

Antitrust 1969

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Recommended Citation

Milton Handler, *Antitrust 1969*, 55 Cornell L. Rev. 161 (1970)
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CORNELL LAW REVIEW

Volume 55

January 1970

Number 2

ANTITRUST: 1969*

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I

TYING ARRANGEMENTS

In *Fortner Enterprises, Inc. v. United States Steel Corp.*,¹ the Supreme Court came close to eliminating a long-standing antitrust anomaly—the differing tests of illegality applied to tie-ins, depending upon the antitrust enactment invoked against them. If the tying or tied product may be classified as “goods, wares, . . . or other commodities,”² the case falls within the ambit of the Clayton Act, and the plaintiff need only show that a not insubstantial amount of commerce

* This article is based upon addresses delivered before the Antitrust Section of the American Bar Association on August 11, 1969, and the Association of the Bar of the City of New York on October 29, 1969. The author acknowledges with gratitude the assistance of Michael D. Blechman, Lawrence S. Feld, and David F. Ryan in the preparation of this article.

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¹ 394 U.S. 495 (1969).

² Clayton Act § 3, 15 U.S.C. § 14 (1964), applies only to sales or leases “of goods, wares, merchandise, machinery, supplies or other commodities”

in the tied product is involved.³ But if the tie does not relate to a commodity, but concerns land, services or credit, which do not fit the Clayton Act's language, it is governed by the Sherman Act, and the plaintiff must accordingly bear the additional burden of proving that defendant's economic power with respect to the tying product is sufficient to produce an appreciable restraint.⁴ This dichotomy, which has never had any functional justification, has been substantially eroded since its original articulation in *Times-Picayune Publishing Co. v. United States*⁵ in 1953. In a series of decisions,⁶ the Court gradually weakened the market power requirement to the point where, in *United States v. Loew's Inc.*,⁷ Justice Goldberg stated that the mere

³ The Clayton Act rule was synthesized in *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594 (1953):

When the seller enjoys a monopolistic position in the market for the "tying" product, or if a substantial volume of commerce in the "tied" product is restrained, a tying arrangement violates the narrower standards expressed in § 3 of the Clayton Act because from either factor the requisite potential lessening of competition is inferred. And because for even a lawful monopolist it is "unreasonable, *per se*, to foreclose competitors from any substantial market," a tying arrangement is banned by § 1 of the Sherman Act whenever *both* conditions are met.

Id. at 608-09 (emphasis by the Court). See Handler, *Recent Antitrust Developments*, 9 RECORD OF N.Y.C.B.A. 171, 175 (1954).

⁴ [Tie-ins] are unreasonable in and of themselves whenever a party has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product and a "not insubstantial" amount of interstate commerce is affected.

Northern Pac. Ry. v. United States, 356 U.S. 1, 6 (1958). See Handler, *Recent Antitrust Developments*, 13 RECORD OF N.Y.C.B.A. 417 (1958). Tie-ins may also be attacked by the Federal Trade Commission as an unfair method of competition under section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (1964). With respect to exclusive dealing arrangements challenged under that statute, the Supreme Court held in *FTC v. Brown Shoe Co.*, 384 U.S. 316, 321 (1966), that the Commission may declare such practices unlawful even though the standards of section 3 of the Clayton Act are not met. See Handler, *Some Misadventures in Antitrust Policymaking—Nineteenth Annual Review*, 76 YALE L.J. 92, 93 (1966). With respect to tie-ins, *Times-Picayune* stated in dictum that the Clayton Act test would apply in FTC proceedings. 345 U.S. at 609. But *Brown Shoe* suggests that even that criterion might not be necessary, although the Commission would not be likely to challenge a transaction with *de minimis* anticompetitive effect. Moreover, if the tying product is patented, the tie-in constitutes patent misuse whether or not the antitrust laws have been violated. See, e.g., *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942), and text at note 228 *infra*. Again, however, if only a *de minimis* amount of commerce is affected, it is hard to see how a successful patent misuse claim can be made out. Hence, for practical purposes, all that need be shown for a Clayton Act violation, an unlawful unfair method of competition, or a patent misuse is that the amount of restricted commerce rises above the level of *de minimis*.

⁵ 345 U.S. 594 (1953).

⁶ *United States v. Loew's Inc.*, 371 U.S. 38 (1962); *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958).

⁷ Market dominance—some power to control price and to exclude competition—is

desirability of the tying product to consumers created a sufficient basis from which the requisite market power could be inferred. The next logical step appeared to be the de facto elimination of the market power criterion by a holding that the very success of a tying arrangement was proof of the seller's power. While the *Fortner* opinion suggests that the Court is inclined to do just that, it retains enough of the market power requirement to perpetuate the confusion enveloping this phase of the law, not least of all for the parties involved in the case.

Fortner, a real estate developer, borrowed \$2 million from a wholly-owned subsidiary of U.S. Steel to finance the entire cost of the purchase and development of two tracts of land.⁸ The interest rate and other charges were extremely low—so low, in fact, that such 100% financing could not have been obtained from any other source on comparable terms.⁹ The loan agreement also provided that, in developing the land, plaintiff was required to use only U.S. Steel prefabricated houses.¹⁰ Plaintiff, believing that U.S. Steel's houses were more expensive and otherwise less desirable than those available elsewhere,¹¹ sued for relief from this restriction and for treble damages for his lost profits.

Unlike the ordinary tie-in, the seller, which was not in the business of lending money generally, supplied credit at uniquely inexpensive and otherwise advantageous terms in order to induce developers to buy U.S. Steel prefabricated homes.¹² Nevertheless, one need have no conceptual difficulty in characterizing this arrangement as a tie-in,¹³ the tying product or service being credit and the tied product being prefabricated homes. The allure necessary to make the tie effective is nothing more than U.S. Steel's willingness to offer the tying product

by no means the only test of whether the seller has the requisite economic power. Even absent a showing of market dominance, the crucial economic power may be inferred from the tying product's desirability to consumers or from uniqueness in its attributes.

United States v. Loew's Inc., 371 U.S. 38, 45 (1962).

⁸ 394 U.S. at 497.

⁹ *Id.* at 504.

¹⁰ *Id.* at 497.

¹¹ *Id.*

¹² In the ordinary tie-in situation, the seller seeks to induce the purchase of the tied product by tying it to that of a separate product, normally not otherwise available to the buyer.

¹³ "[A] tying arrangement may be defined as an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier." Northern Pac. Ry. v. United States, 356 U.S. 1, 5-6 (1958).

at low or non-profitable rates. In short, what we have here is a form of promotion.

The real policy question to be decided was whether or not this kind of tying arrangement should fall within the per se proscription. It is striking that the Court never actually comes to grips with this question. Instead, enmeshed in the rubric of market power, it grapples with a number of difficult—and unnecessary—factual issues which it ultimately orders the district court to resolve on remand.¹⁴ The case thus demonstrates that an old adage may have some truth, even when stood on its head: bad law, it would seem, can sometimes make hard cases.

Justice Black, writing for the majority in *Fortner*,¹⁵ begins his opinion by rearticulating the dual test of substantiality of commerce and market power which must be met in order to find a tie-in per se illegal under the Sherman Act.¹⁶ Dealing first with the question of substantiality, the Court makes clear that the applicable standard is not the amount of plaintiff's purchases, but rather defendant's aggregate sales to all buyers made pursuant to similar arrangements.¹⁷ Finding that the amount of these sales was not *de minimis* and, consequently, that substantial commerce was affected by the tie,¹⁸ Justice Black proceeds to discuss the second Sherman Act criterion: market power.

In the course of his analysis, the Justice suggests at least three separate bases for determining whether the requisite market power exists. The very fact that defendant was able to exact a higher price from plaintiff for prefabricated houses would itself indicate that de-

¹⁴ In essence, the case was remanded for a trial on the issue of U.S. Steel's economic power in the credit market. See 394 U.S. at 509.

¹⁵ Justice Black's opinion was for himself, Chief Justice Warren and Justices Brennan, Marshall, and Douglas. Justice White joined by Justice Harlan, dissented, as did Justice Fortas joined by Justice Stewart.

¹⁶ The opinion quotes the language cited in note 4 *supra* from *Northern Pacific*. 394 U.S. at 498-99.

¹⁷ For purposes of determining whether the amount of commerce foreclosed is too insubstantial to warrant prohibition of the practice, therefore, the relevant figure is the total volume of sales tied by the sales policy under challenge, not the portion of this total accounted for by the particular plaintiff who brings suit. *Id.* at 502. Since the principal tie-in cases decided by the Court had been brought by the government (so that only the total commerce tied could have been relevant), *Fortner* appears to have been the first occasion for the pronouncement of such a rule.

¹⁸ The test of "absolute quantitative substantiality" (as distinguished from a "comparative percentage" test) is far from new. See, e.g., *Oxford Varnish Corp. v. Ault & Wiborg Corp.*, 83 F.2d 764 (6th Cir. 1936) (concerning an exclusive dealing arrangement). It now seems clear that whatever the appropriate test may be for exclusive dealing arrangements, any tie-in which has more than a *de minimis* effect will meet this standard.

fendant had "some special economic power in the credit market."¹⁹ Thus the Court comes close to stating that the success of a tying arrangement constitutes its own proof of market power. If this were the Court's holding, no remand would be necessary. The fact, however, is that the case was remanded for a determination of defendant's market power.

After citing earlier cases to the effect that a showing of monopoly power is no longer required,²⁰ Justice Black indicates that it is sufficient if the seller is able to exert some power over some of the buyers in the market.²¹ "[T]he proper focus of concern" is said to be "whether the seller has the power to raise prices, or impose other burdensome terms such as a tie-in . . .," upon an appreciable number of buyers.²² Although a full page of the opinion is directed to an analysis of this standard,²³ the sum total of what the Court appears to be saying is that market power exists whenever there is power to impose the tie-in. It is thus difficult to discern how the second standard differs from the first.

Justice Black's third test turns on the seller's unique economic advantages over his competitors.²⁴ Such advantages, the Court says, may be legal, physical or economic.²⁵ Since U.S. Steel obviously had no physical advantage in lending money, and since its legal advantages,

¹⁹ 394 U.S. at 504.

²⁰ Our tie-in cases have made unmistakably clear that the economic power over the tying product can be sufficient even though the power falls far short of dominance and even though the power exists only with respect to some of the buyers in the market.

Id. at 502-03, citing *United States v. Loew's Inc.*, 371 U.S. 38 (1962); *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958); *International Salt Co. v. United States*, 332 U.S. 392 (1947).

²¹ "Such appreciable restraints result whenever the seller can exert some power over some of the buyers in the market, even if his power is not complete over them and over all other buyers in the market." 394 U.S. at 503.

²² *Id.* at 504.

²³ *Id.* at 503-04.

²⁴ We do not mean to accept petitioner's apparent argument that market power can be inferred simply because the kind of financing terms offered by a lending company are "unique and unusual." We do mean, however, that uniquely and unusually advantageous terms can reflect a creditor's unique economic advantages over his competitors.

Id. at 505.

²⁵ Uniqueness confers economic power only when other competitors are in some way prevented from offering the distinctive product themselves. Such barriers may be legal, as in the case of patented and copyrighted products, . . . or physical, as when the product is land It is true that the barriers may also be economic, as when competitors are simply unable to produce the distinctive product profitably

Id. at 505 n.2.

if any, would affect banks and similar lending institutions alone (which were arguably prohibited from extending 100% financing²⁶) and not finance companies or other commercial competitors, the Court concentrates on U.S. Steel's possible economic advantages.²⁷ Here, Justice Black refers in general terms to defendant's nationwide operations, and the possible resulting economies of scale.²⁸ Although rejecting the idea that the "unique and unusual financing terms" by themselves warranted an inference of market power²⁹ (a concept which would again be tantamount to eliminating the criterion altogether), Justice Black does say that such attractive terms "can reflect a creditor's unique economic advantages over his competitors."³⁰

Whatever one might think of the Court's standards as an abstract matter, it is hard to fathom their relevance to the fact situation actually presented in *Fortner*. A concept of market power predicated upon the ability to raise prices and impose the tie is without application here. U.S. Steel, which was offering plaintiff money at a particularly cheap rate, obviously did not have the power to raise the price of credit. Indeed, if it had tried to do so, the whole rationale for the deal would have disappeared and Fortner would either have borrowed the money elsewhere or not embarked on the development scheme at all. As Justice White points out in dissent,³¹ a company which has real power does not lower its prices; it raises them.³² The plain fact is that what U.S. Steel did was to induce Fortner to accept the tie by offering him a bargain on the tying product.

A standard focusing on whether U.S. Steel's cheap credit was a resultant of its "economic advantages" as a purveyor of credit appears equally divorced from the realities of the case. A loan is profitable only if the return to the lender is commensurate with his risks. Otherwise the probability is that the lender will lose rather than make

²⁶ "In addition, potential competitors such as banks and savings and loan associations may have been prohibited from offering 100% financing by state or federal law." *Id.* at 506, citing Federal Reserve Act § 24, 12 U.S.C. § 371 (Supp. IV, 1965-68); 12 C.F.R. § 545.6-14(c) (1969).

²⁷ See 394 U.S. at 505-06.

²⁸ [T]he unwillingness of competing financial institutions in the area to offer 100% financing probably reflects their feeling that they could not profitably lend money on the risks involved. U.S. Steel's subsidiary Credit Corp., on the other hand, may well have had a substantial competitive advantage in providing this type of financing because of economies resulting from the nationwide character of its operations.

Id. at 505-06.

²⁹ *Id.* at 505.

³⁰ *Id.*

³¹ *Id.* at 510.

³² *Id.* at 515.

money on the transaction. In such a case, the lender cannot make his unprofitable loan profitable simply by making other unprofitable loans on a nationwide basis. Any attempt to do so would be as futile as that of a manufacturer who sells each unit below cost, but tries to make up his losses on volume. Whatever the source of one's money—be it cheap bank loans, monopoly profits, or inheritance—a decision to sell or lend so as to yield a smaller return than the market would allow is not a question of power so much as a willingness, for some extrinsic reason, to accept less than maximum profits. U.S. Steel was *willing* to allow its subsidiary to operate at a comparatively low profit³³ in order to increase its sales of profitable prefabricated houses. The Court, caught in the terminology of market power, speaks of the "ability to force,"³⁴ rather than a "willingness" to sell for less.

Are the seller's economic advantages more relevant when the tying product is not credit but rather a commodity? The answer may, perhaps, be found in the rationale underlying the invalidation of tie-ins in the first place. A tie-in has two anticompetitive impacts. It compels the buyer to buy a product he does not want in order to obtain one which he desires. And it forecloses the seller's competitors in the market for the tied product from the buyer's business for a reason unrelated to the price or quality of that product.

From the buyer's point of view, if he is, as a practical matter, compelled by the circumstances of the transaction to buy something he does not want, it should not matter what the reason for placing him in that position may be. If the tying product is patented³⁵ or is uniquely desirable to him,³⁶ one could attribute the ability to force the tie to the seller's economic advantages over his competitors and his superior market position. But if the tie-in is attractive to the buyer because of the seller's willingness to set a lower price on the tying product (which presumably would be more expensive without the tie), the ultimate question is whether there is a corresponding economic benefit to the buyer warranting his willing purchase of both products as a package; or whether to obtain the favorable price for the tying product he nonetheless is being compelled to buy the tied product which he would prefer to purchase elsewhere. In either event, it is not the seller's economic advantage which makes for illegality, but rather the compulsion exacted upon the buyer.

³³ "The Credit Corporation did not operate at a loss, but its profit was comparatively low." *Id.* at 525 (Fortas, J., dissenting).

³⁴ See generally *id.* at 503-05.

³⁵ *E.g.*, *International Salt Co. v. United States*, 332 U.S. 392 (1947).

³⁶ *E.g.*, *United States v. Loew's Inc.*, 371 U.S. 38 (1962).

From the viewpoint of the seller's competitors, all that matters is that the tie-in has been successful. Success invariably results in competitive foreclosure. It is thus entirely immaterial, as a practical matter, how the foreclosure came about. If there is a tie-in sale, the seller's competitors suffer regardless of whether it is monopoly, uniqueness, economic advantage or any other factor which brings about the tie. While it may distort the meaning of language to equate economic advantage or a successful promotion with market power in an antitrust sense, one would have to be blind not to recognize that economic advantage can be the instrument by which foreclosure is achieved. Unlike the buyer who has no cause for complaint unless he is compelled to buy something which he does not want, the seller's competitors can be harmed regardless of whether any compulsion is practiced on the buyer. Even a competitor who is so efficient that he can sell the tied product at a price slightly above marginal cost would lose out competitively against the seller who, by virtue of the tie-in, lowers the price of the tying product to a level where the buyer has no alternative but to give him the business on both products. The seller's competitors are accordingly denied the buyer's patronage not because of any lack of efficiency on their part but because of their inability to provide the tying product on equivalent terms. Absent buyer compulsion there is no tie-in; but it does not follow from this fact that there may not be other types of illegality insofar as the seller's competitors are concerned.

Justice Black's conceptual framework is particularly disturbing because the district court has now been ordered to make a factual determination as to whether the defendant actually does possess market power.³⁷ On this point, Justice Fortas' utter confusion as to exactly what it is that plaintiffs will have to show appears justified.³⁸

It is ironic that one rationale given by Justice Goldberg in *United States v. Loew's Inc.*³⁹ for his further restriction of the concept of market power was that by creating a rule which would eliminate the necessity of investigating market position, the application of the per se rule could be simplified. As Justice Goldberg put it:

Since the requisite economic power may be found on the basis of either uniqueness or consumer appeal, and since market determination in the present context does not necessitate a demon-

³⁷ "Under these circumstances the pleadings and affidavits sufficiently disclose the possibility of market power over borrowers in the credit market to entitle petitioner to go to trial on this issue." 394 U.S. at 506.

³⁸ See Justice Fortas' dissent, *id.* at 523-24 n.*.

³⁹ 371 U.S. 38 (1962).

stration of market power in the sense of § 2 of the Sherman Act, it should seldom be necessary in a tie-in sale case to embark upon a full-scale factual inquiry into the scope of the relevant market for the tying product and into the corollary problem of the seller's percentage share in that market.⁴⁰

Like the majority, the dissenters in *Fortner* avoid facing the real issue presented by choosing instead to argue a case that was not before the Court: whether, in extending credit, pure and simple, to a purchaser only in respect of his purchase, there is any tie-in at all. Thus, despite Justice Black's admonition to the contrary, Justice White states that the majority's reasoning would apply equally to a straight credit sale.⁴¹ He then proceeds to equate favorable credit terms with a price reduction, and concludes that U.S. Steel's competitors could have offered equally attractive terms merely by reducing the price of their prefabricated houses.⁴²

In addition to not being germane—since the financing in question in fact covered the purchase of land as well as prefabricated houses⁴³—the dissenters' view ignores some basic economic realities. For a developer, there is a qualitative difference between the alternatives of, on the one hand, embarking on a project without having to put up any money of his own, or, on the other hand, having to invest his own capital, but getting a cheaper price on his materials. Few developers would have any difficulty in opting for 100% financing.

How, then, should the antitrust laws deal with tying arrangements? One thing seems crystal-clear to me. It makes absolutely no sense to have differing legal standards depending upon which statutory prohibition is invoked. If tie-ins can serve a socially useful purpose where there is no demonstrable anticompetitive impact, a plaintiff should be required to demonstrate the likelihood of a lessening of competition in a full-scale, rule-of-reason inquiry. Conversely, if, as the Court has stated,⁴⁴ tie-ins do not generally serve any useful pur-

⁴⁰ *Id.* at 45 n.4.

⁴¹ "The logic of the majority opinion, then, casts great doubt on credit financing by sellers." 394 U.S. at 516.

⁴² *Id.* at 515.

⁴³ Specifically, petitioner claimed that in order to obtain loans totaling over \$2,000,000 from the Credit Corp. for the purchase and development of certain land . . . , it had been required to agree, as a condition of the loans, to erect a prefabricated house manufactured by U.S. Steel on each of the lots purchased with the loan proceeds.

Id. at 497.

⁴⁴ "Tying agreements serve hardly any purpose beyond the suppression of competition." *Standard Oil Co. of Cal. v. United States*, 337 U.S. 293, 305-06 (1949).

pose, they should be condemned, whatever the statutory framework of the proceeding may be.

In view of the ambiguity of what market power means in a tie-in context, we might simply say that all tie-ins are bad and, in the absence of special economic justifications,⁴⁵ should be proscribed.⁴⁶ Illumination is provided by the common law of restraint of trade. Ever since *Mitchel v. Reynolds* in 1711,⁴⁷ a distinction has been drawn between voluntary and involuntary restraints, with the latter being condemned. By focusing upon the involuntary nature of a tie-in,⁴⁸ we can avoid an unnecessary and fruitless inquiry into market power and still achieve a just rule. So long as the buyer must buy a product he does not want in order to purchase one which he does want—which, after all, is the essence of a tie-in—the arrangement should be unlawful unless a special justification for it can be shown. But, if the tying product is not unique and is generally available at an equivalent price, how can it be said that the buyer was required to buy the tied product? If he did not want it, he could easily have obtained the tying product elsewhere. Under such a standard, all of the factors which the courts have examined to discover market power will still be highly relevant, but in a more meaningful sense.

As I mentioned, even a rule premised on the involuntariness of the restraint ought to be subject to justification for special economic circumstances such as the necessity of protecting a nascent industry⁴⁹ and in protecting a seller's good will.⁵⁰ In *Fortner*, one could argue that a similar legitimate purpose would exist if it were in fact the case that, without a tie-in, 100% financing would not be available at all to developers at economically feasible costs. It may be that the availability of such financing serves an important objective—such as encouraging needed construction—which in fact cannot be achieved in

⁴⁵ *E.g.*, *Dehydrating Process Co. v. A.O. Smith Corp.*, 292 F.2d 653 (1st Cir.), *cert. denied*, 368 U.S. 931 (1961); *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961).

⁴⁶ "Of course where the buyer is free to take either product by itself there is no tying problem even though the seller may also offer the two items as a unit at a single price." *Northern Pac. Ry. v. United States*, 356 U.S. 1, 6 n.4 (1958).

⁴⁷ 1 P. Wms. 181, 24 Eng. Rep. 347 (K.B. 1711).

⁴⁸ If there is, as a practical matter, no compulsion (either contractual or economic) to take the tied product as a condition of obtaining the tying product, there is simply no tie-in at all in a meaningful sense.

⁴⁹ See *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961).

⁵⁰ *E.g.*, *Susser v. Carvel Corp.*, 332 F.2d 505 (2d Cir. 1964), *cert. dismissed*, 381 U.S. 125 (1965); *Baker v. Simmons Co.*, 307 F.2d 458 (1st Cir. 1962). See *Handler, Recent Antitrust Developments—1965*, 40 N.Y.U.L. REV. 823, 852 (1965).

a less restrictive manner and which may outweigh the impact upon the buyer or the seller's competitors. Without passing on this question, it nonetheless seems to be an issue which—without the false issue of market power—a court can at least face squarely.

Even if it cannot be shown that there is a meaningful involuntary restraint—if the buyer is not as a practical matter required to purchase an unwanted product—the transaction may not necessarily be free from antitrust concern. To be sure, there would be no tie-in, and hence no occasion to invoke a per se rule. But if the seller, by use of his overall economic advantages, offers a package of products on such attractive terms as to foreclose competition in the market for one such product, there may be a contract in unreasonable restraint of trade or an unfair method of competition to be assessed in the context of a rule of reason.⁵¹

It is significant that, in the only decision⁵² thus far applying *Fortner*, the Fourth Circuit took Justice Black's decision as support for the proposition that market power could be inferred from the very fact of the successful imposition of a tie-in on a substantial number of customers.⁵³ Although the Fourth Circuit has cited *Fortner* for what it might have decided rather than for what the Court in fact held, it does take a large step toward equating the Clayton Act and Sherman Act standards and thus freeing courts from the burden of rationalizing market power language with functional reality. *Fortner* was an unnecessarily difficult case. The Fourth Circuit's decision suggests that perhaps we can hope to soon see better law—and easier cases.

II

AGREEMENTS TO EXCHANGE PRICE INFORMATION

It merely underscores the obvious to assert that a precedent cannot be appraised without an understanding of its exact import.⁵⁴ This

⁵¹ Cf. *FTC v. Brown Shoe Co.*, 384 U.S. 316 (1966).

⁵² *Advance Business Systems & Supply Co. v. SCM Corp.*, 415 F.2d 55 (4th Cir. 1969).

⁵³ "For the same reason, a seller's successful imposition of a tying arrangement on a substantial amount of commerce may be taken as proof of his economic power over the tying product." *Id.* at 62, *citing Fortner*.

⁵⁴ Cases do not unfold their principles for the asking. They yield up their kernel slowly and painfully. The instance cannot lead to a generalization till we know it as it is. That in itself is no easy task. For the thing adjudged comes to us oftentimes swathed in obscuring dicta, which must be stripped off and cast aside.

B. CARDOZO, *THE NATURE OF THE JUDICIAL PROCESS* 29 (1921).

difficulty confronts any commentator endeavoring to determine the significance of *United States v. Container Corp. of America*.⁵⁵

That case dealt with a sui generis situation "unlike any other price decisions"⁵⁶ previously rendered by the Court. At issue was the legality of an informal agreement among competitors to exchange specific information as to the prices charged or quoted to identified customers. The majority opinion does not explicitly declare such an arrangement to be unlawful per se, although it is classified as "a price-fixing agreement,"⁵⁷ and in a footnote referring to *United States v. Socony Vacuum Co.*,⁵⁸ Justice Douglas observes that "all forms of price-fixing are *per se* violations of the Sherman Act."⁵⁹ Yet at one point the Court acknowledges that "price information exchanged in some markets may have no effect on a truly competitive price."⁶⁰ Nevertheless, the opinion concludes with the admonition that "[p]rice is too critical, too sensitive a control to allow it to be used even in an informal manner to restrain competition."⁶¹

The concurring and dissenting opinions only add to the enigma. Justice Fortas, in concurring, states it to be his understanding that the majority does not hold the challenged agreement per se violative of the antitrust laws.⁶² Justice Marshall, on the other hand, in a dissent in which he is joined by Justices Harlan and Stewart, construes the majority as having added another per se prohibition to the ever-increasing list of such offenses.⁶³

Under what circumstances is an agreement among competitors to exchange price information unlawful? Is such an exchange to be treated on a parity with other forms of price agreements? Or does its legality stand on a separate footing? And what is the significance of a price exchange where there is no underlying agreement? These are some of the thorny problems which merit consideration.

Defendants were eighteen⁶⁴ manufacturers of corrugated containers who together accounted for ninety percent of the total ship-

⁵⁵ 393 U.S. 333 (1969).

⁵⁶ *Id.* at 334.

⁵⁷ *Id.*

⁵⁸ 310 U.S. 150 (1940).

⁵⁹ 393 U.S. at 338 n.4.

⁶⁰ *Id.* at 337.

⁶¹ *Id.* at 338.

⁶² *Id.* at 338-39.

⁶³ *Id.* at 341.

⁶⁴ Nineteen defendants were named in the government's complaint. The case against one was dismissed when the firm went out of business. Brief for Appellant at 2 n.1, *United States v. Container Corp. of Am.*, 393 U.S. 333 (1969).

ments of such containers from plants in the southeastern United States. There was no charge that they had engaged in any of the garden varieties of price-fixing.⁶⁵ Nor did the government question the statistical reporting activity of defendants' trade association, which collected price data regarding past or closed sales and disseminated abstract statistical summaries without identifying the parties to specific transactions.⁶⁶ According to the majority, the gist of the case was each defendant's practice of requesting from its competitors "information as to the most recent price charged or quoted, whenever it needed such information and whenever it was not available from another source."⁶⁷

The stress in the complaint was that the challenged agreement had been entered into "for the purpose and with the effect of restricting price competition."⁶⁸ At trial, the government conceded that "if it had only charged in the Complaint that the defendants had agreed to exchange price information, it would have no case, and that the Complaint would be subject to dismissal."⁶⁹ From this concession the district court inferred that the government had undertaken the additional burden of proving a further understanding and agreement to use the exchanged price information "for the purpose and with the effect of maintaining substantially identical price quotations to specific customers or minimizing the amount of any price reductions to be offered to such customers."⁷⁰ Finding that this burden had not been discharged, the trial judge ruled in favor of the defendants.

Justice Douglas, on the other hand, finds that the exchange agreement "seemed to have the effect of keeping prices within a fairly narrow ambit."⁷¹ He thus concludes that the defendants' practice in fact had stabilized prices, "though at a downward level."⁷²

The Court notes that the "industry is dominated by relatively few sellers,"⁷³ the "product is fungible,"⁷⁴ demand is inelastic,⁷⁵ and price is the principal form of competition.⁷⁶ Reasoning that the ex-

65 393 U.S. at 334-35.

66 *United States v. Container Corp. of Am.*, 273 F. Supp. 18, 67 (M.D.N.C. 1967).

67 393 U.S. at 335.

68 Complaint at 7, ¶ 11, *United States v. Container Corp. of Am.*, 393 U.S. 333 (1969).

69 273 F. Supp. at 59.

70 *Id.*

71 393 U.S. at 336.

72 *Id.*

73 *Id.* at 337.

74 *Id.*

75 *Id.*

76 *Id.*

change of price data in this market "tends toward price uniformity,"⁷⁷ it finds that the practice had "an anticompetitive effect . . . chilling the vigor of price competition."⁷⁸

While conceding that the evidence is "not overwhelming," Justice Fortas, in his concurrence, concludes that "the probability that the exchange of specific price information led to an unlawful effect upon prices is adequately buttressed by evidence in the record."⁷⁹ In support of this conclusion, he relies upon the district court's finding that when a defendant received information with respect to a competitor's price he would often quote "substantially the same price."⁸⁰ From this the Justice argues that the agreement to exchange prices made it possible for the defendants "confidently" to "at least . . . limit any price cuts to the minimum necessary to meet competition."⁸¹

Neither the majority nor Justice Fortas appears to give any weight to many of the other facts established below. The trial judge had found on the basis of uncontested statistical data that there was no uniformity, harmony, stability or parallelism in price⁸² either among the defendants or among their individual plants.⁸³ During the period covered by the complaint⁸⁴ the prices declined despite a marked increase in production costs.⁸⁵ In addition, the government had stipulated that each defendant "requested price information from other defendants in order to aid it in making informed pricing and marketing decisions"⁸⁶ and that the ultimate pricing decision of each defendant was made individually in the exercise of its own business judgment.⁸⁷ The district court specifically found that the industry had grown from thirty manufacturers with forty-nine plants in 1955 to fifty-one manufacturers with ninety-eight plants in 1963,⁸⁸ that shipments increased from nine billion square feet to sixteen billion square feet over the same period,⁸⁹ and that a viable manufacturing facility

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.* at 339.

⁸⁰ *Id.*

⁸¹ *Id.* at 340.

⁸² 273 F. Supp. at 61.

⁸³ *Id.*

⁸⁴ January 1, 1955 to October 14, 1963. *Id.* at 21.

⁸⁵ *Id.* at 61.

⁸⁶ Brief for Appellees at 12, *United States v. Container Corp. of Am.*, 393 U.S. 333 (1969).

⁸⁷ 273 F. Supp. at 26-27.

⁸⁸ *Id.* at 22.

⁸⁹ *Id.* at 23.

could be established with as small an investment as \$50,000 to \$75,000.⁹⁰

Justice Marshall, in dissent, first observes that the "court has refused to apply a *per se* rule to exchanges of price and market information in the past,"⁹¹ and perceives no reason in the present case for departing from that conclusion. He agrees with the majority that, "market knowledge is certainly not an evil in perfectly competitive markets."⁹² However, while Justice Douglas emphasizes the fact that the industry is dominated by "relatively few sellers," Justice Marshall notes that entry is easy and that the number of sellers had in fact increased during the complaint period. Though agreeing with the majority that demand is inelastic, Justice Marshall is impressed by the market's having doubled in size in recent years.

According to Justice Marshall, the district court's finding that a defendant would usually charge "substantially the same price" as a reporting competitor should be read together with the finding "that price decisions were individual decisions, and that defendants frequently did cut prices."⁹³ Moreover, he considers the "few isolated statements found in the depositions of industry witnesses . . . totally insufficient" to support a finding of unlawful purpose.⁹⁴ Concluding that the agreement had no adverse anticompetitive effect and was not animated by any improper purpose, he would affirm the dismissal by the court below.

Since it is not readily apparent whether the three opinions rest upon different legal premises or different appraisals of the facts, it may be useful to analyze the problems which the case raises in terms of fundamental antitrust principles.

Let us first consider the situation where price information is exchanged without any express agreement to do so. If such exchanges occur with some degree of regularity, even though infrequently, it would not be improper to infer a tacit agreement to exchange prices from the course of conduct. And it is inarguable that such exchanges constitute circumstantial evidence which, taken together with all the other facts, might also be probative of an agreement to fix prices. In *Container Corp.*, where no uniformity or parallelism of price could be shown and the price trend was downward, the trier of facts would doubtless reach a different conclusion from the case where there was

⁹⁰ *Id.*

⁹¹ 393 U.S. at 341.

⁹² *Id.* at 342.

⁹³ *Id.* at 346.

⁹⁴ *Id.* at 344.

a history of price leadership with rare deviations on the part of any seller from the leader's announced price. In an industry with the latter kind of price behavior, even a casual communication could have a potent effect of implementing the prevailing price pattern.

We next turn to the situation where there exists an actual agreement to exchange prices. I believe the trial court was in error in requiring the government to prove a supplemental agreement to use the exchanged information for the purpose and with the effect of stabilizing prices. A compact to exchange price information plainly should be unlawful without more if its purpose *or* effect was to stabilize prices. The interesting question is whether the agreement of itself, regardless of purpose or effect, should be unlawful as a matter of law.

Justice Marshall, in shying away from a *per se* construction, draws heavily upon the economic philosophy of Professor Turner. While admitting that there "is some danger that price information will be used for anticompetitive purposes, particularly the maintenance of prices at a high level,"⁹⁵ he is of the opinion that the exchange in this industry was, at worst, a neutral factor. Unlike Justice Douglas, he was unwilling to conclude that "this particular market is sufficiently oligopolistic . . . to justify the inference that price information will necessarily be used to stabilize prices."⁹⁶ Justice Marshall illustrates the prerequisites for the application of a *per se* rule by reference to Professor Turner's two classes of cases: (1) where a practice is always economically harmful; *i.e.*, it can serve only to lessen competition; or (2) where a practice is sometimes harmful, sometimes neutral and sometimes beneficial, but "the aggregate of harm in situations in which it is harmful far outweighs the aggregate of benefit in situations in which it makes a beneficial contribution as to the working of the market."⁹⁷ In his view, the facts before the Court fall in neither of these categories and hence should be deemed unlawful only upon a factual showing of illegality, which he finds lacking here.

The basic issue in all branches of antitrust is the extent to which extrinsic facts can be examined without making enforcement so difficult as to be unadministrable. I have been critical of the Court's resort in the past to techniques of presumption and assumption,⁹⁸ as well as its creation of new *per se* rules in invalidating horizontal and

⁹⁵ *Id.* at 342.

⁹⁶ *Id.* at 343.

⁹⁷ C. KAYSEN & D. TURNER, *ANTITRUST POLICY* 143 (1959). Justice Marshall's paraphrase is as follows: "If the potential benefits in the aggregate are outweighed to this degree, then they are simply not worth identifying in individual cases." 393 U.S. at 341 (dissent).

⁹⁸ See, e.g., Handler, *Through the Antitrust Looking Glass—Twenty-First Annual Antitrust Review*, 57 CALIF. L. REV. 182, 202-07 (1969).

vertical mergers.⁹⁹ It has been my belief that ease of enforcement has been placed too high in the Court's scale of legal and social values. I believe, however, along with Justice Douglas, that price is too critical and sensitive a factor to premise the illegality of exchange agreements on the prosecution's ability to prove a wrongful motive, intent or purpose or to demonstrate an adverse effect on the movement of prices. Consequently, I would hold such agreements presumptively unlawful with the burden of justification shifting to the defendants. As a practical matter, this may be tantamount to saying that such agreements are unlawful per se.¹⁰⁰ A contrary rule, however, could well open the door to evasion and impede the effective enforcement of the antitrust laws, particularly in heavily concentrated industries. By stating the rule in presumptive terms we retain a degree of flexibility enabling us to uphold those arrangements in their peculiar market contexts where the aggregate of social benefit far outweighs the theoretical dangers of economic detriment.¹⁰¹

One troublesome aspect of *Container Corp.* is its potential effect on the availability of the "meeting competition" defense¹⁰² in Robinson-Patman cases. Defendants stressed this problem in the Supreme Court, arguing that, under Robinson-Patman, sellers often have a duty to verify customer reports of competitive offers and that the application of a per se rule of illegality would accordingly be inappropriate.¹⁰³ The district court, moreover, had found that, on occasion, container customers had supplied defendants with "incomplete, inaccurate, or misleading information as to prices offered by competing suppliers."¹⁰⁴ It accordingly held that since defendants sometimes requested information to verify customers' reports, their conduct was designed "to prevent the perpetration of a fraud upon them"¹⁰⁵ and thus fell within the rule of *Cement Manufacturers Protective Association v. United States*.¹⁰⁶

Justice Douglas rejected these assertions out of hand, stating

⁹⁹ See, e.g., Handler, *The Supreme Court and the Antitrust Laws (From the Viewpoint of the Critic)*, 34 ABA ANTITRUST L.J. 21, 32-39 (1967).

¹⁰⁰ In the trade association field certain acts have been proscribed because of their inherent danger to competition, even though arguably they do not in fact restrain trade. Frequently in the law we prohibit acts which fall within a penumbra of legality in order to make more effective the condemnation of clearly undesirable conduct.

¹⁰¹ Cf. *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 595-96 (1967) (Harlan, J., concurring).

¹⁰² Clayton Act § 2(b), 15 U.S.C. § 13(b) (1964).

¹⁰³ Brief for Appellees at 42-43, *United States v. Container Corp. of Am.*, 393 U.S. 333 (1969).

¹⁰⁴ *United States v. Container Corp. of Am.*, 273 F. Supp. 18, 28 (M.D.N.C. 1967).

¹⁰⁵ *Id.* at 61.

¹⁰⁶ 268 U.S. 588 (1925).

merely that the "controlling circumstances" of *Cement Manufacturers* were not present.¹⁰⁷ The distinction he draws, however, between fraudulent inducements to deliver cement in excess of the buyer's true needs and fraudulent inducements to obtain containers at unlawfully low prices is far from self-evident. If the inquiries of competitors are limited to instances of overreaching by customers, this procompetitive purpose might well be deemed sufficient to rebut the presumptive illegality of the exchange. But apparently this was not the primary or even the usual purpose of the exchange in *Container Corp.*, and hence the decision could not have rested on this narrow ground.

III

RESURGENCE OF CONSCIOUS PARALLELISM

In a brief per curiam decision, the Supreme Court last term reversed a grant of summary judgment in favor of the defendants in a treble damage action brought by a retail dealer of cemetery markers against a manufacturer of such markers and five cemetery companies. The opinion in *Norfolk Monument Co. v. Woodlawn Memorial Gardens, Inc.*¹⁰⁸ lists eight items of evidence which the Court believes raised a question of fact on the issue of conspiracy, thus requiring the submission of the case to the jury.¹⁰⁹

If all that were involved were the appraisal of the sufficiency of proof, one would hardly be warranted in taking note of the decision in a review of recent Supreme Court developments. But read in the light of last year's *Albrecht v. Herald Co.*¹¹⁰ decision, the case leads one to speculate whether the specter of conscious parallelism may not have been revived.

The facts were these: Plaintiff charged that defendants had conspired to exclude it from and to monopolize the market for bronze grave markers. The cemeteries had refused to permit plaintiff and others similarly situated to install on the cemetery grounds markers sold by them to the plot owners. When markers were purchased from the cemeteries, no installation fee was charged. But a fee for installation and perpetual care was exacted when markers were bought from others. Plaintiff maintained that these fees were excessive, unreasonable and unrelated to the actual cost of installation. The cemeteries

¹⁰⁷ 393 U.S. at 335.

¹⁰⁸ 394 U.S. 700 (1969).

¹⁰⁹ *Id.* at 701-02.

¹¹⁰ 390 U.S. 145 (1968).

required all markers to conform to a specific minimum alloy formula identical to that used by Matthews, the defendant manufacturer. Markers not purchased from the cemeteries had to be accompanied by a certificate of analysis, prepared by an independent laboratory, attesting that their bronze alloy content met the specifications. It was also proved that Matthews had implicitly suggested such a specification in a pamphlet distributed to its customers.¹¹¹

All but one of the cemeteries were Matthews' customers. Although plaintiff charged that the cemeteries purchased their markers exclusively from Matthews, the evidence showed that some had as many as fifty percent of a different brand installed on their grounds; a composite reading of total market installation in all of the cemeteries showed at least thirty percent of different manufacture.¹¹²

On the other hand, there was evidence that three of the defendant cemeteries had attempted to dissuade plot owners from buying markers from plaintiff.¹¹³ Plaintiff also pointed to the fact that several of the cemetery defendants had adopted a number of practices, suggested by Matthews in its pamphlet, which allegedly erected barriers to retailers competing with the cemeteries.¹¹⁴ There was also evidence of frequent visits to and conferences with the cemeteries by sales representatives of Matthews.¹¹⁵ These meetings, however, were found to have involved only "business calls," and plaintiff admitted that it had no evidence that representatives of the cemeteries met with one another or had any discussions among themselves.¹¹⁶

Rather than instituting a series of separate suits against the cemeteries and Matthews complaining against their vertical arrangements, plaintiff brought one action alleging a horizontal conspiracy among all the defendants. The sole issue on defendants' motion for summary judgment, therefore, was whether the evidence relied upon raised a triable issue of fact as to the existence of a horizontal conspiracy.¹¹⁷

The Fourth Circuit, by a divided decision, affirmed the district court's grant of summary judgment.¹¹⁸ The Supreme Court, without

¹¹¹ 394 U.S. at 701-02.

¹¹² *Norfolk Monument Co. v. Woodlawn Memorial Gardens, Inc.*, 290 F. Supp. 1, 3 (E.D. Va. 1967).

¹¹³ 394 U.S. at 702.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Norfolk Monument Co. v. Woodlawn Memorial Gardens, Inc.*, 404 F.2d 1008, 1010 (4th Cir. 1968).

¹¹⁷ 290 F. Supp. 1 (E.D. Va. 1967).

¹¹⁸ 404 F.2d 1008 (4th Cir. 1968).

the benefit of full-scale briefs or oral argument on the merits, granted certiorari and vacated the court of appeals' judgment.¹¹⁹

The opinion notes the district court's finding that the rules relating to alloy content and installation were reasonable in view of the continuing obligation of perpetual care imposed on the cemeteries in their contracts with plot owners.¹²⁰ The Court asserts, however, that the question of their reasonableness was one of fact for resolution by the jury.¹²¹ The Matthews pamphlet, suggesting standards for cemetery regulations, which plaintiff alleged was evidence of an agreement to participate in restrictive practices, was treated in a similar fashion.¹²² As far as the installation fees were concerned, the district court's finding that the wide divergence of prices completely negated any price-fixing was held to be beside the point. Since the complaint did not allege that uniform fees were exacted but that they were "excessive and unreasonable" for the purposes of injuring the plaintiff, the inferences to be drawn therefrom by a jury were not necessarily dispelled by their disparity.¹²³ Finally, the failure to produce any direct written evidence of conspiracy among the defendants did not preclude a jury finding of joint action, since "business behavior is admissible circumstantial evidence from which the fact finder may infer agreement."¹²⁴

I would certainly have no quarrel with a ruling that, on the evidence presented, a jury could reasonably find that each of the cemeteries had combined separately with Matthews, putting aside the question of whether such vertical combinations would be unlawful. But where is the evidence of a horizontal agreement among the cemetery defendants? Treating the record facts in a light most favorable to plaintiff, all that appears is proof of similar exclusionary conduct on the part of the cemeteries connected only by the suggestion of some of such practices in the Matthews pamphlet and the fact that Matthews sales representatives visited the various cemeteries on business calls.

Since the Supreme Court's opinion is truncated, it is difficult to discuss precisely what theory is relied upon in ruling that sufficient evidence was present to permit a jury finding of agreement. Perhaps the Court construes the Matthews pamphlet as a tacit invitation to

¹¹⁹ 394 U.S. 700 (1969).

¹²⁰ *Id.* at 702.

¹²¹ *Id.* at 703.

¹²² *Id.*

¹²³ *Id.* at 703-04.

¹²⁴ *Id.* at 704, quoting *Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.*, 346 U.S. 537, 540 (1954).

each cemetery to join in a horizontal agreement, thus permitting the invocation of *Interstate Circuit, Inc. v. United States*¹²⁵ to infer conspiracy. If such were the case, *Norfolk Monument* would hardly break new ground. But how is one to distinguish between an invitation to conspire and a mere suggestion to follow a certain course of conduct? Surely the Court is not holding that a seller may not make any marketing suggestions to his customers without running the risk that, if the suggestion is followed, the customers will be guilty of conspiracy with one another as well as with him.

One plausible explanation for the Court's decision might be that it relied on the elusive "doctrine" of conscious parallelism. Indeed, the petition for certiorari stated one of the questions presented for review as: "Whether and when agreement can be found in consciously parallel decisions by competitors to adopt substantially identical exclusionary restrictions with respect to installation and sale of grave markers, contrary to the Sherman Antitrust Act."¹²⁶

The tortuous history of conscious parallelism need not be recounted in detail. Suffice it to say that, in *Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.*,¹²⁷ the Court plainly held that consciously parallel conduct is not the substantive equivalent of conspiracy and that evidence of such conduct cannot support a directed verdict for the plaintiff. Although *Theatre Enterprises* did not decide whether proof of uniform conduct without more was sufficient to support a jury verdict for the plaintiff, subsequent court of appeals decisions squarely held that such evidence was insufficient to sustain a finding of conspiracy or to require the submission of the case to the jury.¹²⁸

What makes *Norfolk Monument* particularly disquieting, among other things, is that, if it indeed does reverse the trend of decision on the conscious parallelism question, it fails to grapple directly with the issue. After all, there may be many valid reasons why competitors, faced with identical market conditions, might unilaterally decide to make the same response. It would be one thing if the common response made no business or economic sense—for example, a price increase in

¹²⁵ 306 U.S. 208 (1939).

¹²⁶ Petition for Writ of Certiorari at 2, *Norfolk Monument Co. v. Woodlawn Memorial Gardens, Inc.*, 394 U.S. 700 (1969). The petition also presented three other questions for review.

¹²⁷ 346 U.S. 537 (1954).

¹²⁸ *Winchester Theatre Co. v. Paramount Film Distributing Corp.*, 324 F.2d 652 (1st Cir. 1963); *Independent Iron Works, Inc. v. United States Steel Corp.*, 322 F.2d 656 (9th Cir.), cert. denied, 375 U.S. 922 (1963).

the face of excess capacity and declining demand¹²⁹—but quite another if it were perfectly consistent with the self-interest of everyone concerned.¹³⁰ To predicate a conspiracy solely on the fact that businessmen, knowing what their competitors were doing, took the same action would be to place unwarranted restrictions on business decisions and throttle normal competitive behavior.

Moreover, our discomfort is aggravated when *Norfolk's* implications are assessed in the context of last year's *Albrecht v. Herald Co.*¹³¹ decision, where Justice White, in dictum, suggested that a combination in violation of section 1 could be made out among the defendant newspaper, all of its dealers who agreed to abide by a maximum resale price, and the plaintiff-dealer's customers who benefited by the price restriction. The dilution of the standards for proof of conspiracy which the *Albrecht* dictum and the *Norfolk Monument* decision appear to portend may well become a genuine threat to fairness in the administration of justice.¹³²

A claim of conspiracy involves criminal as well as civil liability. The evidentiary rules concerning the proof of conspiracy permit the charge to be sustained by evidence which would be incompetent in an ordinary trial. As Justice Jackson warned twenty years ago, the procedural disadvantages confronting defendants in conspiracy cases are so enormous that there is an ever-present danger that innocent people may be convicted of crimes they never committed.¹³³ Moreover, the consequences of a conviction for conspiracy as well as a civil judgment based thereon are far-reaching.¹³⁴ Certainly in the interest of justice

¹²⁹ See *American Tobacco Co. v. United States*, 328 U.S. 781, 810-11 (1946).

¹³⁰ See Handler, *Contract, Combination or Conspiracy*, 3 ABA ANTITRUST SECTION 38, 44-45 (1953); Handler, *Recent Antitrust Developments—1964*, 63 MICH. L. REV. 59, 85 (1964); Handler, *Recent Antitrust Developments*, 9 THE RECORD OF N.Y.C.B.A. 171, 173 (1954).

¹³¹ 390 U.S. 145 (1968). See Handler, *Through the Antitrust Looking Glass—Twenty-First Annual Antitrust Review*, 57 CALIF. L. REV. 182 (1969). Two recent court of appeals decisions rejecting the intracorporate conspiracy doctrine as applied to a corporation's divisions suggest that further extensions of the new notions of conspiracy in the Supreme Court's decisions of the past two terms are likely to be stoutly resisted. *Cliff Food Stores, Inc. v. Kroger*, — F.2d — (5th Cir. 1969); *Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors, Ltd.*, — F.2d — (9th Cir. 1969).

¹³² There is another aspect of *Norfolk Monument* which merits comment. I have difficulty with the procedure, increasingly adopted by the Court in recent years, of reversing important cases per curiam on the merits without the benefit of briefs and oral argument on the merits. See, e.g., *Burke v. Ford*, 389 U.S. 320 (1967); Handler, *Through the Antitrust Looking Glass—Twenty-First Annual Antitrust Review*, 57 CALIF. L. REV. 182, 202 (1969).

¹³³ *Krulewitch v. United States*, 336 U.S. 440, 445 (1949) (concurring opinion).

¹³⁴ See, e.g., Clayton Act § 5(a), 15 U.S.C. § 16(a) (1964).

we do not want heavy penalties to be imposed upon those who are guilty of nothing more than parallel behavior.

I do not take issue with the doctrine that conscious parallelism, together with various "plus" factors, warrants the submission of the issue of conspiracy to a jury. Nor do I quarrel with *Interstate Circuit*, which permits an inference of conspiracy from evidence of a joint invitation to participate in a tacit agreement, if indeed such an invitation is clearly made out. I do question, however, a redefinition of combination and conspiracy and a diminution in the requirements of proof which will stigmatize, as conspiratorial, conduct falling short of the agreement which every conspiracy presupposes.¹³⁵ Obviously, the agreement need not be express or in writing. It can be proved circumstantially and inferred or implied from a course of dealing.¹³⁶ But, in my opinion, a redefinition of conspiracy which excludes the consensual element can only result in the imposition of liability upon those who are innocent of any antitrust wrongdoing. Even assuming the illegality of the vertical agreements, five separate illegal contracts are not the equivalent of a horizontal conspiracy absent any showing that they were part and parcel of an integrated plan, scheme, or common course of action.

IV

A DECENT PUBLIC BURIAL FOR LICENSEE ESTOPPEL

In *Lear, Inc. v. Adkins*¹³⁷ the Supreme Court at long last has given the century-old doctrine of licensee estoppel a "decent public burial."¹³⁸ The estoppel concept had been so emasculated by a series of exceptions that its explicit obliteration comes as no surprise to the patent and antitrust bars.

¹³⁵ See *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 387 (1951); *Interstate Circuit, Inc. v. United States*, 306 U.S. 208, 221 (1939); *Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.*, 346 U.S. 537, 541 (1954).

¹³⁶ No formal agreement is necessary to constitute an unlawful conspiracy. Often crimes are a matter of inference deduced from the acts of the person accused and done in pursuance of a criminal purpose. . . . The essential combination or conspiracy in violation of the Sherman Act may be found in a course of dealing or other circumstances as well as in an exchange of words. *United States v. Schrader's Son*, 252 U.S. 85 [1920]. Where the circumstances are such as to warrant a jury in finding that the conspirators had a unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement, the conclusion that a conspiracy is established is justified.

American Tobacco Co. v. United States, 328 U.S. 781, 809-10 (1946).

¹³⁷ 395 U.S. 653 (1969).

¹³⁸ *MacGregor v. Westinghouse Elec. & Mfg. Co.*, 329 U.S. 402, 416 (1947) (Frankfurter, J., dissenting).

The erosion process commenced with *Westinghouse Electric & Manufacturing Co. v. Formica Insulation Co.*¹³⁹ in 1924. In that case, the assignor of a patent, in defense of an infringement suit brought by his assignee, was permitted to cite prior art to narrow the scope of the patent claims. Since the patent's validity was not directly challenged, the Court could pay lip service to the estoppel while disregarding its fundamental purpose. In *Scott Paper Co. v. Marcalus Manufacturing Co.*¹⁴⁰ the assignor relied upon a prior expired patent that relegated the invention in suit to the public domain and thus was held to be available to him as well as to everyone else. The so-called "antitrust" exception first appeared in *Sola Electric Co. v. Jefferson Electric Co.*,¹⁴¹ where a licensee was not precluded from contesting the validity of his licensor's patent where the patentee sought to enforce a price-fixing provision in the license, the legality of which hinged upon the existence of a valid patent.

The *Sola* exception was expanded in *Edward Katzinger Co. v. Chicago Metallic Manufacturing Co.*¹⁴² and *MacGregor v. Westinghouse Electric & Manufacturing Co.*¹⁴³ to cover suits for unpaid royalties where no effort was made to obtain enforcement of the price clause. It was this extension which led Justice Frankfurter in dissent to suggest that "if all the cases which have recognized and applied the doctrine of estoppel have been reduced, as apparently they have been, to derelicts, they should not be allowed to remain as obstructions on the stream of the law."¹⁴⁴

In 1950, however, the Court, in *Automatic Radio Manufacturing Co. v. Hazeltine Research, Inc.*,¹⁴⁵ appeared to reverse this trend. Justice Minton there upheld the estoppel against a licensee absent a showing of misuse. Justices Douglas and Black contended in dissent that there could be no "worse enlargement of monopoly . . . than the attachment of a patent to an unpatentable article."¹⁴⁶ Reasoning that it is often the licensee who is in the best position to appraise the patent's validity, they contended that the estoppel doctrine should be discarded in order that the public be rid of "stale or specious patents."¹⁴⁷

¹³⁹ 266 U.S. 342 (1924).

¹⁴⁰ 326 U.S. 249 (1945).

¹⁴¹ 317 U.S. 173 (1942).

¹⁴² 329 U.S. 394 (1947).

¹⁴³ 329 U.S. 402 (1947).

¹⁴⁴ *Id.* at 413 (dissent).

¹⁴⁵ 339 U.S. 827 (1950).

¹⁴⁶ *Id.* at 839 (dissent).

¹⁴⁷ *Id.* at 840 (dissent).

It was in this context that the Supreme Court decided *Lear*. Justice Harlan's opinion for the majority exhibits the scholarship, candor and painstaking attention to detail which characterize his juristic art. Although he admits that he is not "writing upon a clean slate,"¹⁴⁸ and that the roots of the estoppel doctrine "have often been celebrated in tradition,"¹⁴⁹ he is able to find but one case where it was invoked "in a considered manner,"¹⁵⁰ and that thirty-five years before the passage of the Sherman Act. *Automatic Radio*, he observes, was decided "without prolonged analysis"¹⁵¹ and seemingly ignored the fact that, since 1905,¹⁵² "each time a patentee sought to rely upon his estoppel privilege before this Court, the majority created a new exception to permit judicial scrutiny into the validity of the Patent Office's grant."¹⁵³

The opinion carefully reviews each of the cases in which exceptions to the estoppel rule were created, and in every instance concludes that the rationale underlying the exception applies with equal force to the doctrine itself.¹⁵⁴ The origins of estoppel, the Justice points out, are to be found in "the law of contracts [which] forbids a purchaser to repudiate his promises simply because he later becomes dissatisfied with the bargain he has made."¹⁵⁵ Citing *Sears, Roebuck & Co. v. Stifel Co.*¹⁵⁶ and *Compco Corp. v. Day-Brite Lighting, Inc.*,¹⁵⁷ however, he notes that "federal law requires that all ideas in general circulation be dedicated to the common good unless they are protected by a valid patent."¹⁵⁸

¹⁴⁸ 395 U.S. at 662.

¹⁴⁹ *Id.* at 663.

¹⁵⁰ *Id.*, citing *Kinsman v. Parkhurst*, 59 U.S. (18 How.) 289 (1856).

¹⁵¹ 395 U.S. at 664.

¹⁵² *United States v. Harvey Steel Co.*, 196 U.S. 310 (1905).

¹⁵³ 395 U.S. at 664.

¹⁵⁴ In *Formica* "the patentee's equities were far more compelling than those presented in the typical licensing arrangement," since it was his grantor who questioned the scope of the patent. *Id.* To the Justice the *Formica* result was an anomaly: "If a patent had some novelty," the assignor could defend an infringement suit by narrowing its claim; "if a patent had no novelty at all, the old owner could not defend successfully since he would be obliged to launch" a direct attack on validity. *Id.* at 665.

Justice Harlan believes that it is impossible to limit the *Scott Paper* doctrine to its narrow holding. He reasons that if patent policy forbids estoppel when an assignor attempts to cite a prior expired patent, why should not the doctrine also apply when an attempt is made "to show that the invention lacked novelty because it could be found in a technical journal or because it was obvious to one knowledgeable in the art." *Id.* at 666. The antitrust exception, developed in the Supreme Court in *Sola*, *Katziper* and *MacGregor*, likewise is "profoundly antithetic to the principles underlying estoppel." *Id.*

¹⁵⁵ *Id.* at 668.

¹⁵⁶ 376 U.S. 225 (1964).

¹⁵⁷ 376 U.S. 234 (1964).

¹⁵⁸ 395 U.S. at 668.

Justice Harlan then analyzes the "typical" licensing arrangement and notes that the licensee obtains both freedom from expensive infringement actions and some freedom from competition by unlicensed third parties in return for his royalty payments.¹⁵⁹ He acknowledges that "[u]nder ordinary contract principles the mere fact that some benefit is received is enough to require the enforcement of the [license] . . . , regardless of the validity of the underlying patent."¹⁶⁰ However, he states that it does not seem "unfair" to require the patentee to defend his patent when his licensee places its validity in issue, "especially since the licensor's case is buttressed by the presumption of validity."¹⁶¹ Concluding that estoppel is not "compelled by the spirit of contract law," the Court rules that it must yield to "the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain,"¹⁶² thus explicitly overruling *Automatic Radio*.¹⁶³

Were we writing on a clean slate, we might well hold licensees to their bargains. It is difficult to comprehend why one who has contracted for the privilege of practicing an invention without fear of an infringement suit should be permitted to negate the patent's validity. Similarly, why should one who received value for the transfer of his patent be free to challenge its integrity? It is questionable whether the forces of competition are really undermined if everyone save the assignor is free to attack the patent with only the assignor precluded from practicing the invention which he himself has sold. The usual warranties demanded of a seller provide a compelling analogy.

But, as Justice Harlan points out, the slate is not clean. The numerous exceptions which the Court has promulgated over the years, combined with the thin origins of the estoppel doctrine itself, left the Court with the choice of uprooting the principle or attempting to rationalize an increasingly complex set of rules which confused more than enlightened the bar and the business community. There comes a time when the exception becomes the rule and when certainty outweighs precedent. That was the situation in *Lear*.

My first reaction on reading *Lear* was that there was an element of unfairness in permitting the licensee to have the benefits of two worlds—to retain his license agreement, which provided him with immunity against a claim of infringement, and at the same time to put

¹⁵⁹ *Id.* at 669.

¹⁶⁰ *Id.*

¹⁶¹ *Id.* at 670.

¹⁶² *Id.*

¹⁶³ *Id.* at 671.

the validity of the patent in issue when sued for unpaid royalties. It seemed to me that morality required him to pay for what he bought. I thought that the appropriate rule would have been to permit the licensee to terminate the license agreement on the ground of the alleged invalidity of the licensor's patent and to take his chances in an infringement suit. Under such an approach the licensee would be estopped to deny validity so long as he retained the fruits of the license, but he could escape the inhibiting effects of estoppel by bringing the agreement to an end, regardless of its termination provisions. On reflection, however, I have concluded that the differences between this approach and that adopted by the Court are not very meaningful as a practical matter.

Under the revised patent statute a patentee may no longer recover an infringer's profits, and, except for cases of a wilful invasion of another's patent rights, the measure of damages in an infringement suit is recovery of a reasonable royalty.¹⁶⁴ Hence, there is in the normal case little difference between a suit in contract for royalties and an action in tort for infringement. Thus, if the patent is found to be valid, the licensor will recover the contractual royalties, and be in the same position as if he had prevailed on a claim of infringement.

The other element of apparent unfairness was the fact that the licensee, if his challenge of validity proved unfounded, could retain the shield of his license to safeguard his future use of the patent after the conclusion of the litigation. But where the licensee refuses to pay royalties and assails the patent's validity, the patentee should have the privilege of terminating the license agreement himself and thus foreclose future use of the patent by the licensee.¹⁶⁵

The important point here is that the licensor is in a position to protect himself by suing for the royalties that have already accrued and terminating the license for the future. By eliminating the estoppel in an action for royalties, the public interest is advanced by the encouragement of those best in a position to contest validity¹⁶⁶ to subject the patent to judicial scrutiny and thus rid the economy of the spurious

¹⁶⁴ 35 U.S.C. § 284 (1964). See, e.g., *Union Carbide Corp. v. Graver Tank & Mfg. Co.*, 282 F.2d 653, 673 (7th Cir. 1960), *cert. denied*, 365 U.S. 812 (1961).

¹⁶⁵ The distinction between suing for infringement after termination and suit for unpaid royalties may be academic since the penalty for infringement may be little more than the recovery of the royalties provided for in the agreement. There is this difference however: one who practices an invention after his license agreement has been terminated by the licensor and after the validity of the patent has been upheld could well be regarded as a wilful infringer and thus subject to the recovery of treble damages.

¹⁶⁶ See *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827, 840 (1950) (Douglas, J., dissenting).

patents that are spawned by a Patent Office that continues to be prodigal in its grant of monopoly privileges. At the same time, the licensee who decides to cross the Rubicon assumes the risk that if his claims of invalidity are judicially rejected, he may thereafter be precluded from practicing the invention.¹⁶⁷

V

LICENSES OF KNOW-HOW AND TRADE SECRETS UNDER ATTACK

Article I, section 8, clause 8 of the Constitution empowers Congress "[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." The Supreme Court has discerned in this spacious language a national policy favoring competition and narrowly limiting permissible monopoly to those writings and discoveries that comply with the exacting requirements of the copyright and patent laws.¹⁶⁸ In a sense the Court has thus endowed anti-trust with a constitutional dimension.¹⁶⁹

Five years ago, in *Sears, Roebuck & Co. v. Stiffel Co.*¹⁷⁰ and *Compco Corp. v. Day-Brite Lighting, Inc.*,¹⁷¹ the Court held that under the doctrine of federal preemption and by virtue of the supremacy clause¹⁷² the states were powerless to forbid product simulation resulting in widespread public confusion even where the imitated features

¹⁶⁷ One of the recommendations of the Johnson Antitrust Task Force would involve compulsory licensing of patents to qualified applicants on equivalent terms whenever a patentee has issued at least one license to another. *White House Task Force Report on Antitrust Policy*, in BNA ANTITRUST & TRADE REG. REP. NO. 411, Special Supp., pt. II, at 10 (May 27, 1969). I raise the question as worthy of exploration as to whether, by limiting recovery of damages to the royalties which the patentee is obtaining from others, we may not already have taken an important step in the direction of compulsory licensing.

¹⁶⁸ *Lear, Inc. v. Adkins*, 395 U.S. 653, 677 (1969) (Black, J., concurring in part and dissenting in part); *Compco Corp. v. Day-Brite Lighting, Inc.*, 376 U.S. 234 (1964); *Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225 (1964).

¹⁶⁹ The granting of patent monopolies under . . . constitutional authority represents a very minor exception to the Nation's traditional policy of a competitive business economy, such as is safeguarded by the antitrust laws. When articles are not patentable and therefore are in the public domain, . . . to grant them a legally protected monopoly offends the constitutional plan of a competitive economy

Aro Mfg. Co. v. Convertible Top Replacement Co., 377 U.S. 476, 522 (1964) (Black, J., dissenting).

¹⁷⁰ 376 U.S. 225 (1964).

¹⁷¹ 376 U.S. 234 (1964).

¹⁷² U.S. CONST. art. VI, cl. 2.

were non-functional and had acquired a secondary meaning identifying the source of the originator's goods. The commentators, as might have been expected, were in sharp disagreement as to the thrust of these rulings. Some thought that they neither added to nor subtracted from existing law.¹⁷³ Others,¹⁷⁴ including myself,¹⁷⁵ were disturbed by the implications of the new principle if carried to the limits of its logic.

In 1964, commenting upon these decisions, I raised the question whether they would affect the continued recognition of enforceable rights in trade secrets and know-how since both are unpatented and frequently unpatentable.¹⁷⁶ The state and federal courts, however, save for a single dictum,¹⁷⁷ continued to protect trade secrets, finding nothing in the *Sears* and *Compco* rationale compelling any other course.¹⁷⁸ At least one writer, on the other hand, expressed the view

¹⁷³ E.g., Leeds, *Product Simulation: A Right Or a Wrong?*, 64 COLUM. L. REV. 1179 (1964); Leeds, *The Impact of Sears and Compco*, 55 TRADEMARK REP. 188 (1965); Treece, *Patent Policy and Preemption: The Stiffel and Compco Cases*, 32 U. CHI. L. REV. 80 (1964).

¹⁷⁴ E.g., Chapman, *The Supreme Court and Federal Law of Unfair Competition*, 54 TRADEMARK REP. 573 (1964); Derenberg, *Product Simulation: A Right Or a Wrong?*, 64 COLUM. L. REV. 1192 (1964).

¹⁷⁵ Handler, *Product Simulation: A Right Or a Wrong?*, 64 COLUM. L. REV. 1183 (1964).

¹⁷⁶ *Id.* at 1189-90.

¹⁷⁷ *Winston Research Corp. v. Minnesota Mining & Mfg. Co.*, 350 F.2d 134, 138 (9th Cir. 1965).

¹⁷⁸ Indeed of the 85 cases in which these precedents have been cited, in 24 they were distinguished and held inapplicable: *Black Hills Video Corp. v. FCC*, 399 F.2d 65, 70 (8th Cir. 1968); *Troy Co. v. Products Research Co.*, 339 F.2d 364, 366-67 (9th Cir. 1964), *cert. denied*, 381 U.S. 930 (1965); *Servo Corp. of Am. v. General Elec. Co.*, 337 F.2d 716, 724 (4th Cir. 1964), *cert. denied*, 383 U.S. 934 (1966); *Flexitized, Inc. v. National Flexitized Corp.*, 335 F.2d 774, 781 (2d Cir. 1964), *cert. denied*, 380 U.S. 913 (1965); *Marcal Paper Mills, Inc. v. Scott Paper Co.*, 290 F. Supp. 43, 48 (D.N.J. 1968); *Crossbow, Inc. v. Dan—Dee Imports, Inc.*, 266 F. Supp. 335, 338-39 (S.D.N.Y. 1967); *General Pool Corp. v. Hallmark Pool Corp.*, 259 F. Supp. 383, 387 (N.D. Ill. 1966); *Bogene Inc. v. Whit-Mor Mfg. Co.*, 253 F. Supp. 126, 128 (S.D.N.Y. 1966); *Blazon, Inc. v. DeLuxe Game Corp.*, 268 F. Supp. 416, 431-33 (S.D.N.Y. 1965); *AMCO Eng'r Co. v. Bud Radio, Inc.*, 145 U.S.P.Q. 609 (N.D. Ohio 1965); *Pottstown Daily News Publishing Co. v. Pottstown Broadcasting Co.*, 247 F. Supp. 578, 581-82 (E.D. Pa. 1965); *Edgar Rice Burroughs, Inc. v. Charlton Publications, Inc.*, 243 F. Supp. 731 (S.D.N.Y. 1965); *Samson Cordage Works v. Puritan Cordage Mills*, 243 F. Supp. 1, 7-8 (W.D. Ky. 1964); *Plastics Research & Dev. Corp. v. Norman*, 243 Ark. 780, 422 S.W.2d 121, 125 (1967); *Gordon v. Warner Bros. Pictures, Inc.*, 269 A.C.A. 26, 33-34, 74 Cal. Rptr. 499, 503-04 (1969); *Components for Research, Inc. v. Isolation Prods., Inc.*, 241 Cal. App. 2d 726, 730, 50 Cal. Rptr. 829, 832 (1966); *Schulenburg v. Signatrol, Inc.*, 33 Ill. 2d 379, 386, 212 N.E.2d 865, 868-69 (1965), *cert. denied*, 383 U.S. 959 (1966); *Edgar H. Wood Associates, Inc. v. Skene*, 347 Mass. 351, 356, 197 N.E.2d 886, 890 (1965); *Red Devil Tools v. Tip Top Brush Co.*, 50 N.J. 563, 569-70, 236 A.2d 861, 865 (1967); *Distillerie Flli Ramazotti, S.P.A. v. Banfi Prods. Corp.*, 52 Misc. 2d 593, 602, 276 N.Y.S.2d 413, 423-24 (Sup. Ct. 1966), *aff'd mem.*, 280 N.Y.S.2d 892 (1st Dep't 1967); *Greater Recording Co. v.*

that Justice Black's reasoning in *Sears*, as well as the constitutional plan of a competitive economy, do not allow states to protect rights in trade secrets in a patentable process for a period longer than the federal statutory limit.¹⁷⁰ Others argued in favor of the power of state courts to protect secret information from industrial espionage, breach of confidence and downright fraud.¹⁸⁰ An intermediate position has

Stambler, 144 U.S.P.Q. 547 (N.Y. Sup. Ct. 1965); Capitol Records, Inc. v. Greatest Records, Inc., 43 Misc. 2d 878, 880, 252 N.Y.S.2d 533, 555 (Sup. Ct. 1964); Mastro Plastics Corp. v. Emenee Indus., Inc., 141 U.S.P.Q. 311, 311-12 (N.Y. Sup. Ct. 1964); Columbia Broadcasting System, Inc. v. Documentaries Unlimited, Inc., 42 Misc. 2d 726, 248 N.Y.S.2d 809, 812 (Sup. Ct. 1964).

In 28 cases they were followed on essentially the same state of facts: *Smith v. Chanel, Inc.*, 402 F.2d 562, 564 n.6 (9th Cir. 1968); *Columbia Broadcasting System, Inc. v. DeCosta*, 377 F.2d 315, 318-19 (1st Cir.), *cert. denied*, 389 U.S. 1007 (1967); *Hampton v. Blair Mfg. Co.*, 374 F.2d 969, 973 (8th Cir.), *cert. denied*, 389 U.S. 829 (1967); *Bentley v. Sunset House Distributing Corp.*, 359 F.2d 140, 146-47 (9th Cir. 1966); *Automation Devices, Inc. v. Smalenderger*, 346 F.2d 288, 289 (7th Cir. 1965), *cert. denied*, 382 U.S. 974 (1966); *Cable Vision, Inc. v. KUTV, Inc.*, 335 F.2d 348, 350-51 (9th Cir. 1964), *cert. denied*, 379 U.S. 989 (1965); *Aerosol Research Co. v. Scovill Mfg. Co.*, 334 F.2d 751, 757 (7th Cir. 1964); *Time, Inc. v. Bernard Geis Associates*, 293 F. Supp. 130, 146 (S.D.N.Y. 1968); *Remco Industries, Inc. v. Toyomenka, Inc.*, 286 F. Supp. 948, 952 (S.D.N.Y.), *aff'd mem.*, 397 F.2d 303 (2d Cir. 1968); *Gethers v. Blatty*, 283 F. Supp. 303, 307 (C.D. Cal. 1968); *Sinatra v. Goodyear Tire & Rubber Co.*, 159 U.S.P.Q. 356, 357 (C.D. Cal. 1968); *Wilcox Mfg. Co. v. Eastern Gas & Fuel Associates*, 278 F. Supp. 34, 43 (S.D.W. Va. 1967), *aff'd*, 400 F.2d 960 (4th Cir. 1968), *cert. denied*, 393 U.S. 1051 (1969); *Brumberger Co. v. Chadwick-Miller Importers, Inc.*, 267 F. Supp. 190, 191-92 (D. Mass. 1967); *Haig & Haig Ltd. v. Marald Prods., Inc.*, 249 F. Supp. 575, 578-79 (S.D.N.Y. 1966); *Delamere Co. v. Taylor-Bell Co.*, 249 F. Supp. 471, 478 n.5 (S.D.N.Y. 1966); *T.P. Laboratories, Inc. v. Huge*, 261 F. Supp. 349, 357 (E.D. Wis. 1965), *aff'd*, 371 F.2d 231 (7th Cir. 1966); *Gray v. Eskimo Pie Corp.*, 244 F. Supp. 785, 789 n.3 (D. Del. 1965); *G.P. Putnam's Sons v. Lancer Books, Inc.*, 239 F. Supp. 782, 788 (S.D.N.Y. 1965); *Kingsway, Inc. v. Werner*, 233 F. Supp. 102, 103-04 (E.D. Mo. 1964); *Duplex Straw Dispenser Co. v. Harold Leonard & Co.*, 229 F. Supp. 401, 404-05 (S.D. Cal. 1964); *Titelock Carpet Strip Co. v. Klasner*, 142 U.S.P.Q. 405 (Cal. Super. Ct. 1964); *Herald Publishing Co. v. Florida Antennavision, Inc.*, 173 So. 2d 469, 474 (Fla. Dist. Ct. of App. 1965); *State's Attorney for Prince George's County v. Sekuler*, 249 Md. 499, 501-06, 240 A.2d 608, 610-12 (1968); *Angell Elevator Lock Co. v. Manning*, 348 Mass. 623, 626, 205 N.E.2d 245, 248 (1965); *Nation v. Rejectors, Inc. v. Trieman*, 152 U.S.P.Q. 120, 139, 157 (Mo. 1966); *Merchant Suppliers Paper Co. v. Photo-Marker Corp.*, 29 App. Div. 2d 94, 96-97, 285 N.Y.S.2d 932, 935-36 (1st Dep't 1967); *Flamingo Telefilm Sales, Inc. v. United Artists Corp.*, 22 App. Div. 2d 778, 779, 254 N.Y.S.2d 36, 37 (1st Dep't 1964); *Van Prods. Co. v. General Welding & Fabricating Co.*, 419 Pa. 248, 265 n.15, 213 A.2d 769, 778 n.15 (1965).

In only five could it be said that their principle was extended to other circumstances: *Tappan Co. v. General Motors Corp.*, 380 F.2d 888, 891-92 (6th Cir. 1967); *Spangler Candy Co. v. Crystal Pure Candy Co.*, 353 F.2d 641, 645-50 (7th Cir. 1965); *Parker Metal Goods Co. v. R.M.S. Electronics, Inc.*, 243 F. Supp. 15, 15-16 (S.D.N.Y. 1965); *Piel Mfg. Co. v. George A. Rolfe Co.*, 233 F. Supp. 891, 895-96 (S.D. Iowa 1964), *aff'd*, 363 F.2d 57 (8th Cir. 1966); *In re Shenango Ceramics, Inc.*, 362 F.2d 287, 292 (C.C.P.A. 1966). In 28 other cases, *Sears* and *Compco* were mentioned for incidental points only.

¹⁷⁰ Nimetz, *Design Protection*, 15 COPYRIGHT LAW SYMPOSIUM 79, 93-96 (1967).

¹⁸⁰ See, e.g., R. MILGRIM, *TRADE SECRETS* § 7.08[2][c] (1969); Arnold, *A Philosophy*

been advocated confining judicial protection to those secrets which are incapable of being patented.¹⁸¹

One of the issues in *Lear* was whether a patentee could assert his contractual right to receive royalties for the use of the technology covered by his patent application which had been disclosed and licensed before the patent issued and while the application was kept secret.¹⁸² The majority expressed no opinion on this question, remanding it to the California courts for their consideration.¹⁸³ To three Justices, however, there was no need for any remand. They found it clear beyond any peradventure that to permit the licensing of unpatented and unpatentable know-how would subvert the *Sears* principle and sanction a species of monopoly which the Constitution neither contemplated nor permits.¹⁸⁴ The minority would not go so far as to deny all rights in secret information; what it condemns is the collection of royalties for the use of unpatented or unpatentable inventions.¹⁸⁵

If a know-how license agreement may not be enforced because it conflicts with the national policy favoring free competition, on what basis can the secret itself be shielded from wrongful disclosure? Would not the grant of an injunction or the award of damages sanction a monopoly in unpatented matter for a period of time which may be unlimited? The distinction is difficult to grasp.

On the Protections Afforded By Patent, Trademark, Copyright and Unfair Competition Law: The Sources & Nature of Product Simulation Law, 54 TRADEMARK REP. 413 (1964); Doerfer, *The Limits on Trade Secret Law Imposed By Federal Patent and Antitrust Supremacy*, 80 HARV. L. REV. 1432 (1967); Note, *The Stiffel Doctrine and the Law of Trade Secrets*, 62 NW. U.L. REV. 956 (1968); Note, *Trade Secrets Law After Sears and Compco*, 53 VA. L. REV. 356 (1967); Note, *Unfair Competition After Sears and Compco*, 22 VAND. L. REV. 129 (1968).

¹⁸¹ Adelman, *Trade Secrets and Federal Pre-Emption—The Aftermath of Sears and Compco*, 49 J. PAT. OFFICE SOC. 713 (1967).

¹⁸² 395 U.S. at 674-75.

¹⁸³ *Id.* at 676-77.

¹⁸⁴ I still entertain the belief I expressed for the Court in *Stiffel* and *Compco* that no State has a right to authorize any kind of monopoly on what is claimed to be a new invention, except when a patent has been obtained from the Patent Office under the exacting standards of the patent laws. One who makes a discovery may, of course, keep it secret if he wishes, but private arrangements under which self-styled "inventors" do not keep their discoveries secret, but rather disclose them, in return for contractual payments, run counter to the plan of our patent laws, which tightly regulate the kind of inventions that may be protected and the manner in which they may be protected. The national policy expressed in the patent laws, favoring free competition and narrowly limiting monopoly, cannot be frustrated by private agreements among individuals, with or without the approval of the State.

Id. at 677 (Black, J., concurring in part and dissenting in part).

¹⁸⁵ *Id.*

If the controlling principle is that the only permissible monopolies are those obtained under the patent and copyright laws, many commercially valuable interests may hereafter be bereft of any judicial protection. Why should this be? Is antitrust our only significant social goal? What about the national interest in preventing fraud, theft and breach of confidential relationships? I would hazard the guess that there are thousands, if not hundreds of thousands of know-how agreements presently in effect which would be invalidated if this minority view becomes law. Will our competitive institutions really be strengthened if such agreements are no longer permitted?¹⁸⁶

There are very few areas of the law where there are not conflicting lines of authority reflecting competing policy considerations. Rarely do all the signposts point in the same direction.¹⁸⁷ The resolution of conflicting interests is particularly important in trade regulation, where the goal of unfettered competition must be tempered by the demands of business morality and fair play.¹⁸⁸

In the case of trade secrets, so long as secrecy is maintained, the owner enjoys a monopoly, but one which is quite fragile, since his rights must yield to honest discovery by others. The total denial of rights opens the door to fraud and breach of confidence. Even in an open society, there are personal, business and state secrets that it is

¹⁸⁶ Will the progress of the arts and sciences in fact be promoted by such a rule? Why is it that compulsory licensing of patents by government edict is deemed pro-competitive while the dissemination of technical knowledge by voluntary licensing is anathema? May not the proposed rule lead to even greater concentration of power in our economy since there will be every incentive for firms to keep to themselves their technological insights and procedures? If all that is jeopardized is future royalty payments, may not the prohibition be easily evaded by the requirement of lump-sum payments in advance of disclosure? If that proves to be the case, what would the change in law accomplish?

¹⁸⁷ Justice Cardozo put it this way:

One principle or precedent, pushed to the limit of its logic, may point to one conclusion; another principle or precedent, followed with like logic, may point with equal certainty to another. In this conflict, we must choose between the two paths, selecting one or other, or perhaps striking out upon a third, which will be the resultant of the two forces in combination, or will represent the mean between extremes.

CARDOZO, *supra* note 54, at 40.

¹⁸⁸ In my discussion of *Sears and Compco*, I wrote:

There is always the danger that salutary efforts to curb business improprieties may subvert the competitive process itself. Hence, the courts have had to strike a delicate balance between the social interest in preserving competition and the equally important social interest in prohibiting unfair and deceptive practices. In our eagerness to elevate the ethical levels of business conduct, we must never forget that unfair competition is the other side of the antitrust coin. To attain our dual goals, we must eliminate fraud without preventing competition; in preserving competition we must not immunize fraud.

Handler, *supra* note 175, at 1187.

not in the public interest to reveal. It is my belief that it is better to tolerate a qualified monopoly in business secrets to prevent a fraud than to tolerate a fraud in order to prevent enjoyment of some monopoly advantages. It should not be impossible to fashion compromises which will give due weight to the competitive ideal without immunizing espionage or theft.¹⁸⁹ In any event, I can see no reason why the bargains of those willing to pay money for the disclosure of valuable technical information should not be upheld. I would hope that the door which the *Lear* majority so carefully left open will eventually be firmly closed against doctrines for which I am unable to find any social justification.

VI

PATENT MISUSE VERSUS *in Pari Delicto*

In *Zenith Corp. v. Hazeltine Research, Inc.*,¹⁹⁰ the Court has added another chapter to the confusing jurisprudence of patent misuse. More particularly, Justice White's opinion for an eight-Justice majority¹⁹¹ raises perplexing questions with respect to how royalty payments in a patent license agreement may lawfully be measured.

Although the litigation was unusually complex and involved a host of issues,¹⁹² the facts relevant to the patent misuse question were relatively simple. Hazeltine owned some 500 patents for various types of radio and television apparatus.¹⁹³ Zenith acquired licenses to utilize Hazeltine's patents in the radios and television sets it manufactured. In entering into these licenses, it was Hazeltine's policy to insist "upon acceptance of its standard five-year package license agreement . . . re-

¹⁸⁹ Perhaps limits should be imposed on the temporal scope of the monopoly. Maybe disclosure of the secret should be required, as with patents, after a certain period of exploitation. Other reasonable restrictions might be imposed in the interests of competition. But why throw out the baby with the bath on the doctrinaire ground that no rights are obtainable with regard to anything in the public domain, a thesis which undermines the law of trademarks and unfair competition and could lead to the unenforceability of all ancillary agreements in restraint of trade, to say nothing of the traditional restrictions that are commonplace in all commercial contracts? See, e.g., Macdonald, *Know-How Licensing and the Antitrust Laws*, 62 MICH. L. REV. 351 (1964); Ladas, *Legal Protection of Know-How*, 7 IDEA 397 (1963).

¹⁹⁰ 395 U.S. 100 (1969).

¹⁹¹ Justice Harlan filed a separate opinion, 395 U.S. at 141, dissenting on the patent misuse issue.

¹⁹² Among the other issues decided were the susceptibility to judgment of a subsidiary never served with process, the standard of proof of treble-damages, and the propriety of injunctive relief.

¹⁹³ 395 U.S. at 134.

servicing royalties on the licensee's total radio and television sales, irrespective of whether the licensed patents were actually used in the products manufactured."¹⁹⁴ Zenith declined to renew the license when it expired. Negotiations having proved fruitless, Hazeltine brought suit for patent infringement. Zenith thereupon raised a patent misuse defense and, in addition, counterclaimed for treble damages and injunctive relief, alleging, *inter alia*, that Hazeltine's insistence on royalties for sales of sets produced without practicing the patented inventions violated the antitrust laws.¹⁹⁵

The district court found for Zenith on the infringement issue¹⁹⁶ and, on the antitrust counterclaim, ruled that Hazeltine "had misused its domestic patents by attempting to coerce Zenith's acceptance of a five-year package license, and by insisting on extracting royalties from unpatented products."¹⁹⁷ Treble damages were awarded, as well as an injunction prohibiting Hazeltine from "[c]onditioning . . . the grant of a license . . . to . . . Zenith . . . upon the paying of royalties on the manufacture, use or sale of apparatus not covered by such patent."¹⁹⁸

On appeal of the damage and injunction judgments,¹⁹⁹ the Seventh Circuit affirmed the damage award²⁰⁰ but modified the injunction to strike the above-quoted prohibition.²⁰¹ According to the court of appeals, the Supreme Court's 1950 decision in *Automatic Radio Manufacturing Co. v. Hazeltine Research, Inc.*²⁰² established that it was not misuse to condition the grant of a patent license upon payment of royalties on unpatented products;²⁰³ and, since there was no patent misuse, there obviously could be no antitrust infraction.²⁰⁴

On the misuse issue,²⁰⁵ the Supreme Court reversed, holding that "conditioning the grant of a patent license upon payment of royalties on products which do not use the teaching of the patent does amount to patent misuse."²⁰⁶

¹⁹⁴ *Id.*

¹⁹⁵ *Id.* at 104-05. The counterclaim also alleged conspiracies with foreign patent pools to exclude Zenith and others from exporting to certain foreign markets. *Id.* at 105.

¹⁹⁶ 239 F. Supp. 51, 68-69 (N.D. Ill. 1965).

¹⁹⁷ 395 U.S. at 105.

¹⁹⁸ *Id.* at 133-34 (emphasis by the Court).

¹⁹⁹ 388 F.2d 25 (7th Cir. 1967).

²⁰⁰ The court of appeals' affirmance was, *inter alia*, of damages with respect to the patent misuse claim. *Id.* at 33-35.

²⁰¹ *Id.* at 39.

²⁰² 339 U.S. 827 (1950).

²⁰³ *See* 395 U.S. at 135.

²⁰⁴ *See id.*

²⁰⁵ The Court does not pass on the question of antitrust violation, remanding that issue for further consideration by the court of appeals. *Id.* at 140-41.

²⁰⁶ *Id.* at 135.

Justice White's reasoning is quite simple. Just as a patentee may not condition a license on the licensee's purchase of an unpatented product²⁰⁷ or charge a royalty for use of the invention after the patent has expired,²⁰⁸ so too a requirement that the licensee pay royalties on sales of goods totally unrelated to the patent results in the use of "the power of [the] patent to levy a charge for making, using or selling products not within the reach of the monopoly granted by the Government."²⁰⁹

Nor is the Court troubled by an apparent inconsistency with the holding of *Automatic Radio*. Justice White reads that decision as establishing only that the licensor and licensee may, in the interest of mutual convenience, agree to measure royalties by a percentage of the licensee's total sales. He sees nothing wrong in a voluntary undertaking by the licensee to pay royalties for the privilege of using the licensor's patents even if he fails to exercise that privilege. But he would distinguish an arrangement arrived at after arm's length bargaining from the circumstances present in *Zenith*—a blanket insistence by the licensor on the total-sales royalty as a condition of granting any license at all.²¹⁰ In Justice White's language, "if convenience of the parties rather than patent power dictates the total-sales royalty provision, there are no misuse of the patents and no forbidden conditions attached to the license."²¹¹

Although ruling that Hazeltine's insistence on a total-sales royalty constituted patent misuse, Justice White nevertheless does not uphold the district court's injunction against the practice granted on *Zenith*'s counterclaim. Rather, he notes that the court of appeals had not reviewed the factual finding on which the injunction was predicated, so that a remand for that purpose was necessary.²¹² More significantly for our purposes, the opinion carefully points out that the existence of patent misuse does not necessarily mean that there is an actual or

²⁰⁷ *E.g.*, *International Salt Co. v. United States*, 332 U.S. 392, 395-96 (1947); *Ethyl Gasoline Corp. v. United States*, 309 U.S. 436, 455-59 (1940).

²⁰⁸ *E.g.*, *Brulotte v. Thys Co.*, 379 U.S. 29 (1964).

²⁰⁹ 395 U.S. at 137.

²¹⁰ But we do not read *Automatic Radio* to authorize the patentee to use the power of his patent to insist on a total-sales royalty and to override protestations of the licensee that some of his products are unsuited to the patent or that for some lines of his merchandise he has no need or desire to purchase the privileges of the patent. In such event, not only would royalties be collected on unpatented merchandise, but the obligation to pay for nonuse would clearly have its source in the leverage of the patent.

Id. at 139.

²¹¹ *Id.* at 138.

²¹² *Id.* at 140.

threatened violation of the antitrust laws²¹³ sufficient to warrant an injunction under section 16 of the Clayton Act.

When *Perma Life Mufflers, Inc. v. International Parts Corp.*²¹⁴ was decided last year, I was troubled by whether the total rejection of *in pari delicto* as an antitrust defense implied a repudiation of the unclean hands defense in patent litigation based on the patentee's misuse of his grant. *Hazeltine* confirms the conclusion I had reached that it is consistent with basic antitrust policy to expunge *in pari delicto* while retaining the doctrine of patent misuse in our antitrust and patent jurisprudence.

To restate the *Perma Life* holding briefly,²¹⁵ the *in pari delicto* defense is not generally available in a treble-damage action to immunize a defendant from his antitrust transgressions because the plaintiff, as well, has violated the law. Rather, each party has its remedy for the other's misdeeds.²¹⁶ On the other hand, once a patent owner is found guilty of misuse, his improper conduct constitutes a complete defense to an action for infringement, notwithstanding the fact of the infringing party's plainly unlawful behavior.

Despite the seeming difference in results, the basic goal of both the patent misuse and the *in pari delicto* doctrines is essentially the same, namely, the promotion of the nation's policy against monopoly and the restriction of competition. Both rules are designed to strengthen antitrust enforcement. As explained by the Supreme Court, once a patentee moves beyond the metes and bounds of his patent grant, he encroaches upon "domains where the antitrust acts or other laws, not the patent statutes, define the public policy."²¹⁷ Chief Justice Stone put it this way:

[T]he public policy which includes inventions within the granted monopoly excludes from it all that is not embraced in the inven-

²¹³ And if there was such patent misuse, it does not necessarily follow that the misuse embodies the ingredients of a violation of either § 1 or § 2 of the Sherman Act, or that Zenith was threatened by a violation so as to entitle it to an injunction under § 16 of the Clayton Act.

Id., citing *Transparent-Wrap Machine Corp. v. Stokes & Smith Co.*, 329 U.S. 637, 641 (1947); *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488, 490 (1942); *Laitram Corp. v. King Crab, Inc.*, 245 F. Supp. 1019 (D. Alas. 1965).

²¹⁴ 392 U.S. 134 (1968).

²¹⁵ For an extended discussion of this aspect of *Perma Life*, see Handler, *Through The Antitrust Looking Glass—Twenty-First Annual Antitrust Review*, 57 CALIF. L. REV. 182, 197 (1969).

²¹⁶ As pointed out in Handler, *supra* note 215, at 200-01, it is not clear that *Perma Life* totally expunges *in pari delicto* from antitrust. There may still be limited occasions for application of the doctrine.

²¹⁷ *Mercoide Corp. v. Mid-Continent Investment Co.*, 320 U.S. 661, 666 (1944).

tion. [That policy] forbids the use of the patent to secure an exclusive right or limited monopoly not granted by the Patent Office and which it is contrary to [the] public [interest] to grant.²¹⁸

In *Morton Salt Co. v. G. S. Suppiger Co.*,²¹⁹ the misuse defense was fashioned to prevent the use of the patent monopoly as leverage to control unpatented goods utilized in practicing a patented process or in connection with a patented article or machine. The Court invalidated the tie-in, without pausing to determine whether it offended against the requirements of the antitrust laws. Its reason was that the misuse of the patent concerned "the public interest as well as the private interests of suitors."²²⁰ Accordingly, the patentee was to be denied relief against infringement on the theory that his trespass into the antitrust domain constituted unclean hands. The Court was of the view that enforcement of the patent would reward the patentee in its efforts to restrain competition in the market for the tied, unpatented product, and thus be "a contributory factor in thwarting the public policy underlying the grant of the patent."²²¹ The Court did not assess the gravity of the patentee's misconduct against that of the defendant's infringement. As one court has put it:

The defense, once established, does not require any . . . balancing of the public interest; once patent misuse has been shown, the public interest . . . requires that the action for infringement of the patent must fall.²²²

One can readily understand why the courts would not tolerate the use of the limited patent monopoly to obtain a competitive advantage in the marketing of unpatented goods, though at the time of *Morton Salt* one might have questioned why the standard of legality of a tie-in should have been more stringent under general patent law than under the antitrust laws. In the present antitrust climate towards tie-ins and similar restrictive practices,²²³ however, not even the lantern of Diogenes could discern any signal differences between the standards now applicable to both fields. In upholding the defense, the courts in effect are granting an immunity to the infringer.

In *Perma Life*, on the other hand, in denying the *in pari delicto* defense, the Court made it plain that the miscreant plaintiff, though

²¹⁸ *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488, 492 (1942).

²¹⁹ 314 U.S. 488 (1942).

²²⁰ *Id.* at 493.

²²¹ *Id.*

²²² *Waco-Porter Corp. v. Tubular Structures Corp. of Am.*, 222 F. Supp. 332, 336 (S.D. Cal. 1963).

²²³ See text at notes 1-53 *supra*.

allowed a treble-damages recovery, could himself be mulcted by a counterclaim interposed by the defendant, if he had standing to prosecute the plaintiff's infraction, or by litigation instituted by others, including the enforcement agencies of the government.²²⁴

By a parity of reasoning, the Court could have sanctioned a counterclaim based on the patentee's antitrust transgressions or making the plaintiff amenable, like every other businessman, to the multiple remedies provided by our various antitrust laws, without barring the infringement action because of the plaintiff's own misconduct.

Were the antitrust claimant to be shown the door, the public would lose the advantages thought to result from the enforcement of antitrust by private litigation. The private suitor is not merely obtaining redress of a wrong inflicted upon himself; as a guardian of the public interest he serves as the vicarious avenger of a public wrong.²²⁵

The Supreme Court finds no like public interest in the vindication of the patent grant by judgment halting the infringement. The infringer is providing competition—an ease to the people²²⁶—against a monopoly that has been improperly exploited. The denial of relief serves as punishment for the patentee's abuse of power. What is more, it is a deterrent against similar misconduct by other patent owners. In short, an immunity against an antitrust dereliction runs counter to our antitrust objectives while the immunity against infringement advances the cause of competition.

With this background, let us turn to *Zenith* itself. With respect to patent misuse, the decision raises essentially two questions. First, how may the royalties payable for a patent license properly be measured? And second, what is the relationship between a finding of patent misuse and the requirements for a substantive violation of the

²²⁴ 392 U.S. at 139.

²²⁵ The Supreme Court has often stated that the private antitrust action plays an important role in antitrust enforcement. The following statement in *Bruce's Juices, Inc. v. American Can Co.*, 330 U.S. 743 (1947) is typical.

Where the interests of individuals or private groups or those who bear a special relation to the prohibition of a statute are identical with the public interest in having a statute enforced, it is not uncommon to permit them to invoke sanctions. This stimulates one set of private interest to combat transgressions by another without resort to governmental enforcement agencies. Such remedies have the advantage of putting back of such statutes a strong and reliable motive for enforcement, which relieves the Government of cost of enforcement. . . . It is clear Congress intended to use private self-interest as a means of enforcement and to arm injured persons with private means to retribution when it gave to any injured party a private cause of action in which his damages are to be made good threefold

Id. at 751-52.

²²⁶ See *The Schoolmaster Case*, Y.B., 11 Hen. IV, F.47, pl. 21 (Common Pleas 1410).

antitrust laws? For convenience it seems appropriate to discuss the latter issue first.

Since the misuse doctrine, as I have noted,²²⁷ is a branch of the unclean hands principle applicable only as a defense when the patentee seeks judicial enforcement of his patent, the issue is not whether there has been an antitrust transgression, but whether the patent has been employed as an improper means of obtaining monopoly advantages in fields outside the scope of the grant. The courts have uniformly held that a patent owner's anticompetitive conduct need not rise to the level of an antitrust violation for the defense to be available.²²⁸ And, in *Zenith*, Justice White affirmed this principle by remanding for consideration of the antitrust issue after holding that patent misuse was present.²²⁹

This rule appears eminently sound, as a simple example will demonstrate. Extending the payment of license royalties beyond the life of the patent has consistently been held to constitute misuse²³⁰ because the patentee is plainly utilizing his patent position to reap a reward beyond that provided him by the patent law.²³¹ But there may be many instances in which the anticompetitive impact of such a royalty arrangement will not be sufficiently grave to warrant a finding of independent antitrust illegality. As *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*²³² established, the parameters of a patent are not necessarily coextensive with a relevant product market, so that attempted extension of the patent monopoly, without more, will not establish, ipso facto, an attempt to monopolize in violation of section 2 of the Sherman Act.

What about the converse situation? Suppose an antitrust infraction involving a patent is clearly established. Does a finding of misuse necessarily follow such a determination? The lower courts have gen-

²²⁷ See text at note 217 *supra*.

²²⁸ E.g., *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488, 494 (1942); *Berlenbach v. Anderson & Thompson Ski Co.*, 329 F.2d 782 (9th Cir.), *cert. denied*, 379 U.S. 830 (1964); *Baldwin-Lima-Hamilton Corp. v. Tatnall Measuring Systems Co.*, 169 F. Supp. 1 (E.D. Pa. 1958), *aff'd*, 268 F.2d 395 (3d Cir.), *cert. denied*, 361 U.S. 894 (1959); *Barber-Colman Co. v. National Tool Co.*, 53 U.S.P.Q. 311 (N.D. Ohio 1942), *aff'd*, 136 F.2d 339 (6th Cir. 1945).

²²⁹ 395 U.S. at 140-41.

²³⁰ E.g., *Brulotte v. Thys Co.*, 379 U.S. 29 (1964); *American Securit Co. v. Shatterproof Glass Corp.*, 268 F.2d 769 (3d Cir.), *cert. denied*, 361 U.S. 902 (1959).

²³¹ Justice White stated the principle as follows in *Zenith*: "[A] patentee may not use the power of his patent to levy a charge for making, using, or selling products not within the reach of the monopoly granted by the Government." 395 U.S. at 136-37.

²³² 382 U.S. 172 (1965). See HANDLER, *Some Misadventures in Antitrust Policymaking—Nineteenth Annual Review*, 76 YALE L.J. 92, 110 (1966).

erally answered in the affirmative on the basis of a fortiori reasoning.²³³ And again, this result seems appropriate. Examination of the various practices which have been held to constitute misuse²³⁴ suggests, at least to me, that it is hard to conceive of any antitrust violation in which the leverage provided by a patent plays a significant part which would not, at the same time, amount to an extension of the patent monopoly within the misuse framework.

One further aspect of the misuse doctrine in general merits comment. The defense is absolute; if misuse is proved, the infringement suit must fail.²³⁵ Is such a do-or-die rule just and in keeping with fundamental notions of fair play?

Most laws would be incapable of enforcement if we had to rely exclusively upon the direct sanctions which only prosecuting officials may invoke. The treble damage remedy enlists the aid of private business and the private bar in effective antitrust enforcement. We must never overlook the efficacy in law administration of the prophylactic advice the bar provides its clients. The misuse doctrine creates an indirect sanction of enormous potency. The omnipresent danger of losing the protection of one's valuable property rights will spur a most scrupulous compliance with antitrust's requirements no matter how severe. Sometimes, of course, an indirect sanction can be so potent as to be self-defeating. This was recognized in *Kelly v. Kosuga*,²³⁶ where the Supreme Court refused to uphold a defense, in an action for the recovery of the purchase price, based upon the seller's antitrust violations. Had the Court held otherwise, every action for goods sold and delivered could readily be converted into an antitrust law suit,²³⁷ with devastating effects on the conduct of civil litigation in the state and federal courts.

²³³ See *American Photocopy Equip. Co. v. Rovico, Inc.*, 359 F.2d 745 (7th Cir. 1966); *Performed Line Prods. Co. v. Fanner Mfg. Co.*, 328 F.2d 265 (6th Cir.), cert. denied, 379 U.S. 846 (1964); *Peelers Co. v. Wendt*, 260 F. Supp. 193 (W.D. Wash. 1966).

²³⁴ These practices include royalties extending beyond the patent's expiration, e.g., *Brulotte v. Thys Co.*, 379 U.S. 29 (1964); tying arrangements, e.g., *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942); forced package licensing, e.g., *Shea v. Blaw-Knox Co.*, 388 F.2d 761, 765 (7th Cir. 1968) (dictum); vertical price-fixing in more than one license, e.g., *Newburgh Moire Co. v. Superior Moire Co.*, 237 F.2d 283 (3d Cir. 1956), aff'g 105 F. Supp. 372 (D.N.J. 1952); exclusive dealing arrangements, e.g., *F.C. Russell Co. v. Consumers Insulation Co.*, 226 F.2d 373 (3d Cir. 1955); discriminatory royalties, e.g., *Peelers Co. v. Wendt*, 260 F. Supp. 193 (W.D. Wash. 1966); and restrictions on use after sale, e.g., *Baldwin-Lima-Hamilton Corp. v. Tatnall Systems Co.*, 169 F. Supp. 1, 28-31 (E.D. Pa. 1958), aff'd, 268 F.2d 395 (3d Cir.), cert. denied, 361 U.S. 894 (1959).

²³⁵ See *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942).

²³⁶ 358 U.S. 516 (1959).

²³⁷ See *Bruce's Juices v. American Can Co.*, 330 U.S. 743, 754 (1947).

While I fully understand the philosophic basis of the patent misuse rule, I am not at all sure that it need take its present Draconian form. I am not satisfied that so drastic a punishment necessarily fits the crime in every case. I cannot grasp why the deterrent values of *Morton Salt* cannot be achieved without clothing a wilful infringement with complete immunity. *Morton Salt* itself recognizes the unfairness inhering in its doctrine by making the disqualification temporary only.²³⁸ As soon as the consequences of the misuse are dissipated, the patentee's rights revive.

There is, I believe, another approach. Some forty years ago, in considering the defense of unclean hands in the field of trademark infringement, I had the following to say:

The morals of the situations are curious. In order to penalize the plaintiff for his misrepresentation, the defendant is not only allowed to go scot free but in effect is licensed to continue his piracy, for the time being at least. The interest of the public is lost sight of. The practical way of dealing with this situation would be to compel both parties to call a halt to their deception instead of permitting the roguery of one to neutralize that of the other. Or, if this is not possible under our present procedure, the court could at least render a conditional decree, enjoining the defendant's infringement upon plaintiff's discontinuance of his misrepresentation, the decree taking effect only upon the performance of the condition.²³⁹

Why would it not make sense to punish with evenhanded justice both litigants, the defendant for his infringement and the plaintiff for his patent misuse? Instead of requiring a new suit to be brought after the effects of the misuse are erased, the court could condition its judgment of infringement upon proof that the patentee has corrected his practices, with the decree being operative only so long as the correction persisted. To the extent that the courts grant relief upon a showing of the abandonment of the misuse, obviating the necessity for bringing a new suit,²⁴⁰ the modest reform I have suggested is to a large extent already in effect. I would, of course, go further and follow the procedures of a conditional decree even where there has been no abandonment *pendente lite*. To retain the deterrent effect of the misuse doctrine, it is not necessary in my view to withhold injunctive relief. That end can be achieved by the denial of any accounting for the past infringement. But I would eschew any rigid rule

²³⁸ See *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942).

²³⁹ Handler, *False and Misleading Advertising*, 39 YALE L.J. 22, 49-50 (1929).

²⁴⁰ E.g., *Sylvania Indus. Corp. v. Visking Corp.*, 132 F.2d 947 (4th Cir.), cert. dismissed, 319 U.S. 777 (1943) (allowed supplemental pleadings under FED. R. CIV. P. 15).

precluding the recovery of damages under any or all circumstances. I would restore a sense of balance, weighing the seriousness of the misuse against the gravity and wilfulness of the infringement. By endowing the courts with a measure of discretion in allowing or disallowing damages for the past infringement, in whole or in part, we would enable them to adjust the penalty to fit the offense while imposing a sufficient degree of punishment to retain the deterrent value of this indirect sanction. In this way, patent misuse would no longer partake of vigilante justice.²⁴¹

Turning to the narrower patent misuse issue in *Zenith*, precisely what impact does the ruling have on royalty clauses in patent license agreements? Perhaps it will be easier to ascertain what the Court has held by first determining what it has not done.

It seems fairly clear that Justice White does not deem it to be a patent misuse when a patentee, in licensing a patented machine or a method of process patent, determines the amount of the royalties to be paid by a percentage of the gross sales of goods produced under the patent. Nor is there anything improper under *Zenith* if the royalties are computed on sales of unpatented products produced pursuant to a patented process. In both instances, the licensee's payments are directly related to his practice of the patented invention.

Similarly, the opinion appears to permit the licensor to exact a minimum flat royalty for the licensee's privilege of practicing the invention if he so desires,²⁴² irrespective of whether or not the patent is, in fact, used. And I see nothing in *Zenith* to prohibit the patent owner from insisting on such an arrangement as a condition of any license at all.

The problem arises when the sales on which the royalties are to be measured include goods which are neither covered by the patent nor produced by a patented process. In that situation, Justice White's rule turns on the facts surrounding the negotiation of the license. If the licensee wants the privilege of using one or all of the licensor's patents,

²⁴¹ "Our law frowns on vigilante justice." *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134, 154 (1968) (Harlan, J., dissenting).

²⁴² The Court also said in *Automatic Radio* that if the licensee bargains for the privilege of using the patent in all of his products and agrees to a lump sum or a percentage-of-total-sales royalty, he cannot escape payment on this basis by demonstrating that he is no longer using the invention disclosed by the patent. We neither disagree nor think such transactions are barred by the trial court's injunction.

395 U.S. at 138-39.

he can lawfully agree to pay royalties based on all of his sales, whether or not the licensed patent or patents are utilized. Similarly, if the bargaining parties "find it more convenient and efficient . . . to base royalties on total sales than to face the burden of figuring royalties based on actual use,"²⁴³ there is no misuse in agreeing to such an arrangement.

What does appear to be forbidden is for the patent owner to insist, contrary to the licensee's wishes, that the royalties be measured on all of the licensee's sales, including those of products not involving the patented invention when the licensee wants only the right to a specific patent (or package of patents) and is willing to pay royalties only on sales of products related to the patents he wishes to employ.²⁴⁴ Here the patentee can insist only on a flat sum for the immunity which the licensee desires.

In short, a licensee can willingly undertake to pay a total-sales royalty, but the licensor cannot require it as a condition of any license at all. The Court thus seems to be relying on a doctrine of involuntary restraint similar to that which I have suggested would be appropriate with respect to tie-ins.²⁴⁵

Since involuntary restraints have traditionally been frowned upon for centuries,²⁴⁶ there is little theoretical difficulty with such a rule. However, as Justice Harlan points out in his dissent,²⁴⁷ the practical problems of proof will be substantial. How is the trier of fact to determine whether or not the total-sales royalty was actually imposed against the licensor's will? Is a recitation of mutual convenience in the agreement itself sufficient to save the royalty? If so, all that has been accomplished is the judicial imposition of a new boiler plate provision in every patent license utilizing the total-sales device. In short, *Zenith* may have given us a theoretically sound principle which in practice may have little if any real significance.

²⁴³ *Id.* at 138.

²⁴⁴ But we do not read *Automatic Radio* to authorize the patentee to use the power of his patent to insist on a total-sales royalty and to override protestations of the licensee that some of his products are unsuited to the patent or that for some lines of his merchandise he has no need or desire to purchase the privileges of the patent.

Id. at 139.

²⁴⁵ See text at note 48 *supra*.

²⁴⁶ See *Mitchel v. Reynolds*, 1 P. Wms. 181, 24 Eng. Rep. 347 (K.B. 1711).

²⁴⁷ 395 U.S. at 141-42.

VII

LIMITATIONS ON THE FAILING COMPANY DOCTRINE

In commenting on *United States v. Diebold, Inc.*²⁴⁸ in my 1962 annual review,²⁴⁹ I expressed regret that the Supreme Court, in that case, did not provide us with a full-dress opinion clarifying the philosophic basis of the failing company doctrine or the criteria to be followed in applying it. *Citizen Publishing Co. v. United States*,²⁵⁰ decided in the 1968 term, does deal with the issue at length, but unfortunately many of the questions I posed seven years ago remain unanswered. What is most disturbing, however, is the Court's harsh treatment of the defense. If *Citizen Publishing* means everything it says, the failing company doctrine may now be so shackled with unrealistic requirements that, as a practical matter, it has little or no remaining vitality.

Citizen Publishing raises two distinct questions with respect to the failing company doctrine. First, to what antitrust offenses does the defense apply? Is it limited to mergers and acquisitions challenged under section 7 of the Clayton Act, or does it also have applicability to loose-knit combinations and monopolization attacked under the Sherman Act? Second, what are the substantive elements of the defense?

In *Citizen Publishing* the government challenged the legality of a joint operating agreement between the only two daily newspapers in Tucson, Arizona, one of which had been operated profitably while the other had sustained consistent losses.²⁵¹ When the unprofitable paper was acquired by new management, rather than seeking to sell it to others, its new owners negotiated an agreement with the other publication whereby each retained independent editorial departments, but the circulation and advertising operations of both were jointly run by a new corporation, equally owned by both.²⁵²

Under the joint agreement, the prices at which the newspapers were sold and advertising was placed were agreed upon; profits were pooled; and competing publications by either newspaper or their stockholders were prohibited.²⁵³

248 369 U.S. 654 (1962).

249 Handler, *Fifteenth Annual Review of Antitrust Developments*, 17 RECORD OF N.Y.C.B.A. 411, 427-29 (1962).

250 394 U.S. 131 (1969).

251 *Id.* at 133.

252 *Id.* at 133-34.

253 *Id.* at 134.

The complaint challenged the arrangement under both sections 1 and 2 of the Sherman Act. Prior to trial, the two newspapers merged, and the complaint was amended to add a section 7 count as well.

The district court granted summary judgment for the government on the section 1 count²⁵⁴ and, after trial, also found violations of sections 2 and 7.²⁵⁵ On direct appeal, the Supreme Court affirmed, seven to one,²⁵⁶ with Justice Harlan concurring in the result²⁵⁷ and Justice Stewart dissenting.²⁵⁸

Justice Douglas' opinion commences by stating the not very startling conclusion that horizontal price-fixing, profit pooling and market limitation constitute per se violations of section 1.²⁵⁹ He then turns to "the only real defense" raised below—the failing company rule. The trial court had excluded any evidence with respect to the defense on the section 1 charge, but had admitted the proffered facts on the issues of monopolization and section 7 violation.²⁶⁰ The facts basically were that one of the newspaper companies, *Citizen*, was in precarious financial condition at the time the joint operation agreement was entered into, having averaged over \$20,000 a year in losses for the eight prior years.²⁶¹ Moreover, at the time the joint operation was commenced, the *Citizen* owed \$79,000 to its stockholders for advances on working capital; had liabilities of over \$47,000 compared to assets of \$16,525; and had only \$420 in the bank and \$66 on hand.²⁶²

Justice Douglas finds it unnecessary to determine whether a failing company defense can ever be made out in Sherman Act litigations, because in his view the fundamental conditions of such a defense were not proved. To him there are two elements to the defense: the putative failing company must be in hopeless financial straits, and the competitor which acquires it must be the only available purchaser.

On the question of how weak a company must be before it can be said that it is failing, the Court is quite strict. Applying the language of *International Shoe Co. v. FTC*,²⁶³ Justice Douglas holds that

²⁵⁴ *Id.*

²⁵⁵ 280 F. Supp. 978 (D. Ariz. 1967).

²⁵⁶ Justice Douglas' opinion was joined by Justices Black, White, Brennan, Marshall, and Chief Justice Warren. Justice Fortas did not participate.

²⁵⁷ 394 U.S. at 140.

²⁵⁸ *Id.* at 143.

²⁵⁹ *Id.* at 135-36.

²⁶⁰ *Id.* at 136.

²⁶¹ *Id.* at 133.

²⁶² *Id.* at 144 n.2.

²⁶³ 280 U.S. 291 (1930).

it must face "the grave probability of a business failure."²⁶⁴ Since the district court had found that, despite Citizen's poor financial condition, its owners did not contemplate liquidation if a joint arrangement could not be worked out,²⁶⁵ Justice Douglas concludes that the company was not on the verge of going out of business and hence not a failing company.²⁶⁶ Moreover, following the lead of Justice Stone's dissent in *International Shoe*,²⁶⁷ Justice Douglas goes on to hold that so long as there is a possibility that the "failing company" could continue to operate under receivership or reorganization, competition by that company could be maintained without a merger and therefore its acquisition has anticompetitive effects. The Court's ruling on this point is explicit and virtually black letter: "[t]he prospects of reorganization of the Citizen in 1940 would have to be dim or non-existent to make the failing company doctrine applicable to this case."²⁶⁸

It is not impossible to comprehend why a defendant should be required to make a satisfactory showing that the acquired company was indeed on the brink of financial disaster. But to engraft upon such a requirement the additional burden of establishing that a reorganization or receivership program is not feasible seems unduly onerous. The variety of possible reorganization schemes available under the Federal Bankruptcy Act to an insolvent company is dependent upon a multiplicity of factors which will differ in each case.²⁶⁹ How practical then is it to compel a prospective purchaser to assess the probability of a successful reorganization in order to decide whether his acquisition is lawful?

Justice Douglas' second criterion is that the acquiring company must be the only available purchaser of the failing entity.²⁷⁰ On this point, the opinion is quite clear:

The failing company doctrine plainly cannot be applied in a merger or in any other case unless it is established that the company that acquires the failing company or brings it under dominion is the only available purchaser. For if another person or group could be interested, a unit in the competitive system would be preserved and not lost to monopoly power.²⁷¹

²⁶⁴ 394 U.S. at 137, quoting *International Shoe Co. v. FTC*, 280 U.S. 291, 302 (1930).

²⁶⁵ 280 F. Supp. at 980.

²⁶⁶ 394 U.S. at 137-38.

²⁶⁷ 280 U.S. at 306.

²⁶⁸ 394 U.S. at 138.

²⁶⁹ Factors such as the nature of the company's assets and liabilities, the number of creditors, the likelihood of continued successful operation under reorganization, etc., would plainly be relevant.

²⁷⁰ *Id.* at 138.

²⁷¹ *Id.*

In view of the fact that no effort had been made to sell the *Citizen*, and that there was no evidence with respect to what the market for the paper might have been, the Court concluded that even if it had been a failing company, the defense would still be unavailable to it.²⁷²

In short, the Court appears to hold that before a competitor may purchase a failing company, the to-be-acquired firm must make an effort to sell its business first to non-competitors and then, if that is not possible, to competitors, starting with the smallest companies first and proceeding up the scale until a candidate is found. The questions I asked in this regard with respect to *Diebold* in 1962 are equally pertinent today:

What guidelines must the financially embarrassed company follow in selecting a buyer? How does it justify to its creditors and stockholders the acceptance of a lower bid? Is it feasible to require a company on the brink of financial disaster to shop around for a non-competitor purchaser, and if any such cannot be found, to assess the comparative vigor of those of its competitors who might be induced to buy?²⁷³

Assuming that the stringent elements of the defense as defined in *Citizen Publishing* can somehow be made out, the next, and perhaps most interesting, question is the one the Court does not answer—is there a failing company defense in a case charging per se violations of the Sherman Act such as horizontal price-fixing and profit pooling? I am satisfied that, both as a matter of logic and of precedent, the defense should not be applicable in such cases. To begin with, we must distinguish between a failing company defense to price-fixing and a doctrine of defensive combination which, as I have suggested in the past,²⁷⁴ might make some antitrust sense. I can understand framing a rule based upon the rationale of *Appalachian Coals, Inc. v. United States*²⁷⁵ which would apply different substantive standards to failing industries or to combinations of small businessmen seeking to create countervailing power in face of a threat from larger competitors.²⁷⁶

²⁷² *Id.*

²⁷³ Handler, *supra* note 249, at 429.

²⁷⁴ See, e.g., Handler, *Some Unresolved Problems of Antitrust*, 62 COLUM. L. REV. 930, 954-55 (1962).

²⁷⁵ 288 U.S. 344 (1933).

²⁷⁶ Cf. *United States v. Sealy, Inc.*, 388 U.S. 350 (1967):

It is argued, for example, that a number of small grocers might allocate territory among themselves on an exclusive basis as incident to the use of a common name and common advertisements, and that this sort of venture should be welcomed in the interests of competition, and should not be condemned as *per se* unlawful. But condemnation of appellee's territorial arrangements certainly does not require us to go so far as to condemn that quite different situation, whatever might be the result if it were presented to us for decision.

Id. at 357 (dictum).

But no antitrust rationale or public policy consideration has been suggested to justify a successful solvent enterprise's agreeing to fix prices with its less prosperous competitors.

Insofar as monopolization charges are concerned, if a company seeks to achieve monopoly power by swallowing up a failing company, it is difficult to see how the poor financial condition of the acquired firm saves the transaction from section 2's strictures if the requisite monopolistic intent or effect is present.

What about joint ventures? Since section 7 was held applicable to joint ventures in *United States v. Penn-Olin Chemical Corp.*,²⁷⁷ one could well argue that the failing company defense in section 7 cases should likewise apply. I have a conceptual difficulty in envisaging the circumstances under which a failing company would ever enter into a joint venture in the traditional sense in which the term has been used. To me, a joint venture is a newly created enterprise in which two existing enterprises invest their capital. It seems highly unlikely that a company whose financial failure is imminent would be economically in a position to enter into such an arrangement, so that the question may well be of academic interest only. If, however, a failing concern were able to embark upon a classic type of joint venture, the fact of its weak economic position would certainly be a highly relevant fact in determining the legality of the enterprise under the principles laid down in *Penn-Olin*. For example, how likely would a failing company be to enter the relevant market absent the venture? What quality of potential competition would be eliminated if one of the joint venturers is close to insolvency? In resolving these, and similar issues, the poor financial condition of one of the participants, although it might not constitute an absolute defense, would certainly have to be taken into account.

To be sure, Justice Harlan in his concurrence speaks of the *Citizen Publishing* arrangement as a "joint venture." But there both newspapers placed all their properties in a common pot, maintaining independent editorial activities and independent stock ownership. This seems to partake of a partial or quasi-merger more than a conventional joint venture. The Court's opinion appears to indicate that if two companies want the benefit of rules appertaining to mergers and acquisitions, they must go ahead and merge. So long as business entities hold themselves out to the public as competitors, the antitrust laws require that they act as such.

Unfortunately, the Court does not analyze the theoretical under-

²⁷⁷ 378 U.S. 158 (1964).

pinnings of the defense in merger litigations. There is substantial support in amended section 7's legislative history²⁷⁸ for the view that, if the acquired company is heading towards bankruptcy, the statute was simply not intended to apply at all, so that the defense would be absolute. Under such a rule, the only issue would be whether in fact the company was failing—nothing more. If that is the doctrine's rationale, it makes a certain degree of sense to establish clear guidelines so that one can tell with some certainty whether or not an absolute defense is available with respect to a particular transaction. And it is understandable why an absolute defense, like an exception, will be strictly construed.

On the other hand, *International Shoe*, which preceded the amended statute and gave judicial birth to the doctrine, approached the inquiry merely as a part of the statutory assessment of the probable anticompetitive effects of the acquisition.²⁷⁹ In this context, if the acquired company's financial condition is so weak as to render it an impotent competitor, it is hard to fathom how the merger with a competitor can substantially lessen competition in the market. If the focus is to be on competitive effect, it seems most inappropriate to have rigid or doctrinaire rules as to how close to bankruptcy the failing company must be or what other attempts to sell it have been made before the pertinent facts will be considered. In short, although *Citizen Publishing* may, as a practical matter, have erased the defense, we are yet to be told exactly why this furthers our antitrust goals.

CONCLUSION

For seventeen years I have annually reviewed the antitrust grist of the Warren Court. Some of its decisions have met with applause; others have been questioned. Contrasted with the spirited dissents these rulings have evoked within the Court itself, the criticisms of the bar have been quite muted. With a new Chief Justice and further changes in the composition of the Court in the offing, a new chapter is about to open. No Court writes on a *tabula rasa*. It builds on its inheritance, discarding a bit here, adding a bit there, reshaping, clarifying and restating the law in the glorious tradition of the common law. Time always adds a new dimension and perspective to our jurisprudence.

²⁷⁸ See S. REP. NO. 1775, 81st Cong., 2d Sess. 7 (1950); *Hearings before a Subcomm. of the Senate Judiciary Comm. on H.R. 2734 (Corporate Mergers and Acquisitions)*, 81st Cong., 1st & 2d Sess. 79-81, 134-36, 311-12 (1950).

²⁷⁹ 280 U.S. at 302-03.

What troubled or enthused the contemporary critic is viewed in a new light. That is why the verdict of history does not always coincide with contemporary judgments. There is every reason, in light of the solid achievements of the past, for us to look with hope and confidence to the future as we pursue our endless quest for the excellence that so frequently eludes us.