. denied*, 439 U.S. 829 (1978); Pacific Eng'r & Prod. Co. of Nevada v. Kerr-McGee Corp., 551 F.2d 790 (10th Cir.), *cert. denied*, 434 U.S. 879 (1977); Hanson v. Shell Oil Co., 541 F.2d 1352 (9th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977); International Air Indus., Inc. v. American Excelsior Co., 517 F.2d 714 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976).

85. POSNER, *supra* note 25, at 184-96; Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 YALE L.J. 284 (1977); Williamson, *Williamson on Predatory Pricing II*, 88 YALE L.J. 1183 (1979). See also Scherer, *Predatory Pricing and the Sherman Act: A Comment*, 89 HARV. L. REV. 869 (1976); Scherer, *Some Last Words on Predatory Pricing*, 89 HARV. L. REV. 901 (1976).

86. POSNER, *supra* note 25, at 190-93.

87. *Id.* at 190. It is clear that Posner sees average total cost as a reasonable accounting surrogate for long-run marginal cost only under limited conditions—"where demand and cost are stable over reasonably long periods of time." *Id.*

88. Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 YALE L.J. 284

should be deemed predatory, even if not below short-run or long-run marginal cost, when it accompanies a temporary, preemptive expansion in output designed to forestall entry into the market.<sup>89</sup>

The trial judge in *Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.* did not have to enter the debate because the plaintiff failed to introduce any evidence indicating that the defendant had engaged in predatory pricing, however defined. CS&G did not contest the fact that Martin Marietta had never sold CA-6 at prices below its average variable cost.<sup>90</sup> CS&G did offer evidence to show that Martin Marietta had made a few sales at prices below its average total cost but that evidence was rejected on procedural grounds and, in any event, would have shown that Martin Marietta had made many more sales at prices above its average total cost.<sup>91</sup> CS&G did not even address the possibility of a temporary preemptive expansion in output and, as the table readily reveals, Martin Marietta contracted its output following CS&G's entry into the market. Accordingly, when CS&G rested, the trial judge directed a verdict for Martin Marietta.<sup>92</sup>

On appeal, the Seventh Circuit affirmed.<sup>93</sup> Declaring that Martin Marietta's conduct had to be considered "in light of its effects on the proper functioning of a competitive market . . .,"<sup>94</sup> the court found it perfectly legal. The court did not permit itself to become sidetracked by characterizations of the defendant's "intent," although it was plain that Martin Marietta's management was unhappy about CS&G's entry<sup>95</sup> into the market and had the fixed purpose of defeating CS&G in the price cutting war. The court's opinion was not very enlightening.

(1977); Williamson, *Williamson on Predatory Pricing II*, 88 YALE L.J. 1183 (1979). Areeda and Turner defended themselves and counterattacked in *Williamson on Predatory Pricing*, 87 YALE L.J. 1337 (1978) and *Predatory Pricing: A Rejoinder*, 88 YALE L.J. 1641 (1979).

89. Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 YALE L.J. 284, 333-

37. Williamson's principal proposed rules are:

1. *Lawful Behavior*

1.1 *Short Run*: . . . When dominant firms reduce their output or hold their (demand adjusted) output unchanged in the face of new entry they shall be deemed to be behaving in a nonpredatory way provided that the resulting market price is not less than average variable cost. . . .

2. *Unlawful Behavior*

2.1 *Short Run*: . . . Dominant firms that expand their (demand adjusted) output in the face of new entry will be deemed to be engaged in predatory behavior—even if the resulting market price exceeds the dominant firm's average variable cost. . . .

*Id.* at 333-34 (emphasis in original; footnotes omitted).

90. 615 F.2d at 432.

91. *Id.* at 432 n.7.

92. *Id.* at 428.

93. *Id.* at 427.

94. *Id.* at 431.

95. Martin Marietta conceded that one of its executives told CS&G's principals that it

Its discussion of predatory pricing consisted of little more than a short report on the Areeda and Turner proposal and the reception given it by courts and scholars.<sup>96</sup> The court did comment favorably on the utility of Areeda and Turner's work,<sup>97</sup> but it refused to adopt their approach outright, citing reasons which suggest that the court may not have really understood it.<sup>98</sup> When the court turned to Martin Marietta's particular price cuts, it noted their relationship to both average variable cost and average total cost, but it did not explain the significance of that relationship.<sup>99</sup> Such vices, however, detract only slightly from the essential virtue of the opinion, the holding. The holding indicated that the Seventh Circuit understood the consumer welfare goal of section 2. Unfortunately the court's holdings in *City of Mishawaka v. American Electric Power Co.* and *Photovest Corp. v. Fotomat Corp.* indicated just the opposite.<sup>100</sup>

*City of Mishawaka v. American Electric Power Co.:*  
The "Price Squeeze"

This case arose out of a difference between wholesale and retail rates for electric power charged by the Indiana & Michigan Electric Company ("I&M") during the period 1976-78. I&M, a wholly-owned subsidiary of American Electric Power Company, is in the business of generating and transmitting electric power. It sells its power to municipally-owned distribution companies for resale and directly to industrial, commercial and residential customers. All sales are made subject to a system of dual regulation. The Federal Energy Regulatory Commission ("FERC") regulates I&M's wholesale rates and the public service commissions of Indiana and Michigan regulate its retail rates. Differences in rate-setting techniques between the federal and state

"would not appreciate having a new competitor 'right under their [sic] doorstep. . . ." Brief for Appellee at 34.

96. 615 F.2d at 431-32.

97. *Id.*

98. *Id.* The court criticized Areeda and Turner for their "willingness to allow damage to competition and the destruction, by one competitor, of equally efficient competitors as long as prices remain at or above marginal costs." *Id.* at 432 (citation omitted). It found their reasons, the "inability to arrive at a 'satisfactory' method of eliminating this risk and administrative ease," *id.*, wanting. This suggests that the court may not have understood that Areeda and Turner were attempting to strike a delicate balance between allocative and productive efficiency and, at the same time, articulate a "rule" which a court could apply.

99. *Id.*

100. The inconsistency in these three opinions is particularly striking given the panels that issued them. Judge Wood was a member of all three; Judge Pell was a member of two (he was not a member of the panel that decided *City of Mishawaka v. American Elec. Power Co.*).

agencies accounted for some of the controversial difference in rates.<sup>101</sup> Differences in the agencies powers and procedures, however, played a much more significant role.

The agencies have different powers and procedures for coping with "regulatory lag," the seemingly inevitable delay between the filing of proposed rates and their approval or disapproval. The FERC may suspend proposed rates, but for no more than five months.<sup>102</sup> After that, the utility may put them into effect subject to refund if they are ultimately found unjust and unreasonable. The state commissions apparently may suspend proposed rates indefinitely, subject only to constitutional limitations on the taking of property without due process of law.<sup>103</sup>

The importance of these differences in suspension powers and procedures was evident during the period 1976-78 when I&M had proposals for higher rates pending before the FERC and the state public service commissions. I&M was permitted to put its higher proposed wholesale rates into effect, but not its higher proposed retail rates. As a consequence, municipally-owned distribution companies paid more than they would have paid had each been charged the retail rates in effect for a customer with its load characteristics.<sup>104</sup> Naturally, the municipalities were unhappy. Ten of them brought an antitrust suit against I&M claiming that it had monopolized or attempted to monopolize the market for retail electric power in its service area by creating this difference in rates, a difference they labelled a "price squeeze."<sup>105</sup>

The municipalities were successful at trial<sup>106</sup> and on appeal the judgment they had obtained was, in substance, affirmed by the Seventh Circuit.<sup>107</sup> By labelling the rate difference a "price squeeze" they effec-

101. *City of Mishawaka v. American Elec. Power Co.*, 616 F.2d 976, 983 (7th Cir. 1980). For example, the state commissions required a cost of service study using an historic test year, while the FERC required one using a prospective test year. Stipulations of Fact (Stipulations 15 & 16), Joint Appendix on Appeal at 113-14. The studies are almost bound to reveal different costs of service and the rates designed to reflect those costs are almost bound to be different.

102. 16 U.S.C. § 824d(e) (1976).

103. See 616 F.2d at 983; IND. CODE § 8-1-2-42 (1980 Supp.); MICH. COMP. LAWS § 460.552 (1970).

104. Stipulations of Fact (Stipulations 41, 42, 48, 49, 51, 52 & 53), Joint Appendix on Appeal at 122-26, 128-57; *City of Mishawaka v. American Elec. Power Co.*, 465 F. Supp. 1320, 1324 (N.D. Ind. 1979). The Seventh Circuit thus erred when it stated, "[b]ecause the utility's wholesale rates charged the municipalities during the period 1976-1978 exceeded the retail rates charged to its own retail customers, the utility was found by the trial court to be guilty of a 'price squeeze'. . . ." 616 F.2d at 978. (footnote omitted).

105. *City of Mishawaka v. Indiana & Mich. Elec. Co.*, 560 F.2d 1314, 1316 (7th Cir. 1977), cert. denied, 436 U.S. 922 (1978).

106. *City of Mishawaka v. American Elec. Power Co.*, 465 F. Supp. 1320 (N.D. Ind. 1979).

107. 616 F.2d at 976. The court found merit in the municipalities' section 2 claim, but re-

tively conjured up the populist image of robber barons doing dastardly deeds to the innocents of the marketplace, but invoking pejoratives hardly suffices as analysis. As it happens, it is not at all clear that I&M's conduct was objectionable in terms of section 2.<sup>108</sup>

At the threshold, it may well be doubted that the difference in rates which constituted the "price squeeze" had any significance at all, much less any antitrust significance. It was, after all, the difference between actual wholesale rates and hypothetical retail rates. The actual wholesale rates were the rates which the municipally owned distribution companies paid. The hypothetical retail rates, the retail rates in effect for customers with load characteristics similar to those of each company, were the rates which the municipally owned companies wished they had paid. Wishing, of course, neither makes things so nor gives them significance. I&M might not have been permitted to charge those hypothetical retail rates even if it had applied to do so. To charge each municipally-owned distribution company the retail rate in effect for a customer with its load characteristics might well have been ruled unduly discriminatory.<sup>109</sup>

Putting such doubts to one side, it still does not appear that I&M's "price squeeze" qualified as the kind of strategic behavior which Bork defined as predatory. Because of rate regulation, of course, it is impossible to ascertain whether I&M's conduct would have been profit maximizing regardless of its impact on the municipalities. Also because of rate regulation, however, it seems rather unlikely that I&M hoped to manipulate its rates to its own advantage following a successful "price squeeze," even if a successful "price squeeze" would have driven the municipally-owned distribution companies from the market or chastened them into abandoning some unspecified competitive behavior.

Looking beyond Bork's test, I&M's "price squeeze" could have had an adverse impact on consumer welfare only if it had been discriminatory. If the "price squeeze" had been discriminatory, it could

versed the award of treble damages. *Id.* at 986-90. Damages had been assessed by multiplying the offending rate differentials by the quantity of electric power consumed by the municipalities during the 1976-78 period. The court objected to that method of assessment. It insisted that municipalities "establish their antitrust damages by proof of specific injuries they have suffered as a result of the utility's overcharges and other monopolistic practices." *Id.* at 989. Although the court suggested that the municipalities would be able to do so, *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977) might make their task rather difficult. See note 31 *supra* and accompanying text.

108. It is also less than clear that I&M qualified as a monopolist for the purposes of this suit. In each municipality, the municipally-owned distribution company, rather than I&M, was the virtual monopolist.

109. See 16 U.S.C. § 824d(b) (1976).

have distorted whatever retail competition existed between I&M and the municipalities by making I&M's distribution networks appear less costly than those of the municipalities' when, in fact, the opposite was true. Consumption patterns could have shifted because of this deceptive appearance and, as a result, more resources could have been used to distribute electric power than would have been used otherwise.<sup>110</sup> The inefficiency that could be engendered by a discriminatory "price squeeze" would justify antitrust suspicions, but not necessarily an antitrust condemnation. A discriminatory "price squeeze" could also engender efficiency. By using it, a monopolist might lower his average price and raise his output.<sup>111</sup> Some of the misallocation associated with a monopolist's pricing/output strategy could thus be avoided. To determine whether I&M's "price squeeze" would have engendered more efficiency or inefficiency, assuming that it had been discriminatory, would have required considerable analysis.<sup>112</sup>

The Seventh Circuit did not engage in that analysis because it apparently did not object to the "price squeeze" as discriminatory. Indeed, it would have been improper for it to do so since the municipalities introduced no evidence whatsoever indicating either that I&M's rates were discriminatory, or that, even if they were, there existed substantial retail competition between the municipally-owned distribution companies and I&M which those rates might have distorted.<sup>113</sup> Unfortunately, the court did not explain just why it did object to the "price squeeze."

The Seventh Circuit criticized the "prize squeeze" as "calculated to force the municipalities out of the retail electric business resulting in the conversion of the municipal retail customers into retail customers of the utility."<sup>114</sup> If this criticism constituted the court's objection to the "price squeeze," then its objection was unsound for at least three reasons. First, it is doubtful that I&M had the "intention" the court ascribed to it. The supporting evidence was sketchy at best. The court

110. The effect would be the same had the discriminatory "price squeeze" merely caused the apparent and actual costs of the respective distribution networks to vary.

111. A monopolist will always find it advantageous to reduce his price to those who would otherwise not purchase his product or service, as long as he can readily identify that group. If he does so, his average price will drop and his output will expand.

In an imperfect world, where it may be difficult to differentiate among potential customers, discrimination may not always have such a desirable effect. See POSNER, *supra* note 25, at 64.

112. *Id.*

113. Although the trial judge concluded that there was such competition, 465 F. Supp. at 1323-24, 1326-27, his conclusion appears to have been based on speculation rather than evidence. See Plaintiffs' answers to Defendants' interrogatories requesting information about any competition that might exist. Joint Appendix on Appeal at 1056-88, 1131-74, 1177-86.

114. 616 F.2d at 978.

could only point to I&M's timely notice to the municipalities that it did not anticipate renewing full-requirements contracts with them due to an expected shortage in generating capacity<sup>115</sup> and I&M's acquisition of four municipally-owned distribution companies between 1957 and 1966.<sup>116</sup> The contrary evidence was overwhelming. There would have been no "price squeeze" had all of I&M's proposed rates been approved in a timely fashion by the appropriate agencies.<sup>117</sup> Moreover, I&M seemingly had no incentive to force the municipalities out and take over their customers if it could, in fact, extract more from them under its wholesale rates than under its retail rates.<sup>118</sup>

Second, even if I&M had such an "intention" it is doubtful that it should have been considered "evil" since, in the retail market for electric power it amounted to little more than the "intention" to prevail over one's actual or potential rivals,<sup>119</sup> an "intention" which may be ascribed, as noted earlier, to any competitively energetic firm. Third, and finally, it is doubtful that otherwise lawful conduct should be deemed an antitrust violation simply because it was engaged in with an "evil intention."<sup>120</sup>

The court also complained that in creating the "price squeeze," I&M had breached some putative statutory duty to consider the competitive impact of its own rates,<sup>121</sup> and "abused" the administrative

115. *Id.* at 983. The court made much of this alleged "cut-off" threat although it was clearly nothing of the kind. The court admitted that the "threatened cut-off" would not have constituted a section 2 violation except in the context of the "price squeeze." *Id.* at 985.

116. *Id.* at 981. Joint Appendix on Appeal at 98. I&M also leased Fort Wayne's utility assets in 1975. The acquisitions and the lease obviously occurred before the alleged "price squeeze" and revealed little, if anything, about I&M's "intention" in creating it.

117. 616 F.2d at 984. The court discounted this evidence on the ground that I&M's proposed rates did not necessarily reflect its true "intention" since it frequently proposed rates in excess of those it expected the regulatory agency to approve. *Id.*

There was no evidence, however, that I&M had inflated its proposed wholesale rates any more than its proposed retail rates. The difference between them, therefore, was surely more indicative of I&M's "intent" than the difference upon which the court focused.

118. I&M might have been able to extract more from the municipalities' customers as a group under its retail rates than it was able to extract from the municipalities themselves under its wholesale rates. Retail rates are complex; some retail customers pay more per average kilowatt-hour than do others. Under its retail rates, then, I&M might have extracted more than under its uniform wholesale rates. If this possibility "motivated" I&M's "price squeeze" then the court's emphasis on the difference between wholesale rates and retail rates in effect for customers with the load characteristics of each municipality was probably misplaced.

119. Since the retail market for electric power in any particular area is almost always served most efficiently by one firm, it is practically inevitable that if one firm in that market prevails over another, only the prevailing firm will remain.

120. *Buffalo Courier-Express, Inc. v. Buffalo Evening News, Inc.*, 601 F.2d 48, 54 (2d Cir. 1979); *In re E.I. du Pont de Nemours & Co.*, F.T.C. No. 9108, ANTITRUST & TRADE REG. REP. (BNA) No. 987 (Oct. 30, 1980) F-1, F-5, F-6; AREEDA & TURNER, *supra* note 72, at 73-77.

121. 616 F.2d at 981-82.



process of the FERC.<sup>122</sup> If the court's objection to the "price squeeze" was based on these complaints, then it cannot withstand the slightest scrutiny.

The simple answer to the first complaint is that I&M had no statutory duty to consider the competitive impact of its proposed rates. The court's contrary view was based on a twisted reading of section 205(b) of the Federal Power Act<sup>123</sup> and the Supreme Court's interpretation of that statute in *Federal Power Commission v. Conway Corp.*<sup>124</sup> Section 205(b) forbids public utilities from "maintain[ing] any unreasonable difference in rates . . . between classes of service" for sales subject to FERC jurisdiction. In *Conway*, the question presented was whether, in enforcing section 205(b), the FERC had jurisdiction to consider the relationship between wholesale rates awaiting its approval and retail rates not even subject to its scrutiny. The Supreme Court held that it did. Neither the language of the statute nor the Supreme Court's delineation of the FERC's jurisdiction even speaks to those matters which a public utility must consider in proposing rates.<sup>125</sup> Moreover, the mental process by which a utility's management fashions the rates it will propose has nothing to do with the consumer welfare goal of section 2. Mental processes can have no impact on allocative or productive efficiency; only conduct can.

The second complaint was downright silly. It would have been more accurate to say that I&M had been "abused" by the painful slowness of the FERC than to say, as the court did, that I&M "abused" the administrative process of that agency. The Seventh Circuit was un-

122. *Id.* at 982-83.

123. 16 U.S.C. § 824d(b) (1976).

124. 426 U.S. 271 (1976).

125. It could be argued, unpersuasively I think, that *Conway* imposes a duty on utilities to refrain from putting into effect rates which would be unduly discriminatory. There was no evidence, however, that I&M breached that duty. To prove that I&M had breached that duty, the municipalities would have had to introduce evidence indicating that the difference between the wholesale rates I&M put into effect and its then extant retail rates was disproportionate to the difference in the costs of servicing its wholesale and retail customers. The only evidence relating to costs which was introduced at trial was that which I&M had submitted to the various regulatory agencies to justify its proposed rates.

In any event the argument that *Conway* imposes such a duty is unpersuasive. Section 205(e) of the Federal Power Act, 16 U.S.C. § 824d(e) (1976), provides that a utility's proposed rates may be suspended for no more than five months, and that after that a utility may put its proposed rates into effect subject to refund. It seems unlikely that Congress intended § 205(b) as an amendment to § 205(e). Yet, if the argument is accepted, § 205(b) would become just that, limiting the occasions upon which a utility could put its proposed rates, previously suspended, into effect.

Moreover, even accepting the argument and ignoring the lack of evidence, putting rates into effect which are unduly discriminatory is not necessarily predatory. See note 22 *supra* and accompanying text.

happy with the way I&M had responded to regulatory lag.<sup>126</sup> I&M had found that its rates had been made obsolete by rising costs even before they had been passed upon by the FERC. Therefore, it proposed new rates which the FERC promptly suspended for five months. By the time five months had elapsed, the FERC had not passed upon I&M's proposed new rates. In fact, it had still not passed upon the rates they were to have supplanted. So, I&M put its proposed new rates into effect subject, of course, to refund. By doing so, I&M violated neither the letter nor the spirit of the FERC's procedures. In enacting the Federal Power Act, which governs those procedures, the Congress implicitly determined that the utilities it was subjecting to regulation would not have to suffer rising costs without rate relief for longer than five months, the maximum period of suspension. I&M merely availed itself of its rights. The fact that its rates were not eventually approved in their entirety<sup>127</sup> did not show, despite the court's contrary intimation,<sup>128</sup> that I&M had been engaged in meritless litigation designed to forestall entry, a practice which the Supreme Court has held might violate section 2.<sup>129</sup> It would be preposterous to argue that every time a regulated enterprise failed to win from an administrative agency all that it asked, its very asking would subject it to antitrust scrutiny.

Underlying the court's criticism and complaints was its evident concern about the effects of I&M's conduct on the welfare of the municipally-owned distribution companies. That concern was reflected in the court's very definition of "price squeeze," "a situation where the monopolist charges its wholesale customer a wholesale rate high enough to impede that customer's competition with the monopolist in the retail market."<sup>130</sup> It is all too likely that the court objected to the "price squeeze" because it put in jeopardy the continued survival of those companies. It was for similar reasons that Hand objected to "price squeezes" in *United States v. Aluminum Co. of America*<sup>131</sup> and *United States v. Corn Products Refining Co.*,<sup>132</sup> the only previously reported cases in which the practice was held to run afoul of section 2.<sup>133</sup>

126. 616 F.2d at 982.

127. *Id.*

128. *Id.* at 982-83.

129. *California Motor Transp. Co. v. Trucking Unlimited*, 404 U.S. 508 (1972); *United Mine Workers v. Pennington*, 381 U.S. 657 (1965); *Eastern R.R. Presidents Conf. v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961).

130. 616 F.2d at 978 n.4.

131. 148 F.2d 416, 436-38 (2d Cir. 1945).

132. 234 F. 964, 985-94 (S.D.N.Y. 1916).

133. It appears that Hand, who invented so many other antitrust cliches, also invented this one. All other references to "price squeezes" as antitrust violations have been dicta.

The Seventh Circuit has sounded this populist theme before, interpreting section 2 as if it were designed to preserve the existence of competitors for their own sake rather than for the consuming public's.<sup>134</sup> The court's objection to the "price squeeze" was inconsistent with its decision in *Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.* and indicated that the Seventh Circuit did not truly understand the purpose of the prohibition against monopolizing and attempting to monopolize.

*Photovest Corp. v. Fotomat Corp.* :  
Franchisor/Franchisee Competition and  
Breach of Contract

This case, like so many similar ones, germinated in the fertile anti-trust soil of a franchisor/franchisee relationship. To understand this case, one must understand that relationship, its beginnings, its contractual underpinnings, and its degeneration.

When the defendant Fotomat was incorporated in 1967, it was idea rich and capital poor. Its idea was to retail film and film processing at drive-thru huts, called "kiosks," used exclusively for that purpose.<sup>135</sup> The key to converting that idea into a successful enterprise, in the view of Fotomat's managers, was "blitzing the market," quickly placing kiosks in the most desirable locations, usually shopping centers, in metropolitan areas throughout the United States.<sup>136</sup> "Blitzing the market," however, required considerable capital, which Fotomat lacked. So Fotomat's managers began to solicit potential franchisees, including a group of Indianapolis entrepreneurs who later became the principals of the plaintiff Photovest.

In attempting to persuade the Indianapolis group to invest, Fotomat's managers made what turned out to be critical representations about how much competition each of the group's stores would likely encounter from other Fotomat stores.<sup>137</sup> Fotomat's managers stated that they would refrain, as a general rule, from franchising or operating a store within a two-mile radius of an existing one. It would be from that area, they predicted, that each Fotomat store would draw most of its customers.<sup>138</sup> The group could expect the rule to be observed, they

134. See Lee, *Antitrust: A Collage of Vertical Territorial Restraints, Tying and Monopoly "Misuse," Arbitrariness, and the General Dynamics Defense*, 55 CHI.-KENT L. REV. 1 (1979).

135. 606 F.2d at 707.

136. *Id.* at 715.

137. *Id.* at 716.

138. *Id.* Fotomat's managers called this circle around each store the "market area." Their prediction that each store's customers would come primarily from its market area was purportedly based on demographic studies. *Id.*

claimed, because doing so would not only be honorable but, under the franchise contract, would also be good business for Fotomat. The franchise contract provided that Fotomat would derive a substantial portion of its franchising income from "royalty" payments of 12 percent of each store's gross revenues in excess of \$2500. If stores were placed too close to one another, they explained, each store's gross revenues would decline and thus so would its "royalty" payments to Fotomat.<sup>139</sup>

The solicitation of the Indianapolis group was quite successful. Indeed, the franchisor/franchisee relationship began auspiciously as Fotomat's managers persuaded the group, now Photovest, to acquire all fifteen franchises then planned for the Indianapolis area.<sup>140</sup> Thus, when Photovest opened its first stores in 1968, it alone sold film and film processing at kiosks. Defining the relevant market as selling film and film processing at kiosks, as the Seventh Circuit erroneously did,<sup>141</sup> Photovest would have qualified as a monopolist.

Fotomat and Photovest, of course, memorialized their complex relationship in a contract,<sup>142</sup> the provisions of which loomed large in this case. For its part, Fotomat promised (1) to permit the use of its trademark; (2) to lease sites for the kiosks; (3) to supply kiosks, other minor equipment and an inventory of products; (4) to pick up film deposited by customers and deliver film processed for customers on a daily basis; (5) to sell film and film processing at its own cost; and (6) to give Photovest the option of purchasing any additional stores placed in the Indianapolis area. In return, Photovest promised to pay (1) \$21,000 up front; (2) \$375 per month rent for five years and more thereafter pursuant to a cost index formula; (3) "royalties" as previously mentioned; (4) 3 percent of gross sales (earmarked for advertising, public relations, and promotions); and (5) the wholesale price of all film and film processing which were to be purchased exclusively through Fotomat.<sup>143</sup>

Neither the relationship nor the contract survived the apparent greed of Fotomat's managers. They soon realized that Fotomat could

139. *Id.*

140. *Id.*

141. Apparently, the court defined the market as it did primarily because Fotomat's photo processing prices were 20% higher than those quoted by more conventional retailers. *Id.* at 713. In so doing, the court committed the same error it committed in *United States v. Household Finance*. See text accompanying notes 1-13 *supra*.

142. Actually, a separate contract was signed for each of the fifteen franchises. The essential provisions of each, however, were nearly identical. 606 F.2d at 707.

143. *Id.* at 716-17.

do better financially by opening its own stores and selling directly to the consuming public than it could by franchising.<sup>144</sup> In June, 1974, Fotomat opened a store a scant one and one-half miles from one of Photovest's. To eliminate the resulting rivalry, Photovest exercised its option to buy the store,<sup>145</sup> but Fotomat's managers persisted. They opened two more Indianapolis stores in the fall of 1974 and eight more thereafter. All were within close proximity of Photovest's most profitable ones. Photovest decided not to exercise its option to buy because it found that the price at which Fotomat offered to sell each store was too high, so it simply suffered the competition.<sup>146</sup> Needless to say, the franchisor/franchisee relationship was strained.

Meanwhile, Fotomat's managers had figured out that Fotomat had not been extracting from its franchisees nearly as much as it could on sales of film and film processing. To extract more it had only to mark up its film prices above cost and retain some of the secret discounts it had obtained from the film processors with which it did business. The fact that both practices were expressly forbidden by the franchise contract<sup>147</sup> did not deter Fotomat's managers.

They showed the same lack of concern for contractual niceties when, in the summer of 1974, Photovest decided to switch processors for print film because of customer dissatisfaction with print quality.<sup>148</sup> Three years before, following the Ninth Circuit's decision in *Siegel v. Chicken Delight, Inc.*,<sup>149</sup> Fotomat had released Photovest from its obligation to purchase film processing exclusively through Fotomat. So in deciding to switch processors for print film, Photovest was well within its rights. Fotomat's managers, however, were loathe to honor Photovest's decision because of the additional costs Fotomat would have to bear as a result of the switch, additional costs associated with the transportation of print and slide film to and from separate processors. Therefore, they responded to Photovest's decision by announcing that, despite the franchise contract, it would also have to switch proces-

144. *Id.* at 715. Apparently, Fotomat found it profitable to open stores near those with gross sales in excess of \$70,000 yearly. *Photovest Corp. v. Fotomat Corp.*, [1977-1] TRADE CASES (CCH) ¶ 61,529 at 72,085 (S.D. Ind. 1977).

145. 606 F.2d at 717. Photovest was clearly trying to forestall entry. Perhaps Fotomat would have fared better had it attacked this conduct and "intent" as violative of section 2.

146. *Id.* The court perceived this development as more sinister: "Fotomat announced that the price for a franchise store was now \$30,000 and the required monthly rental would be \$500 per month. It was not economically feasible for Photovest to accept new stores on those terms, a fact which was known to Fotomat." *Id.*

147. *Id.* at 719-20.

148. *Id.* at 720.

149. 448 F.2d 43 (9th Cir. 1971), *cert. denied*, 405 U.S. 955 (1972).

sors for slide film and perform its own pick-up and delivery.<sup>150</sup>

All of these actions, of course, enriched Fotomat at the expense of Photovest, and so did the decision to raise the rent for each store site.

In late 1974 Photovest filed suit, claiming, *inter alia*, that Fotomat had attempted to monopolize the Indianapolis market for selling film and film processing at kiosks by opening stores, breaching the franchise contract, and even by raising the rent for each store site.<sup>151</sup> At a bench trial, Photovest obtained a judgment for treble damages.<sup>152</sup> Fotomat appealed, but the Seventh Circuit, in substance, affirmed.<sup>153</sup>

The Seventh Circuit's decision was, in the tradition of *United States v. Arnold, Schwinn & Co.*<sup>154</sup> and *United States v. Von's Grocery Co.*,<sup>155</sup> a splendid contribution to antitrust's theater of the absurd. It deserves acclaim from all the Albees and Becketts of the bench and bar. What the court did, essentially, was condemn Fotomat for vigorously penetrating a market which, as the court defined it, was dominated by a virtual monopolist, Photovest. Such conduct should have been sacrosanct under section 2.<sup>156</sup> After all, it alone can restore competitive

150. 606 F.2d at 720. The court labelled this anticipatory breach of the franchise contract a "tie." *Id.* Indeed, the court held that Fotomat had transgressed section 1 by tying print film processing (the tied product) to both slide print film processing and pick up and delivery service (the tying products). *Id.* at 724. The court was clearly mistaken.

Assuming that it makes some sense to label Fotomat's simple anticipatory breach of contract a "tie," that tie would have been illegal only if Fotomat had held appreciable economic power in the market of the tying products. *United States Steel Corp. v. Fortner Enterprises, Inc.*, 429 U.S. 610 (1977). "Appreciable economic power" means the power to raise price above and restrict output below levels that would have prevailed had the market been competitively structured. *Id.* at 620. Fotomat had no such power.

The Seventh Circuit argued that Fotomat had such power since Photovest could not obtain the tying products from anyone else for "free." 606 F.2d at 724. The court's argument borders on the disingenuous. Obviously, Photovest was not obtaining the tying products for free. It was paying for them as part of its contractual arrangements with Fotomat. Moreover, the ability to give products away is hardly evidence of "appreciable economic power." 429 U.S. at 620.

151. Photovest also claimed that Fotomat had combined and conspired with its wholly owned subsidiary, Fotomat Labs, Inc., in violation of section 1 to eliminate Photovest as a retail competitor and independent purchaser of photo processing. 606 F.2d at 725-26. In addition, Photovest alleged various transgressions of state laws including a breach of an implied covenant of good faith, tortious breach of contract, and fraud. *Id.* at 727-30.

152. *Photovest Corp. v. Fotomat Corp.*, [1977-1] TRADE CASES (CCH) ¶ 61, 529 (S.D. Ind. 1977).

153. 606 F.2d at 704. The court unqualifiedly endorsed the trial judge's condemnation of Fotomat under section 2. *Id.* at 721.

154. 388 U.S. 365 (1967) (overruled by *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977)).

155. 384 U.S. 270 (1966).

156. AREEDA & TURNER, *supra* note 72, at 323-25. In *Schine Chain Theatres, Inc. v. United States*, 334 U.S. 110, 119 (1948), the threat of vigorous penetration in a market was accepted as evidence of "intent" in a section 2 proceeding. In *Columbia Metal Culvert Co. v. Kaiser Aluminum & Chemical Corp.*, 579 F.2d 20, 31 (3d Cir.), *cert. denied*, 439 U.S. 876 (1978), placement of a plant very near a competitor's was also accepted as evidence of "intent" in a section 2 proceeding. In neither case was the conduct itself deemed predatory, although the Seventh Circuit cited both

health to a monopolistically moribund industry. That the entering firm and the virtual monopolist were franchisor and franchisee made the conduct no less desirable from the viewpoint of the consuming public.

The Seventh Circuit's decision cannot be squared with the Supreme Court's decision in *Brunswick v. Pueblo Bowl-O-Mat, Inc.*,<sup>157</sup> which the Seventh Circuit cavalierly dismissed as inapposite.<sup>158</sup> In that case, the Supreme Court had to determine whether Treadway Companies, Inc., owner of several bowling centers, could recover treble damages for injuries sustained when Brunswick, in violation of section 7 of the Clayton Act, acquired competing centers which had been about to go out of business, and kept them open. "At base," observed Justice Marshall for his unanimous brethren, "[Treadway] complain[s] that by acquiring the failing centers [Brunswick] preserved competition, thereby depriving [Treadway] of the benefits of increased concentration. The damages [Treadway] obtained are designed to provide [it] with the profits [it] would have realized had competition been reduced."<sup>159</sup> Similarly, Photovest complained that by opening stores, Fotomat had introduced competition, thereby depriving Photovest of the benefits of monopoly. The damages Photovest obtained were akin to those obtained by Treadway. Noting that "[t]he antitrust laws . . . were enacted for 'the protection of *competition* not *competitors*,'" Marshall held that it would be "inimical to the purposes of those laws to award damages for the type of injur[ies] claimed" by Treadway.<sup>160</sup> Or by Photovest, we might add.

It is not entirely clear how the Seventh Circuit arrived at its conclusion that Fotomat's vigorous penetration of Photovest's market was predatory. It certainly did not employ Bork's standard. The court may have simply applied the same populist notions that it applied in *City of Mishawaka v. American Electric Power Co.* Perhaps that is why it expressed such solicitude for Photovest's balance sheet<sup>161</sup> and such dismay that Fotomat's managers anticipated and even desired Photovest's financial distress.<sup>162</sup> But the moralistic overtones of its opinion indicate that the court was up to more than that. What really galled the court

in support of its holding. 606 F.2d at 719. Moreover, it is not clear that either survived the Supreme Court's decision in *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977). See text accompanying notes 157-60 *infra*.

157. 429 U.S. 477 (1977).

158. 606 F.2d at 719.

159. 429 U.S. at 488.

160. *Id.* (emphasis in original).

161. 606 F.2d at 715, 717-18.

162. *Id.* at 719.

about Fotomat's vigorous penetration of Photovest's market was what appeared to it to be the money-grubbing perfidy with which the deeds were done. Fotomat's managers had represented that it was unlikely that they would open their own stores. In reliance on that representation, Photovest put its capital at risk and began doing business. And then, simply because it was economically advantageous to do so, Fotomat's managers broke their word.

I think that what the Seventh Circuit really did was unhitch section 2 from its economic moorings. I think it condemned the opening of stores because of the rapacious greed which seemed to motivate that conduct. I think that, for the same reason, it condemned the multiple breaches of the franchise contract, which were unlawful but irrelevant to allocative or productive efficiency, and the raising of the rent for each store site, which was not even unlawful. The court's instincts may have been commendable, but its jurisprudence was not. Using section 2 to police "business ethics" will likely deter efficiency-generating behavior.<sup>163</sup> Using it to punish greed will almost certainly yield particularly perverse results for, although greed may be one of the seven deadly sins, it is also the fuel that fires the engine of competition.

### CONCLUSION

The Seventh Circuit exposed its lack of a coherent antitrust philosophy by resolving antitrust disputes on the basis of words and phrases lifted out of context from leading opinions and applied literally. It is not surprising, then, that in *Chillicothe Sand & Gravel v. Martin Marietta*, the court rendered a decision consistent with consumer welfare goals while in the three other major antitrust cases decided last term it did not.

Ironically, the court's inconsistency may be evidence of a faint silver lining in an otherwise cloudy jurisprudential sky. It is possible that the court's inconsistency may reflect the inconsistency of the defendants' appellate briefs. Only in the brief submitted in behalf of Martin Marietta was the consumer welfare goal of antitrust law articulated and an integrated economic/legal analysis used to explain why that goal required a decision favorable to the defendant.<sup>164</sup> Perhaps if other law-

163. See, e.g., Cooper, *Attempts and Monopolization: A Mildly Expansionary Answer to the Prophylactic Riddle of Section Two*, 72 MICH. L. REV. 373, 435, 450 (1974). Lee, *Antitrust: A Collage of Vertical Territorial Restraints, Tying and Monopoly "Misuse," Arbitrability, and the General Dynamics Defense*, 55 CHI.-KENT L. REV. 1, 18-19 (1979).

164. Brief of Appellee, *Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.*, 615 F.2d 427 (7th Cir. 1980).



yers follow this lead, the Seventh Circuit may be persuaded to reach more sensible, or at least more predictable, decisions.