[Antitrust in the 21st Century]

Casebook

Module 5 – Monopolization

Monopolization Basics

Sherman Act § 2, 15 U.S.C. § 2

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony…

Section 2 of the Sherman Act covers three offenses: monopolization, attempts to monopolize, and conspiracies to monopolize. In practice, monopolization is the most important offence, and we will focus on it here.

While §2 makes monopolization a felony, today it is enforced almost exclusively by civil law. Yet even civil §2 lawsuits are uncommon, because monopolization is tricky to define and prove. For example, intense competition can cause a competitor to exit as can exclusionary conduct.

At root, monopolization is unilateral conduct by a powerful firm that aims to entrench market power or exclude rivals from a market. It involves two elements: 1) monopoly power; and 2) conduct that harms competition.

1) Monopoly power

As we saw from the mergers module, monopoly power is "the power to control prices or exclude competition" in a market (see the *Cellophane* case). As with mergers, to show that a company has monopoly power, the plaintiff can use direct or indirect evidence. The indirect approach defines a valid market and then shows that the company dominates that market.

The conventional approach to demonstrating that a firm is a monopoly is to show that it has a high and stable market share. In the United States, this typically means a market share of around 70–80%; if a firm has less than a 50% market share, an American court would not likely call it a monopolist. In Europe, by contrast, courts have suggested that a market share of as low as 40% could constitute "dominance" in a market—their equivalent of "monopoly power."

To show that a company has market power, these high market shares must be durable. The best evidence of this is that the shares have been stable over time. But courts may also rule that a market share is durable if the market has barriers to entry that will hinder entrants and fringe competitors from competing.

Direct evidence can also prove monopoly power. Price increases, quality decreases, coercion, and other practices that customers do not want but have no way to avoid may be able to demonstrate the dominant firm's market power.

Required reading

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

Department of Justice, Report on Single-Firm Conduct under Section 2 of the Sherman Act, Ch. 2 and 3

(You may also want to go back and reread *du Pont*, the cellophane case.)

Background reading

United States v. Grinnell Corp., 384 U.S. 563 (1966)

2) Conduct that harms competition

Conduct that harms competition has proven challenging to define. The goal is to distinguish between competition "on the merits" and "improper conduct" (*Aspen Skiing*). But what counts as which? Courts often quote *Grinnell* (in the background reading), which defined conduct that harms competition as "the willful acquisition or maintenance of [monopoly] power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." In *Aspen Skiing*, the Court tried another definition: conduct is anticompetitive if it "(1) tends to impair the opportunities of rivals, but also (2) either does not further competition on the merits or does so in an unnecessarily restrictive way." But are these definitions any more helpful, or are they just different ways of saying the same thing?

The problem with finding a more precise definition is that the line between procompetitive and anticompetitive conduct can be thin. Conduct that harms competitors may be exclusionary and harm competition, or it may be intense competition that benefits consumers. What is a harmless business strategy in a competitive market may be anticompetitive in a sufficiently concentrated market.

A useful element to the analysis is the parties' original strategic intent if it is available. Note that competitors often intend to "win" against each other and the emotions inherent in competition can be a healthy part of capitalism. The "intent" that is helpful in antitrust analysis is the purposeful articulation of a firm's strategy by its leadership. For example, evidence that top management was planning to drive a competitor out of the market versus working to lower production costs is revealing.

Because of the variety of markets, firms, and possible tactics in an ever-changing economy, a comprehensive definition of monopolization is elusive. Instead, we use economic analysis to identify whether a particular practice in a particular market reduces competition, and develop a separate legal test for each. When new behavior arises that seems potentially concerning, we can then either form a new category or try to analogize the behavior to the categories we have already identified. We can thus create a history of practices and settings that courts have found to be anticompetitive in the past. When markets change (e.g. the internet arrives), however, that precedent may be less useful. There are bodies of law around specific anticompetitive practices, including tying and bundling, rebates, predatory pricing, and so on. As you read later modules, consider whether modern antitrust issues should lead us to define even more categories.

Also consider whether US monopolization law misses an important a category of behavior that is often captured by competition laws in other countries. The law focuses on “exclusionary” abuses, in which the large company harms competition by blocking its rival or forcing it to bear higher costs. But another cost to a monopoly is simple “exploitation”—the company charges prices that are above competitive levels. This, on its own, is not a violation under US law. One might be able to justify this choice because it is more effective to treat the “disease” than the “symptom.” Anti-enforcement proponents justify high prices on the grounds that they will incentivize rivals to enter the market and restore competition. Some cases have adopted this view (see *Verizon v. Trinko*). But is it right? What about the role of entry barriers and the conduct of the incumbent?

Required reading

<u>Anticompetitive conduct</u>

United States v. United Shoe Machinery Corp., 110 F. Supp. 295 (D. Mass. 1953)

United States v. Dentsply Int’l, Inc., 399 F.3d 181, 187 (3d Cir. 2005)

<u>Predatory pricing</u>

Matsushita Electric Industrial Co. v. Zenith Radio, 475 U.S. 574 (1986)

Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993)

<u>Tying</u>

Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2 (1984)

United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001)

<u>Refusing to deal</u>

Otter Tail Power v. United States, 410 U.S. 366 (1973)

Aspen Highlands Skiing Corp. v. Aspen Skiing Co., 472 U.S. 585 (1985)

Verizon Commc’ns Inc. v. L. Offs. of Curtis V. Trinko, LLP, 540 U.S. 398, 411 (2004)

<u>Price Squeezes</u>

Pacific Bell Telephone Co. v. LinkLine Communications, Inc., 555 U.S. 438 (2009)

<u>Loyalty Rebates</u>

Le Page’s Inc. v. 3M Co., 324 F.3d 141 (3rd Cir. 2003)

Recommended reading

Economics module on predatory pricing

Robinson-Patman Act, 15 U.S.C. §13(a)

Deutsche Telekom AG v. Commission, Case T-271/03 (2008)

Background reading

Utah Pie Co. v. Continental Baking Co., 386 U.S. 685 (1967)

Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., 549 U.S. 312 (2007)

Illinois Toolworks Inc. v. Independent Ink, Inc., 547 U.S. 28 (2006)

United States v. Colgate & Co., 250 U.S. 300 (1919)

Cascade Health Solutions v. Peacehealth, 515 F.3d 883 (9th Cir. 2008)

Remedies

Designing a remedy for illegal unilateral conduct can be challenging: agencies or courts need to pick measures that will prevent the infringing conduct but that are also easy to administer and that will ensure that the monopolist can still compete legitimately. Agencies also must anticipate market developments. Sometimes the remedy can be extreme—for example, the breaking up of AT&T.

Background reading

United States v. American Telephone and Telegraph Co., 524 F. Supp. 1336 (D.D.C. 1981)

United States v. American Tel. & Tel. Co., 552 F. Supp. 131, 1982 (D.D.C. 1982)

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

'Alcoa'… has always been engaged in the production and sale of 'ingot' aluminum, and since 1895 also in the fabrication of the metal into many finished and semi-finished articles. It has proliferated into a great number of subsidiaries, created at various times between the years 1900 and 1929, as the business expanded… [owing to Alcoa's patents] until February 2, 1909, 'Alcoa' had either, a monopoly of the manufacture of 'virgin' aluminum ingot, or the monopoly of a process which eliminated all competition… (at 422)

The extraction of aluminum from alumina requires a very large amount of electrical energy, which is ordinarily, though not always, most cheaply obtained from water power. Beginning at least as early as 1895, 'Alcoa' secured such power from several companies by contracts, containing in at least three instances, covenants binding the power companies not to sell or let power to anyone else for the manufacture of aluminum. 'Alcoa'- either itself or by a subsidiary- also entered into four successive 'cartels' with foreign manufacturers of aluminum by which, in exchange for certain limitations upon its import into foreign countries, it secured covenants from the foreign producers, either not to import into the United States at all, or to do so under restrictions, which in some cases involved the fixing of prices. These 'cartels' and restrictive covenants and certain other practices were the subject of a suit filed by the United States against 'Alcoa' on May 16, 1912, in which a decree was entered by consent on June 7, 1912, declaring several of these covenants unlawful and enjoining their performance; and also declaring invalid other restrictive covenants obtained before 1903 relating to the sale of alumina…

None of the foregoing facts are in dispute, and the most important question in the case is whether the monopoly in 'alcoa's' production of 'virgin' ingot, secured by the two patents until 1909, and in part perpetuated between 1909 and 1912 by the unlawful practices, forbidden by the decree of 1912, continued for the ensuing twenty-eight years; and whether, if it did, it was unlawful under § 2 of the Sherman Act, 15 U.S.C.A. § 2. It is undisputed that throughout this period 'Alcoa' continued to be the single producer of 'virgin' ingot in the United States; and the plaintiff argues that this without more was enough to make it an unlawful monopoly. It also takes an alternative position: that in any event during this period 'Alcoa' consistently pursued unlawful exclusionary practices, which made its dominant position certainly unlawful, even though it would not have been, had it been retained only by 'natural growth.' Finally, it asserts that many of these practices were of themselves unlawful, as contracts in restraint of trade under Sec. 1 of the Act, 15 U.S.C.A. § 1. 'Alcoa's' position is that the fact that it alone continued to make 'virgin' ingot in this country did not, and does not, give it a monopoly of the market; that it was always subject to the competition of imported 'virgin' ingot, and of what is called 'secondary' ingot; and that even if it had not been, its monopoly would not have been retained by unlawful means, but would have been the result of a growth which the Act does not forbid, even when it results in a monopoly. We shall first consider the amount and character of this competition; next, how far it established a monopoly; and finally, if it did, whether that monopoly was unlawful under § 2 of the Act…

There are various ways of computing 'Alcoa's' control of the aluminum market- as distinct from its production- depending upon what one regards as competing in that market. The judge figured its share during the years 1929-1938, inclusive- as only about thirty-three percent; to do so he included 'secondary,' and excluded that part of 'Alcoa's own production which it fabricated and did not therefore sell as ingot. If, on the other hand, 'Alcoa's' total production, fabricated and sold, be included, and balanced against the sum of imported 'virgin' and 'secondary,' its share of the market was in the neighborhood of sixty-four per cent for that period. The percentage we have already mentioned- over ninety- results only if we both include all 'Alcoa's' production and exclude 'secondary'. That percentage is enough to constitute a monopoly; it is doubtful whether sixty or sixty-four percent would be enough; and certainly thirty-three per cent is not. Hence it is necessary to settle what he shall treat as competing in the ingot market. That part of its production which 'Alcoa' itself fabricates, does not of course ever reach the market as ingot; and we recognize that it is only when a restriction of production either inevitably affects prices, or is intended to do so, that it violates § 1 of the Act. Apex Hosiery Co. v. Leader, 310 U.S. 469, 501, 60 S.Ct. 982, 84 L.Ed. 1311, 128 A.L.R. 1044. However, even though we were to assume that a monopoly is unlawful under Sec. 2 only in case it controls prices, the ingot fabricated by 'Alcoa,' necessarily had a direct effect upon the ingot market. All ingot- with trifling exceptions- is used to fabricate intermediate or end, products; and therefore all intermediate, or end, products which 'Alcoa' fabricates and sell, pro tanto reduce the demand for ingot itself. The situation is the same, though reversed, as in Standard Oil Co. v. United States, 221 U.S. 1, 77, 31 S.Ct. 502, 523, 55 L.Ed. 619, 34 L.R.A., N.S., 834, Ann.Cas. 1912D, 734, where the court answered the defendant's argument that they had no control over the crude oil by saying that 'as substantial power over the crude product was the inevitable result of the absolute control which existed over the refined product, the monopolization of the one carried with it the power to control the other.' We cannot therefore agree that the computation of the percentage of 'Alcoa's' control over the ingot market should not include the whole of its ingot production. (at 422-424)

As to 'secondary,' … we can say nothing more definite than that, although 'secondary' does not compete at all in some uses, (whether because of 'sales resistance' only, or because of actual metalurgical inferiority), for most purposes it competes upon a substantial equality with 'virgin.' On these facts the judge found that 'every pound of secondary or scrap aluminum which is sold in commerce displaces a pound of virgin aluminum which otherwise would, or might have been, sold.' We agree… At any given moment therefore 'secondary' competes with 'virgin' in the ingot market; further, it can, and probably does, set a limit or 'ceiling' beyond which the price of 'virgin' cannot go, for the cost of its production will in the end depend only upon the expense of scavenging and reconditioning. It might seem for this reason that in estimating 'Alcoa's' control over the ingot market, we ought to include the supply of 'secondary,' as the judge did. Indeed, it may be thought a paradox to say that anyone has the monopoly of a market in which at all times he must meet a competition that limits his price. We shall show that it is not.

In the case of a monopoly of any commodity which does not disappear in use and which can be salvaged, the supply seeking sale at any moment will be made up of two components: (1) the part which the putative monopolist can immediately produce and sell; and (2) the part which has been, or can be, reclaimed out of what he has produced and sold in the past. By hypothesis he presently controls the first of these components; the second he has controlled in the past, although he no longer does. During the period when he did control the second, if he was aware of his interest, he was guided, not alone by its effect at that time upon the market, but by his knowledge that some part of it was likely to be reclaimed and seek the future market. That consideration will to some extent always affect his production until he decides to abandon the business, or for some other reason ceases to be concerned with the future market. Thus, in the case at bar 'Alcoa' always knew that the future supply of ingot would be made up in part of what it produced at the time, and, if it was as far-sighted as it proclaims itself, that consideration must have had its share in determining how much to produce. How accurately it could forecast the effect of present production upon the future market is another matter. Experience, no doubt, would help; but it makes no difference that it had to guess; it is enough that it had an inducement to make the best guess it could, and that it would regulate that part of the future supply, so far as it should turn out to have guessed right. The competition of 'secondary' must therefore be disregarded, as soon as we consider the position of 'Alcoa' over a period of years; it was as much within 'Alcoa's' control as was the production of the 'virgin' from which it had been derived…

We conclude therefore that 'Alcoa's' control over the ingot market must be reckoned at over ninety per cent; that being the proportion which its production bears to imported 'virgin' ingot. If the fraction which it did not supply were the produce of domestic manufacture there could be no doubt that this percentage gave it a monopoly- lawful or unlawful, as the case might be. The producer of so large a proportion of the supply has complete control within certain limits. It is true that, if by raising the price he reduces the amount which can be marketed- as always, or almost always, happens- he may invite the expansion of the small producers who will try to fill the place left open; nevertheless, not only is there an inevitable lag in this, but the large producer is in a strong position to check such competition; and, indeed, if he has retained his old plant and personnel, he can inevitably do so. There are indeed limits to his power; substitutes are available for almost all commodities, and to raise the price enough is to evoke them. United States v. Corn Products Refining Co., D.C., 234 F. 964, 976; United States v. Associated Press, D.C., 52 F.Supp. 362, 371; Fashion Originators Guild v. Federal Trade Commission, 2 Cir., 114 F.2d 80, 85. Moreover, it is difficult and expensive to keep idle any part of a plant or of personnel; and any drastic contraction of the market will offer increasing temptation to the small producers to expand. But these limitations also exist when a single producer occupies the whole market: even then, his hold will depend upon his moderation in exerting his immediate power.

…It is entirely consistent with the evidence that it was the threat of greater foreign imports which kept 'Alcoa's' prices where they were, and prevented it from exploiting its advantage as sole domestic producer; indeed, it is hard to resist the conclusion that potential imports did put a 'ceiling' upon those prices. Nevertheless, within the limits afforded by the tariff and the cost of transportation, 'Alcoa' was free to raise its prices as it chose, since it was free from domestic competition, save as it drew other metals into the market as substitutes. Was this a monopoly within the meaning of § 2? The judge found that, over the whole half century of its existence, 'Alcoa's' profits upon capital invested, after payment of income taxes, had been only about ten per cent, and, although the plaintiff puts this figure a little higher, the difference is negligible. The plaintiff does indeed challenge the propriety of computing profits upon a capital base which included past earnings that have been allowed to remain in the business; but as to that it is plainly wrong. An argument is indeed often made in the case of a public utility, that the 'rate-base' should not include earnings re-invested which were greater than a fair profit upon the actual investment outstanding at the time. That argument depends, however, upon the premise that at common law- even in the absence of any commission or other authority empowered to enforce a 'reasonable' rate- it is the duty of a public utility to charge no more than such a rate, and that any excess is unlawfully collected. Perhaps one might use the same argument in the case of a monopolist; but it would be a condition that one should show what part of the past earning were extortionate, for not all that even a monopolist may earn is caput lupinum. The plaintiff made no such attempt, and its distinction between capital, 'contributed by consumers' and capital, 'contributed by shareholders,' has no basis in law. 'Alcoa's' earnings belonged to its shareholders, they were free to withdraw them and spend them, or to leave them in the business. If they chose to leave them, it was no different from contributing new capital out of their pockets. This assumed, it would be hard to say that 'Alcoa' had made exorbitant profits on ingot, if it is proper to allocate the profit upon the whole business proportionately among all its products- ingot, and fabrications from ingot. A profit of ten per cent in such an industry, dependent, in part at any rate, upon continued tariff protection, and subject to the vicissitudes of new demands, to the obsolescence of plant and process- which can never be accurately gauged in advance- to the chance that substitutes may at any moment be discovered which will reduce the demand, and to the other hazards which attend all industry; a profit of ten per cent, so conditioned, could hardly be considered extortionate.

There are however, two answers to any such excuse; and the first is that the profit on ingot was not necessarily the same as the profit of the business as a whole, and that we have no means of allocating its

proper share to ingot. It is true that the mill cost appears; but obviously it would be unfair to 'Alcoa' to take, as the measure of its profit on ingot, the difference between selling price and mill cost; and yet we have nothing else. It may be retorted that it was for the plaintiff to prove what was the profit upon ingot in accordance with the general burden of proof. We think not. Having proved that 'Alcoa' had a monopoly of the domestic ingot market, the plaintiff had gone far enough; if it was an excuse, that 'Alcoa' had not abused its power, it lay upon 'Alcoa' to prove that it had not. But the whole issue is irrelevant anyway, for it is no excuse for 'monopolizing' a market that the monopoly has not been used to extract from the consumer more than a 'fair' profit. The Act has wider purposes. Indeed, even though we disregard all but economic considerations, it would by no means follow that such concentration of producing power is to be desired, when it has not been used extortionately. Many people believe that possession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; that immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress; that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone. Such people believe that competitors, versed in the craft as no consumer can be, will be quick to detect opportunities for saving and new shifts in production, and be eager to profit by them. In any event the mere fact that a producer, having command of the domestic market, has not been able to make more than a 'fair' profit, is no evidence that a 'fair' profit could not have been made at lower prices. United States v. Corn Products Refining Co., supra, 1014, 1015 (234 F. 964). True, it might have been thought adequate to condemn only those monopolies which could not show that they had exercised the highest possible ingenuity, had adopted every possible economy, had anticipated every conceivable improvement, stimulated every possible demand. No doubt, that would be one way of dealing with the matter, although it would imply constant scrutiny and constant supervision, such as courts are unable to provide. Be that as it may, that was not the way that Congress chose; it did not condone 'good trusts' and condemn 'bad' ones; it forbad all. Moreover, in so doing it was not necessarily actuated by economic motives alone. It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of a few. These considerations, which we have suggested only as possible purposes of the Act, we think the decisions prove to have been in fact its purposes. (at 424-427)

…Starting, however, with the authoritative premise that all contracts fixing prices are unconditionally prohibited, the only possible difference between them and a monopoly is that while a monopoly necessarily involves an equal, or even greater, power to fix prices, its mere existence might be thought not to constitute an exercise of that power. That distinction is nevertheless purely formal; it would be valid only so long as the monopoly remained wholly inert; it would disappear as soon as the monopoly began to operate; for, when it did- that is, as soon as it began to sell at all- it must sell at some price and the only price at which it could sell is a price which it itself fixed. Thereafter the power and its exercise must needs coalesce. Indeed it would be absurd to condemn such contracts unconditionally, and not to extend the condemnation to monopolies; for the contracts are only steps toward that entire control which monopoly confers: they are really partial monopolies.

… Perhaps, it has been idle to labor the point at length; there can be no doubt that the vice of restrictive contracts and of monopoly is really one, it is the denial to commerce of the supposed protection of competition. To repeat, if the earlier stages are proscribed, when they are parts of a plan, the mere projecting of which condemns them unconditionally, the realization of the plan itself must also be proscribed.

We have been speaking only of the economic reasons which forbid monopoly; but, as we have already implied, there are others, based upon the belief that great industrial consolidations are inherently undesirable, regardless of their economic results. In the debates in Congress Senator Sherman

himself in the passage quoted in the margin showed that among the purposes of Congress in 1890 was a desire to put an end to great aggregations of capital because of the helplessness of the individual before them.[1] Another aspect of the same notion may be found in the language of Mr. Justice Peckham in United States v. Trans-Missouri Freight Association, supra, at page 323 (166 U.S. 290, 17 S.Ct. 540, 41 L.Ed. 1007). That Congress is still of the same mind appears in the Surplus Property Act of 1944, 50 U.S.C.A.Appendix § 1611 et seq., and the Small Business Mobilization Act, 50 U.S.C.A.Appendix § 1101 et seq. Not only does § 2(d) of the first declare it to be one aim of that statute to 'preserve the competitive position of small business concerns,' but § 18 is given over to directions designed to 'preserve and strengthen' their position. In United States v. Hutcheson, 312 U.S. 219, 61 S.Ct. 463, 85 L.Ed. 788, a later statute in pari materia was considered to throw a cross light upon the Anti-trust Acts, illuminating enough even to override

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[1] 'If the concerted powers of this combination are intrusted to a single man, it is a kingly prerogative, inconsistent with our form of government, and should be subject to the strong resistance of the State and national authorities * * *.' 21 Cong.Record, 2457.

'The popular mind is agitated with problems that may disturb social order, and among them all none is more threatening than the inequality of condition, of wealth, and opportunity that has grown within a single generation out of the concentration of capital into vast combinations to control production and trade and to break down competition. These combinations already defy or control powerful transportation corporations and reach State authorities. They reach out their Briarean arms to every part of our country. They are imported from abroad. Congress alone can deal with them, and if we are unwilling or unable there will soon be a trust for every production and a master to fix the price for every necessity of life. * * * ' 21 Cong.Record, 2460. See also 21 Cong.Record 2598.

an earlier ruling of the court. Throughout the history of these statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other. We hold that 'Alcoa's' monopoly of ingot was of the kind covered by § 2.

It does not follow because 'Alcoa' had such a monopoly, that it 'monopolized' the ingot market: it may not have achieved monopoly; monopoly may have been thrust upon it. If it had been a combination of existing smelters which united the whole industry and controlled the production of all aluminum ingot, it would certainly have 'monopolized' the market. In several decisions the Supreme Court has decreed the dissolution of such combinations, although they had engaged in no unlawful trade practices. Perhaps we should not count among these Northern Securities Co. v. United States, 193 U.S. 197, 327, 24 S.Ct. 436, 48 L.Ed. 679, because it was decided with Standard Oil Co. v. United States, supra, (221 U.S. 1, 31 S.Ct. 502, 55 L.Ed. 619, 34 L.R.A.,N.S., 834, Ann.Cas. 1912D, 734); but the following cases were later. United States v. Union Pacific R. Co., 226 U.S. 61, 88, 33 S.Ct. 53, 57 L.Ed. 124; International Harvester v. Missouri, 234; U.S. 199, 209, 34 S.Ct. 859, 58 L.Ed. 1276, 52 L.R.A.,N.S., 525; United States v. Reading Co., 253 U.S. 26, 57-59, 40 S.Ct. 425, 64 L.Ed. 760; United States v. Southern Pacific Co., 259 U.S. 214, 230, 231, 42 S.Ct. 496, 66 L.Ed. 907. We may start therefore with the premise that to have combined ninety per cent of the producers of ingot would have been to 'monopolize' the ingot market; and, so far as concerns the public interest, it can make no difference whether an existing competition is put an end to, or whether prospective competition is prevented. The Clayton Act itself speaks in that alternative: 'to injure, destroy, or prevent competition.' § 13(a) 15 U.S.C.A. Nevertheless, it is unquestionably true that from the very outset the courts have at least kept in reserve the possibility that the origin of a monopoly may be critical in determining its legality; and for this they had warrant in some of the congressional debates which accompanied the passage of the Act. In Re Greene, C.C. Ohio, 52 F. 104, 116, 117; United States v. Trans Missouri Freight Association, 8 Cir., 58 F. 58, 82, 24 L.R.A. 73. This notion has usually been expressed by saying that size does not determine guilt; that there must be some 'exclusion' of competitors; that the growth must be something else than 'natural' or 'normal'; that there must be a 'wrongful intent,' or some other specific intent; or that some 'unduly' coercive means must be used. At times there has been emphasis upon the use of the active verb, 'monopolize,' as the judge noted in the case at bar. United States v. Standard Oil Co., C.C. Mos., 173 F. 466, 478; Patterson v. United States, 6 Cir., 222 F. 599, 619; National Biscuit Co. v. Federal Trade Commission, 2 Cir., 299 F. 733, 738. What engendered these compunctions is reasonably plain; persons may unwittingly find themselves in possession of a monopoly, automatically so to say: that is, without having intended either to put an end to existing competition, or to prevent competition from arising when none had existed; they may become monopolists by force of accident. Since the Act makes 'monopolizing' a crime, as well as a civil wrong, it would be not only unfair, but presumably contrary to the intent of Congress, to include such instances. A market may, for example, be so limited that it is impossible to produce at all and meet the cost of production except by a plant large enough to supply the whole demand. Or there may be changes in taste or in cost which drive out all but one purveyor. A single producer may be the survivor out of a group of active competitors, merely by virtue of his superior skill, foresight and industry. In such cases a strong argument can be made that, although the result may expose the public to the evils of monopoly, the Act does not mean to condemn the resultant of those very forces which it is its prime object to foster: finis opus coronat. The successful competitor, having been urged to compete, must not be turned upon when he wins.

The most extreme expression of this view is in United States v. United States Steel Corporation, 251 U.S. 417, 40 S.Ct. 293, 64 L.Ed. 343, 8 A.L.R. 1121, from which we quote in the margin;[2] and which Sanford, J., in part repeated in United States v. International Harvester Corporation, 274 U.S. 693, 708, 47 S.Ct. 748, 71 L.Ed. 1302. It so chances that in both instances the corporation had less than two-thirds of the production in its hands, and the language quoted was not necessary to the decision; so that even if it had not later been modified, it has not the authority of an actual decision. But whatever authority it does have was modified by the gloss of Cardozo, J., in United States v. Swift & Co., 286 U.S. 106, p. 116, 52 S.Ct. 460, 463, 76 L.Ed. 999, when he said, 'mere size * * * is not an offense against the Sherman Act unless magnified to the point at which it amounts to a monopoly * * * but size carries with it an opportunity for abuse that is not to be ignored when the opportunity is proved to have been utilized in the past.' 'Alcoa's' size was 'magnified' to make it a 'monopoly'; indeed, it has never been anything else; and its size, not only offered it an 'opportunity for abuse,' but it 'utilized' its size for 'abuse,' as can easily be shown.

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

[2] Justice McKenna for the majority said, 251 U.S. 417 at page 451, 40 S.Ct. 299: 'The corporation is undoubtedly of impressive size, and it takes an effort of resolution not to be affected by it or to exaggerate its influence. But we must adhere to the law, and the law does not make mere size an offense, or the existence of unexerted power an offense. It, we repeat, requires overt acts and trusts to its prohibition of them and its power to repress or punish them. It does not compel competition, nor require all that is possible.' The minority through Day, J. agreed, 251 U.S. 417 at page 460, 40 S.Ct. 302: 'the act offers no objection to the mere size of a corporation, nor to the continued exertion of its lawful power, when that size and power have been obtained by lawful means and developed by natural growth, although its resources, capital and strength may give to such corporation a dominating place in the business and industry with which it is concerned. It is entitled to maintain its size and the power that legitimately goes with it, provided no law has been transgressed in obtaining it.'

demand for ingot and be prepared to supply them. Nothing compelled it to keep doubling and redoubling its capacity before others entered the field. It insists that it never excluded competitors; but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connections and the elite of personnel. Only in case we interpret 'exclusion' as limited to maneuvres not honestly industrial, but actuated solely by a desire to prevent competition, can such a course, indefatigably pursued, be deemed not 'exclusionary.' So to limit it would in our judgment emasculate the Act; would permit just such consolidations as it was designed to prevent…

We disregard any question of 'intent.' Relatively early in the history of the Act- 1905- Holmes, J., in Swift & Co. v. United States, supra, (196 U.S. 375, 396, 25 S.Ct. 276, 49 L.Ed. 518), explained this aspect of the Act in a passage often quoted. Although the primary evil was monopoly, the Act also covered preliminary steps, which, if continued, would lead to it. These may do no harm of themselves; but, if they are initial moves in a plan or scheme which, carried out, will result in monopoly, they are dangerous and the law will nip them in the bud. For this reason conduct falling short of monopoly, is not illegal unless it is part of a plan to monopolize, or to gain such other control of a market as is equally forbidden. To make it so, the plaintiff must prove what in the criminal law is known as a 'specific intent'; an intent which goes beyond the mere intent to do the act. By far the greatest part of the fabulous record piled up in the case at bar, was concerned with proving such an intent. The plaintiff was seeking to show that many transactions, neutral on their face, were not in fact necessary to the development of 'Alcoa's' business, and had no motive except to exclude others and perpetuate its hold upon the ingot market. Upon that effort success depended in case the plaintiff failed to satisfy the court that it was unnecessary under § 2 to convict 'Alcoa' of practices unlawful of themselves. The plaintiff has so satisfied us, and the issue of intent ceases to have any importance; no intent is relevant except that which is relevant to any liability, criminal or civil: i.e. an intent to bring about the forbidden act. (at 427-432)

…

II (abuses)

The plaintiff's theory is that 'Alcoa' consistently sold ingot at so high a price that the 'sheet rollers,' who were forced to buy from it, could not pay the expenses of 'rolling' the 'sheet' and make a living profit out of the price at which 'Alcoa' itself sold 'sheet.' To establish this the plaintiff asks us to take 'Alcoa's' costs of 'rolling' as a fair measure of its competitors' costs, and to assume that they had to meet 'Alcoa's' price for all grades of 'sheet,' and could not buy ingot elsewhere. It seems to us altogether reasonable, in the absence of proof to the contrary, to suppose that 'Alcoa's' 'rolling' costs were not higher than those of other 'sheet rollers'; and, although it is true that theoretically, imported 'virgin' was always available, for the reasons we have already given when we were discussing the monopoly in ingot, we think that it could at best be had at very little less than 'Alcoa's' prices. As for 'secondary,' there were a number of uses for 'sheet' for which the trade would not accept such of it as was available in the years in question. Besides, the 'spread' between suitable grades of 'secondary' and 'virgin' was also very small.

Compressing into reasonable compass what the tables show, the result is as follows. For all the five 'gauges' of 'coiled sheet' for eight years, 1925-1932, the average profit open to competing 'rollers' was .84 cents a pound, as against 4.7 cents for the five succeeding years, 1933-1937. The corresponding figures for 'flat sheet' were .59 cents and 4 cents; and for 'Duralumin,' 4.9 cents and 11.8 cents. Moreover, in 31 instances out of 112 there was no 'spread' at all; that is, the cost of ingot plus the cost of 'rolling' was greater than the price at which 'Alcoa' was selling 'sheet.' Obviously, there was in the eight years little or no inducement to continue in the 'sheet' business, and Baush, the only 'roller' of 'duralumin,' gave up in 1931, although 'Alcoa' insists, and the judge found, that this was because of its inefficiency. There can be little doubt that 'Alcoa' changed the price of ingot in 1933 because it feared some action by the Department. True, it dropped the cost of ingot only about two and a half cents, and that advantage did not all inure to the profit of 'sheet rollers,' for the price of the majority of the 'gauges' in all three kinds of 'sheet' fell as well. However, the cost of making 'sheet' also fell for every 'gauge,' and that in some part offset the fall in the price of 'sheet.' There resulted an average net gain in 1933 in all 'gauges' of 'coiled sheet' of 2.84 cents a pound; and the corresponding figure for 'flat sheet' was 4.49 cents, and for 'Duralumin,' 3.14 cents. Moreover, although this advantage necessarily varied during the years 1934- 1937, the cost of ingot- the most important factor- continued to be lower than in 1933 for all the following years except 1937, and then it was higher by only a quarter of a cent. The judge held and we agree that the 'squeeze' was eliminated by lowering the price of ingot; and to do so 'Alcoa' had to reduce the price, not only to 'sheet rollers', but to all customers who bought ingot for any purpose. The drop of two and one half cents in 1933 went along with an actual- though it is true a very small- increase in mill cost, which left a margin of 4.62 cent for overhead expenses. Since 1925 that margin had never been less than ten cents except in 1932, when it was seven and a half cents. It is of course possible that the reduction in the price of ingot was accompanied by a corresponding drop in overhead; the record is silent; but it seems to us unreasonable to make that assumption: sudden changes of such magnitude are not to be expected. Rather we think that the plaintiff made out a prima facie case that 'Alcoa' had been holding ingot at a price higher than a 'fair price,' and had reduced the price only because of pressure. If that was not so, it should have rebutted the inference.

In spite of this evidence the judge found that in these years 'Alcoa' had not intended to monopolize the 'sheet' market; or to exclude others; or to fix discriminatory prices, or prices of any kind; or to sell below the cost of production, measuring ingot price as part of the cost. The last of these findings presupposes that 'Alcoa' could not have known the cost of 'rolling sheet', for obviously it knew the prices at which 'sheet' and ingot were selling. It says that it did not know, because the cost of 'rolling sheet' varied from year to year, so that it could never tell in advance what part of the gross 'spread' between the 'sheet' price and the ingot price would be left as profit. That is indeed hard to believe; but, assuming that it could not, since the judge so found, at least as early as 1930 the complaints charged it with notice of the effect of what it was doing; and yet it kept on until the Department began to move, when it at once found means to cure the situation. Since we have not the question whether competitors were in fact damaged, but only whether there was enough evidence on which to base an injunction for the future, the only doubts are two: first, whether, when 'Alcoa' came to know the effect of the 'squeeze,' as it did, the 'squeeze' became unlawful; and second, whether the issue has become moot, which we will reserve until we come to discuss remedies. That it was unlawful to set the price of 'sheet' so low and hold the price of ingot so high, seems to us unquestionable, provided, as we have held, that on this record the price of ingot must be regarded as higher than a 'fair price.' True, this was only a consequence of 'Alcoa's' control over the price of ingot, and perhaps it ought not to be considered as a separate wrong; moreover, we do not use it as part of the reasoning by which we conclude that the monopoly was unlawful. But it was at least an unlawful exercise of 'Alcoa's' power after it had been put on notice by the 'sheet rollers" complaints; and this is true, even though we assent to the judge's finding that it was not part of an attempt to monopolize the 'sheet' market. We hold that at least in 1932 it had become a wrong. (at 437-438)

Comment

Was *Alcoa*'s approach to market definition sound?

The Court stated that a monopoly is more concerning than agreements between competitors. But as you learned in the previous modules, courts' position on this has changed. Today, unilateral conduct gets less antitrust scrutiny than collusion.

United States v. Grinnell Corp., 384 U.S. 563 (1966)

Grinnell manufactures plumbing supplies and fire sprinkler systems. It also owns 76% of the stock of ADT, 89% of the stock of AFA, and 100% of the stock of Holmes. ADT provides both burglary and fire protection services; Holmes provides burglary services alone; AFA supplies only fire protection service. Each offers a central station service under which hazard-detecting devices installed on the protected premises automatically transmit an electric signal to a central station. The central station is manned 24 hours a day. Upon receipt of a signal, the central station, where appropriate, dispatches guards to the protected premises and notifies the police or fire department direct. There are other forms of protective services. But the record shows that subscribers to accredited central station service (*i.e*., that approved by the insurance underwriters) receive reductions in their insurance premiums that are substantially greater than the reduction received by the users of other kinds of protection service. In 1961 accredited companies in the central station service business grossed $ 65,000,000. ADT, Holmes, and AFA are the three largest companies in the business in terms of revenue: ADT (with 121 central stations in 115 cities) has 73% of the business; Holmes (with 12 central stations in three large cities) has 12.5%; AFA (with three central stations in three large cities) has 2%. Thus the three companies that Grinnell controls have over 87% of the business. (at 566-567)

…

The offense of monopoly under § 2 of the Sherman Act has two elements: (1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident. We shall see that this second ingredient presents no major problem here, as what was done in building the empire was done plainly and explicitly for a single purpose. In *United States* v. *du Pont & Co*., 351 U.S. 377, 391, we defined monopoly power as "the power to control prices or exclude competition." The existence of such power ordinarily may be inferred from the predominant share of the market. In *American Tobacco Co*. v. *United States*, 328 U.S. 781, 797, we said that "over two-thirds of the entire domestic field of cigarettes, and . . . over 80% of the field of comparable cigarettes" constituted "a substantial monopoly." In *United States* v. *Aluminum Co. of America*, 148 F.2d 416, 429, 90% of the market constituted monopoly power. In the present case, 87% of the accredited central station service business leaves no doubt that the congeries of these defendants have monopoly power -- power which, as our discussion of the record indicates, they did not hesitate to wield -- if that business is the relevant market. The only remaining question therefore is, what is the relevant market?

In case of a product it may be of such a character that substitute products must also be considered, as customers may turn to them if there is a slight increase in the price of the main product. That is the teaching of the *du Pont* case (*supra*, at 395, 404), *viz*., that commodities reasonably interchangeable make up that "part" of trade or commerce which § 2 protects against monopoly power.

The District Court treated the entire accredited central station service business as a single market and we think it was justified in so doing. Defendants argue that the different central station services offered are so diverse that they cannot under *du Pont* be lumped together to make up the relevant market. For example, burglar alarm services are not interchangeable with fire alarm services. They further urge that *du Pont* requires that protective services other than those of the central station variety be included in the market definition.

But there is here a single use, *i.e*., the protection of property, through a central station that receives signals. It is that service, accredited, that is unique and that competes with all the other forms of property protection. We see no barrier to combining in a single market a number of different products or services where that combination reflects commercial realities. To repeat, there is here a single basic service -- the protection of property through use of a central service station -- that must be compared with all other forms of property protection.

In § 2 cases under the Sherman Act, as in § 7 cases under the Clayton Act (*Brown Shoe Co*. v. *United States*, 370 U.S. 294, 325) there may be submarkets that are separate economic entities. We do not pursue that question here. First, we deal with services, not with products; and second, we conclude that the accredited central station is a type of service that makes up a relevant market and that domination or control of it makes out a monopoly of a "part" of trade or commerce within the meaning of § 2 of the Sherman Act. The defendants have not made out a case for fragmentizing the types of services into lesser units.

Burglar alarm service is in a sense different from fire alarm service; from waterflow alarms; and so on. But it would be unrealistic on this record to break down the market into the various kinds of central station protective services that are available. Central station companies recognize that to compete effectively, they must offer all or nearly all types of service. The different forms of accredited central station service are provided from a single office and customers utilize different services in combination. We held in *United States* v. *Philadelphia Nat. Bank*, 374 U.S. 321, 356, that "the cluster" of services denoted by the term "commercial banking" is "a distinct line of commerce." There is, in our view, a comparable cluster of services here. That bank case arose under § 7 of the Clayton Act where the question was whether the effect of a merger "in any line of commerce" may be "substantially to lessen competition." We see no reason to differentiate between "line" of commerce in the context of the Clayton Act and "part" of commerce for purposes of the Sherman Act. See *United States* v. *First Nat. Bank & Trust Co*., 376 U.S. 665, 667-668. In the § 7 national bank case just mentioned, *services*, not *products* in the mercantile sense, were involved. In our view the lumping together of various kinds of *services* makes for the appropriate market here as it did in the § 7 case.

There are, to be sure, substitutes for the accredited central station service. But none of them appears to operate on the same level as the central station service so as to meet the interchangeability test of the *du Pont* case. Nonautomatic and automatic local alarm systems appear on this record to have marked differences, not the low degree of differentiation required of substitute services as well as substitute articles.

Watchman service is far more costly and less reliable. Systems that set off an audible alarm at the site of a fire or burglary are cheaper but often less reliable. They may be inoperable without anyone's knowing it. Moreover, there is a risk that the local ringing of an alarm will not attract the needed attention and help. Proprietary systems that a customer purchases and operates are available; but they can be used only by a very large business or by government and are not realistic alternatives for most concerns. There are also protective services connected directly to a municipal police or fire department. But most cities with an accredited central station do not permit direct, connected service for private businesses. These alternate services and devices differ, we are told, in utility, efficiency, reliability, responsiveness, and continuity, and the record sustains that position. And, as noted, insurance companies generally allow a greater reduction in premiums for accredited central station service than for other types of protection.

Defendants earnestly urge that despite these differences, they face competition from these other modes of protection. They seem to us seriously to overstate the degree of competition, but we recognize that (as the District Court found) they "do not have unfettered power to control the price of their services . . . due to the fringe competition of other alarm or watchmen services." 236 F.Supp., at 254. What defendants overlook is that the high degree of differentiation between central station protection and the other forms means that for many customers, only central station protection will do. Though some customers may be willing to accept higher insurance rates in favor of cheaper forms of protection, others will not be willing or able to risk serious interruption to their businesses, even though covered by insurance, and will thus be unwilling to consider anything but central station protection.

The accredited, as distinguished from nonaccredited service, is a relevant part of commerce. Virtually the only central station companies in the status of the nonaccredited are those that have not yet been able to meet the standards of the rating bureau. The accredited ones are indeed those that have achieved, in the eyes of underwriters, superiorities that other central stations do not have. The accredited central station is located in a building of approved design, provided with an emergency lighting system and two alternate main power sources, manned constantly by at least a required minimum of operators, provided with a direct line to fire headquarters and, where possible, a direct line to a police station; and equipped with all the devices, circuits and equipment meeting the requirements of the underwriters. These standards are important as insurance carriers often require accredited central station service as a condition to writing insurance. There is indeed evidence that customers consider the unaccredited service as inferior.

We also agree with the District Court that the geographic market for the accredited central station service is national. The activities of an individual station are in a sense local as it serves, ordinarily, only that area which is within a radius of 25 miles. But the record amply supports the conclusion that the business of providing such a service is operated on a national level. There is national planning. The agreements we have discussed covered activities in many States. The inspection, certification and rate-making is largely by national insurers. The appellant ADT has a national schedule of prices, rates, and terms, though the rates may be varied to meet local conditions. It deals with multistate businesses on the basis of nationwide contracts. The manufacturing business of ADT is interstate. The fact that Holmes is more nearly local than the others does not save it, for it is part and parcel of the combine presided over and controlled by Grinnell.

As the District Court found, the relevant market for determining whether the defendants have monopoly power is not the several local areas which the individual stations serve, but the broader national market that reflects the reality of the way in which they built and conduct their business.

We have said enough about the great hold that the defendants have on this market. The percentage is so high as to justify the finding of monopoly. And, as the facts already related indicate, this monopoly was achieved in large part by unlawful and exclusionary practices. The restrictive agreements that pre-empted for each company a segment of the market where it was free of competition of the others were one device. Pricing practices that contained competitors were another. The acquisitions by Grinnell of ADT, AFA, and Holmes were still another. Grinnell long faced a problem of competing with ADT. That was one reason it acquired AFA and Holmes. Prior to settlement of its dispute and controversy with ADT, Grinnell prepared to go into the central station service business. By acquiring ADT in 1953, Grinnell eliminated that alternative. Its control of the three other defendants eliminated any possibility of an outbreak of competition that might have occurred when the 1907 agreements terminated. By those acquisitions it perfected the monopoly power to exclude competitors and fix prices… (at 570-576)

Comment

Grinnell is often cited as the source for the two-part test for a §2 violation.

United States v. United Shoe Machinery Corp.,110 F. Supp. 295 (D. Mass. 1953)

There are 18 major processes for the manufacturing of shoes by machine. Some machine types are used only in one process, but others are used in several; and the relationship of machine types to one another may be competitive or sequential. The approximately 1460 shoe manufacturers themselves are highly competitive in many respects, including their choice of processes and other technological aspects of production. Their total demand for machine services, apart from those rendered by dry thread sewing machines in the upper-fitting room, constitutes an identifiable market which is a 'part of the trade or commerce among the several States'. Sec. 2 of the Sherman Act, 15 U.S.C.A. § 2.

United, the largest source of supply, is a corporation lineally descended from a combination of constituent companies, adjudged lawful by the Supreme Court of the United States in 1918. United States v. United Shoe Machinery Co. of N.J., 247 U.S. 32, 38 S.Ct. 473, 62 L.Ed. 968. It now has assets rising slightly over 100 million dollars and employment rolls around 6,000. In recent years it has earned before federal taxes 9 to 13.5 million dollars annually.

Supplying different aspects of that market are at least 10 other American manufacturers and some foreign manufacturers, whose products are admitted to the United States free of tariff duty. Almost all the operations performed in the 18 processes can be carried out without the use of any of United's machines, and (at least in foreign areas, where patents are no obstacle,) a complete shoe factory can be efficiently organized without a United machine.

Nonetheless, United at the present time is supplying over 75%, and probably 85%, of the current demand in the American shoe machinery market, as heretofore defined. This is somewhat less than the share it was supplying in 1915. In the meantime, one important competitor, Compo Shoe Machinery Corporation, became the American innovator of the cement process of manufacture. In the sub-market Compo roughly equals United. (at 337-338)

…

Once designed, a shoe machine can be copied, as German competitors have shown. But the copying is not easy, and an American machine manufacturer unfamiliar with the art of shoemaking would not ordinarily enter the field even if United gave him technical assistance, at least, unless he were assured that he would be encouraged to continue making similar machines for a long time.

United is the only machinery enterprise that produces a long line of machine types, and covers every major process. -it is the only concern that has a research laboratory covering all aspects of the needs of shoe manufacturing; though Compo has a laboratory concentrating on the needs of those in the cement process. United's heavy research expenditures, over $ 3 million annually, have been pro-rated roughly according to those fields where maximum revenue has been or could be attained, and, except in the cement process, often in inverse proportion to actual competition. Through its own research, United has developed inventions many of which are now patented. Roughly 95% of its 3915 patents are attributable to the ideas of its own employees.

Although at the turn of the century, United's patents covered the fundamentals of shoe machinery manufacture, those fundamental patents have expired. Current patents cover for the most part only minor developments, so that it is possible to 'invent around' them, to use the words of United's chief competitor. However, the aggregation of patents does to some extent block potential competition. It furnishes a trading advantage. It leads inventors to offer their ideas to United, on the general principle that new complicated machines embody numerous patents. And it serves as a hedge or insurance for United against unforeseen competitive developments.

…

However, United's leases, in the context of the present shoe machinery market, have created barriers to the entry by competitors into the shoe machinery field.

First, the complex of obligations and rights accruing under United's leasing system in operation deter a shoe manufacturer from disposing of a United machine and acquiring a competitor's machine. He is deterred more than if he owned that same United machine, or if he held it on a short lease carrying simple rental provisions and a reasonable charge for cancelation before the end of the term. The lessee is now held closely to United by the combined effect of the 10 year term, the requirement that if he has work available he must use the machine to full capacity, and by the return charge which can in practice, through the right of deduction fund, be reduced to insignificance if he keeps this and other United machines to the end of the periods for which he leased them.

Second, when a lessee desires to replace a United machine, United gives him more favorable terms if the replacement is by another United machine than if it is by a competitive machine.

Third, United's practice of offering to repair, without separate charges, its leased machines, has had the effect that there are no independent service organizations to repair complicated machines. In turn, this has had the effect that the manufacturer of a complicated machine must either offer repair service with his machine, or must face the obstacle of marketing his machine to customers who know that repair service will be difficult to provide.

Through its success with its principal and more complicated machines, United has been able to market more successfully its other machines, whether offered only for sale, or on optional sale or lease terms. In ascending order of importance, the reasons for United's success with these simpler types are these. These other, usually more simple, machines are technologically related to the complex leased machines to which they are auxiliary or preparatory. Having business relations with, and a host of contracts with, shoe factories, United seems to many of them the most efficient, normal, and above all, convenient supplier. Finally, United has promoted the sale of these simple machine types by the sort of price discrimination between machine types, about to be stated.

Although maintaining the same nominal terms for each customer, United has followed, as between machine types, a discriminatory pricing policy. Clear examples of this policy are furnished by the nine selected instances reviewed in detail in the findings. Other examples of this policy can be found in the wide, and relatively permanent, variations in the rates of return United secures upon its long line of machine types. United's own internal documents reveal that these sharp and relatively durable differentials are traceable, at least in large part, to United's policy of fixing a higher rate of return where competition is of minor significance, and a lower rate of return where competition is of major significance. Defendant has not borne the burden of showing that these variations in rates of return were motivated by, or correspond with, variations in the strength of the patent protection applicable to different machine types. Hence there is on this record no room for the argument that defendant's discriminatory pricing policy is entirely traceable to, and justified by, the patent laws of the United States.

On the foregoing facts, the issue of law is whether defendant in its shoe machinery business has violated that provision of Sec. 2 of the Sherman Act, 15 U.S.C.A. § 2, addressed to 'every person who shall monopolize, or attempt to monopolize * * * any part of the trade or commerce among the several States'.

The historical development of that statutory section can be speedily recapitulated.

When they proposed the legislation, Senators Hoar and Edmunds thought it did little more than bring national authority to bear upon restraints of trade known to the common law, and it could not apply to one 'who merely by superior skill and intelligence * * * got the whole business because nobody could do as well'. (21 Cong.Rec. 3146-3152). They did not discuss the intermediate case where the causes of an enterprise's success were neither common law restraints of trade, nor the skill with which the business was conducted, but rather some practice which without being predatory, abusive, or coercive was in economic effect exclusionary.

Early Supreme Court decisions went in different directions, until Mr. Justice White announced 'the 'rule of reason'' in 1911 in Standard Oil Co. of New Jersey v. United States, 221 U.S. 1, 31 S.Ct. 502, 531, 55 L.Ed. 619, and United States v. American Tobacco Co., 221 U.S. 106, 31 S.Ct. 632, 55 L.Ed. 663. His opinions encouraged the view that there was no monopolization unless defendant had reported to predatory practices. And this was unquestionably the view to which Mr. Justice McKenna led the Court in United States v. United Shoe Machinery Company of N.J., 247 Us.S. 32, 38 S.Ct. 473, 62 L.Ed. 968 and United States v United States Steel Corp., 251 U.S. 417, 40 S.Ct. 293, 64 L.Ed. 343. But a reversal of trend was effectuated through the landmark opinion of Judge Learned Hand in United States v. Aluminum Co. of America, 2 Cir., 148 F.2d 416.

In Aluminum Judge Hand, perhaps because he was cabined by the findings of the District Court, did not rest his judgment on the corporation's coercive or immoral practices. Instead, adopting an economic approach, he defined the appropriate market, found that Alcoa supplied 90% of it, determined that this control constituted a monopoly, and ruled that since Alcoa established this monopoly by its voluntary actions, such as building new plants, though, it was assumed, not by moral derelictions, it had 'monopolized' in violation of Sec. 2. Judge Hand reserved the issue as to whether an enterprise could be said to 'monopolize' if its control was purely the result of technological, production, distribution, or like objective factors, not dictated by the economic character of the industry; and he also reserved the question as to control achieved solely 'by virtue of * * * superior skill, foresight and industry.' At the same time, he emphasized that an enterprise had 'monopolized' if, regardless of its intent, it had achieved a monopoly by manuvers which, though 'honestly industrial', were not economically inevitable, but were rather the result of the firm's free choice of business policies.

The justification for this interpretation of the law Judge Hand found in the purposes of the Sherman Act, which he stated in language often quoted, 148 F.2d at page 427. He referred to the economic purpose in these words:

'Many people believe that possession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; that immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress; that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone.'

And he referred to the social purpose in this passage:

'It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of a few.'

Both the technique and the language of Judge Hand were expressly approved in American Tobacco Co. v United States, 1946, 328 U.S. 781, 66 S.Ct. 1125, 90 L.Ed. 1575. Comparable principles were applied in United States v. Griffith, 1948, 334 U.S. 100, 68 S.Ct. 941, 92 L.Ed. 1236; Schine Chain Theatres, Inc. v. United States, 1948, 334 U.S. 110, 68 S.Ct. 947, 92 L.Ed. 1260 [**150] and, also, though the Government lost the case, in United States v Columbia Steel Co., 1948, 334 U.S. 495, 68 S.Ct. 1107, 92 L.Ed. 1533. (at 340-342)

…

Indeed the way in which Mr. Justice Douglas used the terms 'monopoly power' and 'effective market control', 334 U.S. 100, 107, lines 2 and 6, 68 S.Ct. 941, at page 945, and cites Aluminum suggests that he endorses a third and broader approach, which originated with Judge Hand. It will be recalled that Judge Hand said that one who has acquired an overwhelming share of the market 'monopolizes' whenever he does business, 148 F.2d at page 428, column 1, apparently even if there is no showing that his business involves any exclusionary practice. But, it will also be recalled that this doctrine is softened by Judge Hand's suggestion that the defendant may escape statutory liability if it bears the burden of proving that it owes its monopoly solely to superior skill, superior products, natural advantages, (including accessibility to raw materials or markets), economic or technological efficiency, (including scientific research), low margins of profit maintained permanently and without discrimination, or licenses conferred by, and used within, the limits of law, (including patents on one's own inventions, or franchises granted directly to the enterprise by a public authority).

In the case at bar, the Government contends that the evidence satisfies each of the three approaches to Sec. 2 of the Sherman Act, so that it does not matter which one is taken.

If the matter were res integra, this Court would adopt the first approach, and, as a preliminary step to ruling upon Sec. 2, would hold that it is a restraint of trade under Sec. 1 for a company having an overwhelming share of the market, to distribute its more important products only by leases which are not terminable cheaply, which involve discrimination against competition, and which combine in one contract the right to use the product and to have it serviced. But this inferior court feels precluded from so deciding because of the overhanging shadows of United States v United Shoe Machinery Co. of N.J., 247 U.S. 32, 38 S.Ct. 473, 62 L.Ed. 968, and United Shoe Machinery Corp. v. United States, 258 U.S. 451, 42 S.Ct. 363, 66 L.Ed. 708, the Sherman and Clayton Act cases involving this company's predecessor and itself. Though these cases may ultimately be overruled by the Supreme Court, they have not yet lost all authority. See Hartford Empire Co. v. United States, 1945, 323 U.S. 386, 412, footnote 10, 65, S.Ct. 373, 89 L.Ed. 322.

This Court finds it unnecessary to choose between the second and third approaches. For, taken as a whole, the evidence satisfies the tests laid down in both Griffith and Aluminum. The facts show that (1) defendant has, and exercises, such overwhelming strength in the shoe machinery market that it controls that market, (2) this strength excludes some potential, and limits some actual, competition, and (3) this strength is not attributable solely to defendant's ability, economies of scale, research, natural advantages, and adaptation to inevitable economic laws.

In estimating defendant's strength, this Court gives some weight to the 75 plus percentage of the shoe machinery market which United serves. But the Court considers other factors as well. In the relatively

static shoe machinery market where there are no sudden changes in the style of machines or in the volume of demand, United has a network of long-term, complicated leases with over 90% of the shoe factories. These leases assure closer and more frequent contacts between United and its customers than would exist if United were a seller and its customers were buyers. Beyond this general quality, these leases are so drawn and so applied as to strengthen United's power to exclude competitors. Moreover, United offers a long line of machine types, while no competitor offers more than a short line. Since in some parts of its line United faces no important competition, United has the power to discriminate, by wide differentials and over long periods of time, in the rate of return it procures from different machine types. Furthermore, being by far the largest company in the field, with by far the largest resources in dollars, in patents, in facilities, and in knowledge, United has a marked capacity to attract offers of inventions, inventors' services, and shoe machinery businesses. And, finally, there is no substantial substitute competition form a vigorous secondhand market in shoe machinery.

To combat United's market control, a competitor must be prepared with knowledge of shoemaking, engineering skill, capacity to invent around patents, and financial resources sufficient to bear the expense of long developmental and experimental processes. The competitor must be prepared for consumers' resistance founded on their long-term, satisfactory relations with United, and on the cost to them of surrendering United's leases. Also, the competitor must be prepared to give, or point to the source of, repair and other services, and to the source of supplies for machine parts, expendable parts, and the like. Indeed, perhaps a competitor who aims at any large scale success must also be prepared to lease his machines. These considerations would all affect potential competition, and have not been without their effect on actual competition.

Not only does the evidence show United has control of the market, but also the evidence does not show that the control is due entirely to excusable causes. The three principal sources of United's power have been the original constitution of the company, the superiority of United's products and services, and the leasing system. The first two of these are plainly beyond reproach. The original constitution of United in 1899 was judicially approved in United States v United Shoe Machinery Company of New Jersey, 247 U.S. 32, 38 S.Ct. 473, 62 L.Ed. 968. It is no longer open to question, and must be regarded as protected by the doctrine of res judicata, which is the equivalent of a legal license. Likewise beyond criticism is the high quality of United's products, its understanding of the techniques of shoemaking and the needs of shoe manufacturers, its efficient design and improvement of machines, and its prompt and knowledgeable service. These have illustrated in manifold ways that 'superior skill, foresight and industry' of which Judge Hand spoke in Aluminum, 148 F.2d at page 430.

But United's control does not rest solely on its original constitution, its ability, its research, or its economies of scale. There are other barriers to competition, and these barriers were erected by United's own business policies. Much of United's market power is traceable to the magnetic ties inherent in its system of leasing, and not selling, its more important machines. The lease-only system of distributing complicated machines has many 'partnership' aspects, and it has exclusionary features such as the 10- year term, the full capacity clause, the return charges, and the failure to segregate service charges from machine charges. Moreover, the leasing system has aided United in maintaining a pricing system which discriminates between machine types.

In addition to the foregoing three principal sources of United's power, brief reference may be made to the fact that United has been somewhat aided in retaining control of the shoe machinery industry by its purchases in the secondhand market, by its acquisitions of patents, and to a lesser extent, by its activities in selling to shoe factories supplies which United and others manufacture.

In one sense, the leasing system and the miscellaneous activities just referred to (except United's purchases in the secondhand market) were natural and normal, for they were, in Judge Hand's words, 'honestly industrial'. 148 F.2d at page 431. They are the sort of activities which would be engaged in by other honorable firms. And, to a large extent, the leasing practices conform to long-standing traditions in the shoe machinery business. Yet, they are not practices which can be properly described as the inevitable consequences of ability, natural forces, or law. They represent something more than the use of accessible resources, the process of invention and innovation, and the employment of those techniques of employment, financing, production, and distribution, which a competitive society must foster. They are contracts, arrangements, and policies which, instead of encouraging competition based on pure merit, further the dominance of a particular firm. In this sense, they are unnatural barriers; they unnecessarily exclude actual and potential competition; they restrict a free market. While the law allows many enterprises to use such practices, the Sherman Act is now construed by superior courts to forbid the continuance of effective market control based in part upon such practices. Those courts hold that market control is inherently evil and constitutes a violation of Sec. 2 unless economically inevitable, or specifically authorized and regulated by law.[2]

It is only fair to add that the more than 14,000 page record, and the more than 5,000 exhibits, representing the diligent seven year search made by Government counsel aided by this Court's orders giving them full access to United's power does not rest on predatory practices. Probably few monopolies could produce a record so free from any taint of that kind of wrong-doing. The violation with which United is now charged depends not on moral considerations, but on solely economic considerations. United is denied the right to exercise effective control of the market by business policies that are not the inevitable consequences of its capacities or its natural advantages. That those policies are not immoral is irrelevant.

Defendant seems to suggest that even if its control of the market is not attributable exclusively to its superior performance, its research, and its economies of scale, nonetheless, United's market control should not be held unlawful, because only through the existence of some monopoly power can the thin shoe machinery market support fundamental research of the first order, and achieve maximum economies of production and distribution.

To this defense the shortest answer is that the law does not allow an enterprise that maintains control of a market through practices not economically inevitable, to justify that control because of its supposed social advantage. Cf. Fashion Originators' Guild of 'america v. Federal Trade Commission, 312 U.S. 457, 668, 61 S.Ct. 703, 85 L.Ed. 949. It is for Congress, not for private interests, to determine whether a monopoly, not compelled by circumstances, is advantageous. And it is for Congress to decide on what conditions, and subject to what regulations, such a monopoly shall conduct its business.

Moreover, if the defense were available, United has not proved that monopoly is economically compelled by the thinness of the shoe machinery market. It has not shown that no company could undertake to develop, manufacture, and distribute certain types of machines, unless it alone met the total demand for those types of machines.

Nor has United affirmatively proved that it has achieved spectacular results at amazing rates of speed, nor has it proved that comparable research results and comparable economies of production, distribution and service could not be achieved as well by, say, three important shoe machinery firms, as by one. Compo with a much smaller organization indicates how much research can be done on a smaller scale. Yet since Compo is limited to the simpler cement process machines, too much reliance should not be placed on this comparison. Nonetheless, one point is worth recalling. Compo's inventors first found practical ways to introduce the cement process which United had considered and rejected. This experience illustrates the familiar truth that one of the dangers of extraordinary experience is that those who have it may fall into grooves created by their own expertness. They refuse to believe that hurdles which they have learned from experience are insurmountable, can in fact be overcome by fresh, independent minds.

So far, nothing in this opinion has been said of defendant's intent in regard to its power and practices in the shoe machinery market. This point can be readily disposed of by reference once more to Aluminum, 148 F.2d at pages 431-432. Defendant intended to engage in the leasing practices and pricing policies which maintained its market power. That is all the intent which the law requires when both the complaint and the judgment rest on a charge of 'monopolizing', not merely 'attempting to monopolize'. Defendant having willed the means, has willed the end.

Next, come those issues relating to supplies, each of which is, for factual reasons stated in the findings, a separate market under Sec. 2 of the Sherman Act.

The most important fact with respect to United's manufacturing and distributive activities in these supply markets is that they are a consequence of United's power in the shoe machinery market and to some extent buttress that power.

In certain of those supply fields such as cutters and irons, nails and tacks, eyelets, and wire, United has control of the market as is shown by the fact that it is supplying much more than half the demand. This control comes principally from United's power over the shoe machinery market. And for that reason the exercise of dominant power in those supply fields is unlawful. An enterprise that by monopolizing one field, secures dominant market power in another field, has monopolized the second field, in violation of Sec. 2 of the Sherman Act.

With respect to the miscellaneous supply fields such as shoe boxes, lasts, wood heels, shanks, adhesives, finishes, and reinforcing material, where United has not over 50% of the share of the market, it has nothing more than a limited market power flowing from its generally long line of supplies, its many business relations with shoe manufacturers, and its competitors' comparative weakness in resources and variety of products. The consequence is that in these fields United has not such market power as to furnish a basis for a conclusion that it has monopolized the field.

So far as concerns the charge that United has attempted to monopolize those fields, the Government would have had to show that defendant had a specific intent or plan to monopolize those markets. See Aluminum, 148 F.2d at pages 431-432. No such intent was proved. The only evidence of any consequence was two decades old, and related mostly to wood heels. That will not warrant a finding adverse to defendant. (at 342-346)

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IV.

Opinion on Remedy.

Where a defendant has monopolized commerce in violation of Sec. 2, the principal objects of the decrees are to extirpate practices that have caused or may hereafter cause monopolization, and to restore workable competition in the market.

A trial judge, until he is otherwise directed by the Supreme Court or Congress, (see 100 F.Supp. 345 footnote 2, supra, must frame a decree upon the basis of the presuppositions underlying Aluminum and Griffith. He must accept these as the premises of the current interpretation of Sec. 2 of the Sherman Act. Concentrations of power, no matter how beneficently they appear to have acted, not what advantages they seem to possess, are inherently dangerous. Their good behavior in the past may not be continued; and if their strength were hereafter grasped by presumptuous hands, there would be no automatic check and balance from equal forces in the industrial market. And in the absence of this protective mechanism, the demand for public regulation, public ownership, or other drastic measures would become irresistible in time of crisis. Dispersal of private economic power is thus one of the ways to preserve the system of private enterprise. Moreover, well as a monopoly may have behaved in the moral sense, its economic performance is inevitably suspect. The very absence of strong competitors implies that there cannot be an objective measuring rod of the monopolist's excellence, and the test of its performance must, therefore, be largely theoretical. What appears to the outsider to be a sensible, prudent, nay even a progressive policy of the monopolist, may in fact reflect a lower scale of adventurousness and less intelligent risk-taking than would be the case if the enterprise were forced to respond to a stronger industrial challenge. Some truth lurks in the cynical remark that not high profits but a quiet life is the chief reward of monopoly power. And even if a particular enterprise seeks growth and not repose, and increased rate in the growth of ideas does not follow from an increased concentration of power. Industrial advance may indeed be in inverse proportion to economic power; for creativity in business as in other areas, is best nourished by multiple centers of activity, each following its unique pattern and developing its own esprit de corps to respond to the challenge of competition. The dominance of any one enterprise inevitably unduly accentuates that enterprise's experience and views as to what is possible, practical, and desirable with respect to technological development, research, relations with producers, employees, and customers. And the preservation of any unregulated monopoly is hostile to the industrial and political ideals of an open society founded on the faith that tomorrow will produce a better than the best.

Yet a trial judges's decree attempting to recreate a competitive market should be drafted in the spirit which has been attributed to Lord Acton- the most philosophical mind that has ever been directed to the evils of concentration of power. 'No one can be sure what view Acton would have adopted on contemporary economic issues. What is certain is the principles and tests he would have employed. Of every proposal he would have asked, Is it just? Is it in accordance with the permanent will of the community? -is it practicable? Will it be efficient? Will it increase or diminish real freedom?' Fasnacht, Acton's Political Philosophy (1952), p. 124.

Judges in prescribing remedies have known their own limitations. They do not ex officio have economic or political training. Their prophecies as to the economic future are not guided by unusually subtle judgment. They are not so representative as other branches of the government. The recommendations they receive from government prosecutors do not always reflect the over-all approach of even the executive branch of the government, sometimes not indeed the seasoned and fairly informed judgment of the head of the Department of Justice. Hearings in court do not usually give the remote judge as sound a feeling for the realities of a situation as other procedures do. Judicial decrees must be fitted into the framework of what a busy, and none too expert, court can supervise. Above all, no matter with what authority he is invested, with what facts and opinion he is supplied, a trial judge is only one man, and should move with caution and humility.

That considerations of this type have always affected anti-trust courts is plain from the history of the Standard Oil, American Tobacco and Alcoa cases. To many champions of the anti-trust laws these cases indicate judicial timidity, economic innocence, lack of conviction, or paralysis of resolution. Yet there is another way of interpreting this judicial history. In the anti-trust field the courts have been accorded, by common consent, an authority that have in no other branch of enacted law. Indeed, the only comparable examples of the power of judges is the economic role they formerly exercised under the Fourteenth Amendment, and the role they now exercise in the area of civil liberties. They would not have been given, or allowed to keep, such authority in the antitrust field, and they would not so freely have altered from time to time the interpretation of its substantive provisions, if courts were in the habit of proceeding with the surgical ruthlessness that might comment itself to those seeking absolute assurance that there will be workable competition, and to those aiming at immediate realization of the social, political, and economic advantages of dispersal of power.

Such self-restraining considerations have peculiar force in this case. Until Alcoa lost its case in 1945, there was no significant reason to suppose that United's conduct violated Sec. 2 of the Sherman Act. The Supreme Court had three times, in United States v. Winslow, 227 U.S. 202, 33 S.Ct. 253, 57 L.Ed. 481, United States v. United Shoe Machinery Company of N.J., 247 U.S. 32, and United Shoe Machinery Corp. v. United States, 258 U.S. 451, 42 S.Ct. 363, 66 L.Ed. 708 reviewed aspects of this company's, or its predecessor's, activities. What United is now doing is similar to what it was then doing, but the activities which were similar stood uncondemned,- indeed, one ought to go further and say they were in part endorsed. In the face of these decisions, it would be anomalous to charge the officers of United with any moral deficiency.

In the light of these general considerations, it is now meet to consider four of the principal problems respecting a proposed decree: first, dissolution, second, treatment of the leases, third, divestiture of supply activities, and fourth, patents.

The Government's proposal that the Court dissolve United into three separate manufacturing companies is unrealistic. United conducts all machine manufacture at one plant in Beverly, with one set of jigs and tools, one foundry, one laboratory for machinery problems, one managerial staff, and one labor force. It takes no Solomon to see that this organism cannot be cut into three equal and viable parts.

Nor can the division of United's business be fairly accomplished by dividing the manufacture of machinery into three broad categories, and then issuing an injunction restraining the Beverly plant from manufacturing two broad categories of machine types, and vesting in each of two new companies the right to manufacture one of those categories. Such an order would create for the new companies the most serious type of problems respecting the acquisition of physical equipment, the raising of new capital, the allotment of managerial and labor forces, and so forth. The prospect of creating three factories where one grew before has not been thought through by its proponents.

A petition for dissolution should reflect greater attention to practical problems and should involve supporting data and prophesies such as are presented in corporate reorganization and public utility dissolution cases. Moreover, the petition should involve a more formal commitment by the Attorney General, than is involved in the divergent proposals that his assistants have made in briefs and in oral arguments addressed to the Court.

On the whole, therefore, the suggested remedy of dissolution is rejected.

From the opinion on defendant's violations it follows that some form of relief regarding defendant's leases and leasing practices is proper and necessary.

The Government does not propose that United should cease leasing machines. It does suggest that this Court order defendant to eliminate from the leases those provisions found to be restrictive, to offer for sale every type of machine which it offers for lease, and to make the sales terms somewhat more advantageous to customers, than the lease terms.

The Court agrees that it would be undesirable, at least until milder remedies have been tried, to direct United to free to abolish leasing if it chooses to do so, but this Court hesitates to lay down any absolute ban for two reasons. First, if a ban were immediately applied, a substantial number of shoe factories would probably be put out of business, for they have not the assets, nor the capacity to borrow, requisite to purchase machines, even on conditional sales agreements. Second, if this Court forbade United to lease machines, it could not apply a similar ban to its competitors. This would constitute for United a major not a minor competitive handicap if one accepts the testimony of the large number of shoe manufacturers who have already expressed their preference for leasing rather than buying machines. How deeply rooted is this preference might be disputed; but it cannot be denied that virtually all the shoe manufacturers who took the stand, and the 45 shoe manufacturers who were selected as a sample by the Court, expressed a preference for the leasing system. It is, of course, possible that through inertia, fear of reprisal, or other motives, those who oppose the leasing system did not speak up. Yet, the number of dissenters must be small. Moreover, Compo, which is United's chief rival, and which the Government claims was a chief victim of United's policies, favors the leasing system, and might encourage shoe factories to continue leasing.

Although leasing should not now be abolished by judicial decree, the Court agrees with the Government that the leases should be purged of their restrictive features. In the decree filed herewith, the term of the lease is shortened, the full capacity clause is eliminated, the discriminatory commutative charges are removed, and United is required to segregate its charges for machines from its charges for repair service. For the most part, the decree speaks plainly enough upon these points. Yet, on two matters, a further word is in order.

The decree does not prohibit United from rendering service, because, in the Court's view, the rendition of service, if separately charged for, has no exclusionary effects. Moreover, the rendition of service by United will keep its research and manufacturing divisions abreast of technological problems in the shoe manufacturing industry; and this will be an economic advantage of the type fostered by the Sherman Act.

Nor does the decree attempt to deal with that feature of United's pricing policy which discriminates between machine types. To try to extirpate such discrimination would require either an order directing a uniform rate of markup, or an order subjecting each price term and each price change to judicial supervision. Neither course would be sound. Some price discrimination, if not too rigid, is inevitable. Some may be justified as resting on patent monopolies. Some price discrimination is economically desirable, if it promotes competition in a market where several multi-product firms compete. And while price discrimination has been an evidence of United's monopoly power, a buttress to it, and a cause of its perpetuation, its eradication cannot be accomplished without turning United into a public utility, and the Court into a public utility commission, or requiring United to observe a general injunction of non discrimination between different products- an injunction which would be contrary to sound theory, which would require the use of practices not followed in any business known to the Court, and which could not be enforced.

The Court also agrees with the Government that if United chooses to continue to lease any machine type, it must offer that type of machine also for sale. The principal merit of this proposal does not lie in its primary impact, that is, in its effect in widening the choices open to owners of shoe factories. For present purposes it may be assumed that the anti-trust laws are not designed, chiefly, if at all, to give a customer choice as to the selling methods by which his supplier offers that supplier's own products. The merit of the Government's proposal is in its secondary impact. Insofar as United's machines are sold rather than leased, they will ultimately, in many cases, reach a second-hand market. From that market, United will face a type of substitute competition which will gradually weaken the prohibited market power which it now exercises. Moreover, from that market, or from United itself, a competitor of United can acquire a United machine in order to study it, to copy its unpatented features, and to experiment with improvements in, or alterations of, the machine. Thus, in another and more direct way, United's market power will be diminished.

Furthermore, the creation of a sales market together with the purging of the restrictive features of the leases will, in combination, gradually diminish the magnetic hold now exercised by what United properly describes as the partnership features of the leasing system. As United's relationships with its customers grow feebler, competitors will have an enhanced opportunity to market their wares… (at 346-350)

The Government goes one step further and asks the Court to require defendant to make its sales terms more attractive to customers than any lease terms it offers. One difficulty with this proposal is that, instead of redressing the balance between United and its competitors, it would give a marked advantage to such of United competitors as chose to continue leasing machines. But there are even more serious practical objections. If this Court were to direct United to make its sales terms more favorable than lease terms, and to keep that discrimination effective every time that new terms were set, every time that new machine types were introduced, and every time that money rates changed in the financial world, this Court would be creating administrative problems which would require its continuous judicial supervision. To avoid the difficulties just stated, it seems to the Court sufficient to direct defendant, if it offers any machine type for lease, to set such terms for leasing that machine as do not make it substantially more advantageous for a shoe factory to lease rather than to buy a machine. Admittedly, there is in this direction some flexibility. But defendant is forewarned by the decree itself that if it abuses this flexibility, the Court after the entry of this decree may modify it. Thus the decree invokes the precedent not of Draco, but of Damocles and Dionysius. Compare Appalachian Coals, Inc. v. United States, 288 U.S. 344, 378, 53 S.Ct. 471, 77 L.Ed. 825.

One other phase of the decree to which this opinion should expressly advert is the method of handling those subsidiaries and braches which produce supplies in fields which United has monopolized. The clearest examples are nails and tacks, and eyelets for the shoe machinery market. These are large scale monopolizations attributable to the machinery monopoly. And United should be divested of its business of manufacturing and distributing these particular supplies, because this is the kind of dissolution which can be carried out practically, and which will also reduce monopoly power in each of the affected supply fields. Logically, the same principle might be applied to those other parts of United's enterprise which manufacture other supplies that United monopolizes. But in each of the other cases where this might at first blush seem reasonable, the supply is technically so intimately related to a machine as to be naturally manufactured by the maker of the machine, or the supply is sold in such small annual volume, or the difficulties of enforcing divestiture of part of a plant are so obvious, as to make the extension of the decree to those instances undesirable.

No similar practical difficulties exist in ordering United to divest itself of its business of distributing supplies manufactured by companies which are not part of United's organization. The annual dollar volume of some of these supplies, if looked at individually, is often not large; but the annual volume of all of them together is roughly $ 4 1/2 million. The specifications for some of these supplies did originate with United, but their continued manufacture does not require United's assistance. Their distribution could be economically undertaken, if not by the several manufacturers, by a new supply distributor. And United ought not to be allowed to continue these distributorships because they flowed to United partly, at any rate, as an indirect consequence of United's prohibited monopolization of shoe machinery. To be sure other advantages flowed to United from its monopolization, but the particular advantages inherent in the large scale distribution of supplies are, as already noted, easily severable, and would probably lead to the organization of a new supply company, or the expansion of an existing supply company, which could become in time a manufacturer of certain machine types, or a source of repair service. Thus the total effect would be to develop avenues for the dissipation of United's monopoly power in the machinery field.

Similar reasoning dictates the decree's treatment of patents. Defendant is not being punished for abusive practices respecting patents, for it engaged in none, except possibly two decades ago in connection with the wood heel business. It is being required to reduce the monopoly power it has, not as a result of patents, but as a result of business practices. And compulsory licensing, on a reasonable royalty basis, is in effect a partial dissolution, on a non-confiscatory basis. In regard to patents, as in regard to the termination of supply distributorships, the decree does no more than what defendant's own expert recognized would be appropriate if the Court found defendant had monopolized the shoe machinery market. (at 350-351)

United States v. Dentsply Int'l, Inc., 399 F.3d 181, 187 (3d Cir. 2005)

In this antitrust case we conclude that an exclusivity policy imposed by a manufacturer on its dealers violates Section 2 of the Sherman Act. We come to that position because of the nature of the relevant market and the established effectiveness of the restraint despite the lack of long term contracts between the manufacturer and its dealers…

Because of advances in dental medicine, artificial tooth manufacturing is marked by a low or no-growth potential. Dentsply has long dominated the industry consisting of 12-13 manufacturers and enjoys a 75% - 80% market share on a revenue basis, 67% on a unit basis, and is about 15 times larger than its next closest competitor…

For more than fifteen years, Dentsply has operated under a policy that discouraged its dealers from adding competitors' teeth to their lines of products. In 1993, Dentsply adopted "Dealer Criterion 6." It provides that in order to effectively promote Dentsply-York products, authorized dealers "may not add further tooth lines to their product offering." Dentsply operates on a purchase order basis with its distributors and, therefore, the relationship is essentially terminable at will. Dealer Criterion 6 was enforced against dealers with the exception of those who had carried competing products before 1993 and were "grandfathered" for sales of those products… (at 184-185)

…

III. MONOPOLY POWER

The concept of monopoly is distinct from monopoly power, which has been defined as the ability "to control prices or exclude competition." Grinnell, 384 U.S. at 571; see also United States v. E.I. du Pont de Nemours and Co., 351 U.S. 377, 100 L. Ed. 1264, 76 S. Ct. 994 (1956). However, because such evidence is "only rarely available, courts more typically examine market structure in search of circumstantial evidence of monopoly power." Microsoft, 253 F.3d at 51. Thus, the existence of monopoly power may be inferred from a predominant share of the market, Grinnell, 384 U.S. at 571, and the size of that portion is a primary factor in determining whether power exists. Pennsylvania Dental Ass'n v. Med. Serv. Ass'n of Pa, 745 F.2d 248, 260 (3d Cir. 1984).

A less than predominant share of the market combined with other relevant factors may suffice to demonstrate monopoly power. Fineman v. Armstrong World Indus., 980 F.2d 171, 201 (3d Cir. 1992). Absent other pertinent factors, a share significantly larger than 55% has been required to established prima facie market power. Id. at 201. Other germane factors include the size and strength of competing firms, freedom of entry, pricing trends and practices in the industry, ability of consumers to substitute comparable goods, and consumer demand. See Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 5 L. Ed. 2d 580, 81 S. Ct. 623 (1961); Barr Laboratories, Inc. v. Abbott Laboratories, 978 F.2d 98 (3d Cir. 1992); Weiss v. York Hosp., 745 F.2d 786, 827 n.72 (3d Cir. 1984).

A. The Relevant Market

Defining the relevant market is an important part of the analysis. The District Court found the market to be "the sale of prefabricated artificial teeth in the United States." United States v. Dentsply Int'l Inc., 277 F. Supp. 2d. 387, 396 (D. Del. 2003). Further, the Court found that "the manufacturers participating in the United States artificial tooth market historically have distributed their teeth into the market in one ofthree ways: (1) directly to dental labs; (2) through dental dealers; or (3) through a hybrid system combining manufacturer direct sales and dental dealers."…

There is no dispute that the laboratories are the ultimate consumers because they buy the teeth at the point in the process where they are incorporated into another product. Dentsply points out that its representatives concentrate their efforts at the laboratories as well as at dental schools and dentists. See Dentsply Int'l Inc., 277 F. Supp. 2d. at 429-34.

During oral argument, Dentsply's counsel said, "the dealers are not the market…the market is the dental labs that consume the product." Transcript of Oral Argument at 47. Emphasizing the importance of end users, Dentsply argues that the District Court understood the relevant market to be the sales of artificial teeth to dental laboratories in the United States. Although the Court used the word "market" in a number of differing contexts, the findings demonstrate that the relevant market is not as narrow as Dentsply would have it. In FF238, the Court said that Dentsply "has had a persistently high market share between 75% and 80% on a revenue basis, in the artificial tooth market." Dentsply sells only to dealers and the narrow definition of market that it urges upon us would be completely inconsistent with that finding of the District Court.

The Court went on to find that Ivoclar "has the second-highest share of the market, at approximately 5%." FF239. Ivoclar sells directly to the laboratories. Therefore, these two findings establish that the relevant market in this case includes sales to dealers and direct sales to the laboratories. Other findings on Dentsply's "market share" are consistent with this understanding. FF240-243.

These findings are persuasive that the District Court understood, as do we, the relevant market to be the total sales of artificial teeth to the laboratories and the dealers combined.

Dentsply's apparent belief that a relevant market cannot include sales both to the final consumer and a middleman is refuted in the closely analogous case of Allen-Myland, Inc. v. IBM Corp., 33 F.3d 194 (3d Cir. 1994). In that case, IBM sold mainframe computers directly to the ultimate consumers and also sold to companies that leased computers to ultimate users. We concluded that the relevant market encompassed the sales directly to consumers as well as those to leasing companies. "…to the extent that leasing companies deal in used, non-IBM mainframes that have not already been counted in the sales market, these machines belong in the relevant market for large-scale mainframe computers." Id. at 203.

To resolve any doubt, therefore, we hold that the relevant market here is the sale of artificial teeth in the United States both to laboratories and to the dental dealers.

B. Power to Exclude

Dentsply's share of the market is more than adequate to establish a prima facie case of power. In addition, Dentsply has held its dominant share for more than ten years and has fought aggressively to maintain that imbalance. One court has commented that, "in evaluating monopoly power, it is not market share that counts, but the ability to *maintain* market share." United States v. Syufy Enters., 903 F.2d 659, 665-66 (9th Cir. 1990).

The District Court found that it could infer monopoly power because of the predominant market share, but despite that factor, concluded that Dentsply's tactics did not preclude competition from marketing their products directly to the dental laboratories. "Dentsply does not have the power to exclude competitors from the ultimate consumer." United States v. Dentsply Int'l, Inc., 277 F. Supp. 2d 387, 452 (D. Del. 2003).

Moreover, the Court determined that failure of Dentsply's two main rivals, Vident and Ivoclar, to obtain significant market shares resulted from their own business decisions to concentrate on other product lines, rather than implement active sales efforts for teeth.

The District Court's evaluation of Ivoclar and Vident business practices as a cause of their failure to secure more of the market is not persuasive. The reality is that over a period of years, because of Dentsply's domination of dealers, direct sales have not been a practical alternative for most manufacturers. It has not been so much the competitors' less than enthusiastic efforts at competition that produced paltry results, as it is the blocking of access to the key dealers. This is the part of the real market that is denied to the rivals.

The apparent lack of aggressiveness by competitors is not a matter of apathy, but a reflection of the effectiveness of Dentsply's exclusionary policy. Although its rivals could theoretically convince a dealer to buy their products and drop Dentsply's line, that has not occurred. In United States v. Visa U.S.A., Inc., 344 F.3d at 229, 240 (2d Cir. 2003), the Court of Appeals held that similar evidence indicated that defendants had excluded their rivals from the marketplace and thus demonstrated monopoly power.

The Supreme Court on more than one occasion has emphasized that economic realities rather than a formalistic approach must govern review of antitrust activity. "Legal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law . . . in determining the existence of market power . . . this Court has examined closely the economic reality of the market at issue." Eastern Kodak Co. v. Image Technical Servs., Inc., 504 U.S. 451, 466-67, 119 L. Ed. 2d 265, 112 S. Ct. 2072 (1992). "If we look at substance rather than form, there is little room for debate." United States v. Sealy, Inc., 388 U.S. 350, 352, 18 L. Ed. 2d 1238, 87 S. Ct. 1847 (1967). We echoed that standard in Weiss v. York Hosp., 745 F.2d 786, 815 (3d Cir. 1984). "Antitrust policy requires the courts to seek the economic substance of an arrangement, not merely its form." Id.

The realities of the artificial tooth market were candidly expressed by two former managerial employees of Dentsply when they explained their rules of engagement. One testified that Dealer Criterion 6 was designed to "block competitive distribution points." He continued, "Do not allow competition to achieve toeholds in dealers; tie up dealers; do not 'free up' key players." (at 187-189)

Another former manager said:

> You don't want your competition with your distributors, you don't want to give the distributors an opportunity to sell a competitive product. And you don't want to give your end user, the customer, meaning a laboratory and/or a dentist, a choice. He has to buy Dentsply teeth. That's the only thing that's available. The only place you can get it is through the distributor and the only one that the distributor is selling is Dentsply teeth. That's your objective.

These are clear expressions of a plan to maintain monopolistic power.

The District Court detailed some ten separate incidents in which Dentsply required agreement by new as well as long-standing dealers not to handle competitors' teeth. For example, when the DLDS firm considered adding two other tooth lines because of customers' demand, Dentsply threatened to sever access not only to its teeth, but to other dental products as well. DLDS yielded to that pressure. The termination of Trinity Dental, which had previously sold Dentsply products other than teeth, was a similar instance. When Trinity wanted to add teeth to its line for the first time and chose a competitor, Dentsply refused to supply other dental products.

Dentsply also pressured Atlanta Dental, Marcus Dental, Thompson Dental, Patterson Dental and Pearson Dental Supply when they carried or considered adding competitive lines. In another incident, Dentsply recognized DTS as a dealer so as to "fully eliminate the competitive threat that [DTS locations] pose by representing Vita and Ivoclar in three of four regions."

The evidence demonstrated conclusively that Dentsply had supremacy over the dealer network and it was at that crucial point in the distribution chain that monopoly power over the market for artificial teeth was established. The reality in this case is that the firm that ties up the key dealers rules the market.

In concluding that Dentsply lacked the power to exclude competitors from the laboratories, "the ultimate consumers," the District Court overlooked the point that the relevant market was the "sale" of artificial teeth to both dealers and laboratories. Although some sales were made by manufacturers to the laboratories, overwhelming numbers were made to dealers. Thus, the Court's scrutiny should have been applied not to the "ultimate consumers" who used the teeth, but to the "customers" who purchased the teeth, the relevant category which included dealers as well as laboratories. This mis-focus led the District Court into clear error.

The factual pattern here is quite similar to that in LePage's, Inc. v. 3M, 324 F.3d 141 (3d Cir. 2003). There, a manufacturer of transparent tape locked up high volume distribution channels by means of substantial discounts on a range of its other products. LePage's, 324 F.3d at 144, 160-62. We concluded that the use of exclusive dealing and bundled rebates to the detriment of the rival manufacturer violated Section 2. See LePage's, 324 F.3d at 159. Similarly, in Microsoft, the Court of Appeals for the D. C. Circuit concluded that, through the use of exclusive contracts with key dealers, a manufacturer foreclosed competitors from a substantial percentage of the available opportunities for product distribution. See Microsoft, 253 F.3d at 70-71.

The evidence in this case demonstrates that for a considerable time, through the use of Dealer Criterion 6 Dentsply has been able to exclude competitors from the dealers' network, a narrow, but heavily traveled channel to the dental laboratories. (at 189-190)

C. Pricing

An increase in pricing is another factor used in evaluating existence of market power. Although in this case the evidence of exclusion is stronger than that of Dentsply's control of prices, testimony about suspect pricing is also found in this record.

The District Court found that Dentsply had a reputation for aggressive price increases in the market. It is noteworthy that experts for both parties testified that were Dealer Criterion 6 abolished, prices would fall. A former sales manager for Dentsply agreed that the company's share of the market would diminish should Dealer Criterion 6 no longer be in effect. In 1993, Dentsply's regional sales manager complained, "we need to moderate our increases - twice a year for the last few years was not good." Large scale distributors observed that Dentsply's policy created a high price umbrella.

Although Dentsply's prices fall between those of Ivoclar and Vita's premium tooth lines, Dentsply did not reduce its prices when competitors elected not to follow its increases. Dentsply's profit margins have been growing over the years. The picture is one of a manufacturer that sets prices with little concern for its competitors, "something a firm without a monopoly would have been unable to do." Microsoft, 253 F.3d at 58. The results have been favorable to Dentsply, but of no benefit to consumers.

Moreover, even "if monopoly power has been acquired or maintained through improper means, the fact that the power has not been used to extract [a monopoly price] provides no succor to the monopolist." Microsoft, 253 F.3d at 57 (quoting Berkey Photo, Inc. v. Eastman Kodak, Co., 603 F.2d 263, 274 (2d Cir. 1979)). The record of long duration of the exclusionary tactics and anecdotal evidence of their efficacy make it clear that power existed and was used effectively. The District Court erred in concluding that Dentsply lacked market power. (at 190-191)

…

IV. ANTI-COMPETITIVE EFFECTS

Having demonstrated that Dentsply possessed market power, the Government must also establish the second element of a Section 2 claim, that the power was used "to foreclose competition." United States v. Griffith, 334 U.S. 100, 107, 92 L. Ed. 1236, 68 S. Ct. 941 (1948). Assessing anti-competitive effect is important in evaluating a challenge to a violation of Section 2. Under that Section of the Sherman Act, it is not necessary that all competition be removed from the market. The test is not total foreclosure, but whether the challenged practices bar a substantial number of rivals or severely restrict the market's ambit. LePage's, 324 F.3d at 159-60; Microsoft, 253 F.3d at 69.

A leading treatise explains,

> A set of strategically planned exclusive dealing contracts may slow the rival's expansion by requiring it to develop alternative outlets for its products or rely at least temporarily on inferior or more expensive outlets. Consumer injury results from the delay that the dominant firm imposes on the smaller rival's growth. Herbert Hovenkamp, Antitrust Law P 1802c, at 64 (2d ed. 2002).

By ensuring that the key dealers offer Dentsply teeth either as the only or dominant choice, Dealer Criterion 6 has a significant effect in preserving Dentsply's monopoly. It helps keep sales of competing teeth below the critical level necessary for any rival to pose a real threat to Dentsply's market share. As such, Dealer Criterion 6 is a solid pillar of harm to competition.

Comment

Note that the Court's assessments of monopoly power and anticompetitive conduct involved some degree of overlap.

***United States v. American Telephone and Telegraph Co.*, 524 F. Supp. 1336 (D.D.C. 1981)**

Under United States v. Grinnell Corp., 384 U.S. 563, 570-71, 86 S. Ct. 1698, 1703-04, 16 L. Ed. 2d 778 (1966), the offense of monopolization under section 2 of the Sherman Act has two elements: (1) the possession of monopoly power in the relevant market, and (2) the willful acquisition or maintenance of that power... The government has identified three relevant markets: local telecommunications service, intercity telecommunications service, and telecommunications equipment. In addition, it has subdivided the equipment market, identifying two submarkets: (1) a terminal equipment market, and (2) a "Bell Market," that is, a market consisting of the equipment purchased by the Bell Operating Companies and Long Lines. The government alleges that defendants have monopoly power in each of these markets and, to prove the existence of such power, evidence has been offered of market share, barriers to entry, size, and the exercise of power. (at 1346)

…

Defendants argue primarily that the government's reliance upon high market shares is fundamentally unsound in the context of a regulated industry because such reliance ignores the substantial periods of time during which the Federal Communications Commission restricted entry, thereby effectively granting monopolies to the Bell System. See United States v. Marine Bancorporation, Inc., 418 U.S. 602, 631-32 n. 34, 94 S. Ct. 2856, 2874-75, 41 L. Ed. 2d 978 (1974). In this view, the government's demonstrations of market share "are almost totally irrelevant" because the "alleged markets (are treated) not as products of regulation, but as though they had come into being through a long history of open competition" (Memorandum, p. 26). Although defendants' point may have some conceptual validity, it is not grounds for dismissal, for two reasons. (at 1347)

…

Second, even if defendants are ultimately sustained on this issue, the government's market contentions would still not fail, for these contentions do not rely exclusively, or even primarily, upon market shares to prove monopoly power. While such shares clearly constitute one part of the proof, evidence has also been offered on barriers to entry, size, and conduct, all of which tend to prove such power. Although the size and conduct factors do not appear to be highly probative, a persuasive showing has been made that defendants havemonopoly power (wholly apart from FCC orders with respect to interconnection) through various barriers to entry, such as the creation of bottlenecks, entrenched customer preferences, the regulatory process, large capital requirements, access to technical information, and disparities in risk. These factors, in combination with the evidence of market shares, suffice at least to meet the government's initial burden, and the burden is then appropriately placed upon defendants to rebut the existence and significance of barriers to entry. On that basis, the defendants' regulatory defense to the government's claim of monopoly power must and will be rejected.

The Court will next consider evidence concerning, and the various issues surrounding, the claim that defendants engaged in anticompetitive conduct.

III

Interconnection of Customer-Provided Terminal Equipment

A. Until 1968, the connection to the public network of any piece of equipment not provided by an operating telephone company was prohibited by what was called the "foreign attachment provision" of Tariff No. 263. A principal rationale for this ban was that the interconnection of equipment of undetermined origin and quality might injure the network as a whole. The FCC struck down this tariff in its Carterfone decision (13 F.C.C.2d 420 (1968)), which determined the practice of prohibiting equipment interconnection "without regard to its effect upon the telephone system" to be unlawful and unreasonably discriminatory. 13 F.C.C.2d at 425. The FCC held that customers had a right to the unimpeded use of their own equipment, and that the Bell System could more appropriately protect the telephone network from harm (1) by preventing of the use of devices "which actually cause harm," and (2) by establishing "reasonable standards to be met by interconnection devices." 13 F.C.C.2d at 424. Defendants' response to this decision forms the principal basis of the government's claim in this area.

That response was the filing of the "post-Carterfone" tariffs. The pertinent provisions of these tariffs required that any piece of equipment provided by a customer for use in conjunction with Bell facilities could be connected with the public switched network only through a protective connecting arrangement (PCA) provided (and leased to the customer for a fee) by the Bell System. The questions here are whether this requirement and its implementation were intended unreasonably and anticompetitively to ensure that Western Electric would remain the dominant supplier of telecommunications equipment in the United States, and whether, in fact, they had that effect. (at 1348-1349)

…

The Court concludes that the evidence sustains the allegation that defendants have used their local exchange monopolies to foreclose competition in the terminal equipment market by refusing unreasonably to interconnect equipment not provided by the Bell System, or by unreasonably impeding such interconnection, and that neither the government's interconnection claim nor the subsidiary contentions relating thereto should be dismissed. (at 1352)

IV

Intercity Services Offered in Competition with AT&T Long Lines

The government's claims with regard to the intercity services offerings of non-Bell carriers revolve around one central point: that because the Bell System (with its Operating Companies) possesses a monopoly in the distribution of local telecommunications services, meaningful competition in the provision of intercity services is precluded unless the non-Bell carriers are able to obtain interconnection with the Bell local distribution facilities under non-discriminatory terms and conditions. Long distance and other intercity lines are essentially useless unless they can be connected to the local switches from which both business and residential customers may be reached.

A. It may be helpful at the outset to state the applicable legal standard. Any company which controls an "essential facility" or a "strategic bottleneck" in the market violates the antitrust laws if it fails to make access to that facility available to its competitors on fair and reasonable terms that do not disadvantage them. United States v. Terminal R.R. Assn. of St. Louis, supra; Otter Tail Power Co. v. United States, supra; Hecht v. Pro-Football, Inc., supra; Gamco, Inc. v. Providence Fruit & Produce Building, Inc., 194 F.2d 484 (1st Cir. 1952); Woods Exploration and Producing Co., Inc. v. Aluminum Corp. of America, 438 F.2d 1286, 1300-09 (5th Cir. 1971). Such access must be afforded "upon such just and reasonable terms and regulations as will, in respect of use, character and cost of services, place every such company upon as nearly as equal plane as may be." United States v. Terminal R.R. Association, supra, 224 U.S. at 411, 32 S. Ct. at 515. In the view of the Court, it is clear that the local facilities controlled by Bell are "essential facilities" within the meaning of these decisions and that, to the extent that the antitrust laws provide the legal standards governing the conduct here at issue, defendants are obligated to provide the kind of non discriminatory access which the cases contemplate.

This recitation of events should not be read to imply that defendants do not contest the facts established by the government's evidence or the inferences and conclusions that may be drawn therefrom. Indeed, they do. But evidentiary refutations, if any, will have to await the introduction of defendants' own proof. The Court finds that, as of now, sufficient evidence has been adduced to dictate the conclusion that AT&T has monopolized the intercity services market by frustrating the efforts of other companies to compete with it in that market on a fair and reasonable basis. (at 1352-3)

…

VI

Interconnection Standards

The parties are in sharp disagreement on the question of the standard to be applied by the Bell System in providing interconnection to competing carriers.

Defendants appear to concede that they are now obliged to provide interconnection to the non-Bell carriers offering MTS-like service-both under the Execunet II decision and under the essential facilities doctrine of the antitrust laws. However, they differ with the government as to how the essential facilities doctrine should be applied. The government argues that AT&T is required to afford interconnection to the non-Bell carriers on terms of "parity" with those interconnections now enjoyed by Long Lines, while defendants contend that the essential facilities doctrine entitles Long Lines' competitors not to parity but only to the use of facilities, essential for their service, on a reasonable basis.

…

But it does not follow that, as defendants request, this portion of the government's case must be dismissed. The government has shown (and defendants concede) that AT&T and its subsidiaries now discriminate between Long Lines and non-Bell carriers with regard to access to Bell System facilities. It has also shown this discrimination to be anticompetitive in its effect. The burden is now upon defendants to show why, despite that anticompetitive impact, such unequal treatment is reasonable, whether because of technical infeasibility or otherwise.

…

VIII

Intercity Pricing

The government has charged that defendants have priced their intercity services without regard to the cost of these services, on the following basis... the government claims, Bell had an incentive to set its prices high in the MTS and WATS areas (where it enjoyed a monopoly) and low in private line areas (where it was faced with competition) so as to exclude the existing competition and to deter further entry into the intercity services market.

Bell accomplished its objective, according to the government, by deliberately pricing its intercity services without regard to their costs, with the objective of maintaining maximum flexibility for such cross subsidization. Specifically, it is contended that Bell failed to calculate accurately the costs of providing intercity private line services or, to the extent that costs were calculated, to consider these costs in setting prices. From these failures, it is said, the Court may infer that Bell deliberately intended to exclude competition on the basis indicated.

…

B. With respect to the legal and economic underpinnings of the government's pricing case, defendants argue that the "only accepted test for predatory pricing is whether rates were intentionally set at a level below marginal costs" (Defendants' Memorandum at p. 451), and that the government's failure to allege below-cost pricing therefore completely bars all of its pricing contentions. The Court will not sustain this argument at this juncture, for the following reasons.

In the first place, defendants overstate the extent to which the marginal cost test (or its surrogate, the average variable cost test), advanced by Areeda and Turner, in Predatory Pricing and Related Practices Under Section 2 of the Sherman Act, 88 Harv.L.Rev. 697 (1975), has become the sole legal standard for identifying non-compensatory pricing. Although courts have frequently incorporated these cost tests into their pricing analysis, they have done so with the clear understanding that the relationship between prices and marginal (or average variable) costs is not the sole criterion appropriately considered to distinguish predatory from competitive pricing. See, e.g., International Air Industries, Inc. v. American Excelsior Co., supra, 517 F.2d at 724; Pacific Engineering & Production Co. v. Kerr-McGee Corp., 551 F.2d 790, 797 (10th Cir. 1977); Janich Brothers, Inc. v. American Distilling Co., supra, 570 F.2d at 857; William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 652 F.2d 917 (9th Cir. 1981). Recent professional literature has likewise pointed to the fallacy of a mechanical application of a marginal or average variable cost test. See Williamson, Predatory Pricing: A Strategic and Welfare Analysis, 87 Yale L.J. 284 (1977); Scherer, Predatory Pricing and the Sherman Act: A Comment, 89 Harv.L.Rev. 869 (1976); Baumol, Quasi-Permanence of Price Reductions: A Policy for Prevention of Predatory Pricing, 89 Yale L.J. 1 (1979); Joskow & Klevorick, A Framework for Analyzing Predatory Pricing Policy, 89 Yale L.J. 213 (1979).

…

C. Furthermore, and perhaps more significantly, although economists disagree on the frequency with which the phenomenon of predatory pricing occurs, the conditions under which it is likely to exist, and the indicia by which it may be detected, there is consensus that the term refers to "the deliberate sacrifice of present revenues for the purpose of driving rivals out of the market and then recouping the losses through higher profits earned in the absence of competition." 3 Areeda & Turner, supra, P 771b, at p. 151.

Whatever may be the appropriateness of the marginal (or the average variable) cost test in such a context, the pricing phenomenon that is challenged in this action is quite different. The government does not allege an intertemporal shift in profits-a sacrifice of profits in the short-run in return for more than their recoupment in the long-run-but an inter-service shift. Specifically, it is claimed that the Bell System has engaged in pricing practices which allow it to sacrifice profits from one service and to recoup the lost profits during the same period in another service. In such circumstances, a pricing-without-regard-to-cost approach is not necessarily inappropriate, for the opportunity which a multiproduct firm subject to rate of return regulation has to cross-subsidize low prices for one product across other products (rather than across time) renders it far more likely to engage in anticompetitive pricing than the firm that must wait to hope to recoup its losses. See Posner, Natural Monopoly and its Regulation, 21 Stan.L.Rev. 548, 615-16 (1969). Because the likelihood that anticompetitive pricing will occur in a particular context is a salient and perhaps the critical-factor affecting the choice of a standard for the legality vel non of the pricing, this increased probability of anticompetitive pricing may alone be a sufficient reason to relax a standard such as the marginal cost test, whose use is predicated upon the assumption that such pricing is unlikely. See Joskow & Klevorick, supra, at 215; Easterbrook, Predatory Strategies and Counterstrategies, 48 U.Chi.L.Rev. 263, 265-318.

D. Defendants object that a pricing-without-regard-to-cost approach reverses normal procedure by imposing upon them the burden of proving that their pricing was reasonable. But such a conclusion would not necessarily be fatal to the government's theory, for a shifting of the burden of production of evidence may well be legitimate under certain circumstances. (at 1368-9)

…

E. The government has presented, by its own admission, a novel approach. In response to the objection that its theory is unknown to either law or economics, it states in effect that the mapping of virgin territory is warranted by the uniqueness of the American Telephone & Telegraph Company, which is able to shift profits almost at will between monopoly and competitive services, and whose cost data are apparently impenetrable even to its own regulators. Although the government may not be able to rely upon direct legal precedent, it has presented persuasive theoretical underpinnings for its claim, and it has documented its allegations with extensive (if in places overly conclusory) testimonial and documentary evidence.

The Court may eventually conclude that only proof of predatory pricing in the sense in which that concept is employed in the Northeastern Telephone Co. line of cases will suffice to support a charge of violation of the Sherman Act (or even the intent element of such a charge). However, in an area as fraught with uncertainty as the complex intercity service pricing question at issue in this proceeding, it would be unwise to truncate the hearing of these issues at this point. A dismissal at this stage based essentially upon the unwillingness of the Court to accept a novel legal and economic theory (which is certainly not so unpersuasive conceptually that it could not, in this factual setting, ultimately find acceptance, either here or on appeal) would entail the real risk of a retrial of the entire case. Since the Court has the option under Rule 41(b) to defer ruling on the motion, or portions thereof, until all the evidence has been received, that course seems the more appropriate one, and it is the one the Court will follow.

IX

Bell Procurement of Equipment Manufactured by the General Trade

The government's general "procurement" charge is that defendants reinforced and exploited the Bell Operating Companies' structural incentives to purchase equipment, without regard to quality or price, from Western Electric instead of from non-Bell sources (known as the general trade suppliers) and that they thereby anticompetitively foreclosed competition.

…

The government's evidence has depicted defendants as sole arbiters of what equipment is suitable for use in the Bell System-a role that carries with it a power of subjective judgment that can be and has been used to advance the sale of Western Electric's products at the expense of the general trade. First, AT&T, in conjunction with Bell Labs and Western Electric, sets the technical standards under which the telephone network operates and the compatibility specifications which equipment must meet. Second, Western Electric and Bell Labs (most recently through the BSPPD) serve as counselors to the Operating Companies in their procurement decisions, ostensibly helping them to purchase equipment that meets network standards. Third, Western also produces equipment for sale to the Operating Companies in competition with general trade manufacturers.

The upshot of this "wearing of three hats" is, according to the government's evidence, a rather obviously anticompetitive situation. By setting technical or compatibility standards and by either not communicating these standards to the general trade or changing them in mid-stream, AT&T has the capacity to remove, and has in fact removed, general trade products from serious consideration by the Operating Companies on "network integrity" grounds. By either refusing to evaluate general trade products for the Operating Companies or producing biased or speculative evaluations, AT&T has been able to influence the Operating Companies, which lack independent means to evaluate general trade products, to buy Western. And the in-house production and sale of Western equipment provides AT&T with a powerful incentive to exercise its "approval" power to discriminate against Western's competitors.

… Defendants argue that the government's evidence shows nothing more than that they took advantage of the efficiencies of their vertically integrated structure, as they are permitted to do under the law. Clearly, vertical integration is not prohibited per se (see United States v. Columbia Steel Co., 334 U.S. 495, 525-26, 68 S. Ct. 1107, 1123, 92 L. Ed. 1533 (1948); United States v. Winslow, 227 U.S. 202, 218, 33 S. Ct. 253, 255, 57 L. Ed. 481 (1913); United States v. Yellow Cab Co., 332 U.S. 218, 227, 67 S. Ct. 1560, 1565, 91 L. Ed. 2010 (1947); Kaysen & Turner, Antitrust Policy, p. 123 (1959)), and even an alleged monopolist has the right to compete vigorously. See Berkey Photo, Inc. v. Eastman Kodak Co., supra; ILC Peripherals Leasing Corp. v. IBM Corp., 458 F. Supp. 423, 439 (N.D.Cal.1978), aff'd. sub nom., Memorex Corp. v. IBM

Corp., 636 F.2d 1188 (9th Cir. 1980). But vertical integration may be unlawful under the Sherman Act if it creates monopoly power and is accompanied by an intent to exclude competition. United States v. Paramount Pictures, Inc., supra. Moreover, when activity among vertically-related affiliates restrains trade it violates the antitrust laws. International Tel. & Tel. Co. v. General Tel. & Elec. Corp., supra, 449 F. Supp. 1158, 1171-74 (D.Hawaii 1978); United States v. Pullman Co., 50 F. Supp. 123 (E.D.Pa.1943), aff'd, 330 U.S. 806, 67 S. Ct. 1078, 91 L. Ed. 1263 (1947).

The government here did not attempt to prove that vertical integration itself amounts to anticompetitive conduct. Rather, its experts have testified that a combination of vertical integration and rate-of-return regulation has tended to generate decisions by the Operating Companies to purchase equipment produced by Western that is more expensive or of lesser quality than that manufactured by the general trade. The Operating Companies have taken these actions, it is said, because the existence of rate of return regulation removed from them the burden of such additional expense, for the extra cost could simply be absorbed into the rate base or expenses, allowing extra profits from the higher prices to flow upstream to Western rather than to its non-Bell competition. See Byars v. Bluff City News Co., 609 F.2d 843, 861 (6th Cir. 1979); Six Twenty-Nine Productions v. Rollins Telecasting, Inc., 365 F.2d 478 (5th Cir. 1966); 3 Areeda & Turner, supra, P 726, p. 218.

Operating Company officials-as distinguished from the organizations themselves-likewise have an individual incentive to act to further this goal because, as the testimony shows, promotion decisions within the Bell System tend to create a predisposition within Operating Company managers towards deciding in favor of Western profits and against the general trade competition. It seems that it is helpful to the advancement of an individual's career within an Operating Company to have had a tour of duty at AT&T headquarters in New York, and that it is common for those who occupy high-level positions in the Operating Companies to have had such a tour at some point in their careers. Personnel rotate through Western Electric, Bell Labs, the Operating Companies, and AT&T central headquarters with some regularity, and they come to acquire a familial attitude towards the different parts of the Bell System as they rise through its ranks. Through this process, those holding management positions in the Bell

Operating Companies appear to adopt the objectives, incentives, and prejudices of AT&T and Western top management as their own.

In short, the government has demonstrated that incentives other than those arising from vertical integration per se have underlain the procurement decisions of the Bell Operating Companies, and the Columbia Steel line of cases is therefore inapplicable. (at 1373-4)

…

XII

Conclusion

The motion to dismiss is denied. The testimony and the documentary evidence adduced by the government demonstrate that the Bell System has violated the antitrust laws in a number of ways over a lengthy period of time. On the three principal factual issues-whether there has been proof of anticompetitive conduct with respect to the interconnection of customer-owned terminal equipment (Part III), the Bell System's treatment of competitors in the intercity services area (Part IV), and its procurement of equipment (Part IX)- the evidence sustains the government's basic contentions, and the burden is on defendants to refute the factual showings made in the government's case-in-chief. (at 1381)

Comment

In denying AT&T's motion to dismiss, the Court demonstrated a willingness to engage with novel theories related to the affairs of a large and multifaceted corporation, including a more expansive notion of predatory pricing.

United States v. American Tel. & Tel. Co., 552 F. Supp. 131, 1982 (D.D.C. 1982)

These actions are before the Court for a determination whether a consent decree proposed by the parties is in the "public interest" and should therefore be entered as the Court's judgment… (at 135)

The Divestiture

A key feature of the proposed decree is the divestiture of the Operating Companies from the remainder of AT&T. In order to determine whether that divestiture is in the public interest, the Court must decide first whether it is a remedy that is likely to eliminate anticompetitive conditions within the telecommunications industry. In addition, the Court must assess the efficacy of alternative remedies and it must also weigh the effect of the divestiture on the public interest generally, particularly on the level of charges for local telephone service. *(at 160)*

A. *Conditions Necessitating Antitrust Relief*

1. *Evidence of Anticompetitive Actions by AT&T*

[The government argued that AT&T was able to preclude competition in the intercity telecommunications market and in the market for telecommunications equipment owing to its control of local operating companies. The Court found this connection credible to the standard of review required for its review of the consent decree.] (at 160-164)

2. *Concentration of Power in the Telecommunications Industry*

There is an additional reason, largely independent of the factors discussed above, which supports some type of antitrust relief in this case: AT&T's substantial domination of the telecommunications industry in general.

The antitrust laws are most often viewed as only a means for ensuring free competition in order to achieve the most efficient allocation of society's resources. See slip op. at 28-29 *supra*. However, Congress and the courts have repeatedly declared that these laws also embody "a desire to put an end to great aggregations of capital because of the helplessness of the individual before them." *United States v. Aluminum Company of America*, 148 F.2d 416, 428 (2d Cir. 1945) (footnote omitted). See also *Standard Oil Co. v. United States*, 221 U.S. 1, 50, 55 L. Ed. 619, 31 S. Ct. 502 (1911); *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290, 323-24, 41 L. Ed. 1007, 17 S. Ct. 540 (1897).

The legislators who enacted the Sherman Act voiced concerns beyond the effects of anticompetitive activities on the economy: they also greatly feared the impact of the large trusts, which then dominated the business world, on the nation's political system, and they regarded the power of these trusts as an evil to be eradicated. Thus, Senator Sherman stated:

> If the concentrated powers of [a] combination are intrusted to a single man, it is a kingly prerogative, inconsistent with our form of government, and should be subject to the strong resistance of the State and national authorities. If anything is wrong, this is wrong. If we will not endure a king as a political power we should not endure a king over the production, transportation, and sale of any of the necessaries of life.

21 Cong.Rec. 2457 (1890).

These views have been repeatedly echoed since that time, as, for example, during the congressional debates at the time of the enactment of the 1950 amendments to the Clayton Act. See 96 Cong. Rec. 16450 (1950) (Remarks of Sen. Kefauver); 95 Cong. Rec. 11494 (1950) (Remarks of Rep. Bryson); 95 Cong. Rec. 11486 (1949) (Remarks of Rep. Celler). See also *Brown Shoe Co. v. United States*, 370 U.S. 294, 344, 8 L. Ed. 2d 510, 82 S. Ct. 1502 (1962). As Justice Douglas stated in his dissenting opinion in *United States v. Columbia Steel Co.*, 334 U.S. 495, 536, 92 L. Ed. 1533, 68 S. Ct. 1107 (1948):

> Power that controls the economy should be in the hands of elected representatives of the people, not in the hands of an industrial oligarchy. Industrial power should be decentralized. It should be scattered into many hands so that the fortunes of the people will not be dependent on the whim or caprice, the political prejudices, the emotional stability of a few self-appointed men. The fact that they are not vicious men but respectable and social-minded is irrelevant. That is the philosophy and the command of the Sherman Act. It is founded on a theory of hostility to the concentration in private hands of power so great that only a government of the people should have it.

Our political system is designed so that the power of one group may be checked by the power of another. The antitrust laws require this same approach in the economic sphere. Obviously, if one company controlled an essential part of the economy, it would be in a position to gain an undue influence over economic decisions and, as a result, most likely over political decisions. Thus, the antitrust laws seek to diffuse economic power in order to promote the proper functioning of both our economic and our political systems. See generally, A.D. Neale, *The Antitrust Laws of the United States of America*, 422-23 (1962); Blake & Jones, *Antitrust Dialogue: Defense*, 65 Colum. L. Rev. 337, 384 (1965).

The significance of these concepts is accentuated by the context in which the Court must consider the public interest in these cases. The telecommunications industry plays a key role in modern economic, social, and political life. Indeed, many commentators have asserted that we are entering an age in which information will be the keystone of the economy as steel was when Justice Douglas wrote in the *Columbia Steel Co.* case.

The only pervasive two-way communications system is the telephone network. It is crucial in business affairs, in providing information to the citizenry, and in the simple conduct of daily life. In its present form, AT&T has a commanding position in that industry. The men and women who have guided the Bell System appear by and large to have been careful not to take advantage of its central position in America's economic life. There is no guarantee, however, that future managers will be equally careful. In any event, it is antithetical to our political and economic system for this key industry to be within the control of one company.

For these reasons, the Court concludes that the loosening of AT&T's control over telecommunications through the divestiture of the Operating Companies will entail benefits which transcend those which flow from the narrowest reading of the purpose of the antitrust laws. (at 164-165)

B. *Effect of the Divestiture*

The remedy in an antitrust action -- whether imposed by a court or agreed upon between the parties -- is measured both by how well it halts the objectionable practices and by its prospects for minimizing the likelihood that such practices will occur in the future. See Part II *supra*. Where, as here, the Court has heard substantially all of the evidence, it is appropriate that it weigh the proposed remedy against the evidence in that context.

As indicated in Part IV(A) *supra*, the ability of AT&T to engage in anticompetitive conduct stems largely from its control of the local Operating Companies. Absent such control, AT&T will not have the ability to disadvantage competitors in the interexchange and equipment markets.

For example, with the divestiture of the Operating Companies AT&T will not be able to discriminate against intercity competitors, either by subsidizing its own intercity services with revenues from the monopoly local exchange services, or by obstructing its competitors' access to the local exchange network. The local Operating Companies will not be providing interexchange services, and they will therefore have no incentive to discriminate. Moreover, AT&T's competitors will be guaranteed access that is equal to that provided to AT&T, and intercity carriers therefore will no longer be presented with the problems that confronted them in that area. See Part VIII, *infra*.

Abuses will also be unlikely in the equipment interconnection area, for the simple reason that the Operating Companies will not manufacture equipment and will therefore lack AT&T's incentive to favor the connection of one manufacturer's equipment over that of another. Even as to the part of the government's case dealing with procurement, the divestiture of the Operating Companies will go a long way toward eliminating the potential for anticompetitive behavior. Any pro-Western Electric bias on the part of these companies will be eliminated once the intra-enterprise relationship between the Operating Companies and Western Electric is broken.

To the extent, then, that the proposed decree proceeds on the assumption that the structural reorganization will make it impossible, or at least unprofitable, for AT&T to engage in anticompetitive practices, it is fully consistent with the public interest in the enforcement of the antitrust laws. The soundness of this remedy becomes even more apparent when it is compared with other relief alternatives.

[The Court went on to consider alternative remedies and concluded that they would not be as effective as the proposed divestiture.]

D. *Effect of the Divestiture Upon Other Interests*

A number of individuals have written to the Court and to the Department of Justice urging the rejection of the proposed decree. They contend that AT&T in its present, integrated form has rendered excellent and affordable telephone service to the citizens of this nation, including those with modest incomes and those who live in sparsely populated areas. Many note that AT&T's securities have been a mainstay of the small investor, with a long history of stable prices and dividend payments. Given that record, the argument goes, the break-up of AT&T could not possibly be in the public interest. While the Court has very carefully considered these concerns, it has concluded that they are not sufficient to overcome the considerations supporting divestiture.

The divestiture of the Operating Companies will not necessarily have an adverse effect upon the cost of local telephone service. The decree would leave state and federal regulators with a mechanism -- access charges -- by which to require a subsidy from intercity service to local service. By means of these access charges, the regulators would be free to maintain local rates at current levels or they could so set the charges as to increase or decrease local rates.

As to the second claim, there is simply no evidence or reason to believe that, funding aside, the quality of service will decline as a result of divestiture. The divested Operating Companies will not be technical backwaters: they will have substantial incentives to upgrade their networks and to provide high-quality interconnections for other carriers in order to maximize revenues from access charges and from local rates.

As noted above, it is unlikely that the divestiture will impair the research capabilities of Bell Laboratories. See slip op. at 61-62 *supra*. The scientists and engineers working in that organization will retain their incentive to improve the equipment and technology used to provide local telephone service, if only because the largest potential customers of Western Electric -- Bell Laboratories' companion in the "new" AT&T complex -- will be the divested

Operating Companies. In addition, AT&T's information services and interexchange services can be provided to customers only over the Operating Companies facilities, again creating large incentives for continued improvement and upgrading of these facilities.

In the final analysis, it is apparent that, as with so many public issues, a choice must be made.

There has long been a debate over the relative merits of regulation and competition. The evidence adduced during the *AT&T* trial indicates that the Bell System has been neither effectively regulated nor fully subjected to true competition. The FCC officials themselves acknowledge that their regulation has been woefully inadequate to cope with a company of AT&T's scope, wealth, and power. The efforts of various arms of government to introduce true competition into the telecommunications industry have been similarly feeble. The antitrust suit brought by the Department of Justice in 1949 ended in 1956 with a consent decree which imposed injunctive relief that was patently inadequate. It took from 1968 when the *Carterfone* decision was handed down by the FCC to 1978 when the United States Court of Appeals decided *Execunet II* to establish even the very principle of competition so that it was beyond dispute by AT&T. Future regulatory and injunctive remedies are unlikely to be more successful than were similar efforts in the past. In short, the choice is between a Bell System restrained by neither regulation nor true competition and a Bell System reorganized in such a way as to diminish greatly the possibility of future anticompetitive behavior.

The history of the American economic system teaches that fair competition is more likely to benefit all, especially consumers, than an industry dominated by a single-company monopolist. There is no reason to believe that the experience of the telecommunications industry will be contrary to that rule.

For all of these reasons, the Court concludes that the divestiture from AT&T of companies providing local telephone service is in the public interest. (at 167-9)

[Previous consent decrees and antitrust litigation had subjected AT&T to a number of restrictions on its business. This consent decree removed many of those restrictions in exchange

for breaking up AT&T. The Court deemed that the removal of these restrictions was largely in the public interest. And AT&T was subject to sufficient competition after the breakup.]

The antitrust laws do not require that a company be prohibited from competing in a market unless it can be demonstrated that its participation in that market will have anticompetitive effects. Past restrictions on AT&T were justified primarily because of its control over the local Operating Companies. With the divestiture of these local exchange monopolies, continued restrictions are not required unless justified by some other rationale.

A. *AT&T Power in the Interexchange Market*

Virtually all those who suggest that restrictions beyond those in the proposed decree be imposed on AT&T make the same general arguments. Their basic claim is that AT&T still possesses monopoly power in the interexchange market and that it will leverage this power by cross subsidizing its competitive services with monopoly revenues. These interexchange monopoly revenues, it is said, will subsidize a variety of business activities, ranging from competitive interexchange routes to equipment manufacturing to alternative local distribution facilities.

The validity of these arguments depends, of course, upon the soundness of the claim that after the divestiture AT&T will still possess monopoly power in the interexchange market. If AT&T lacks such power, it would be unable to reap supracompetitive profits with which to support its other activities; it would only recover a profit commensurate with its interexchange operations.

There can be no doubt that AT&T's market share in the interexchange market is high. Although it is not possible to focus on a precise figure inasmuch as the number of market share estimates is almost as varied as the number of persons submitting comments, even AT&T concedes that as late as 1981 its share of interexchange revenue was around 77 percent. But the inquiry of whether AT&T possesses monopoly power in the interexchange areas does not end with a description of AT&T's size or its market share.

As defined by the Supreme Court, monopoly power is "the power to control prices or exclude competition." *United States v. Grinnell Corp., supra*, 384 U.S. at 571 (1966); *United States v. duPont & Co.*, 351 U.S. 377, 391, 100 L. Ed. 2d 1264, 76 S. Ct. 994 (1956). Although monopoly power may be inferred from a firm's predominant share of the market, size alone is not synonymous with market power, particularly where entry barriers are not substantial. *United States v. Grinnell, supra*, 384 U.S. at 571; *United States v. AT&T, supra*, 524 F. Supp. at 1347; Posner, *Market Power in Antitrust Cases*, 94 Harv. L. Rev. 937, 947-51 (1981).

Both the Department of Justice and AT&T contend that competition in the interexchange market is growing and that this increase in competition demonstrates an absence of monopoly power. There is some validity to this claim. The interexchange market is now being served not only by relatively young businesses but also by subsidiaries of such well established firms as ITT, Southern Pacific, and IBM.

That is not to say, however, that competition has flourished without impediment or that it would soar if the Bell System were not broken up. There is substantial merit to the suggestion that, absent divestiture, AT&T would still possess significant monopoly power, and that whatever competition developed in the past did so despite anticompetitive conditions. See Part IV *supra*. But the overriding fact is that the principal means by which AT&T has maintained monopoly power in telecommunications has been its control of the Operating Companies with their strategic bottleneck position. The divestiture required by the proposed decree will thus remove the two main barriers that previously deterred firms from entering or competing effectively in the interexchange market.

First. AT&T will no longer have the opportunity to provide discriminatory interconnection to competitors. The Operating Companies will own the local exchange facilities. Since these companies will not be providing interexchange services, they will lack AT&T's incentive to discriminate. Moreover, they will be required to provide all interexchange carriers with exchange access that is "equal in type, quality, and price to that provided to AT&T and its affiliates." Proposed Decree, Section II. See Part VIII *infra*.

Second. Once AT&T is divested of the local Operating Companies, it will be unable either to subsidize the prices of its interexchange service with revenues from local exchange services or to shift costs from competitive interexchange services.

With the removal by the decree of all these burdens on competition, the number of firms entering the interexchange market is thus likely to increase. This development should be further assisted by the reduction of other barriers to entry. For example, although the cost of entering the telecommunications business is still substantial, the size of the required capital investment is not as great as it once was. In addition, as more competitors begin to offer more services that are comparable to those offered by AT&T, entrenched customer preferences in favor of AT&T will decrease.

With the removal of these barriers to competition, AT&T should be unable to engage in monopoly pricing in any market. To be sure, there are a number of routes for which AT&T is the sole interexchange carrier. However, several of these routes serve sparsely populated areas and apear to be only marginally profitable. On the other hand, should it turn out that these routes are in fact lucrative and that AT&T is nevertheless charging monopoly prices, then, following divestiture, market forces should fairly rapidly remedy the situation: because of the elimination of entry barriers, new entrants will be attracted to these markets, and prices, in turn, will fall to their competitive levels.

For these reasons, it appears that after divestiture, AT&T will largely lack the monopoly power that the opponents of the decree suggest, and the trend of increasing competition may therefore be expected to continue. (at 171-2)

...

VIII

Equal Exchange Access

One of the government's principal contentions in the *AT&T* case was that the Operating Companies provided interconnections to AT&T's intercity competitors which were inferior in many respects to those granted to AT&T's own Long Lines Department. There was ample evidence to sustain these contentions. See Part IV *supra*.

Although after divestiture the Operating Companies will no longer have the same incentive to favor AT&T, a substantial AT&T bias has been designed into the integrated telecommunications network, and the network, of course, remains in that condition. It is imperative that any disparities in interconnection be eliminated so that all interexchange and information service providers will be able to compete on an equal basis.

The Court has examined the equal access provisions of the decree and it is satisfied that, with limited exceptions, they meet the public interest standard.

A. *General Principles*

The governing principle established by the proposed decree is that by September 1, 1986, the Operating Companies must provide access services to interexchange carriers and information service providers which are "equal in type, quality, and price" to the access services provided to AT&T and its affiliates. Section II(A). This broad guarantee of equal treatment, when implemented, will effectively remove any interconnection-type obstacles to free competition between AT&T and the other carriers; it therefore comports with the public interest and will be endorsed and enforced by the Court. (at 195-6)

…

Conclusion

The proposed reorganization of the Bell System raises issues of vast complexity. Because of their importance, not only to the parties but also to the telecommunications industry and to the public, the Court has discussed the various problems in substantial detail. It is appropriate to summarize briefly the major issues and the Court's decisions which are central to the proceeding.

A. The American telecommunications industry is presently dominated by one company -- AT&T. It provides local and long-distance telephone service; it manufactures and markets the equipment used by telephone subscribers as well as that used in the telecommunications network; and it controls one of the leading communications research and development facilities in the world. According to credible evidence, this integrated structure has enabled AT&T for many years to undermine the efforts of competitors seeking to enter the telecommunications market.

The key to the Bell System's power to impede competition has been its control of local telephone service. The local telephone network functions as the gateway to individual telephone subscribers. It must be used by long-distance carriers seeking to connect one caller to another. Customers will only purchase equipment which can readily be connected to the local network through the telephone outlets in their homes and offices. The enormous cost of the wires, cables, switches, and other transmission facilities which comprise that network has completely insulated it from competition. Thus, access to AT&T's local network is crucial if long distance carriers and equipment manufacturers are to be viable competitors.

AT&T has allegedly used its control of this local monopoly to disadvantage these competitors in two principal ways. First, it has attempted to prevent competing long distance carriers and competing equipment manufacturers from gaining access to the local network, or to delay that access, thus placing them in an inferior position vis-a-vis AT&T's own services. Second, it has supposedly used profits earned from the monopoly local telephone operations to subsidize its long distance and equipment businesses in which it was competing with others.

For a great many years, the Federal Communications Commission has struggled, largely without success, to stop practices of this type through the regulatory tools at its command. A lawsuit the Department of Justice brought in 1949 to curb similar practices ended in an ineffectual consent decree. Some other remedy is plainly required; hence the divestiture of the local Operating Companies from the Bell System. This divestiture will sever the relationship between this local monopoly and the other, competitive segments of AT&T, and it will thus ensure -- certainly better than could any other type of relief -- that the practices which allegedly have lain heavy on the telecommunications industry will not recur.

B. With the loss of control over the local network, AT&T will be unable to disadvantage its competitors, and the restrictions imposed on AT&T after the government's first antitrust suit -- which limited AT&T to the provision of telecommunications services -- will no longer be necessary. The proposed decree accordingly removes these restrictions.

The decree will thus allow AT&T to become a vigorous competitor in the growing computer, computer related, and information markets. Other large and experienced firms are presently operating in these markets, and there is therefore no reason to believe that AT&T will be able to achieve monopoly dominance in these industries as it did in telecommunications. At the same time, by use of its formidable scientific, engineering, and management resources, including particularly the capabilities of Bell Laboratories, AT&T should be able to make significant contributions to these fields, which are at the forefront of innovation and technology, to the benefit of American consumers, national defense, and the position of American industry vis-a-vis foreign competition.

All of these developments are plainly in the public interest, and the Court will therefore approve this aspect of the proposed decree, with one exception. Electronic publishing, which is still in its infancy, holds promise to become an important provider of information -- such as news, entertainment, and advertising -- in competition with the traditional print, television, and radio media; indeed, it has the potential, in time, for actually replacing some of these methods of disseminating information.

Traditionally, the Bell System has simply distributed information provided by others; it has not been involved in the business of generating its own information. The proposed decree would, for the first time, allow AT&T to do both, and it would do so at a time when the electronic publishing industry is still in a fragile state of experimentation and growth and when electronic information can still most efficiently and most economically be distributed over AT&T's long distance network. If, under these circumstances, AT&T were permitted to engage both in the transmission and the generation of information, there would be a substantial risk not only that it would stifle the efforts of other electronic publishers but that it would acquire a substantial monopoly over the generation of news in the more general sense. Such a development would strike at a principle which lies at the heart of the First Amendment: that the American people are entitled to a diversity of sources of information. In order to prevent this from occurring, the Court will require, as a condition of its approval of the proposed decree, that it be modified to preclude AT&T from entering the field of electronic publishing until the risk of its domination of that field has abated.

C. After the divestiture, the Operating Companies will possess a monopoly over local telephone service. According to the Department of Justice, the Operating Companies must be barred from entering all competitive markets to ensure that they will not misuse their monopoly power. The Court will not impose restrictions simply for the sake of theoretical consistency. Restrictions must be based on an assessment of the realistic circumstances of the relevant markets, including the Operating Companies' ability to engage in anticompetitive behavior, their potential contribution to the market as an added competitor for AT&T, as well as upon the effects of the restrictions on the rates for local telephone service.

This standard requires that the Operating Companies be prohibited from providing long distance services and information services, and from manufacturing equipment used in the telecommunications industry. Participation in these fields carries with it a substantial risk that the Operating Companies will use the same anticompetitive techniques used by AT&T in order to thwart the growth of their own competitors. Moreover, contrary to the assumptions made by some, Operating Company involvement in these areas could not legitimately generate subsidies for local rates. Such involvement could produce substantial profits only if the local companies used their monopoly position to dislodge competitors or to provide subsidy for their competitive services or products -- the very behavior the decree seeks to prevent.

Different considerations apply, however, to the marketing of customer premises equipment -- the telephone and other devices used in subscribers' homes and offices -- and the production of the Yellow Pages advertising directories. For a variety of reasons, there is little likelihood that these companies will be able to use their monopoly position to disadvantage competitors in these areas. In addition, their marketing of equipment will provide needed competition for AT&T, and the elimination of the restriction on their production of the Yellow Pages will generate a substantial subsidy for local telephone rates. The Court will therefore require that the proposed decree be modified to remove the restrictions on these two types of activities.

D. With respect to a number of subjects, the proposed decree establishes merely general principles and objectives, leaving the specific implementing details for subsequent action, principally by the plan of reorganization which AT&T is required to file within six months after entry of the judgment. The parties have also made informal promises, either to each other or to the Court, as to how they intend to interpret or implement various provisions. The Court has decided that its public interest responsibilities require that it establish a process for determining whether the plan of reorganization and other, subsequent actions by AT&T actually implement these principles and promises in keeping with the objectives of the judgment. Absent such a process, AT&T would have the opportunity to interpret and implement the broad principles of the decree in such a manner as to disadvantage its competitors, the Operating Companies, or both, or otherwise to act in a manner contrary to the public interest as interpreted by the Court in this opinion.

For that reason, the Court is requiring that the judgment be modified (1) to vest authority in the Court to enforce the provisions and principles of that judgment on its own rather than only at the request of a party; and (2) to provide for a proceeding, accessible to third party intervenors and to the chief executives of the seven new regional Operating Companies, in which the Court will determine whether the plan of reorganization is consistent with the decree's general principles and promises.

E. For the reasons stated in this opinion, the Court will approve the proposed decree as in the public interest… (at 223-225)

Comment

Some of the "other interests" discussed by the court—price, quality, and innovation—are the normal fare of antitrust analysis. But the court also discussed issues like the value of AT&T to politically salient small investors. Should that have mattered?