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ANTITRUST: A COLLAGE OF VERTICAL TERRITORIAL
RESTRAINTS, TYING AND MONOPOLY "MISUSE,"
ARBITRABILITY, AND THE *GENERAL*
DYNAMICS DEFENSE

MARK R. LEE*

During the 1977-78 term, the United States Court of Appeals for the Seventh Circuit dealt with the problems of vertical territorial restraints, tying and monopoly "misuse," the arbitrability of antitrust claims, and mergers. The only common thread running through the four major antitrust decisions rendered was a fairly literalistic jurisprudence which apparently led the court to both rational and irrational results.

VERTICAL TERRITORIAL RESTRAINTS: THE SCOPE OF *CONTINENTAL T.V., INC. v. GTE SYLVANIA INC.*¹

A garden-variety business dispute between supplier and distributor, brought to trial² in the form of a *Schwinn*³-style antitrust claim,⁴ presented the Seventh Circuit with the task of interpreting the United States Supreme Court's latest pronouncement on the legality of vertical territorial restraints,⁵ *Continental T.V., Inc. v. GTE Sylvania Inc.*⁶ Adhering to both the language and logic of *Continental T.V.*, in which the Supreme Court overruled *United States v. Arnold, Schwinn & Co.*,⁷ the Seventh Circuit, in *General Beverage Sales Co. v. East-Side Winery*,⁸

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1. 433 U.S. 36 (1977).

2. The original complaint was filed during April 1972, in the United States District Court for the Eastern District of Wisconsin. Trial on the amended complaint proceeded in August 1976, before Judge John W. Reynolds. 568 F.2d 1147, 1149-50 (7th Cir. 1978).

3. *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), *overruled in Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

4. The three-pronged amended complaint also alleged breach of contract (Count I) and violations of Sections 2(d) and 2(e) of the Robinson-Patman Act, 15 U.S.C. §§ 13(d), (e) (1970) (current version at 15 U.S.C. §§ 13(d), (e) (1976)) (Count III). 568 F.2d at 1150.

5. A vertical territorial restraint is a restriction on the geographical area in which a firm at one level in the distribution chain (*e.g.*, a wholesaler) can do business. It is imposed on the firm by a firm at a preceding level (*e.g.*, a manufacturer). *See* BORK, *THE ANTITRUST PARADOX* 288 (1978).

6. 433 U.S. 36 (1977).

7. 388 U.S. 365 (1967), *overruled in Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

8. 568 F.2d 1147 (7th Cir. 1978).

ruled that, until proven otherwise, vertical territorial restraints, unaccompanied by resale price maintenance, are not illegal per se.

The Schwinn and Continental T.V. Decisions

In 1967, the United States Supreme Court held per se unlawful under section 1 of the Sherman Act⁹ the practice whereby Arnold, Schwinn & Company restricted the territories within which and the retailers to whom its wholesale¹⁰ distributors re-sold¹¹ its bicycles.¹² In so holding the Court stated, "Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it."¹³ Nonetheless, the *Schwinn* rule's controversial¹⁴ life was cut short by the Court's 1977 *Continental T.V.* decision.

Continental T.V. resolved a challenge to Sylvania's requirement that its franchised retailers sell its television and other home entertainment products only from designated locations. The District Court for the Northern District of California refused Sylvania's request to instruct the jury that its location clause was illegal only if it unreasonably restrained or suppressed competition. Instead, following *Schwinn*, it gave a per se rule instruction:

[I]f you find by a preponderance of the evidence that Sylvania entered into a contract, combination or conspiracy with one or more of its dealers pursuant to which Sylvania exercised dominion or control over the products sold to the dealer, after having parted with title and risk to the products, you must find any effort thereafter to restrict outlets or store locations from which its dealers resold the merchandise which they had purchased from Sylvania to be a violation of Section 1 of the Sherman Act, regardless of the reasonableness of the

9. 15 U.S.C. § 1 (1976).

10. It would appear, however, that the Court perceived no material distinction between the restrictions on those selling at wholesale and those selling at retail. In *Schwinn* the Court stated, "The principle is, of course, equally applicable to sales to retailers, and the decree should similarly enjoin the making of any sales to retailers upon any condition, agreement or understanding limiting the retailer's freedom as to where and to whom it will resell the products." 388 U.S. at 378.

11. A different "rule" applied to the identical restrictions on distributors who did not actually "re-sell" the bicycles, but merely forwarded orders from the retailers to the factory. Distributors who merely forwarded orders acted essentially as sales agents or manufacturer's representatives. Territorial and customer restrictions on these "Schwinn Plan" distributors, to whom neither title nor possession passed, were not illegal per se. 388 U.S. at 380.

12. *Id.* at 379.

13. *Id.*

14. The "*Schwinn* rule" was subjected to unrelenting criticism by the commentators. See, e.g., articles and comments listed in *GTE Sylvania Inc. v. Continental T.V., Inc.*, 537 F.2d 980, 988 n.13 (9th Cir. 1976). In addition it underwent "interpretive erosion" in the lower courts. See 433 U.S. at 48 n.14. Justice Fortas' opaque opinion was doubtless the source of analytical difficulty for antitrust students and Socratic delight for antitrust professors.

location restrictions.¹⁵

Not surprisingly, the jury found against Sylvania and judgment was entered accordingly.

Holding that location clauses were not per se illegal, even under *Schwinn*, the United States Court of Appeals for the Ninth Circuit reversed and found that the jury instructions were inconsistent with both existing case law permitting exclusive dealerships and, ultimately, with the very purpose of the Sherman Act.¹⁶ To distinguish *Schwinn*, the broad language of which seemed applicable, the court analyzed the practices challenged in each case. It found that Schwinn, a company enjoying a very large share of the bicycle market, imposed restrictions which utterly foreclosed its wholesale distributors from selling Schwinn products to any purchaser located outside its exclusive territory.¹⁷ Sylvania, in contrast, a firm struggling to obtain more than an insignificant share of the television market,¹⁸ limited the locations from which its franchised retailers could make sales, but otherwise permitted them to compete for any sales that they could make.¹⁹ Moreover, as a matter of company practice, Sylvania franchised at least two dealers in the major markets.²⁰ The Ninth Circuit found that Schwinn's practices were much more likely than Sylvania's to have a net anticompetitive effect. Thus, the court concluded that while the former might be, and had been, condemned as illegal per se, the latter should be tested under the rule of reason.

The Supreme Court found the Ninth Circuit's analysis unpersuasive but affirmed the appellate court's holding. The Court found that both Sylvania and Schwinn placed restrictions on their franchisees in order to reduce intrabrand and promote interbrand competition. Thus, it concluded that in terms of functional antitrust analysis, the restrictions were indistinguishable.²¹ Nevertheless, the Court affirmed

15. 433 U.S. at 40-41.

16. *GTE Sylvania Inc. v. Continental T.V., Inc.*, 537 F.2d 980 (9th Cir. 1976). The court stated, "That purpose is to insure the 'unrestrained interaction of competitive forces' that 'will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions.'" *Id.* at 988 (citations omitted).

17. *Id.* at 990.

18. It was apparently in response to its declining market share, one or two percent in 1962, that Sylvania changed from its traditional "saturation" distribution system (manufacturer-distributor-retailer) to direct dealing by the factory with a limited number of franchised dealers at designated locations. Three years later, Sylvania found itself with a five percent market share. 537 F.2d at 982-84.

19. *Id.* at 990.

20. *Id.*

21. 433 U.S. at 46. A location clause like Sylvania's could be at least as restrictive of intrabrand competition as a territorial restraint like Schwinn's. For example, if Sylvania had limited its outlets to one franchised dealer in each of the nation's fifty largest cities it would have

the Ninth Circuit's decision because of the absence of any showing that non-price "vertical restrictions have or are likely to have a 'pernicious effect on competition' or that they 'lack . . . any redeeming virtue,'"²² *Schwinn* notwithstanding. Indeed, the Court suggested that these restrictions might be used pro-competitively by a new manufacturing entrant to attract competent and aggressive retailers or by an established manufacturer to overcome the "free rider" obstacle to the retail provisioning of information, display, and repair services.²³

General Beverage Sales Co. v. East-Side Winery

The business dispute between General Beverage Sales Company and East-Side Winery arose when East-Side Winery, a supplier of wines and brandies, terminated its exclusive distributor for certain Wisconsin counties, General Beverage Sales Company. East-Side charged that General Beverage failed to meet sales quota obligations incurred as part of the distributorship agreement. General Beverage blamed East-Side for failing to make timely shipments of the products ordered. Lured by the prospect of treble-damages and attorneys' fees,²⁴ General Beverage filed suit claiming its termination not only breached its contract, but also violated section 1 of the Sherman Act because it was prompted by a refusal to abide by vertically imposed territorial sales restrictions.²⁵ The suit proceeded to trial in August 1976, and the jury, instructed that the territorial sales restrictions were, according to *Schwinn*, per se illegal, found that East-Side had violated the antitrust laws and thereby caused injury to General Beverage's business.²⁶

effectively stifled, given the local nature of television retailing, all competition between them. *But see* 433 U.S. at 59-60 (White, J., concurring).

22. 433 U.S. at 58. The Court articulated the classic justification for a per se rule in *Northern Pacific Ry. v. United States*, 356 U.S. 1, 5 (1958).

23. 433 U.S. at 55.

24. At trial General Beverage obtained a verdict for \$500,000 trebled pursuant to 15 U.S.C. § 15 (1970) to \$1,500,000. 568 F.2d at 1151. The district judge awarded attorneys' fees in the amount of \$127,564.98 for 2,531.3 hours of legal services billed at plaintiff's normal rate of \$50 per hour. Apparently not satisfied, General Beverage moved that East-Side be forced to pay twice the normal rate, but the motion was denied. *General Beverage Sales Co.-Oshkosh v. East-Side Winery*, [1977] 1 TRADE CAS. (CCH) ¶ 61,283 (E.D. Wis. Feb. 1, 1977), *rev'd*, 568 F.2d 1147 (7th Cir. 1978).

25. In addition, General Beverage alleged that East-Side shipped goods more quickly to competing distributors, as well as favoring them with promotional allowances and services and facilities, all in violation of sections 2(d) and 2(e) of the Robinson-Patman Act, 15 U.S.C. §§ 13(d), (e) (1970). 568 F.2d at 1150.

26. The jury was asked, "Did the defendant East-Side Winery violate the antitrust laws of the United States?" 568 F.2d at 1151. Since the district judge defined antitrust laws as including the Robinson-Patman Act, the jury's affirmative response could not be sustained on the theory that it was independently supported by East-Side Winery's violation of the Robinson-Patman Act.

East-Side appealed, but before the Seventh Circuit heard the case, the United States Supreme Court handed down *Continental T.V.*

Recognizing²⁷ that the court was bound to apply the current law rather than the law that existed at the time of the trial,²⁸ General Beverage sought to avoid the necessity of a retrial under *Continental T.V.* by arguing that the decision dealt only with location clauses and not with territorial sales restrictions.²⁹ The Seventh Circuit was not persuaded that Justice Powell's language was so limited. In fact, it found that he had expressly rejected the very distinction that General Beverage urged, stating, "The fact that one restriction was addressed to territory and the other to customers is irrelevant to functional antitrust analysis."³⁰ The judgment, concluded the court of appeals, had to be reversed and remanded for a new trial.

The logic of *Continental T.V.* compelled the Seventh Circuit's conclusion. In *Continental T.V.*, the Supreme Court reached the question of the continued viability of *Schwinn* only because it could not find, for antitrust purposes, a principled basis for distinguishing location clauses from territorial sales restrictions. Had the Seventh Circuit permitted location clauses to be tested under the rule of reason but subjected territorial sales restrictions to a per se rule, it would have rendered the Supreme Court's decision mere surplusage, an idle postscript to the Ninth Circuit's opinion. By refusing to do so the Seventh Circuit joined almost every other court which has been asked to interpret the proper scope of *Continental T.V.*³¹

27. General Beverage did argue that East-Side waived its challenge to the instructions by failing to object at trial. The court rejected the argument because to do otherwise would (1) undermine the policy of applying the existing law rather than the law that existed at the time of the trial, and (2) exceed the purpose of requiring contemporaneous objection which is to permit the trial judge to correct any errors. 568 F.2d at 1152.

28. *Bradley v. Richmond School Bd.*, 416 U.S. 696, 711 (1975). *Thorpe v. Housing Auth.*, 393 U.S. 268, 281 (1969).

29. General Beverage also argued that *Continental T.V.* was not controlling for territorial restrictions used as part of a resale price maintenance scheme. While conceding that the argument might reflect a fair reading of the case, the Seventh Circuit found it inapplicable to this case. 568 F.2d at 1153.

30. 433 U.S. at 46.

31. See *Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc.*, 572 F.2d 883 (1st Cir. 1978), *petition for cert. filed*, 46 U.S.L.W. 3793 (U.S. June 14, 1978) (No. 77-1769). (Defendant terminated plaintiff's dealership for violating its policy of making sales outside of its territory at prices below list. Reasoning that defendant's policy was no worse than territorial restrictions alone, the court reversed the judgment for plaintiff and remanded the cause for a new trial in light of *Continental T.V.*); *Lamp Liquors, Inc. v. Adolph Coors Co.*, 563 F.2d 425 (10th Cir. 1977); *Adolph Coors Co. v. A & S Wholesalers, Inc.*, 563 F.2d 425 (10th Cir. 1977); *Florida Harvestore, Inc. v. A.O. Smith Harvestore Prods., Inc.*, [1977] 2 TRADE CAS. (CCH) ¶ 61,679 (5th Cir. Oct. 17, 1977); *United States v. Arnold Schwinn & Co.*, [1977] 2 TRADE CAS. (CCH) ¶ 61,776 (N.D. Ill. Nov. 23, 1977) (vacating the injunction issued in *Schwinn* on remand and approving the vertical restraints in the company's revised authorized Dealer Agreement); *Newberry v. Washington Post Co.*, 438 F. Supp. 470 (D.D.C. 1977); *Lucas Hoist & Equip. Co. v. Eaton Corp.*, [1978] 1 TRADE

TYING AND SECTION TWO MONOPOLY "MISUSE"

With all the earmarks of a hum-drum dealer cancellation case, *Sargent-Welch Scientific Co. v. Ventron Corp.*³² hardly seemed the likely vehicle for potentially limiting the reach of the tying laws or for an apparently expansive interpretation of section two of the Sherman Act.³³

Background

Ventron's Cahn Instruments Company developed and manufactured precision weighing devices, "electrobalances," which, utilizing an electromagnetic weighing principle, balanced a sample's unknown weight with the force of an electric current. With these instruments, a sample's weight could be determined with extraordinary accuracy by comparing the amount of electrical force needed to balance it with the amounts needed to balance standard weights.³⁴ Cahn electrobalances varied somewhat in their capacities, modes of operation, types of read-out, sources of power, and, most significantly for the purposes of this case, sensitivities. The least sensitive, a "millibalance" model, measured accurately to within 100 micrograms;³⁵ the most sensitive, a "microbalance" model, was accurate to within 1/20 microgram.³⁶ In 1971, the year in which Cahn terminated Sargent-Welch's dealership, Cahn sold 141 millibalances and 359 microbalances in the United States.³⁷

From the beginning of its operation, Cahn marketed its electrobalances in the United States primarily through dealers like Sargent-Welch. Sargent-Welch represented, in addition to Cahn, some 3,000 other manufacturers of various types of scientific and laboratory equipment. Its 1970 sales totalled about \$60,000,000, of which less than

Cas. (CCH) ¶ 62,046 (W.D. Pa. Dec. 1, 1977). The only discovered case containing arguably contrary language is *Pitchford Scientific Instruments Corp. v. Pepi, Inc.*, [1977] 2 TRADE CAS. (CCH) ¶ 61,741 (W.D. Pa. July 13, 1977). In that case, in an opinion manifestly hostile to the Supreme Court's opinion, the district judge distinguished *Continental T.V.* from the case before him on the ground, among others, that the former dealt only with location clauses.

32. 567 F.2d 701 (7th Cir. 1977), *petition for cert. filed*, 46 U.S.L.W. 3695 (U.S. May 1, 1978) (No. 77-1566).

33. 15 U.S.C. § 2 (1976).

34. 567 F.2d at 704 n.1.

35. A microgram is one one-millionth of a gram (.000001 gram); a gram is the weight equivalent of .035 ounces.

36. *Sargent-Welch Scientific Co. v. Ventron Corp.*, [1976] 2 TRADE CAS. (CCH) ¶ 61,146 (N.D. Ill. Nov. 1, 1976), *aff'd in part, vacated in part*, 567 F.2d 701 (7th Cir. 1977), *petition for cert. filed*, 46 U.S.L.W. 3695 (U.S. May 1, 1978) (No. 77-1566). In this article, models having sensitivities of less than one microgram will be referred to as microbalances, as they were by the Seventh Circuit.

37. *Id.* at 70,174.

\$40,000 were attributable to Cahn balances.³⁸

In order to “consolidate sales among its more effective dealers,”³⁹ Cahn began to eliminate those with spotty records.⁴⁰ Sargent-Welch’s performance suffered, in Cahn’s view,⁴¹ from decreasing sales,⁴² failure to carry millibalances, and inadequate promotion.⁴³ In April 1971 Cahn cancelled.

The cancellation, according to Sargent-Welch’s complaint, contravened the antitrust laws in two ways. First, it furthered Cahn’s tie of millibalances to microbalances in violation of section one of the Sherman Act⁴⁴ and section three of the Clayton Act.⁴⁵ Second, it constituted, along with its dealer reduction program, an effort by Cahn to maintain its monopoly in electromagnetic microbalances and to use that monopoly to enhance the sales of its millibalances in violation of section two of the Sherman Act.⁴⁶ After a bench trial in the fall of 1976, the District Court for the Northern District of Illinois entered judgment for Cahn.⁴⁷ On the tying claim the district court found not

38. 567 F.2d at 705.

39. *Id.* Apparently Cahn predicted that if it limited the number of its dealers, each could realistically hope to make sufficient sales of Cahn balances to justify the expense of technical training for its salesmen. Presumably, the better trained salesmen would make more sales. *Id.* at 712.

40. Giving explanations similar to the one it gave Sargent-Welch, Cahn cancelled two other dealers in 1972. *Id.* at 705.

41. In his letter cancelling the Sargent-Welch dealership, Cahn’s director of marketing noted these factors which were purportedly related to the action taken. *Id.*

42. Sargent-Welch’s orders of Cahn products fell from \$148,000 in 1968 to \$68,272 in 1969 to \$39,728 in 1970. Its orders for the first quarter of 1971 were about the same as for the first quarter of 1970. [1976] 2 TRADE CAS. (CCH) ¶ 61,146 at 70,172-73.

43. For example, Cahn’s balances were indexed in Sargent-Welch’s Catalog 119, described by Sargent-Welch’s president and board chairman as its “most important selling tool,” under the company’s name and the terms “balance” and “Electrobalance.” The only balances indexed under the term “Microbalances” were those manufactured by a competitor. Yet the introduction to Catalog 119 explains to the reader that “each item in the general index is entered by every probable terminology.” (Finding of Fact #25). *Id.* at 70,173.

44. 15 U.S.C. § 1 (1976).

45. 15 U.S.C. § 14 (1976).

46. Sargent-Welch also claimed that Cahn cancelled the dealership to enforce its illegal resale price maintenance or “fair trade” program. The district court found that Cahn maintained prices only in “fair trade” states, a practice then protected by the Miller-Tydings Amendment, Act of August 17, 1937, 50 Stat. 693 (1937), and the McGuire Act, Act of July 14, 1952, Pub. L. No. 542, 66 Stat. 631 (1952). Only in California, where it competed with its own dealers, did Cahn’s program fall outside the scope of those laws’ protection. Even the illegality of the California program was unavailing to Sargent-Welch, however, for the district court also found that Cahn’s cancellation of the dealership was unrelated to Sargent-Welch’s price-cutting. Moreover, the district court found that Sargent-Welch failed to prove that it suffered any injury from that program. The Seventh Circuit, while suggesting that the California program might well have been protected, upheld the district court’s other findings as well-supported by the evidence. 567 F.2d at 706-08.

47. [1976] 2 TRADE CAS. (CCH) ¶ 61,146 (N.D. Ill. Nov. 1, 1976), *aff’d in part, vacated in part*, 567 F.2d 701 (7th Cir. 1977), *petition for cert. filed*, 46 U.S.L.W. 3695 (U.S. May 1, 1978) (No. 77-1566).

only that:

Sargent-Welch "failed to prove that defendant attempted to coerce plaintiff into handling [its] new products by, for example, threatening termination," or that Cahn "refused to sell its microbalances to a dealer who would not handle the millibalance," but also that Cahn "did not require its dealers to handle the millibalance models as a condition to continuing to be a dealer."⁴⁸

In short, the court found that Cahn did not engage in tying. On the section two claim, the district court found that Cahn enjoyed a nonmonopolistic 8.2 percent share of the relevant precision balance product market, did not intend to have the power to monopolize that market, and had neither obtained nor maintained its position in the electromagnetic microbalance field by illegal means.⁴⁹ Sargent-Welch appealed this district court decision.

Tying

The United States Court of Appeals for the Seventh Circuit stated that "[t]o establish a tying arrangement violative of § 1 of the Sherman Act or of § 3 of the Clayton Act the plaintiff must first prove an agreement or understanding between the seller and buyer conditioning the seller's sale of one product upon the buyer's purchase of another."⁵⁰ The district court had seemingly found that Cahn did not, in fact, condition the sale of its microbalances upon the purchase of its millibalances. Since the appellate court found that this conclusion was supported by adequate evidence,⁵¹ it could have been a routine matter to affirm the judgment on the tying claim. But antitrust cases, based on laws of near-constitutional dimension and arising with relative infrequency, seem to tempt courts to reject the routine in favor of the overbroad. The Seventh Circuit did not resist this temptation. The court went out of its way, through dictum and by necessary implication, to twice limit the reach of the tying laws.

The "Individual Coercion Doctrine"

Not content with its explanation of the tying offense, the Seventh Circuit observed that "[c]oercion has [also] been viewed as an essential element."⁵² As pure dictum this observation had no impact on the Cahn/Sargent-Welch dispute, but it may, if followed, place a major obstacle in the path of plaintiffs in tying cases. For example, a Mc-

48. 567 F.2d at 709.

49. *Id.* at 706.

50. *Id.* at 708.

51. *Id.* at 709.

52. *Id.* at 708.

Donald's franchisee might know that it is useless or against his ultimate best interests to overtly resist McDonald's "request" that he buy his hamburger meat from the franchisor's regional storehouse. If he complained of tying in an antitrust suit, he would experience some difficulty proving that McDonald's conditioned the granting of the franchise on the purchase of its meat. But having acceded to the "request," he would have considerably more trouble proving that McDonald's actually "coerced" him into making those meat purchases.⁵³ Generally, plaintiffs like the hypothetical McDonald's franchisee could find the burden of distinguishing "coercion" from "persuasion" extremely onerous.⁵⁴

Making litigation more arduous for plaintiffs in tying cases is perfectly proper, of course, as long as it is required by or consistent with the prohibition on tying. Neither the broad formulation of section one nor the narrow language of section three speaks expressly of coercion. In interpreting those statutes, the United States Supreme Court has said that coercion of distributors by suppliers is one of the evils of tying,⁵⁵ but it has neither held nor suggested that it is one of the elements of the offense.⁵⁶

The "individual coercion doctrine" seems to have had its genesis in lower court rulings on class certification in suits brought by franchisees against their franchisors.⁵⁷ Opposing certification under rule 23(b)(3) of the Federal Rules of Civil Procedure,⁵⁸ the franchisors have argued that questions of fact common to all class members do not predominate since each plaintiff must prove that he was "coerced." The argument has struck a responsive chord in courts which seem to be troubled by the prospect of awarding treble damages to franchisees who initially welcomed the opportunity to purchase the allegedly tied products.

As a limitation on recovery the "doctrine" may make some

53. See generally Austin, *The Individual Coercion Doctrine in Tie-In Analysis: Confusing and Irrelevant*, 65 CAL. L. REV. 1143 (1977) (hereinafter cited as Austin).

54. Cf. *Ungar v. Dunkin' Donuts of America, Inc.*, 531 F.2d 1211 (3d Cir.), cert. denied, 429 U.S. 823 (1976). (In rejecting a class certification on the ground that each member of the class would have to show that he or she had been individually coerced, the court admitted that "there can be no bright line distinguishing influence, persuasion, and aggressive salesmanship on the one hand from coercion on the other." *Id.* at 1224. Neither the franchisor's superior economic power nor its practice of permitting franchisees only thirty days to obtain equipment from a supplier other than the one approved by the franchisor was sufficient to prove that all franchisees were "coerced.")

55. *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 605 (1953).

56. Austin, *supra* note 53, at 1147-49.

57. *E.g.*, *Response of Caroline, Inc. v. Leasco Response, Inc.*, 537 F.2d 1307 (5th Cir. 1976); *Lah v. Shell Oil Co.*, 50 F.R.D. 198 (S.D. Ohio 1970).

58. FED. R. CIV. P. 23(b)(3).

sense.⁵⁹ In the usual case, the plaintiff claims that his business or property was injured by a tie to the extent that he purchased "unwanted" tied products.⁶⁰ The injury may be rather difficult to verify. It would seem tautological that the plaintiff, typically a businessman, purchased the defendant's products because they were worth the asking price. Distinguishing, then, between the "wanted" and the "unwanted" purchases may become quite a metaphysical challenge. That challenge should be met by the plaintiff since he is the one claiming injury and he is in a better position than the defendant to show what it is that he "wanted." Requiring proof of "coercion" may be an effective method of making sure that the plaintiff verifies his injury. Many courts, however, have not made such limited use of the "doctrine."⁶¹

Rather, the courts have interpreted the doctrine to require proof of "coercion" as an element of the offense. This requirement appears to be inconsistent with both the "anti-leverage" and "anti-discrimination" rationales of the prohibition on tying. Traditionally, tying was thought to be an antitrust evil for it supposedly enabled a monopolist to use his power in one market as a lever in gaining a monopoly in another. Modern economic scholarship has largely discredited this "leverage" theory, suggesting instead that tying may be used to facilitate price discrimination.⁶² Price discrimination itself may be an antitrust evil. As a revenue-maximizing device, it may attract resources into socially inefficient efforts to monopolize,⁶³ or it may simply "imply the existence of power that a free market would not tolerate."⁶⁴ Whether the evil to be avoided is a "levered" monopoly or price discrimination, it should be of no concern to an antitrust court in deciding the liability question that the particular plaintiff before it can or cannot prove that he was "coerced." It is the practice itself, not the plaintiff's state of

59. Cf. *Kestenbaum v. Falstaff Brewing Corp.*, 514 F.2d 690 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976). (Plaintiff-distributor claimed, *inter alia*, that he lost profits due to defendant-brewery's practice of placing a ceiling on wholesale prices. The ceiling was allegedly created by the brewery's instructions to stay competitive with other local or "popular" brands coupled with its practice of automatically increasing its own selling price by one-half of any increase imposed by him. Despite the distributor's admission that he would have remained competitive in any event, the jury returned a verdict in his favor. Reversing, the appellate court suggested that the distributor could recover damages, if any, only for those lost profits attributable to the brewery's coercion.)

60. The plaintiff will commonly argue that he purchased tied products which were more costly than substitutes made by the defendant's competitors or which were simply not used.

61. See the cases collected in Austin, *supra* note 53, at 1145 n.8.

62. See POSNER, *ANTITRUST LAW* 171-78 (1976); Bowman, *Tying Arrangements and the Leverage Problem*, 67 *YALE L.J.* 19 (1957); Director & Levi, *Law and the Future: Trade Regulation*, 51 *Nw. U.L. REV.* 281 (1956); Markovits, *Tie-ins, Reciprocity, and the Leverage Theory*, 76 *YALE L.J.* 1397 (1967).

63. POSNER, *ANTITRUST LAW* 176-78 (1976).

64. *United States Steel Corp. v. Fortner Enterprises*, 429 U.S. 610, 617 (1977).

mind, that is arguably dangerous.⁶⁵

The Seventh Circuit and the federal district courts in Illinois, Indiana, and Wisconsin would do well to narrow the *Sargent-Welch* "coercion" dictum. It could be construed, for example, to require proof of "coercion" as an element of the offense only in similar cases, dealer cancellation suits, in which "coercion" is likely to be at issue in any event.⁶⁶ Alternatively, without doing violence to the case or tying law, one could read the dictum to mean no more than an authorization to take "coercion" into account in assessing damages.

The Requirement of "Something More Than An Inference?"

Sargent-Welch places still another limitation on the law of tying. Unfortunately, this second limitation is so metaphysical that it must be suggested by analysis rather than stated directly. The first step in the analysis will be to identify the crucial element of the tying offense and its communication component. That will provide a useful context within which to examine the Seventh Circuit's opinion. At the close of the examination, it will only remain to recognize the necessary implication.

Whatever its vices, the offense of tying is at least well-named. The name itself clearly identifies the offense's crucial element: conditioning the sale of one product on the purchase of another. It is the condition that gives the offense its distinctive character; it is the condition that supposedly gives rise to untoward effects in the market place.

All would presumably agree that if a tie is to be more than a seller's wistful daydream, the condition must be communicated to a buyer. The message might be sent, of course, in any number of ways and one might imagine them arrayed along a continuum of "expressness." At the "most express" end one might find, for example, a seller's take-it-or-leave-it order form for the purchase of product A which conditions any sale on the buyer's simultaneous purchase of product B. Around the middle of the continuum one might find, for another example, a manufacturer's letter advising a recalcitrant dealer that since his practice of purchasing product A to the exclusion of product B was not only unprecedented, but also disproportionately raised shipping costs, and "disrupted transactions with other dealers," a re-evaluation of the existing relationship would be undertaken. And, at

65. Of course, the "individual coercion doctrine" may be an effective but intellectually dishonest way of undermining the Supreme Court's "quasi-per se" rule against tying. See *Fortner Enterprises v. United States Steel Corp.*, 394 U.S. 495 (1969).

66. Austin, *supra* note 53, at 1165-68.

the "least express" end, one might find for a final example, a supplier's unpublicized and unexplained practice of cancelling distributorships which, according to government compiled statistics, placed annual product B orders amounting to less than seventy-five percent of their product A orders. The seller's choice of medium for sending his message may have an impact on the buyer's ability to make his case, but it is immaterial to the existence of the tie.

In *Sargent-Welch* the Seventh Circuit failed to distinguish the medium from the message. It mistakenly focused on an agreement or understanding between seller and buyer, a bilateral contract of sorts, as the crucial element of tying.⁶⁷ The court acknowledged that the agreement or understanding might be inferred from the circumstances,⁶⁸ but it held, giving the findings of fact a peculiarly narrow interpretation, that *Sargent-Welch* had simply failed to prove one.⁶⁹ Thus, the offense had not been established. That did not preclude the possibility, however, at least in the court's view, that Cahn had "unilaterally us[ed] monopoly power in microbalances to force unwanted millibalances on its dealers."⁷⁰ Although a potential section two violation, this practice, according to the court, would not have constituted tying.

This distinction between "agreement or understanding" and "unilateral forcing" does not turn at all on whether the sale of one product is or is not conditioned on the purchase of another. Rather, it rests entirely on the manner in which the condition is communicated. On the one hand, if the condition is stated in so many words or suggested by the language used under the circumstances, then there is an "agreement or understanding" and, of course, a tie. The seller's order form and the manufacturer's letter would be examples. On the other hand, if the condition is communicated by way of conduct and reasonable inference, there is "unilateral forcing" and no tie. An example might be the supplier's distributorship cancellation practice. In effect, the court eliminates the most subtly communicated ties from the reach of section one and section three.

This limitation is unsound for at least three reasons. First, it does little more than invite the substitution of subtle for direct communica-

67. 567 F.2d at 708-09.

68. *Id.* at 709.

69. *Id.* At the risk of being repetitious the district court made numerous findings to make it abundantly clear that Cahn had not conditioned the sale of microbalances on the purchase of millibalances. [1976] 2 TRADE CAS. (CCH) ¶ 61,146 *passim* (N. D. Ill. Nov. 1, 1976), *aff'd in part, vacated in part*, 567 F.2d 701 (7th Cir. 1977), *petition for cert. filed*, 46 U.S.L.W. 3695 (U.S. May 1, 1978) (No. 77-1566).

70. *Id.* The court subsequently addressed the question of relevant market and market share. 567 F.2d at 709.

tion as a means of committing the offense. Second, it is not well-suited to judicial use for it requires a highly metaphysical inquiry into the inner process by which a buyer becomes aware of the seller's tie. Third, it seems to bear no discernible relationship to the policies underlying the prohibition against tying.

Section Two "Abuse of Monopoly"

As the Seventh Circuit limited the reach of the tying laws so it expanded the scope of section two. According to the court, Cahn's alleged use of "monopoly power in microbalances to force unwanted millibalances on its dealers" did not violate the tying laws but could well have violated section two. Two obstacles to this expansion of section two, however, loomed large. One was the district court's finding that the relevant product market was precision balances. Cahn had only 8.2 percent of that market and it had neither the intent nor the power to monopolize it. The other was the district court's finding that Cahn had obtained and maintained its position in electromagnetic microbalances "due . . . to its patents, its skill and knowledge, and its aggressiveness."⁷¹

The Relevant Market

A section two claim ultimately calls into question the extent of the defendant's power, usually the power to raise the price and restrict the output of a particular good or service. Answering the ultimate question directly, however, would be a task of extraordinary complexity. The task may be simplified by indulging in the reasonable presumption that the greater the defendant's share of the market, the greater is his power. Then, the antitrust court may undertake to make two lower order inquiries. First, what definition of the market will best capture the play of supply and demand forces which significantly impinge on the defendant's conduct? Second, what is the defendant's share of that market? If these instrumental inquiries are undertaken with the ultimate question firmly in mind, their resolution should help answer it.

In the instant case, Sargent-Welch claimed that Cahn had the power to "force" it and other dealers to purchase millibalances in order to obtain microbalances. Any such power would have been limited, naturally, by the dealers' ability to acquire substitute products. To dealers who ordered microbalances for resale, not end-use, all other scientific and laboratory equipment may have been substitute products.

71. [1976] 2 TRADE CAS. (CCH) ¶ 61,146 at 70,168.

That equipment, it could have been argued, constituted the relevant product market for evaluating Cahn's alleged power.⁷² Since Cahn's share of that market must have been negligible, it could have been presumed that Cahn's power was, too. But apparently the argument was never made.

Indeed, the district court and the Seventh Circuit inquiries into the relevant product market were made without consideration of the ultimate power question. Consequently, both courts ignored the economics of Cahn's relationship with its dealers. Instead, each court, invoking the language of *Brown Shoe*⁷³ and *du Pont*,⁷⁴ focused on the interchangeability of electromagnetic microbalances and other instruments for the purposes of potential end-users. Potential end-users, however, were supplied by dealers like Sargent-Welch and were not "forced" to purchase any Cahn product. Thus, the courts' focus caused their market analyses to be largely beside the point.⁷⁵

But even assuming materiality *arguendo*, the courts' focus also caused their market analyses to be substantially incomplete. Demand forces, like the interchangeability of products for particular purposes, are only one-half of those that shape a market. The other one-half are supply forces. To be complete, a market analysis must take into account the forces of both demand and supply. The Tenth Circuit's market analysis in *Telex Corp. v. I.B.M. Corp.*,⁷⁶ for example, did just that. Telex claimed that I.B.M. unlawfully monopolized a market which it defined as peripheral equipment plug-compatible with I.B.M. Demand forces supported Telex's definition. Only peripheral equipment plug-compatible with I.B.M. computers could be used by I.B.M. computer end-users. Nevertheless, the court rejected Telex's definition. Supply forces supported the rejection. Other manufacturers could have made their peripheral equipment plug-compatible with I.B.M. computers with the simple and inexpensive addition of an adaptive "in-

72. *Cf. Cass Student Advertising, Inc. v. National Educ. Advertising Serv., Inc.*, 516 F.2d 1092 (7th Cir. 1975). (In *Cass*, the court held that the defendant might have market power in the market for representing college newspapers in the placement of national advertising even though it did not have market power in the market for publicizing a national advertiser's product or service to college students. The court stated, "It would . . . be possible for a middleman to lack the requisite market power in one direction while achieving a complete stranglehold in the other direction." *Id.* at 1099. Similarly, Cahn might have market power in relationship to microbalance end-users without having market power in relationship to scientific and laboratory equipment dealers.)

73. *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962).

74. *United States v. E.I. DuPont de Nemours & Co.*, 351 U.S. 377, 395 (1956).

75. Clearly, the characteristics of potential end-user demand for electronic microbalances would bear marginally on Cahn's power with respect to its dealers.

76. 510 F.2d 894, 914-19 (10th Cir.), *cert. denied*, 423 U.S. 802 (1975), *overruled in* *Memorex Corp. v. I.B.M. Corp.*, 555 F.2d 1379 (10th Cir. 1977).

terface.” Taking into account both demand and supply forces, the Tenth Circuit defined the market as all peripheral equipment. The *Sargent-Welch* courts did not profit by the Tenth Circuit’s example. By focusing on the interchangeability of electromagnetic microbalances with other instruments for the purposes of end-users, both the district court and the Seventh Circuit failed to take into account supply forces. Neither court considered the possibility, for example, that several instrument manufacturers might have been ready, willing and able to retool their facilities for the production of electromagnetic microbalances had Cahn effectively raised its prices by “forcing” dealers who wanted microbalances to purchase millibalances. The courts’ market analyses were, therefore, incomplete.

Although both courts’ analyses of interchangeability were largely beside the point and significantly incomplete, at least the district court’s opinion appears to have been somewhat better rooted in business reality than the Seventh Circuit’s. The district court defined the relevant product market as all precision balances. In support of that definition, it found that electromagnetic microbalances competed in end-use with mechanical microbalances, electromagnetic millibalances, and non-gravimetric devices used instrumentally to generate comparable measurements.⁷⁷ On appeal, these findings were held clearly erroneous.⁷⁸ Mechanical microbalances were considered non-competitive because, unlike their electromagnetic cousins, they had to be shielded from heat and vibration, could not be used in a vacuum, and were not designed for use with a recorder to measure weight changes over time. Electromagnetic millibalances were considered non-competitive because they were incapable of measurement as accurate as that of microbalances. Further, non-gravimetric devices were considered non-competitive because “[t]estimony as to non-gravimetric techniques was largely hypothetical.”⁷⁹ In the Seventh Circuit’s view, “an end-user who had certain applications had little choice but to purchase a[n] [electromagnetic] microbalance.”⁸⁰ Accordingly, it redefined the relevant product market as electromagnetic microbalances.⁸¹

77. [1976] 2 TRADE CAS. (CCH) ¶ 61,146 at 70,168.

78. 567 F.2d at 709-11.

79. *Id.* at 710.

80. *Id.* at 711.

81. In support of its market definition the court did mention several other factors. One was that the self-aggrandizing statements made by Cahn executives suggested to the court that “Cahn considered microbalances as a distinct market and itself as the market leader.” *Id.* Another factor consisted of the intertwined observations that “Cahn’s pricing structure was unrelated to that of coarser balances” and that “because of Cahn’s preeminence in the microweighing field, the demand for its microbalances was relatively insensitive to price changes.” *Id.* Neither sales puffery nor good quality, however, should define a market.

These market definitions may be tested for functional value by how well they reflect the product context in which the potential end-user makes his choice. The potential end-user here needs to measure the weight, or another functionally related property, of an object. To meet that need, the end-user employs one of a variety of instruments, each of which has its own level of accuracy and its own price tag. The choice of instrument, it is submitted, must ultimately depend on whether a given level of accuracy is worth the associated price. For example, suppose a potential end-user has narrowed his choice to three Cahn instruments:⁸² (1) the G-2 microbalance which is accurate to 1/20 microgram and costs \$5,000; (2) the RG microbalance which is accurate to 1/10 microgram and costs \$2,500; and (3) the RH millibalance which is accurate to 2 micrograms and costs \$125. The G-2 is twice as accurate and, under the stated assumptions, twice the price of the RG; the RG, in turn, is twenty times as accurate and, under the pricing assumptions, twenty times the price of the RH. The potential end-user then will predict the amount of additional income which he can generate over the life of the instrument by making more accurate measurements. If the predicted amount is very great he may choose the G-2; if it is more moderate, he may choose the RG; and if it is quite small, he may choose the RH. In any event, the product context in which he makes his choice seems to include both electromagnetic microbalances and millibalances. Similar illustrations involving mechanical microbalances and non-gravimetric devices would suggest that they, too, are part of the product context. When the test for functional value is applied, it seems that the district court's precision balance market definition is more realistic than the Seventh Circuit's electromagnetic microbalance market definition.

Monopoly "Misuse"

Once the relevant product market was defined as electromagnetic microbalances, it was indisputable that Cahn with its ninety percent share, had a monopoly,⁸³ but that, in and of itself, was not illegal. Section two would have been transgressed, of course, had Cahn obtained or maintained its monopoly by untoward means⁸⁴ or used it in an attempt to monopolize the larger precision balance market.⁸⁵ Cahn,

82. The sensitivity specifications are based on actual data. [1976] 2 TRADE CAS. (CCH) ¶ 61,146 at 70,172. The price of each item has been assumed solely for purposes of illustration.

83. 567 F.2d at 709.

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

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

however, had done none of these.⁸⁶ Nevertheless, the Seventh Circuit remanded the section two claim on the ground that the district court's findings did not preclude the possibility that Cahn had "misused monopoly power."⁸⁷

As authority for the existence of this novel "monopoly misuse" offense, the court relied on *United States v. Griffith*⁸⁸ and *Lorain Journal Co. v. United States*.⁸⁹ Its reliance was misplaced for, despite Justice Douglas' colorful and undisciplined opinions, both cases dealt with standard section two fare. In *Griffith* the Supreme Court held that a movie theater circuit which owned the only theater in some towns violated section two by using that monopoly to gain another in those towns where its theater faced competition. In *Lorain Journal* the Supreme Court held that a newspaper publisher which had had a monopoly in the mass dissemination of news and advertising prior to the entry of a competing television station violated section two when it tried to re-obtain or maintain that monopoly by organizing and enforcing an advertising boycott of its competitor. Since the Seventh Circuit found that Cahn's conduct did not resemble that of the movie theater circuit or the newspaper publisher, but might still be illegal, it appears that the court may have invented a new offense.

The court did little to explain the meaning of its invention. Its entire explanation consisted of dividing the undefined offense into two categories of conduct. The first category included "acts . . . which, because of their tendency to foreclose competitors from access to markets or customers or some other inherently anticompetitive tendency, [were] unlawful under § 2 if done by a monopolist."⁹⁰ The second category included other undescribed acts which would be illegal only if done by a monopolist for unspecified forbidden purposes.

The court's use of its invention was equally unilluminating. Having fixed its categories, the court eschewed analysis and merely sought to classify Cahn's dealer reduction program and cancellation of the Sargent-Welch dealership. Cahn's conduct, it thought, fell definitely without the first category but perhaps within the second. Legality turned on Cahn's purpose⁹¹ which would have to be determined by the

86. 567 F.2d at 709, 710 nn.14, 15.

87. *Id.* at 709.

88. 334 U.S. 100 (1948).

89. 342 U.S. 143 (1951).

90. 567 F.2d at 711-12.

91. The Seventh Circuit seemed to have made too much of Cahn's purpose. Although purpose may be useful in evaluating ambiguous conduct, it generally ought not convert otherwise legal conduct into that which is illegal. Cf. Cooper, *Attempts and Monopolization: A Mildly Expansionary Answer to the Prophylactic Riddle of Section Two*, 72 MICH. L. REV. 373, 392-400

district court on remand. If Cahn had reduced the number of its dealers to improve marketing efficiency⁹² and cancelled the Sargent-Welch dealership to eliminate a poor performer, its purposes were permissible. But if it had engaged in these acts to "further sales of millibalances to surviving dealers by causing them to fear that unless they handled millibalances they would not be able to buy microbalances,"⁹³ then its purpose was forbidden.

The Seventh Circuit's explanation and use of its invention suggests that monopoly "misuse," like hardcore pornography, cannot be defined but the court knows it when the court sees it. This undefined quality causes the invention to suffer from lack of both predictability and recognizable relationship to antitrust policy. These defects may be illustrated by way of example. Suppose MRL Company, which enjoys a ninety percent share of the thing-a-majig market, considers diversification. Assume its highly aggressive chief executive is intent on making his firm the leader in the tightly oligopolistic widget market. The executive plans to use retained monopoly earnings to finance *de novo* entry and a heavy promotional campaign featuring television advertising and massive give-aways. The executive asks his general counsel to review the plan for antitrust compliance. *Sargent-Welch* would not provide the general counsel with any way of gauging what the executive could do or even what the executive could wish to do. Conduct could be illegal because of its "inherently anticompetitive tendency" or because one of its animating purposes is forbidden. The general counsel will have to advise the executive that if the plan is put into effect, it may be challenged as monopoly "misuse" and that the likelihood of a guilty verdict cannot be predicted. After obtaining this advice, the executive could well decide that the risk of treble-damages, albeit uncertain, outweighs the probable gains of diversification. He might, therefore, scuttle his plan to the great detriment of widget consumers who should have been among the principal beneficiaries of any application of the antitrust laws.

The monopoly "misuse" offense does seem tailor-made for limiting "unfair" business conduct or "correcting" the inequality of economic advantage in the marketplace. Pursuit of these goals, however, is of doubtful desirability. It could weaken competitive discipline and

(1974) (hereinafter cited as Cooper). (Prof. Cooper suggests that for cases involving attempts to monopolize, the courts should re-define "specific intent," and recognize that the central task is to evaluate the alleged conduct.)

92. See note 39 *supra*.

93. 567 F.2d at 713.

create disincentives to efficiency.⁹⁴ Ultimately, non-optimal resource allocation could result. More importantly, pursuit of these goals would be inconsistent with the application of antitrust laws.

The Seventh Circuit's invention is seriously defective. Accordingly, its use should be restricted⁹⁵ or banned.

NON-ARBITRABILITY OF ANTITRUST CONTROVERSIES

Relationships between many business firms are governed by contracts containing a clause which requires all disputes to be submitted to arbitration. Yet, when one of these relationships ruptures, one firm is all too likely to bring suit, despite the clause, charging the other with violations of the antitrust laws as well as with more routine misdeeds. In *Applied Digital Technology, Inc. (Adtech) v. Continental Casualty Co.*⁹⁶ the Seventh Circuit decided that an antitrust complainant may indeed avoid arbitration if and to the extent that antitrust issues "permeate" the case. In so deciding, it joined in the view of every other court which has considered the matter.⁹⁷

Perhaps the unanimity of judicial opinion led the parties to argue the appeal as if the avoidability of arbitration were a given, the only question being the degree of "permeation" in this particular case.⁹⁸ Perhaps the parties' arguments, in turn, led the court to provide very little reasoning in support of its decision. In any event, all that it did provide was the Fifth Circuit's language in *Cobb v. Lewis*,⁹⁹ itself largely a paraphrase of the Second Circuit's in *American Safety Equipment Corp. v. J.P. Maguire*,¹⁰⁰ which the court described as an articulation of

94. Cooper, *supra* note 91 at 435-62. Elsewhere in his otherwise excellent article, Prof. Cooper advocates the recognition of the misuse of the monopoly power offense. *Id.* at 403-07. He would apparently limit the offense, however, to those activities which would have the likely effect of distorting competition in another market or of permitting the monopolist to more effectively exploit his market power. See also Hawk, *Attempts to Monopolize—Specific Intent as Antitrust's Ghost In the Machine*, 58 CORNELL L. REV. 1121, 1127-35, 1156-59 (1973).

95. If monopoly "misuse" were confined to instances of "unilateral forcing" then the substance, though not the language, of both the law of tying and section two would be the same in the Seventh Circuit as it is in other courts.

96. 576 F.2d 116 (7th Cir. 1978).

97. *E.g.*, *Cobb v. Lewis*, 488 F.2d 41 (5th Cir. 1974); *Varo v. Comprehensive Designers, Inc.*, 504 F.2d 1103 (9th Cir. 1974); *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968).

98. On the "permeation" question, the court held that it was not clearly erroneous for the district court to find that Adtech had a reasonable chance of success and that the arbitrator would have difficulty avoiding areas which require determinations critical to the antitrust claims. The correctness of the court's holding may well be doubted. For reasons suggested in the text, Adtech's antitrust claims appear weak. The area which the court seemed to think the arbitrator would have difficulty avoiding, Continental's "good faith," seems only tangentially related to antitrust.

99. 488 F.2d 41 (5th Cir. 1974).

100. 391 F.2d 821 (2d Cir. 1968).

the major underlying considerations. Enumerating these considerations, the Seventh Circuit stated:

The first is the broad range of public interests affected by private antitrust claims. The Court [in *American Safety Equipment Corp.* . . .] recognized that “[a] claim under the antitrust laws is not merely a private matter,” because private antitrust actions are an integral part of the effort of the antitrust laws “to promote the national interest in a competitive economy” The Second Circuit noted that it is doubtful Congress could have “intended such claims to be resolved elsewhere than and in the courts” The second is the complexity of the issues and the extensiveness and diversity of the evidence antitrust cases usually involve. These render antitrust claims “far better suited to judicial than to arbitration procedures” The third is the questionable propriety of entrusting the decision of antitrust issues to commercial arbitrators, who “are frequently men drawn for their business expertise,” when “it is the business community generally that is regulated by the antitrust laws.”¹⁰¹

These considerations, which will be examined seriatim, do not in fact require the court’s decision for they are of limited applicability, dubious relevance, or questionable validity.

A principal purpose of the antitrust laws is to secure for the consuming public the optimal allocation of resources available from vigorous competition.¹⁰² Any case arising under those laws might therefore affect the public interest. But simply because any case has that potential does not mean that every case realizes it. Antitrust suits are far too frequently brought by a firm in order to undo the verdict of the marketplace, to protect incumbent management from the threat of takeover, to invalidate contractual limitations on its business autonomy, or to gain negotiating leverage in an otherwise ordinary business dispute. The public interest in such suits is rather minimal. Consider, as examples, the other major private antitrust cases decided by the Seventh Circuit during the 1977-78 term.¹⁰³ Liquor retailers in the Oshkosh, Wisconsin area were probably unmoved by the replacement of General Beverage with another exclusive wholesaler as their supplier of East-Side Winery wines and beers. The sophisticated users of scientific and laboratory equipment were probably indifferent to whether they purchased their Cahn electromagnetic microbalances through Sargent-Welch’s or a rival’s catalogue. Surely the consuming public quite properly ignored both matters entirely. Before an antitrust plaintiff is

101. 576 F.2d at 117.

102. *Gordon v. New York Stock Exchange*, 422 U.S. 659, 689 (1975).

103. *General Beverage Sales Co. v. East-Side Winery*, 568 F.2d 527 (7th Cir. 1978); *Sargent-Welch Scientific Co. v. Ventron Corp.*, 567 F.2d 701 (7th Cir. 1977), *petition for cert. filed*, 46 U.S.L.W. 3695, (U.S. May 1, 1978) (No. 77-1566).

permitted to avoid arbitration on the ground that his claim affects the public interest he ought to show that there are reasons and/or evidence for believing that it does so.¹⁰⁴

It seems unlikely that Adtech could have made such a showing. It brought suit against Continental, Sybrandt, Inc., and Lockheed Electronics Corporation claiming breach of contract and warranty by Continental, tortious interference with contract by Sybrandt, and antitrust violations by all three. Continental demanded and commenced arbitration proceedings with respect to the contract claims and Adtech sought and obtained an injunction against those proceedings. Continental appealed from the issuance of that injunction. Continental had been engaged in the business of renting Lockheed computers and Sybrandt software to insurance agents and agencies. It entered into an agreement which contained a standard arbitration clause for the sale of its business, including its supply contracts, to Adtech. Before the sale was consummated, however, Continental sold out to Sybrandt, which had obtained its financing from Lockheed.¹⁰⁵ According to Continental the sale was made pursuant to its supply contract with Sybrandt which granted each party the right of first refusal in the event that the other wished to sell its interest. According to Adtech the sale was made pursuant to a conspiracy to "prevent Adtech from acquiring Continental's business, . . . to prevent Adtech from competing with Lockheed and Sybrandt, . . . and to monopolize¹⁰⁶ the rental of computers and computer software to insurance agents and agencies."¹⁰⁷

It is difficult to perceive the public interest at stake in Adtech's suit. Certainly there would be none in the mere identity of the new corporate owners of Continental absent some adverse effect on competition like an increase in concentration and the associated likelihood of tacit collusion or the establishment of a monopoly. It appears unlikely that the Sybrandt/Lockheed acquisition could have had any such effect. It was not even alleged that prior to the acquisition Sybrandt or Lockheed engaged in the business of renting computers and software to

104. *Cf.* *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974). (The Court ordered to arbitration a claim arising under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1976), despite its ruling in *Wilko v. Swan*, 346 U.S. 427 (1953), that a claim arising under the same statute was non-arbitrable. The Court justified its apparent departure from precedent on the grounds that considerations of international business and policies embodied in international law controlled. Although the case might be considered *sui generis*, it seems to suggest that the policies actually at stake, not merely the statute under which a claim is pressed, ought to determine the permissibility of arbitration.)

105. Lockheed had also agreed to indemnify Sybrandt for any liability stemming from the acquisition.

106. Adtech also accused the three defendants of conspiracy to monopolize.

107. 576 F.2d at 118.

insurance agents and agencies.¹⁰⁸ How their entry into that business would adversely affect competition is, at best, shrouded in mystery.

It can hardly be denied that antitrust cases commonly raise complex issues which must be decided on the basis of extensive and diverse evidence. Why that makes them far better suited to cumbersome judicial than to arbitration procedures is far from clear. The courts have expressed some concern that arbitration proceedings may not provide for thorough discovery¹⁰⁹ and effective appellate review,¹¹⁰ and perhaps it was those concerns which moved the Seventh Circuit. If so, then those concerns could be ameliorated by measures far less drastic than permitting an antitrust plaintiff to avoid arbitration.

The United States Arbitration Act,¹¹¹ which grants arbitrators the power to summon witnesses and compel the production of any book, record, document or paper which may be deemed material evidence,¹¹² is silent with respect to the availability of discovery devices to parties. In interpreting the Act, some courts have been reluctant to order the kind of far-reaching discovery which is characteristic of and arguably necessary for the prosecution of antitrust claims.¹¹³ Apparently, those courts feared that such discovery might interfere with the expeditiousness of arbitration. In *Bigge Crane & Rigging Co. v. Docatel Corp.*,¹¹⁴ however, the District Court for the Eastern District of New York held that it had the discretion to compel discovery so long as it did not delay arbitration.¹¹⁵ Extending *Bigge Crane*, a court could require that parties be permitted full discovery whenever it would order an antitrust claim to arbitration. Surely that would undercut the pro-arbitration policies of the Arbitration Act less than permitting an antitrust plaintiff to avoid arbitration.

The Arbitration Act does not require that a record of arbitration proceedings be made and the parties to a proceeding frequently wish to avoid the expense, procedural niceties, and formality associated with

108. Although it was not in issue, it may well be doubted that renting computers and software to insurance agents and agencies constitutes a meaningful market.

109. *E.g.*, *Wilko v. Swan*, 346 U.S. 427 (1953). *Cf.* Pitofsky, *Arbitration and Antitrust Enforcement*, 44 N.Y.U. L. REV. 1072 (1969) (suggesting a modification in the antitrust arbitration procedure to include effective techniques assuring plaintiffs of discovery).

110. *Wilko v. Swan*, 346 U.S. 427 (1953).

111. 9 U.S.C. §§ 1-14, 201-08 (1976).

112. 9 U.S.C. § 7 (1976).

113. *E.g.*, *Dickstein v. duPont*, 320 F. Supp. 150 (D. Mass. 1970) *aff'd*, 443 F.2d 783 (1st Cir. 1971).

114. 371 F. Supp. 240 (E.D.N.Y. 1973).

115. The court's decision was at least not inconsistent with, and perhaps was supported by, the Federal Rules of Civil Procedure. Rule 81(a)(3) provides that the federal rules apply only to the extent that matters of procedure are not provided for in the Arbitration Act. FED. R. CIV. P. 81(a)(3).

making one. The absence of a record, of course, makes judicial review of most arbitration proceedings rather ineffective. Ineffective review is only troublesome, however, if its expected costs exceed its expected benefits. The costs of ineffective review of arbitrated antitrust claims might be assessed as prohibitive either because arbitrators are more likely to make errors in the application of antitrust laws or because the external losses stemming from misapplication may be high. Even if that assessment were correct,¹¹⁶ a court could alleviate the trouble by requiring that a full record be made whenever it would order an antitrust claim to arbitration.¹¹⁷ Once again, that would better accommodate the Arbitration Act and the antitrust laws than permitting an antitrust plaintiff to avoid arbitration.

In questioning the propriety of entrusting antitrust claims to the decisions of commercial arbitrators, the court seems to be suggesting that the business expertise of the arbitrators creates a bias against antitrust enforcement. No factual support for that suggestion was offered and none could be found. Moreover, there seems little reason to accept it since businessmen are both antitrust plaintiffs and defendants.

The court's reasoning is further undermined by a well-accepted, though inapplicable, exception to the avoidability of arbitration by an antitrust plaintiff.¹¹⁸ The exception, recognized by the principal case upon which the Seventh Circuit relies,¹¹⁹ is made when the agreement to arbitrate is entered after the dispute arises. However, this exception exposes the speciousness of the three major considerations underlying the *Adtech* decision, for the timing of the agreement has nothing whatsoever to do with the public interest at stake in, the nature of the issues and evidence common to, or the impropriety of entrusting to commercial arbitrators the decisions about antitrust controversies.

The courts which have considered the exception seem to believe that an arbitration agreement entered after, rather than before, a dispute arises is more likely to represent a settlement procedure negotiated

116. That assessment is probably incorrect. Arbitrators, if properly selected, may well be more expert in the law of antitrust than many, if not most, federal district judges. See Aksen, *Arbitration and Antitrust—Are They Compatible?*, 44 N.Y.U. L. REV. 1097 (1969). Unless the public interest at stake in a particular antitrust claim is quite high, the external losses stemming from a misapplication of the antitrust laws are likely to be negligible.

117. In *Sobel v. Hertz, Warner & Co.*, 469 F.2d 1211 (2d Cir. 1972), the court reversed a remand to arbitration made for the purpose of developing a full record. The rationale for the decision was that requiring a record would frustrate some of the purposes of arbitration. The decision is not inconsistent with the suggestion made in the text, however, for it would frustrate the purposes of arbitration less to require a record than to have no arbitration at all.

118. See *Wilko v. Swan*, 346 U.S. 427 (1953); *Coenen v. R.W. Pressprich & Co.*, 453 F.2d 1209 (2d Cir. 1972).

119. *Cobb v. Lewis*, 488 F.2d 41 (5th Cir. 1974).

at arm's length, not one imposed by a powerful adversary.¹²⁰ This suggests that the true rationale for the avoidability of arbitration by antitrust plaintiffs may be protection from "overreaching." If that were the rationale, it would not require the decision reached by the Seventh Circuit for there is no reason to believe that Adtech was "overreached" by Continental.

Professor Pitofsky has made two additional arguments for permitting antitrust plaintiffs to avoid arbitration.¹²¹ Both are rooted in his laudable concern for deterring would-be antitrust violators. The first is that decisions of arbitrated antitrust claims would not put the business community on notice as to what its members may or may not do because arbitration decisions are generally not published. This argument is unpersuasive because it is at once too broad and too narrow. It is too broad for it applies equally to non-antitrust arbitrations. It is too narrow for it only suggests that courts require published decisions when they order antitrust claims to arbitration. The second argument is a bit more complex. Pitofsky predicts that treble-damage awards would be a rarity among decisions of arbitrated antitrust claims. Based on that prediction, he concludes that fewer suits would be brought by private attorneys general against local and not too flagrant violations which public agencies with limited budgets must ignore. It is not clear that his prediction is sound, particularly if courts would require records to be made and decisions to be published whenever antitrust claims were ordered to arbitration. But even if his prediction were sound, it does not follow that fewer private antitrust claims would be pressed. It is at least arguable that the lower costs and greater likelihood of success that might be associated with arbitration proceedings would provide as much incentive to private action as treble-damages.

Had the Seventh Circuit come to the opposite conclusion in *Adtech* it would have better effectuated the Arbitration Act and barred some time consuming, strictly private vexatious antitrust suits from federal court. It should have done so.

MERGERS: THE "GENERAL DYNAMICS DEFENSE"

In a 1975 civil action, the United States Department of Justice challenged the acquisition of a thirty-nine percent stock interest in Stei-

120. Indeed, in the seminal case, *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968), the court suggested, "[I]t is also proper to ask whether contracts of adhesion between alleged monopolists and their customers should determine the forum for trying antitrust violations." *Id.* at 827.

121. See Pitofsky, *Arbitration and Antitrust Enforcement*, 44 N.Y.U. L. REV. 1072 (1969).

ger Tractor, Inc. by International Harvester as likely to substantially lessen competition in both the production and the sale of high-powered four-wheel-drive farm tractors throughout the nation. After a bench trial, the district court found for the defendants¹²² and the government appealed. In *United States v. International Harvester Co.*¹²³ the Seventh Circuit held that the defendants had successfully proven two alternative theories to rebut the prima facie Clayton Act¹²⁴ case against them. The first theory was that due to Steiger's weak financial condition the past market shares upon which the government relied did not paint a true picture of Steiger's ability to compete in the future. The second was that other characteristics of the market simply made it unlikely that competition would be substantially lessened. Acceptance of the first theory constitutes an unwarranted departure from, while acceptance of the second theory is an economically sound application of, the principles of section seven.

At trial the government showed that by virtue of the stock acquisition an undue percentage share of the relevant market was brought under partly common control, resulting in a significant increase in concentration. The parties stipulated that the nationwide production and sale of high-powered four-wheel-drive farm tractors were the relevant markets within which to gauge the effects of the acquisition. In 1973, the year preceding the acquisition, both markets were already concentrated with the top four firms controlling seventy-nine percent of the production and seventy-four percent of the sales. The acquisition brought together Steiger, the third largest producer and fourth largest seller,¹²⁵ with International Harvester which ranked sixth in both markets. In 1973 Steiger accounted for sixteen percent of production and seven percent of sales while International Harvester had seven percent of production and eight percent of sales. By that showing alone, according to *United States v. Philadelphia National Bank*,¹²⁶ the government established its prima facie case against the acquisition.

Pursuant to *United States v. General Dynamics*,¹²⁷ however, the defendants sought to rebut the government's case. In *General Dynamics* the government attacked the merger of two coal mining companies each of which enjoyed a sizeable share of a concentrated

122. *United States v. International Harvester Co.*, [1976] 2 TRADE CAS. (CCH) ¶ 61,028 (N.D. Ill. Aug. 17, 1976), *aff'd*, 564 F.2d 769 (7th Cir. 1977).

123. 564 F.2d 769 (7th Cir. 1977).

124. 15 U.S.C. § 18 (1976).

125. The reason for the discrepancy is that Steiger produced some tractors for sale by other firms, including International Harvester. [1976] 2 TRADE CAS. (CCH) ¶ 61,028 at 69,530-31.

126. 374 U.S. 321 (1963).

127. 415 U.S. 486 (1974).

market. The government proved that a small number of leading producers dominated the coal mining industry; that there had been a trend toward increasing concentration; and that the merger significantly enhanced the acquiring company's market share—enough to establish prima facie illegality. Yet the Supreme Court upheld the merger. The companies had demonstrated that coal was sold principally to utilities on the basis of long-term contracts. Past production, therefore, was a misleading index of competitive vigor. A better index was uncommitted reserves of recoverable coal. Since the acquired firm had nearly exhausted its reserves and was not in a position to replenish them, there was in fact no substantial competition for the merger to lessen. Thus, the "*General Dynamics* defense" was born.

To establish a *General Dynamics* defense the defendants introduced evidence to prove that due to Steiger's weak financial condition, its market share, like that of the acquired firm in *General Dynamics*, overstated its future ability to compete. The health of Steiger's balance sheet in the years preceding the acquisition was anything but robust. In 1970 Steiger's assets, of which few were liquid, barely exceeded its liabilities, and it suffered a net loss of more than one-half million dollars on sales totalling almost three million dollars.¹²⁸ Its condition was so precarious that its suppliers refused to ship parts and components on credit. Management made efforts to correct some of the company's most pressing problems and, on the strength of a manufacturing agreement with a Canadian cooperative, secured debt financing through Merchants National Bank of Fargo. Still, at the end of 1971, Steiger's liabilities substantially exceeded its assets, and its losses had increased to more than \$800,000 despite the doubling of sales. In early 1972 Merchants National cut off the company's credit and advised its shareholders to sell the business.¹²⁹ Steiger remained afloat by borrowing working capital from its customers, but its liabilities grew faster than its assets. The only modest improvement it showed in 1972 was a reduction in its net loss. Not conventionally "bankable," Steiger turned for financing to a commercial credit firm. The firm required extensive collateral and Steiger's agreement to desist from certain corporate activities without the firm's consent. Its interest rates were high. For the first one and one-half million dollars in credit the firm charged 11 1/4 percent interest, almost twice the prime rate, and then for the second one and one-half million dollars 15 1/2 percent, almost three times the prime rate. At the close of fiscal 1973 Steiger's assets of

128. [1976] 2 TRADE CAS. (CCH) ¶ 61,028 at 69,531.

129. *Id.*

\$8,190,840 exceeded its liabilities of \$7,081,518 and it reported a net income of about one million dollars (about one-half of which resulted from loss carry-forwards). But even being in the black in 1973 did not change the fact that Steiger's financial condition was far worse than any of the other seven firms in the industry for which figures were available.¹³⁰ "[I]t could not withstand any economic adversities."¹³¹ It is certainly plausible that Steiger's weak financial condition impaired its ability to compete, but proof of that condition did not establish a *General Dynamics* defense. More should have been required. The acquired coal producing company in *General Dynamics* was an insubstantial future competitor not only because it had exhausted its reserves but also because it could not replace them. By analogy, the defendants should have been required to prove not only Steiger's condition but also that it could not be remedied.

They did not. The evidence adduced at trial showed that Steiger "made numerous and repeated efforts, beginning as early as 1971, to secure additional equity investment in the company through public and private offerings of Steiger stock from virtually any source."¹³² Some of those who were approached made offers.

In fact, some financing was offered on substantially the same terms as that offered by Harvester. For example, the investment banking firm of Dain, Kalman & Quail ("DKQ") offered to raise \$1 million for Steiger by a private placement of common stock or convertible subordinated debentures. When Steiger asked for a larger private placement, DKQ proposed \$2 - \$3 million equity financing in October 1973. Although DKQ's price of \$5 per share was the same that [International] Harvester later paid, Steiger rejected it because at that time Steiger felt the price was not high enough.¹³³

Yet the defendants persuaded the district court that all offers were rejected because "the financing firms . . . wanted too much of the company for a small amount of equity."¹³⁴ According to the district court, Steiger reasonably concluded that International Harvester's offer of a stock acquisition and manufacturing agreement was the "only practicable source of sufficient amounts of equity financing to solve its pressing needs."¹³⁵ One is left with the impression that the district court did not think that Steiger's financial condition was remediless but only that International Harvester's offer was the remedy least costly to those in

130. 564 F.2d at 775-76.

131. *Id.* at 776.

132. [1976] 2 TRADE CAS. (CCH) ¶ 61,028 at 69,531.

133. Brief for Appellant at 25, *United States v. International Harvester Co.*, 564 F.2d 769 (7th Cir. 1977).

134. [1976] 2 TRADE CAS. (CCH) ¶ 61,028 at 69,533.

135. *Id.*

control of Steiger. That was certainly the Seventh Circuit's interpretation for it held the district court's finding "fully supported by evidence showing the onerous options otherwise available to Steiger."¹³⁶

The fact that among Steiger's financing options International Harvester's offer was accompanied by the fewest restrictions on managerial prerogative or was least apt to dilute the value of existing shares, had little, if any, bearing on the company's future ability to compete. Had Steiger accepted an alternative offer it might not have been as profitable to its principals but it could have continued as an independent force in the market. Steiger's continued independent existence would have made tacit collusion, the real danger against which section seven is aimed, somewhat more difficult. By accepting the defendants' first rebuttal theory, then, the Seventh Circuit subordinated the probable harm from a likely lessening of competition to the very real gain for Steiger's existing management and shareholders. The court was mistaken in doing so for the purpose of section seven is to protect competition, and not competitors,¹³⁷ and certainly not those who happen to be in control of a particular competitor.¹³⁸

Nevertheless, the court correctly upheld the merger for tacit collusion in the relevant market appeared to be a rather remote possibility.¹³⁹ Increasing demand¹⁴⁰ and the introduction of new products¹⁴¹ would have made any understandings as to output or price extremely difficult to police. Had any such understandings been reached, they probably would have been disrupted by the entry of new firms and/or expansion by regional ones.¹⁴² Certainly, the slight decline in concentration,¹⁴³ the change in market share rankings,¹⁴⁴ and the evidence of price competition¹⁴⁵ were inconsistent with such understandings. Moreover, the partial nature of the acquisition and the portions of the Stock Purchase Agreement which provided that International Harvester shall not limit Steiger's efforts to sell its products to competitors of International Harvester or to undertake other financially sound business activities¹⁴⁶ also minimized the danger of tacit collusion. This evidence showed that the "concentration ratios, which can be unreliable

136. 564 F.2d at 779.

137. *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962).

138. *United States v. Amax*, 402 F. Supp. 956, 971 (D. Conn. 1975).

139. See POSNER, *ANTITRUST LAW* 47-77 (1976).

140. 564 F.2d at 770.

141. [1976] 2 TRADE CAS. (CCH) ¶ 61,028 at 69,540.

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.*

146. 564 F.2d at 777.

indicators of actual market behavior, did not accurately depict the economic characteristics of the . . . market."¹⁴⁷ The defendants' second theory established a proper *General Dynamics* defense and rebutted the government's prima facie case.¹⁴⁸ Thus, the Seventh Circuit was correct in affirming the district court's decision.

CONCLUSION

A close reading of the four major antitrust opinions authored during the 1977-78 term by the United States Court of Appeals for the Seventh Circuit suggests that the court possesses no coherent antitrust theory, no clear conception of the function of antitrust law. The court's jurisprudential conundrum is perhaps best illustrated by its approval of the International Harvester/Steiger Tractor merger, a merger which the government had proven presumptively harmful. In the court's view, apparently, the merger's presumptive harms were either outweighed by the benefits it would yield for Steiger's owners and managers or rebutted by evidence that the chances for oligopolistic coordination in the production and sale of four-wheel-drive farm tractors were small. It seems rather unlikely that those benefits and that evidence could both be of genuine antitrust significance.

Lacking a firm policy direction, the court eschewed functional antitrust analysis in favor of the mechanical application of language from some leading antitrust opinions. That approach led the court to the correct disposition of a vertical territorial restraint claim in *General Beverage Sales Co. v. East Side Winery*,¹⁴⁹ but to unsatisfactory dispositions of tying and monopoly "misuse" claims in *Sargent-Welch Scientific Co. v. Ventron Corp.*¹⁵⁰ and a non-arbitrability claim in *Applied Digital Technology, Inc. (Adtech) v. Continental Casualty Co.*¹⁵¹ This unimpressive record is not surprising. A literalistic legal methodology is particularly dangerous in antitrust cases because antitrust opinions are far too full of lay economic cliches, populist talismans, and ill-considered labels which serve only to mask antitrust policy.

147. *United States v. Marine Bancorporation*, 418 U.S. 602, 631 (1974).

148. The United States argued that *General Dynamics* only permitted a section seven defendant to rebut a prima facie case by showing that the market-share statistics gave an inaccurate account of the acquisition's probable effects on competition. 564 F.2d at 773. In *United States v. Marine Bancorporation*, 418 U.S. 602 (1974), however, the Supreme Court seemed to read the defense more broadly, as did the Seventh Circuit.

149. 568 F.2d 1147 (7th Cir. 1978). See text accompanying notes 8 to 31 *supra*.

150. 567 F.2d 701 (7th Cir. 1977), petition for cert. filed, 46 U.S.L.W. 3695 (U.S. May 1, 1978) (No. 77-1566). See text accompanying notes 32 to 95 *supra*.

151. 576 F.2d 116 (7th Cir. 1978). See text accompanying notes 96 to 121 *supra*.

