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## Antitrust Law

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# ANTITRUST LAW

## *PHONETELE V. AMERICAN TELEPHONE & TELEGRAPH:* THE NINTH CIRCUIT DEREGULATES MA BELL

### A. INTRODUCTION

In *Phonetele v. American Telephone & Telegraph*,<sup>1</sup> the Ninth Circuit held that telephone companies have no implied antitrust immunity under the Communications Act of 1934.<sup>2</sup> The court held that a telephone company may, however, defend antitrust violations by showing that it had a reasonable basis to conclude its actions were necessitated by explicit regulatory mandates. This note will examine federal and state regulation of telecommunications and how the court reconciled the conflict between such regulations and the antitrust laws.

### B. FACTS

Plaintiffs Phonetele and DASA manufacture and market telephone call monitoring and diverting devices for consumer

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1. 664 F.2d 716 (9th Cir. 1981), consolidated appeal with *DASA Corporation v. General Telephone & Telegraph*; (per Kennedy, J.; the other panel members were Fletcher, J., and Claiborne, D.J., sitting by designation, dissenting), *cert. denied*, 103 S. Ct. 785 (1983).

2. Communications Act of 1934, ch. 151, 48 Stat. 1064 (1934) (current version at 47 U.S.C. § 151 (1976)). Section 151 states:

For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, for the purpose of promoting safety of life and property through the use of wire and radio communication, and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, there is created a commission to be known as the "Federal Communications Commission", which shall be constituted as hereinafter provided, and which shall execute and enforce the provisions of this chapter.

and business use.<sup>3</sup> The devices must be electrically connected to the national telephone network to operate.

Defendant American Telephone and Telegraph (AT & T) had prohibited, pursuant to a regulatory tariff filed with the Federal Communications Commission (FCC),<sup>4</sup> the direct electrical connection of customer-provided equipment to the telephone network without the use of a telephone company supplied device known as a "protective connecting arrangement," or PCA. Defendant General Telephone and Telegraph (General) had also filed a similar tariff with the California Public Utilities Commission (CPUC).<sup>5</sup>

DASA's 1973 complaint alleged that General and Ford Industries, manufacturer of another automatic call diverter, had combined since the filing of the subject tariff to unreasonably restrain trade in the call diverter market with a concerted goal of suppressing competition in violation of section one of the Sherman Act.<sup>6</sup> DASA further alleged that General and its co-conspirators had controlled at least 90% of the call diverter market in particular parts of California, monopolizing that market and undertaking to destroy actual and potential competitors in violation of section two of the Sherman Act.<sup>7</sup>

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3. Phonetele manufactures and markets a device called a "Phonemaster," which, when electrically connected to the telephone network, prevents outgoing calls to telephones that are not in preselected area codes. The result to its users is a cost savings through prevention of misdialed or unauthorized calls.

DASA manufactures and markets the "Divert-A-Call" which is also electrically attached to the telephone system. It screens incoming calls and automatically transfers them to other numbers or extensions. 664 F.2d at 720.

4. Revised Tariff F.C.C. No. 263, filed October 22, 1968, permitting interconnection, provided that AT & T hardware was used to form the linkage between the customer-supplied device and the telephone line. The tariff also required the customer to pay AT & T an installation charge and a monthly service fee for the interconnecting equipment. 664 F.2d at 724.

5. C.P.U.C. Interim Decision No. 80972, April 22, 1975, finalized in May 1976, modifying General's tariff, provided for a system of registration of customer-provided equipment based on their varying technical specifications. 664 F.2d at 726.

6. Section one of the Sherman Antitrust Act, 15 U.S.C. § 1 (1973 & Supp. 1982) states in part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."

7. Section two of the Sherman Antitrust Act, 15 U.S.C. § 2 (1973 & Supp. 1982) states in part "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

Phonetele's 1974 complaint alleged that AT & T, the 23 companies in which it has major interests, and its subsidiaries Western Electric and Bell Telephone Laboratories combined and agreed to restrain trade in the marketing, sales and distribution of Phonetele's "Phonemaster". It also alleged that these defendants conspired to monopolize the telephone terminal equipment market, and conducted tying<sup>8</sup> arrangements, all in violation of sections one and two of the Sherman Act<sup>9</sup> and section three of the Clayton Act.<sup>10</sup>

The district courts dismissed both actions on the ground that the FCC had exclusive jurisdiction concerning the intercon-

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felony . . . ."

8. To establish a tying arrangement in violation of the Sherman Act, it must be demonstrated that a scheme involves two distinct items and provides that one, the tying product, may not be obtained unless the other, the tied product, is also purchased; that the tying product possesses sufficient economic power to appreciably restrain competition in the tied product's market; and that a not insubstantial amount of commerce is affected by the arrangement. *See, e.g., Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 47 (9th Cir.), *cert. denied*, 405 U.S. 955 (1972).

9. *See* notes 6 and 7, *supra*.

10. Section three of the Clayton Antitrust Act, 15 U.S.C. § 14 (1976) states:

It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

Phonetele further claimed that AT & T and its operating subsidiaries control approximately 80% of the telephone lines and that this effectively gave AT & T complete power over all 1,700 independent phone companies (such as defendant General), which must use these interstate lines. Phonetele also alleged AT & T's misconduct in the implementation of the relevant tariff and that AT & T was wrongfully responsible for the conforming state tariffs and enforcement efforts. 664 F.2d at 721.

Phonetele specifically charged that the interconnection of the Phonemaster required only a simple terminal block. It complained of the poor quality of the PCA available and that it was only available for a time in limited parts of the country. When finally available to states outside California, Phonetele alleged that it was three-and-one-half times as expensive as the already too expensive coupler in California. 664 F.2d at 721.

nection of equipment with the telephone network. Those courts found the defendants were therefore impliedly immune from antitrust suits pursuant to the FCC's authority under the Communications Act.<sup>11</sup>

### C. BACKGROUND

The Communications Act of 1934 (the Act) provides the FCC with regulatory powers over common carriers engaged in telecommunications.<sup>12</sup> The Act's primary purpose is to further the public interest by making available rapid and efficient telephone service.<sup>13</sup> The Act gives the FCC jurisdiction over interstate and foreign telephone communications, but expressly excludes FCC jurisdiction over intrastate communications.<sup>14</sup>

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11. See *Phonetele, Inc. v. American Tel. & Tel. Co.*, 435 F. Supp. 207 (C.D. Cal. 1977).

The district court decision discussed the statutory and regulatory foundations of telecommunications, concluding that the FCC's authority and the pervasive regulatory scheme of the Act impliedly immunized AT & T from antitrust suit. See also *DASA Corp. v. General Tel. & Tel. Co.*, 1977-2 Trade Cas. (CCH) ¶ 61,610 (C.D. Cal. 1977). The *DASA* district court decision rested on the conclusion that the FCC has exclusive jurisdiction over interconnection and therefore did not reach the implied immunity issue with respect to General's conduct.

12. The Act specifically granted the FCC jurisdiction over "all instrumentalities, facilities, apparatus and services . . . incidental to [wire communications] transmission." 47 U.S.C. § 153(a) (1976).

13. See note 2, *supra*. In addition, 47 U.S.C. § 201(b) (1976) states: "The Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the [Act]."

As a further part of its public interest function, the FCC has an express duty to "keep itself informed as to the manner and method in which [the business of all carriers] is conducted and as to technical developments and improvements in wire and radio communication . . . to the end that the benefits of new inventions and developments may be made available to [consumers]." 47 U.S.C. § 218 (1976).

14. 47 U.S.C. § 152(b) (1976) states in part that nothing in the chapter on common carriers "shall be construed to apply or to give the [FCC] jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier . . ." It is further provided that the FCC shall not have jurisdiction over any "connecting carrier," i.e., a carrier which provides interstate communication only through physical connection with another carrier not controlling it or controlled by it. 47 U.S.C. § 205 (1976).

Even though General is an intrastate carrier regulated by the CPUC, it is subject to AT & T's tariffs regarding interconnection because of the potential use of terminal equipment in interstate connections. Thus, the FCC's assertion of primary authority is controlling over both AT & T's and General's interconnection-related conduct. This exercise of jurisdiction has been upheld. See *Telerent Leasing Corp.*, 45 F.C.C.2d 204 (1974), *aff'd sub nom.*, *North Carolina Util. Comm'n v. FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976).

To carry out its policies, the Act requires that carriers file tariffs with the FCC, outlining the carriers' plans for operation.<sup>15</sup> No carrier may engage in business unless, upon proper notice, tariffs have been filed, nor may a carrier change any of its practices before amending a previous tariff or by filing a new tariff.<sup>16</sup>

A tariff must be "just and reasonable"<sup>17</sup> and "any change, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful."<sup>18</sup> The FCC may, either at its discretion or upon the filing of a complaint by a third party, hold hearings regarding the legality of a carrier's practices, and may suspend a tariff pending completion of its hearings.<sup>19</sup> Upon a finding that a tariff violates or may violate the Act, the FCC may grant injunctive relief and other sanctions.<sup>20</sup>

### *AT & T and Interconnection Tariffs*

Until 1956, AT & T's tariffs generally prohibited interconnection of all non-telephone company supplied equipment. In *Hush-A-Phone Corp. v. United States*,<sup>21</sup> blanket prohibitions

15. Section 203(a) of the Act, 47 U.S.C. § 203(a) (1976), requires such carriers to file tariffs with the FCC "showing all charges . . . and showing the classifications, practices, and regulations affecting such charges."

16. 47 U.S.C. § 203(b)(1) (1976 & Supp. 1982).

17. 47 U.S.C. § 201(b) (1976).

18. *Id.* Also, 47 U.S.C. § 202(a) (1976) states:

It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage.

19. 47 U.S.C. § 204 (1976 & Supp. 1982) allows the FCC to suspend use of a new tariff for 5 months. If the hearings have not been completed within that time, the tariff becomes effective, although it may later be invalidated by the FCC.

20. Failure to obey an FCC order will result in a \$1,000 fine for each violation, to be levied each day in the case of continuing offenses. 47 U.S.C. § 205(b) (1976). A carrier found to have violated the Act is liable to any person injured for the "full amount of damages sustained," plus attorney's fees. 47 U.S.C. § 206 (1976). There are two avenues of recovery: a party may sue in any United States district court, 47 U.S.C. § 207 (1976), or a party may file a complaint with the FCC, 47 U.S.C. § 208 (1976). The FCC may conduct an investigation and, if it concludes there are reasonable grounds to support the complaint and the complaining party is entitled to damages, it may order the carrier to pay. 47 U.S.C. § 209 (1976). See 664 F.2d 716, 722 n.12.

21. 238 F.2d 266 (D.C. Cir. 1956), *after remand*, 22 F.C.C. 112 (1957).

against interconnection of all such equipment were struck down. AT & T thereafter filed a tariff prohibiting all "direct electrical connection" and interconnection by any means of customer-provided equipment.<sup>22</sup> In 1965, this tariff was the subject of an anti-trust suit brought against AT & T which was stayed pending FCC review of its validity under the Act's standards.<sup>23</sup> That review culminated in the *Carterphone* decision,<sup>24</sup> wherein the FCC held that the subject tariff's overbreadth violated the Act's just and reasonable standard.<sup>25</sup> The FCC thereafter permitted carriers to submit new tariffs allowing interconnection that would not "adversely affect the [carrier's] operations or the telephone system's utility for others."<sup>26</sup>

AT & T responded to the new FCC mandate with a tariff prohibiting direct electrical connection of certain devices without PCAs provided and installed by the carrier.<sup>27</sup> Without either affirming or rejecting the tariff, the FCC left it operational pending consideration of the effect the tariff might have on the telephone network.<sup>28</sup> The FCC commenced investigations and, in 1975, concluded that the latest tariff also violated the Communications Act.<sup>29</sup> As part of that decision, the FCC proposed a registration program which in part permitted carriers to require the use of PCAs for certain customer-supplied terminal equipment<sup>30</sup>

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The Hush-A-Phone was a cup-shaped listening device physically connected to the telephone receiver. Requiring no electrical connection to the telephone network, it provided privacy to the user and quiet for persons around the phone. *Id.* at 267.

22. Tariff F.C.C. No. 132 (filed April 16, 1957), *superseded by* tariff F.C.C. No. 263 (filed January 2, 1968).

23. *Carter v. American Tel. & Tel.*, 250 F. Supp. 188 (N.D. Tex.), *aff'd*, 365 F.2d 486 (5th Cir. 1966), *cert. denied*, 385 U.S. 1008 (1967). The plaintiff manufactured the Carterphone, which was inductively connected to the telephone, thereby permitting the caller to connect his telephone to a two-way radio. 365 F.2d at 490.

24. *Use of the Carterphone Device in Message Toll Telephone Service*, 13 F.C.C.2d 420, *reconsideration denied*, 14 F.C.C.2d 571 (1968).

25. The tariff was found unreasonable because it "prohibit[ed] the use of harmless as well as harmful devices." *Carterphone*, 13 F.C.C.2d at 424, *quoted in Phonetele*, 664 F.2d at 724.

26. 13 F.C.C.2d 420, 424.

27. Revised Tariff F.C.C. No. 263 (filed November, 1968).

28. The FCC stated: "[W]e will permit the tariff revisions to become effective as scheduled with the understanding that in doing so we are not giving any specific approval to the revised tariffs." *See Phonetele*, 664 F.2d at 723-24 n.21.

29. 56 F.C.C.2d 593 (1975), *modified in part*, 57 F.C.C.2d 1216 (1976), *aff'd sub. nom.* *North Carolina Util. Comm'n. v. FCC*, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977).

30. The program basically allows interconnection if equipment is attached with FCC

including Phonetele's "Phonemaster" and DASA's "Divert-A-Call."<sup>31</sup>

### *Implied Antitrust Immunity*

Where Congress has failed to explicitly address the issue of the antitrust liability of a regulated entity, courts have generally implied such immunity to preserve the integrity of the regulatory scheme.<sup>32</sup> However, despite this apparent preference for regulatory statutes, the Supreme Court has stressed that implied antitrust immunity is strongly disfavored,<sup>33</sup> that it should be found only where a "clear repugnancy" between the antitrust and regulatory laws exist,<sup>34</sup> and only where conferring an implied antitrust immunity is necessary to make the regulatory program work.<sup>35</sup>

In *Pan American World Airways v. United States*,<sup>36</sup> the Court set forth a standard whereby antitrust immunity will not be implied where the alleged antitrust violations comprise the "precise ingredients" of the regulatory agency's authority.<sup>37</sup> Other factors have been considered such as whether the agency may grant adequate relief,<sup>38</sup> whether competition is part of the

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registered protective connectors or if the customer-supplied equipment is itself registered. See generally 47 C.F.R. §§ 68.100-.110 (1981). The validity of this program has been upheld. See *North Carolina Util. Comm'n. v. FCC*, *supra* note 29.

31. CPUC's consideration and investigations of the tariffs filed by General which paralleled AT & T's are discussed at 664 F.2d at 725-26. The "primary jurisdiction" holding of *North Carolina Util. Comm'n.*, *supra* note 29, appears to resolve any conflict between state and federal interpretation of the similar tariffs.

32. See, e.g., *United States v. National Ass'n. of Securities Dealers*, 422 U.S. 694 (1975) (securities dealers); *Gordon v. New York Stock Exchange, Inc.*, 422 U.S. 659 (1975) (stock exchanges); *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973) (generation and transmission of electrical power); *Hughes Tool Co. v. Trans World Airlines, Inc.*, 409 U.S. 363 (1973) (airline parts supply); *Pan American World Airways, Inc. v. United States*, 371 U.S. 296 (1963) (airlines); *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963) (national banking); *Georgia v. Pennsylvania R.R. Co.*, 324 U.S. 439 (1945) (railroads); *National Gerimedical Hosp. & Gerontology Center v. Blue Cross of Kansas City*, 628 F.2d 1050 (8th Cir. 1980) (group medical insurance plans).

33. *United States v. Philadelphia Nat'l Bank*, 374 U.S. at 351.

34. *Georgia v. Pennsylvania R.R. Co.*, *supra* note 32, at 456.

35. *Silver v. New York Stock Exchange, Inc.*, 373 U.S. 341, 357 (1963).

36. 371 U.S. 296 (1963).

37. *Id.* at 307-08.

38. The *Pan Am* case concerned unfair practices in air carrier routes. The action, for trade restraint in violation of the Sherman Act, was brought by the Government and dismissed by the Supreme Court which held that the Civil Aeronautics Board was statutorily granted the authority under the Civil Aeronautics Act to regulate the division of



agency's guiding standards,<sup>39</sup> whether the agency has sufficient expertise in a particular area,<sup>40</sup> and whether the antitrust case involves important questions of regulatory policy.<sup>41</sup> The Court has cautioned that where "relationships [with competitors] are governed in the first instance by business judgment and not regulatory coercion, courts must be hesitant to conclude that Congress intended to override the fundamental national policies embodied in the antitrust laws."<sup>42</sup>

Regarding telecommunications, most courts have found no such immunity exists.<sup>43</sup> Those courts have noted the Act's silence on the subject as well as the lack of any clear indication concerning immunity from its legislative history.<sup>44</sup> Courts considering interconnection-related activities have held, as the *Phonetele* court did, that no implied antitrust immunity exists

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territories and allocation of routes between carriers. The Court stated: "Limitation of routes and divisions of territories and the relation of common carriers to air carriers are basic in [the Civil Aeronautics Act] regulatory scheme. The acts charged in this civil suit as antitrust violations are precise ingredients of the Board's authority in granting, qualifying, or denying certificates to air carriers, . . . and in allowing or disallowing affiliations between common carriers and air carriers." 371 U.S. at 305.

39. *FCC v. RCA Communications, Inc.*, 346 U.S. 86, 94 (1953).

40. *Carter*, *supra* note 23, at 492.

41. *Pan American World Airways*, *supra* note 32, at 310.

42. *Otter Tail Power Co. v. United States*, *supra* note 32, at 374.

43. *See, e.g., Essential Communications Sys., Inc. v. American Tel. & Tel. Co.*, 610 F.2d 1114 (3d Cir. 1979); *United States v. American Tel. & Tel. Co.*, 461 F. Supp. 1314 (D.D.C. 1978); *M.C.I. Communications Corp. v. American Tel. & Tel. Co.*, 462 F. Supp. 1072 (N.D. Ill.), *mandamus denied*, 594 F.2d 594 (7th Cir. 1978), *cert. denied*, 440 U.S. 971 (1979). For a detailed discussion of antitrust laws in the telecommunications industry, see Note, *The Application of Antitrust Law to Telecommunications*, 69 CALIF. L. REV. 497 (1981); Note, *AT & T and the Antitrust Laws*, 85 YALE L.J. 254 (1975).

44. Federal regulation of the telecommunications industry begins with the Mann-Elkins Act, ch. 309, 36 Stat. 539 (1910) (current version at 49 U.S.C. §§ 1, 4, 6, 10, 13, 15, 16, 20 (1976)), and the Willis-Graham Act, ch. 20, 42 Stat. 27 (1921). The Senate discussions during the drafting of the Communications Act indicate that the FCC is to have "comprehensive jurisdiction over the [telecommunications] industry." S. REP. NO. 781, 73d Cong., 2d Sess. 3 (1934).

Explicit immunity from antitrust violations is found regarding certain FCC-approved consolidations and mergers of telephone companies. 47 U.S.C. § 221(a), 222(c)(1) (1976). One court opined that the "explicit immunization of certain FCC-approved consolidations and mergers [under these sections of the Act] . . . indicates that Congress did not contemplate blanket [antitrust] immunity." *Sound, Inc. v. American Tel. & Tel. Co.*, 631 F.2d 1324, 1327 (8th Cir. 1980).

As recently as 1970, Congress has declined to extend the applicability of the antitrust laws to telecommunications while doing so to radio. *See* 47 U.S.C. § 313 (1976). The discrepancy in congressional intent appears to be based upon the interpretation that broadcasters are not common carriers. *See* Note, *AT & T and the Antitrust Laws*, *supra* note 43, at 270 n.76, *citing* *FCC v. Sanders Bros. Radio Station*, 309 U.S. 470, 474 (1940).

and that liability for violations of the antitrust laws is subject to proof.<sup>45</sup>

For example, in *Sound, Inc. v. American Tel. & Tel. Co.*,<sup>46</sup> plaintiff alleged that defendant Bell Systems' required use of its own PCAs had violated the antitrust laws. Bell claimed that it had required the PCAs because it did not know how otherwise to protect the integrity of its equipment. The court noted that determining such harm was a "factual matter to be established at trial. The claim is relevant, if at all, only to the merits of the antitrust charges rather than to the claim of immunity."<sup>47</sup>

#### D. THE COURT'S ANALYSIS

##### 1. *The Majority*

The Ninth Circuit held that the defendant telephone companies were not impliedly immune from antitrust violations, but that they may, upon a sufficient factual showing, defend against antitrust claims on the basis of necessary compliance with explicit regulatory mandates.<sup>48</sup> The court did not hold that implied antitrust immunity is never applicable. Rather, it noted the lack of a "simplistic and mechanically universal doctrine of implied antitrust immunity."<sup>49</sup> A court must therefore consider special aspects of an industry<sup>50</sup> as well as the existence of an explicit regulatory mandate sufficient to confer such an immunity<sup>51</sup> before holding that a defendant's actions shall enjoy protection from the antitrust laws.

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45. See, e.g., *Northeastern Tel. Co. v. American Tel. & Tel. Co.*, 651 F.2d 76 (2d Cir. 1981); *Sound, Inc. v. American Tel. & Tel. Co.*, 631 F.2d 1324 (8th Cir. 1980); *Essential Communications Sys., Inc. v. American Tel. & Tel. Co.*, 610 F.2d 1114 (3d Cir. 1979); *Litton Sys., Inc. v. American Tel. & Tel. Co.*, 487 F. Supp. 942 (S.D.N.Y. 1980); *Jarvis, Inc. v. American Tel. & Tel. Co.*, 481 F. Supp. 120 (D.D.C. 1978); *Interconnect Planning v. American Tel. & Tel. Co.*, 465 F. Supp. 811 (S.D.N.Y. 1978); *Macom Prods. Corp. v. American Tel. & Tel. Co.*, 359 F. Supp. 973 (C.D. Cal. 1973).

46. 631 F.2d 1324 (8th Cir. 1980). See also *Northeastern Tel. Co. v. American Tel. & Tel. Co.*, 651 F.2d 76 (2d Cir. 1981) (propriety of design of AT & T's PCA a jury question); *Essential Communications Sys., Inc. v. American Tel. & Tel. Co.*, 610 F.2d 1114 (3d Cir. 1979) (facts parallel to those of *Phonetele*).

47. 631 F.2d at 1330 n.7.

48. 664 F.2d 716, 740.

49. *Id.* at 727.

50. *Id.*

51. *Id.* at 731.

*Special Aspects of a Regulated Industry*

The court found that defendants' interpretation of the implied immunity cases ignored consideration of the special aspects of a particular industry. Specifically, the historical contexts, legislative histories and express statutory authority of the agencies that regulate such industries differ widely.<sup>52</sup>

The court paid particular attention to defendants' reliance<sup>53</sup> on two Supreme Court cases granting implied antitrust immunity in the securities field: *Gordon v. New York Stock Exchange*,<sup>54</sup> and *United States v. National Association of Securities Dealers (NASD)*.<sup>55</sup> In *Gordon*, a group of investors had challenged the Securities and Exchange Commission's (SEC) authorized fixing of stock sales commission rates as a violation of the antitrust laws. Rejecting the challenge, the Court held that, under the Securities Exchange Act,<sup>56</sup> Congress had intended to leave supervision of the fixing of reasonable rates of commission to the SEC and thus had impliedly immunized the practice from antitrust suit. The Court found such immunity despite the fact that seven years prior to the grant of supervisory power to the SEC, it had held that price fixing was a *per se* violation of the Sherman Act.<sup>57</sup> Further, the Court held that implying immunity would impede the operation of the SEC which had been successfully supervising the fixing of commissions for a period of years.<sup>58</sup>

In *NASD*, the Court found implied immunity necessary to curb competition in mutual fund brokerage transactions. It held

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52. *Id.* at 727-30.

53. General also relied on the so-called state action exemption of *Parker v. Brown*, 317 U.S. 341 (1943). Interpreting the recent case of *California Retail Liquor Dealers Ass'n. v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980), the court stated that (1) if the challenged restraint is clearly articulated and affirmatively expressed as state policy and (2) that policy is actively supervised by the state, such an exemption would protect General. The court did not find that the CPUC's involvement with the relevant tariff rose to the *Parker* level, since the CPUC only permitted General to file the PCA tariff. As with the FCC, this was not to be interpreted as the CPUC's (and therefore the state's) adoption of the tariff as its policy. 664 F.2d at 736.

54. 422 U.S. 659 (1975).

55. 422 U.S. 694 (1975).

56. 15 U.S.C. § 78(a) (1975).

57. 422 U.S. 659, 691. The *per se* rule was established in *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927).

58. 422 U.S. at 687.

that vertical restrictions on secondary market activities created to limit such transactions were the exact prohibitions contemplated by the Investment Company Act of 1940.<sup>59</sup>

The *Phonetele* court distinguished the securities cases by noting the Supreme Court's deference to the SEC in order to make the securities laws work, laws which were designed to prevent harm to investors that might occur in the absence of regulations.<sup>60</sup> In comparison, the court found, such harm to the public from the lack of regulation of interconnection had not been shown, either through legal precedent or regulatory action.<sup>61</sup>

The court further noted that the authority given the FCC by statute was significantly different from that of the SEC as evidenced by an analysis of the legislative history as well as an examination of the language of the statutes. For example, as found in *Gordon*, under the Securities Exchange Act the SEC is given express authority to regulate the securities exchanges' fixing of reasonable rates of commission,<sup>62</sup> despite Congress' understanding that an antitrust violation might result.<sup>63</sup> In contrast, the FCC neither approves nor disapproves an industry-submitted tariff, nor does it adopt such tariff as agency policy or have any obligation under the statute to find that the tariff necessarily effectuates the purpose of the Communications Act.<sup>64</sup>

#### *Antitrust Immunity Implied by Regulatory Mandate*

The Ninth Circuit held that implied antitrust immunity may be conferred by the presence of three elements demonstrating a regulatory mandate: (1) explicit congressional approval of the ultimate anticompetitive effect of the challenged conduct; (2) explicit authorization by Congress to an agency or private entity to order the challenged conduct; and (3) no inconsistency between the challenged conduct and an express policy of the governing agency.<sup>65</sup> The *Phonetele* court found none of these el-

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59. 422 U.S. 694, 721-22 (1975).

60. 664 F.2d at 727 n.31.

61. *Id.*

62. 15 U.S.C. § 78f(e)(1), (e)(1)(B) (1981).

63. *Gordon*, *supra* note 54, at 664-68.

64. 664 F.2d at 733.

65. This standard appears to have been culled from *Gordon* and *NASD*, i.e., that "the agency must have sufficient freedom of action to carry out its regulatory mission,

ements present. With respect to the third element, the court particularly noted that, to the contrary, the FCC had clearly expressed a preference for competition unless a lack of restrictions necessary to preventing damage to the phone system was evident.<sup>66</sup>

The court recognized some merit to defendants' primary argument.<sup>67</sup> Defendants had asserted that, after *Carterphone*, they were faced with the conflicting duties of ensuring the expansion of the use of non-telephone company supplied interconnection devices while at the same time ensuring the safety and efficiency of the phone network against harm from such devices. They argued that the pro-competitive purpose of the antitrust laws conflicted with the public interest purpose of the Communications Act, therefore requiring immunity.<sup>68</sup> However, the court found that no *actual* repugnancy existed.<sup>69</sup> For example, it found that the remedies available under the Act and the antitrust laws were complimentary,<sup>70</sup> and that the *Carterphone* mandate, upon which defendants had based their argument, was inapposite. *Carterphone*, the court noted, was "itself responsive to a stay in an antitrust case pending in the federal courts, and the FCC's decision contemplated that the federal court would 'pass ulti-

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and the regulated entity should not be required to act with reference to inconsistent standards of conduct." 664 F.2d 716, 731-32.

66. *Carterphone* mandated that an interconnection-restricting tariff was unreasonable under the Act unless its intent was to prevent *actual* harm to the telephone network. *Phonetele*, 664 F.2d at 731 n.38.

67. 664 F.2d at 732.

68. The Eighth Circuit was much tougher on the telephone companies in this regard. In *Sound, Inc. v. American Tel. & Tel. Co.*, 631 F.2d 1324 (8th Cir. 1980), the court found the "inconsistency" that AT & T had based its argument for immunity on was self-imposed, rather than the result of any regulatory mandate. It noted that in the filing of its prohibitory tariffs, defendant "implements its own business judgment in regard to its relationship with competitors." *Id.* at 1331.

69. 664 F.2d at 732.

70. *Carterphone*, *supra* note 24, at 421 (quoted in *Phonetele*, 664 F.2d at 730-31).

The court also noted that the "absence of a damages remedy under the [Act] weighs against finding an implied antitrust immunity and gives the antitrust court a role in enforcing the public interest standards of the [Communications Act]." *Id.* at 735 n.47. Consistency could further be inferred in that it is doubtful plaintiff could recover under both statutes. *Id.* at 735 n.48. *But see* *Comtronics, Inc. v. Puerto Rico Tel. Co.*, 409 F. Supp. 800 (D.C. Puerto Rico 1975), *aff'd*, 553 F.2d 701 (1st Cir. 1979) for the proposition that the Communications Act does not grant a private right of action for a telephone company's refusal to interconnect plaintiff's own phone system with the telephone network. *See also Phonetele*, 664 F.2d at 734 n.46 and cases cited therein.

mately upon the antitrust issues . . . .'<sup>71</sup>

### *Regulatory Necessity as a Defense*

The court concluded its decision by recognizing that, where no implied immunity exists, "[i]f a defendant can establish that, at the time the various anticompetitive acts alleged . . . were taken, it had a reasonable basis to conclude that its actions were necessitated by concrete factual imperatives recognized as legitimate by the regulatory authority, then its actions did not violate the antitrust laws."<sup>72</sup> The defense may only be established through a factual inquiry, focusing on whether the interconnection equipment could damage defendants' equipment or disrupt the telephone system in identifiable ways, and whether the tariff as filed was the most reasonable, narrowly tailored method then available to guard against harm.<sup>73</sup>

The court made it clear that these issues were factual and that it would not undertake an exploration of the merits of plaintiff's claims.<sup>74</sup> Further, it admonished defendants that the justification of regulatory necessity could not be based on mis-

71. *Id.* at 730-31.

72. *Id.* at 737-38. The court noted that General may be entitled to antitrust immunity on another ground. Its facilities were used for interstate communications and, under *Telerent*, *supra* note 15, federal law controlled their tariffs. Therefore, "[t]o the extent General's decision to require [PCAs] was dictated by AT & T's tariff revisions filed with the FCC, its own PCA tariff may have been a justified, if not a coerced, compliance with the requirements of the federal and state regulatory schemes." 664 F.2d at 737 n.56.

73. 664 F.2d at 738. The court also suggested how defendants might sustain their burden of proof:

The defendants might, for example, attempt to demonstrate why methods of protecting the system which did not depend on particularized knowledge about the technical specifications of all types of equipment that might be interconnected, would have been either inadequate or not reasonably foreseeable. One such method is suggested by the FCC-proposed tariff in 1975, namely the requirement that those desiring to connect foreign equipment first notify the telephone company with the provision that the telephone company could temporarily discontinue service to any customer whose equipment was causing actual harm to the telephone network.

*Id.* at 738 n.58.

74. The court stated: "These factual justifications, the resolution of which is necessarily open at this point, are to be distinguished from the various legal issues in the case which we now foreclose." 664 F.2d at 738.

Nevertheless, in what appears to be dicta, the court surveyed Ninth Circuit law with respect to plaintiffs' claims for antitrust violations, particularly with a view toward how defendants might defend against them. See 664 F.2d at 738-40.

takes of law or interpretation of the Act, judicial or FCC opinions.<sup>75</sup> Defendants would also be precluded from filing any tariffs they chose or arguing they had to file tariffs absent a demonstration of the factors required to satisfy the defense.<sup>76</sup>

## 2. *The Dissent*

Judge Claiborne, dissenting, surveyed the four most recent Supreme Court opinions on implied antitrust immunity.<sup>77</sup> He argued that, under those cases, immunity must be found if three questions are affirmatively answered:

- 1) Has Congress conferred upon the regulatory agency sufficient authority to regulate the conduct which is alleged to be anticompetitive? 2) Does the history of the regulatory agency's activities with respect to the regulation of this conduct suggest no laxity in the exercise of this authority? 3) If the federal antitrust laws were to be construed by a federal court as outlawing the regulated activity, is there reason to believe that the agency's regulation of the industry in question will no longer be able to function effectively?<sup>78</sup>

As to the first question, the dissent argued that Congress had granted individuals a right of action against AT & T for damages resulting from unjust and unreasonable practices set forth by tariffs.<sup>79</sup> He added that AT & T's liability is not necessarily limited to anticompetitive practices.<sup>80</sup>

As to the second question, Judge Claiborne traced the history of FCC involvement in interconnection tariffs. He noted the studies that had been commissioned by the FCC and at least 17 states, including California, concerning the "whole matter" of interconnection.<sup>81</sup> Those studies had culminated in the FCC's adoption of a federal registration program for the regulation of

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75. *Id.* at 738.

76. The court was apparently foreclosing the argument that an antitrust-violative tariff is reasonable or necessary until the FCC disapproves of it.

77. 664 F.2d at 747. The cases examined by the dissent were *Gordon*, *supra* note 32, *NASD*, *supra* note 32, *Hughes Tool Co.*, *supra* note 32, and *Cantor v. Detroit Edison Co.*, 428 U.S. 579 (1976).

78. 664 F.2d at 747.

79. *Id.* at 750.

80. *Id.*

81. *Id.*

interconnection of customer-provided equipment.<sup>82</sup> He argued that the FCC's regulation of interconnection clearly showed no laxity in the exercise of its authority, in one case to the point of preempting the state public utility/service commissions.<sup>83</sup>

As to the third question, the dissent reasoned that the FCC should have the power to regulate interconnection. Conceding speculation, he suggested that allowing private interconnection in order to avoid defendants' antitrust liability might simultaneously result in harm to the telephone network. The FCC's authority to regulate would thus be impaired by what obviously appears to be the courts' partiality to unfettered competition, rather than deference to the FCC's role and the purpose of the Communications Act.<sup>84</sup>

The dissent acknowledged that his view would create a conflict with the Third Circuit's holding in *Essential Communications Systems, Inc. v. AT & T*,<sup>85</sup> which dealt with the same issues and facts as *Phonetele*. Nevertheless, he found that the *Essential Communications* court had failed to attend to the holdings of *Gordon*<sup>86</sup> and *NASD*.<sup>87</sup> He found that the *Essential Communications* court had especially ignored the parallels between the SEC's involvement with the regulated broker-dealers and the FCC's involvement with the telephone companies. That similarity, as well as the lack of specific anticompetitive language in either the relevant securities laws or the Act also required a finding of implied immunity here.<sup>88</sup>

The dissent further noted that the existence of a "savings clause" in the Act did not alter the general rule requiring that plaintiffs exhaust their administrative remedies under the Act prior to initiating suit.<sup>89</sup> The Ninth Circuit, he argued, had previously addressed that same issue and had deferred to the

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82. 47 C.F.R. §§ 68.100-506 (1981); 664 F.2d at 750.

83. 664 F.2d at 744, 750. See *Telerent*, *supra* note 14.

84. 664 F.2d at 750-51.

85. 610 F.2d 1114 (3d Cir. 1979).

86. *Supra* note 32.

87. *Supra* note 32.

88. 664 F.2d at 752.

89. 47 U.S.C. § 414 (1981) reads: "Nothing in this chapter contained shall in any way abridge or alter the remedies now existing at common law or by statute, but the provisions of this chapter are in addition to such remedies." See also 664 F.2d at 751-52.



FCC.<sup>90</sup>

## E. SIGNIFICANCE

The Communications Act was enacted for the purpose of regulating wire communication and making available a "rapid and efficient . . . wire communication service . . . with adequate facilities at reasonable charges."<sup>91</sup> When enacted, telecommunications technology was primitive compared with the complex systems currently in use. Even as late as the 1950's, there were few private companies engaged in the field and the prevailing concern with maintaining an efficient telephone network was with avoiding duplicative facilities, not with the possibility of improving the phone system through the efforts of private enterprise.<sup>92</sup>

In this regard the *Phonetele* decision, at least in result, appears to embrace the spirit of the Act. There is little doubt that plaintiffs' devices will make more rapid and efficient their consumers' use of the telephone system. All cases considered by the courts and the FCC concerning private entries into the telecommunications marketplace have recognized such a benefit.<sup>93</sup> The *Phonetele* decision comports with this limited precedent.

More broadly, the court commendably addressed the problem of the lack of a rational standard for implying antitrust immunity. Other courts have adopted such watchwords as "exclusive jurisdiction," "pervasive regulatory scheme," or "repeals by implication are strongly disfavored," as starting points for inferring immunity.<sup>94</sup> These terms add little to solving the more fundamental problem of how regulatory policy and competition can be reconciled. The Ninth Circuit has recognized that the statutory schemes of regulation, the implementation of those schemes and the competitive situations have varied so greatly from in-

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90. See *International Tel. & Tel. Corp. v. General Tel. & Elec. Corp.*, 518 F.2d 913 (9th Cir. 1975).

91. 47 U.S.C. § 151 (1976).

92. In *FCC v. RCA Communications, Inc.*, 346 U.S. 86 (1953), Justice Frankfurter stated that, with regard to the congressional intent of the Communications Act, restrictions on entries into communications existed because "Congress may have considered the possible inconvenience to the public of duplicate facilities—as would clearly be the case with telephones . . . ." *Id.* at 92-93.

93. See notes 43 and 45, *supra*.

94. See notes 32-36, *supra*, and cases cited therein.

dustry to industry that no coherent body of antitrust implied immunity law really exists. Instead, the Ninth Circuit's factual examination of "special aspects" of an industry views a regulatory statute's silence concerning antitrust immunity in light of contemporary political policy, technology and economics.

Despite its *laissez faire* result and more rational implied immunity standard, *Phonetele*'s reasoning is questionable. The court appears to have ignored the clear language of the Act, which mandates that the FCC keep itself informed "as to technical developments and improvements in wire and radio communication . . . to the end that the benefits of new inventions and developments may be made available to [consumers]."<sup>95</sup> No doubt Congress gave the inquisitory incentive to the FCC, rather than to the courts, as the former would obviously be better able to conduct investigations and compile studies toward such ends.<sup>96</sup> However, the *Phonetele* court conducted its own inquiry as to an aspect of the Act that clearly seems the domain of the FCC.

Even if the *Phonetele* decision can be seen as deferential to the FCC's duty to keep apprised of the latest technology, the court ignored the extent to which the FCC has actually satisfied that duty. This is particularly true when considering interconnection.

First, the FCC itself has expressed a preference for competition concerning interconnection. This is manifested both in its arguments set forth in court<sup>97</sup> as well as in its consistent rejection of interconnection-restricting tariffs.<sup>98</sup> Further, there is no

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95. 47 U.S.C. § 218 (1976). See *United Telegraph Workers, AFL-CIO v. FCC*, 436 F.2d 920 (D.C. Cir. 1970) for one court's interpretation of the great deference that should be given the FCC to sanction new inventions in conformity with this mandate.

96. One author suggests this as Congress' abdication of responsibilities "to whatever branch of government that seems willing to assume them." He suggests instead the formation of some entity, similar to the Temporary National Economic Committees in the 1930's, in order to study the basic conflicts between regulation and competition in each regulated industry. See Handler, *Regulation Versus Competition*, 44 CINN. L. REV. 191, 205-06 (1975).

97. "The Commission has never considered its authority over equipment interconnection to displace the antitrust laws." Memorandum of FCC as *amicus curiae* in *United States v. American Tel. & Tel. Co.*, 461 F. Supp. 1314 (D.D.C. 1978), 62 F.C.C.2d 1102, 1114 (1975).

98. For a discussion of FCC involvement with interconnection tariffs and related

reason to assume that the FCC-proposed registration program for interconnection devices does any less than allow for competition simultaneous with protection of the phone network. It therefore appears that court intervention is not only inappropriate, but unnecessary to prohibit antitrust violations, at least in the discreet area of telecommunications interconnection. 4

Second, the court's *ad hoc* approach to implying antitrust immunity forced it to completely retrace the FCC's involvement in the area. The Commission's findings could just as well have been found erroneous by the court, a body that has far less experience with interconnection activities than the Commission. It thus remains unclear whether the FCC or any regulatory agency, if subject to such scrutiny, has any *de facto* authority.<sup>99</sup>

Ultimately, the decision appears to be an expression of the court's dissatisfaction with the Act's basic regulatory scheme. From the court's extensive exposition of the history of interconnection tariffs, and the FCC's registration program as a solution to the instant problem, one can infer that the court sees a cumbersome, ineffective mechanism which inefficiently addresses contemporary economic problems.

The court's view is undoubtedly "fashionable" as the dissent notes.<sup>100</sup> However, deregulation should not be undertaken by the judiciary.<sup>101</sup> The inherent lack of consistency, a product of jurisdictional and factual differences in each case, provides little assistance toward resolving important questions of economic policy which prompted the need for antitrust laws and

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activity, see *Phonetele*, 664 F.2d at 723-25.

99. The Act gives the United States Court of Appeals the power to review the FCC's orders and decisions but is silent as to whether the court may review investigations of the FCC which have not culminated in a particular order or decision. See 47 U.S.C. § 401(b) (1976). Further, the appellate courts may only inquire into the FCC's reasoned consideration of relevant factors, and is necessarily narrow to give proper effect to the agency's expertise. See, e.g., *Civic Telecasting Corp. v. FCC*, 523 F.2d 1185 (D.C. Cir. 1975), *cert. denied*, 426 U.S. 949 (1976).

100. 664 F.2d at 753. See *supra* notes 43 and 45 for some of the recent cases attacking the apparent telephone company monopolies. The recent Justice Department consent decree reflecting the breakup of AT & T and its subsidiaries is further evidence of the "fashion".

101. The inherent limitations of the court's powers of review of the FCC arise from 47 U.S.C. § 402 (1976).

regulatory statutes.<sup>102</sup>

The *Phonetele* court may not have needed to address the more vexing policy questions. The majority of decisions involving the antitrust liability of AT & T and similar state and local entities have favored the entry of new products into the marketplace, particularly regarding interconnection.<sup>103</sup> Thus, the court's result was not unusual and unlikely to provoke any controversy. Future cases, where results are less "fashionable", will provide a better test of whether courts should implicitly deregulate or impliedly immunize.

Mark Aveis\*

## NEW PRESUMPTION OF PREDATORY PRICING UNDER THE SHERMAN ACT

### A. INTRODUCTION

In *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*,<sup>1</sup> the Ninth Circuit held that anticompetitive conduct under section 2 of the Sherman Antitrust Act<sup>2</sup> may be shown by proof of pricing below the average variable cost of production (AVC). As a corollary, prices above AVC or marginal

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102. Regulatory laws are predicated on the assumption that unrestrained interaction of competitive forces in a particular industry will not serve the public interest. Antitrust laws, on the other hand, are based on the notion that such unrestrained interaction will yield the best allocation of economic resources. See e.g., 2 A. KAHN, *THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS* 1, 4-5 (1971), cited in *Phonetele v. American Telephone & Telegraph*, 435 F. Supp. 207, 210 (C.D. Cal. 1977).

103. See 664 F.2d 716, 719 n.1, and cases cited therein.

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1. 668 F.2d 1014 (9th Cir. 1981) (per Sneed, J.; the other panel members were Browning, J., and Peck, J., sitting by designation, dissenting) (as amended on denial of rehearing and rehearing en banc, Feb. 10, 1982. Wallace, J., dissented from denial of rehearing en banc and filed opinion), cert. denied, 103 S. Ct. 57 (1982).

2. The Sherman Antitrust Act, § 2, 15 U.S.C. § 2 (1976 & Supp. IV 1980) states: "Every person who shall monopolize, or attempt 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 4 of the Clayton Act permits private plaintiffs to sue for treble damages for injuries suffered as a result of "anything forbidden in the antitrust laws." 15 U.S.C. § 15 (1976 & Supp. IV 1980).

cost (MC) may be considered predatory. In addition, the court held that in the appropriate circumstances, the other elements of an attempted illegal monopolization may be inferred from proof of such conduct.<sup>3</sup>

Plaintiff, an independent bakery, and defendant were competitors in the Northern California wholesale bread market.<sup>4</sup> Both parties sold pound and pound and one half loaves of white bread; both sold their product under a "private" label and an "advertised" label.<sup>5</sup> Plaintiff alleged that the growth of the private label bread market in the area during 1967 and 1968 began to weaken defendant's market for its advertised label, and that in response, defendant undertook a strategy of predatory pricing<sup>6</sup> to eliminate competition in the private label bread market.<sup>7</sup>

At trial, plaintiff introduced evidence that defendant had reduced its wholesale price on one pound loaves of private label from nineteen cents to seventeen and two-tenths cents during the period from 1970 to 1973.<sup>8</sup> Also, plaintiff introduced expert testimony that during 1972 and 1973, the price charged by defendant to wholesalers was below its average variable cost of production.<sup>9</sup> It was also shown that during the late 1960's and early 1970's, the wholesale bakers in the area were experiencing excess productive capacity,<sup>10</sup> and that beginning in 1967, plaintiff suffered operating losses until going out of business in 1976, five years after filing its complaint.<sup>11</sup>

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3. *Inglis* also presented claims under the Robinson-Patman Act, 15 U.S.C. § 13 (1976 & Supp. IV 1980), and the California Unfair Practices Act, CAL. BUS. & PROF. CODE §§ 17000-17101 (West 1982). This note will focus solely on the Sherman Act claims.

4. *William Inglis & Sons v. ITT Continental Baking Co.*, 461 F. Supp. 410, 416 (N.D. Cal. 1978).

5. *Id.* Private label bread is sold under a brand name individual to the purchasing store. Advertised label is a national brand name available to all stores. Plaintiff's advertised label was "Sunbeam", and defendant's was "Wonderbread". The chief difference, aside from label design and packaging, is the price. This being the case, an advertised label is more profitable than a private label. *Id.*

6. See *infra* text accompanying notes 40-55 for a discussion of predatory pricing.

7. By driving out competitors, defendant could raise prices of private label and reduce the competitive disadvantage of its highly profitable "Wonderbread". 461 F. Supp. at 416.

8. 668 F.2d 1014, 1025.

9. 461 F. Supp. 410, 418.

10. This was due in part to the establishment of "captive bakeries" by large chain stores. *Id.* at 416.

11. 668 F.2d 1014, 1024.

On this evidence, the jury awarded over four million dollars in treble damages on plaintiff's claim of attempted monopolization.<sup>12</sup> The trial judge granted defendant's motions for a judgment notwithstanding the verdict (JNOV), and alternatively, for a new trial.<sup>13</sup> In granting the JNOV, the trial judge concluded that plaintiff's showing of below average variable cost pricing was not competent evidence to state a prima facie case of price predation.<sup>14</sup> Although the court recognized that average variable cost may be used as an evidentiary surrogate for marginal cost, the standard endorsed in the Ninth Circuit, there may be cases that are not amenable to this substitution.<sup>15</sup> Even if this were a case where average variable cost could be used as evidence, the district court judge found that plaintiff's evidence of this cost figure was erroneous, and that in itself would warrant a JNOV.<sup>16</sup> The unreliability of plaintiff's cost study was cited as the reason for granting the new trial motion as well.<sup>17</sup>

The Ninth Circuit reversed the grant of JNOV, but concluded that the trial court had not abused its discretion in granting a new trial.<sup>18</sup>

## B. BACKGROUND

In order to state a claim for attempted monopolization under section 2 of the Sherman Antitrust Act, three basic elements of proof are required: (1) a specific intent to obtain or exercise monopoly power; (2) a dangerous probability of success in realizing the proscribed goal; and, (3) predatory or anticompetitive conduct directed toward accomplishing that goal.<sup>19</sup>

### *Specific Intent*

To establish liability for attempted monopolization, plaintiff must prove that it was defendant's design or purpose to obtain power to control prices or exclude competition from the relevant

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12. 461 F. Supp. at 415.

13. *Id.* at 415.

14. *Id.* at 419.

15. *Id.* at 418.

16. *Id.* at 419.

17. *Id.*

18. 668 F.2d 1014, 1039.

19. See *California Computer Prod., Inc. v. International Business Mach. Corp.*, 613 F.2d 727, 736 (9th Cir. 1979).

market segment.<sup>20</sup> More specifically, what is required is an intent to gain this market power through the use of unfair or predatory means.<sup>21</sup> "The mere intention of [defendant] to exclude competition . . . is insufficient to establish specific intent to monopolize by some illegal means . . . . To conclude otherwise would contravene the very essence of a competitive marketplace which is to prevail against all competitors."<sup>22</sup> Defining specific intent in terms of some "bad" conduct attempts to distinguish between legitimate and predatory conduct,<sup>23</sup> and as such, evidence of that conduct is indispensable.<sup>24</sup> Thus, one who specifically intends to acquire the power to control prices or exclude competitors, but uses a legitimate means such as efficient production, will not be found to have the intent required to satisfy this element.<sup>25</sup>

Direct evidence of a specific intent to unlawfully acquire market power is generally rare, and defendant's subjective state of mind is difficult to prove.<sup>26</sup> For this reason, the specific intent element may be inferred from circumstantial evidence, principally of a defendant's conduct.<sup>27</sup> It has been held that such an inference is proper when the defendant exercises a large degree

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20. See *Janich Bros., Inc. v. American Distilling Co.*, 570 F.2d 848, 853 (9th Cir. 1977), *cert. denied*, 439 U.S. 829 (1978) (defendant distilling company not subject to liability under § 2 for geographical price variations); *Lessig v. Tidewater Oil Co.*, 327 F.2d 459, 474 (9th Cir.), *cert. denied*, 377 U.S. 993 (1964) (oil company that imposed exclusive dealing requirements and "tying" arrangement requiring purchase of that company's accessory products upon its dealers subject to liability under §§ 1 and 2 of the Sherman Antitrust Act).

21. 668 F.2d at 1028.

22. *Blair Foods Inc. v. Ranchers Cotton Oil*, 610 F.2d 665, 670 (9th Cir. 1980) (cotton seed oil manufacturer/distributor not subject to liability even where there is direct evidence of intent, absent some unlawful conduct). *Accord* *Buffalo Courier-Express, Inc. v. Buffalo Evening News, Inc.*, 601 F.2d 48, 54 (2d Cir. 1979); *Hayes v. Solomon*, 597 F.2d 958, 977 (5th Cir. 1979), *cert. denied*, 444 U.S. 1078 (1980).

23. 668 F.2d 1014, 1028.

24. *Id.*

25. *California Computer*, *supra* note 19, at 742; *United States v. Grinnell*, 384 U.S. 563, 571 (1966) (acquisition of monopoly power as a result of a superior product, business acumen, or historical accident, not within the scope of § 2).

26. "[A]vailability of evidence of improper intent is often a function of luck and of the defendant's legal sophistication, not of the underlying reality." R. POSNER, *ANTITRUST LAW — AN ECONOMIC PERSPECTIVE*, 1.89-1.90 (1976). "Ordinarily, specific intent is difficult to prove." *Hallmark Indus. v. Reynolds Metals Co.*, 489 F.2d 8, 12 (9th Cir. 1973) (stringent credit terms demanded by defendant resulting in loss of business to plaintiff motivated by legitimate business concerns, not from a conspiratorial motive; market power not essential to attempt claim).

27. 668 F.2d 1014, 1027.

of control over the market,<sup>28</sup> or in the absence of significant market power, where the conduct is "of a kind clearly threatening to competition or clearly exclusionary."<sup>29</sup> Some cases seem to require an actual violation of section 1 of the Sherman Antitrust Act.<sup>30</sup> The consensus in the Ninth Circuit seems to endorse the "clearly threatening" language as the guide to the sort of conduct required to support the inference of specific intent.<sup>31</sup>

### *Dangerous Probability of Success*

This element originates in the relationship between the separate offenses of monopolization and attempt to monopolize.<sup>32</sup> It has been treated as equivalent to significant market power.<sup>33</sup> Some decisions have held that proof of substantial market power

28. See *Lessig v. Tidewater Oil Co.*, *supra* note 20, at 474.

29. *Janich Bros. v. American Distilling Co.*, 570 F.2d at 854 n.4. *Accord* *Hunt-Wesson Foods, Inc. v. Ragu Foods, Inc.*, 627 F.2d 919, 926 (9th Cir. 1980); *California Computer Prod., Inc. v. International Business Mach. Corp.*, 613 F.2d at 737; *Sherman v. British Leyland Motors, Ltd.*, 601 F.2d 429, 453 n.47 (9th Cir. 1979); *Gough v. Rossmoor Corp.*, 585 F.2d 381, 390 (9th Cir. 1978), *cert. denied*, 440 U.S. 936 (1979). See generally L. SULLIVAN, *HANDBOOK ON THE LAW OF ANTITRUST* 134-40 (1977).

30. *Gough v. Rossmoor Corp.*, 585 F.2d 381, 390 (9th Cir. 1978), *cert. denied*, 440 U.S. 936 (1979) (refusal of community newspaper to print plaintiff's advertisements not per se unreasonable restraint of trade pursuant to Sherman Act); *Sherman v. British Leyland Motors, Ltd.*, 601 F.2d 429, 453 n.47 (9th Cir. 1979) (automobile manufacturers refusal to renew franchise contract with distributor pursuant to that contract not conspiracy or attempt to monopolize under the Sherman Act); *California Computer Prod. v. International Business Mach. Corp.*, 613 F.2d at 737.

31. See *Hunt-Wesson Foods, Inc. v. Ragu Foods, Inc.*, 627 F.2d 919, 925 (9th Cir. 1980) (non-price related activities may support an attempt to monopolize; here, defendant introduced a new product similar to defendant's new product at about the same time, used similar label and name as plaintiff's new product, and introduced price discounts to correspond to introduction of plaintiff's new product); *California Computer Prod. v. International Business Mach. Corp.*, 613 F.2d at 737; *Sherman v. British Leyland Motors, Ltd.*, *supra* note 30, at 453 n.47; *Gough v. Rossmoor Corp.*, *supra* note 30, at 390.

32. See *Swift & Co. v. United States*, 196 U.S. 375 (1905) (per Holmes, J.).

Where acts are not sufficient in themselves to produce a result which the law seeks to prevent—for instance, the monopoly—but require further acts in addition to the mere forces of nature to bring that result to pass, an intent to bring it to pass is necessary in order to produce a dangerous probability that it will happen. But when that intent and the consequent dangerous probability exist, this statute . . . directs itself against that dangerous probability as well as against the complete result.

*Id.* at 396 (citations omitted).

33. *Cornwell Quality Tools Co. v. C.T.S. Co.*, 446 F.2d 825, 832 (9th Cir. 1971) (attempt to monopolize claim requires "specific intent to monopolize, and . . . sufficient market power to come dangerously close to success.") (emphasis added).



may serve as direct evidence of a dangerous probability of success,<sup>34</sup> and may be relevant circumstantial evidence of specific intent.<sup>35</sup> However, no particular degree of control over the market is required to prove a dangerous probability of success.<sup>36</sup>

Absent direct evidence that defendant's intent to monopolize combined with predatory conduct has a dangerous probability of bringing about a proscribed end, this element may be inferred from direct evidence of specific intent plus proof of conduct,<sup>37</sup> or from evidence of conduct alone, provided that it is the sort of conduct from which specific intent could be inferred.<sup>38</sup> As such, a showing of "predatory" or "anticompetitive" conduct that is clearly threatening or clearly in restraint of trade will state the entire claim under section 2 of the Act.<sup>39</sup>

### *Predatory Conduct*

The element of predatory conduct is central to a section 2 attempted monopolization claim. Even where direct evidence of intent to monopolize and dangerous probability of success are present, direct evidence of predatory conduct is indispensable.<sup>40</sup> The conduct which will support the double inference must amount to a substantial claim of restraint of trade or be clearly threatening or exclusionary,<sup>41</sup> and has been described as activity "without legitimate business purpose."<sup>42</sup> More specifically, con-

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34. See *California Computer*, *supra* note 19, at 737; *Sherman*, *supra* note 29, at 453 n.47; *Janich*, *supra* note 20, at 853; *Hallmark*, *supra* note 26, at 12.

35. *Lessig*, *supra* note 20, at 474.

36. *Hallmark*, *supra* note 26, at 12 n.3.

37. *Janich*, *supra* note 20, at 853; *Hallmark*, *supra* note 25, at 12; *Moore v. Jas. H. Matthews & Co.*, 550 F.2d 1207, 1219 (9th Cir. 1977); *Pacific Coast Agricultural Export Ass'n v. Sunkist Growers, Inc.*, 526 F.2d 1196, 1205 (9th Cir. 1975), *cert. denied*, 425 U.S. 959 (1976).

38. *Hunt-Wesson*, *supra* note 31, at 926; *California Computer*, *supra* note 19, at 737; *Sherman*, *supra* note 30, at 453 n.47; *Janich*, *supra* note 20, at 854; *Hallmark*, *supra* note 26, at 12-13.

39. Direct evidence of intent may permit the court to rely upon a broader range of predatory conduct, since the purpose of engaging in such conduct may be more clearly understood as predatory, even though such conduct taken alone would not clearly indicate predation or support an inference of specific intent. 668 F.2d 1014, 1030.

40. *Id.*

41. See *supra* note 39.

42. *Chisholm Bros. Farm Equip. Co. v. International Harvester Co.*, 498 F.2d 1137, 1145 (9th Cir.), *cert. denied*, 419 U.S. 932 (1974) (liquidation of obsolete or used equipment to free up capital and avoid interest costs a legitimate business tactic despite short term loss); *Mount Lebanon Motors, Inc. v. Chrysler Corp.*, 283 F. Supp. 453, 457 (W.D.

duct is predatory if the advantage to the actor is "dependent upon its tendency to discipline or eliminate competition; and thereby enhance the firm's long term ability to reap the benefits of monopoly power."<sup>43</sup>

"Pricing is predatory when a firm forgoes short term profits in order to develop a market position such that the firm can later raise prices and recoup lost profits . . . ." <sup>44</sup> While such a statement captures the spirit of the distinction between valued competitive conduct and proscribed anticompetitive conduct, there are economic tests that are more specific and helpful in determining whether a particular pricing policy is predatory within the meaning of the Act.

Professors Areeda and Turner<sup>45</sup> suggest that a price should not be considered predatory if it is at, or above, the firm's marginal cost of production (MC). Marginal cost is that incremental increase in production costs associated with producing the last unit of production.<sup>46</sup> This is so because short run economic welfare is increased as the price is lowered toward the marginal cost of production, and maximized where price exactly equals MC.<sup>47</sup>

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Pa. 1968), *aff'd on other grounds*, 417 F.2d 622 (3d Cir. 1969) (Chrysler subsidized unprofitable company stores in order to sell cars at a loss; held—not a legitimate business purpose).

43. See Areeda & Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975) [hereinafter cited as Areeda & Turner] (endorsing the use of average variable cost to determine if pricing is predatory).

44. *Janich*, *supra* note 20, at 856; *Hanson v. Shell Oil Co.*, 541 F.2d 1352, 1358 (9th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977) (Independent gasoline distributor sued Shell Oil Company for attempted monopolization. The court affirmed a directed verdict for defendant for lack of proof of below AVC or MC pricing).

45. See Areeda & Turner, *supra* note 43, at 711.

46. *Id.* at 700.

47. F. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 15-19 (1970). *Janich* noted:

In economic analysis, the marginal cost of a good is construed as the cost to society of that good, for its production requires resources which could be used in the production of other goods. The price which people are willing to pay to obtain the good is construed as the social value of the good . . . . As prices decline more people are willing to buy. For a firm to sell more goods, prices must be reduced.

As a matter of short-run economic welfare, it is beneficial to increase production and lower prices so long as price exceeds marginal cost. In other words, so long as there are people who are willing to pay an amount for the good which is above its marginal cost, it is socially beneficial to continue to

As such, any rule of law that would penalize a firm for selling *at* MC would burden the efficient allocation of resources among alternative uses, at the expense of society.<sup>48</sup>

It is when prices are set below MC that they become suspect since, the seller is, by definition, incurring an out-of-pocket "loss" for each additional unit it sells.<sup>49</sup> The firm can continue to do so as long as it has cash reserves to support such losses. Such conduct may have the effect of expelling or excluding competitors from the market for reasons unrelated to their relative efficiencies.<sup>50</sup>

The problem with MC as the standard by which predation is judged is that such a cost figure is not readily calculated from standard business records, and is somewhat difficult to prove with certainty.<sup>51</sup> Areeda and Turner thus suggest the use of average variable cost (AVC) as an evidentiary surrogate for MC.<sup>52</sup> Average variable cost is the total of costs that vary with the level of output, divided (averaged) by the number of units produced.<sup>53</sup> Typical of such costs are material and labor. Fixed costs, on the other hand, are those expenditures that do not vary over the relevant range of production. Capital costs, plant facilities, and machinery are examples of non-varying costs; characteristic of such costs is that they will be incurred even if production is ceased.<sup>54</sup>

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increase production. Of course this will require a continued reduction in prices in order to sell the full amount produced. Thus, social welfare is maximized in the short run . . . where the price of the good equals its marginal cost.

570 F.2d 848, 857 n.9.

48. In *California Computer*, the Ninth Circuit found:

The thrust of this analysis is that price reductions up to the point of marginal cost are consistent with competition on the merits, since in this case only less efficient firms will be disadvantaged, while a firm pricing below marginal cost by definition incurs losses, so that competition on the basis of efficiency in this situation is frustrated.

613 F.2d 727, 743.

49. *Id.*

50. *Janich*, *supra* note 20, at 858.

51. *Hanson*, *supra* note 44, at 1358; Areeda & Turner, *supra* note 43, at 700 n.13, 716-17 & n.42.

52. Areeda & Turner, *supra* note 43, at 717. The authors argue that even where the two cost measures diverge, AVC is the proper measure of cost, since pricing below AVC will so rarely be loss minimizing. *Id.*

53. *Id.* at 700.

54. *Janich*, *supra* note 20, at 858.

For example, a firm must continue to make payments on its machinery even if it is not using it to produce its product.

Average total cost is the sum of all fixed and variable costs divided by the number of units produced.<sup>55</sup> Typically, a firm will desire to sell its product at or above this average total cost (ATC), thereby recovering all costs of production, including a reasonable return in invested capital.

It is against this economic and legal background that the Ninth Circuit panel was called upon to review the grant of JNOV and determine whether plaintiff had effectively demonstrated predatory pricing.

### C. THE COURT'S REASONING

#### *The Court's Approach to Establishing Predation*

The *Inglis* court held that a showing of below AVC pricing could in fact support the double inference of specific intent and dangerous probability, and state a prima facie case of attempted monopolization.<sup>56</sup> It reasoned that although defendant had priced its product below its ATC, this, taken alone, would not prove that the conduct was predatory.<sup>57</sup> Such a finding may, however, lead a jury to conclude that the benefit of such conduct was an improved market position whereby short term losses could be recouped. The court found that the reason below ATC pricing is not presumptively predatory is that such a pricing policy may be an effective means to minimize losses when the firm is experiencing temporary excess capacity or a decrease in the demand for its product.<sup>58</sup> When the firm is recovering a price below its ATC, but above its AVC, it is recovering all of its variable costs associated with continued production, and at least a portion of its fixed costs that would be incurred even if production were to cease.<sup>59</sup> Therefore, it would cost the firm more to shut down than it would to continue production at a "loss" because it would no longer be recovering that portion of fixed costs

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55. Areeda & Turner, *supra* note 43, at 700.

56. 668 F.2d 1014, 1041.

57. *Id.* at 1035.

58. *Id.* at 1035 n.32.

59. *Id.* at 1035.

that are, by definition, incurred even if it shuts down.<sup>60</sup>

The court did not suggest that a showing of prices below ATC will conclusively determine that the conduct was predatory.<sup>61</sup> Predation will be found when "the justification of these prices is based, not on their effectiveness in minimizing losses, but on their tendency to eliminate rivals and create a market structure enabling the seller to recoup his losses."<sup>62</sup>

However, the *Inglis* court found that prices below AVC do not warrant the benefit of the doubt extended to prices above AVC, because the former are less likely to be motivated by some legitimate business purpose.<sup>63</sup> At this price level, not only is the firm *not* recovering a portion of its fixed costs, but it is also losing a portion of the additional cost associated with continued production. The court reasoned that if the firm is forced by the market to accept this price for its product, "[t]he economic case for discontinuance of production is strong."<sup>64</sup> If the firm remains in production at a loss under these circumstances, it is highly probable that doing so is part of a scheme to eventually reap ill-gotten gains; therefore, the benefit of the doubt will go to plaintiff rather than defendant.

After *Inglis*, a showing of prices below AVC will establish a *prima facie* case of predatory pricing, and the burden will shift to defendant to prove that the prices were justified without regard to any anticipated destructive effect they might have on competitors.<sup>65</sup> Moreover, the court emphasized that its decision was aimed not merely at endorsing the below AVC standard as an acceptable means of proof of predation, but also at "eschew[ing] dogmatic adherence to a particular, rigid test and to fashion broad and flexible objective standards concerned with accurately evaluating the purposes of business behavior."<sup>66</sup> The ultimate standard remains the same: did the justification for the pricing policy depend upon anticipated disruption and exclusion

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60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.* at 1036.

66. *Id.* at 1031 n.18.

of competitors such that defendant could recoup short term losses from its enhanced market position.<sup>67</sup>

### *Determination of Fixed and Variable Costs*

The *Inglis* court held that the cost categories previously enumerated by the Ninth Circuit<sup>68</sup> were “illustrative . . . not prescriptive,”<sup>69</sup> and that determination of which costs are fixed and which are variable will change from case to case.<sup>70</sup> As such, the categorization of fixed and variable costs, and the determination of AVC, must be made on an individual case basis.

The first step in such a determination is to compare the “cost of production before and after the price reduction. The variable cost would . . . be those expenses that increased as a result of the output expansion attributable to the price reduction.”<sup>71</sup> Utilizing this approach, the court avoided the problems of misclassifying as fixed costs those that are in fact variable, or as variable costs those which are actually fixed, during the relevant time period.<sup>72</sup>

The court then reemphasized that these cost categories are not an end in themselves, but rather “solely for the purpose of . . . answering the ultimate question: Did the justification for the defendant’s price depend upon its anticipated destructive effect on competition or was the price justified as a reasonably calculated means of . . . minimizing losses, or achieving some other legitimate business end?”<sup>73</sup> The court therefore held that the determination of fixed and variable costs, hence, the determination of AVC, is a matter for the jury with appropriate instructions.<sup>74</sup>

### *The Dissents*

In addition to the dissent from the majority’s decision by Judge Peck, Judge Wallace filed a dissent from the decision to

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67. *Id.* at 1038.

68. *Janich*, *supra* note 20, at 858.

69. 668 F.2d at 1037.

70. *Id.* at 1038.

71. *Id.* at 1037.

72. *Id.*

73. *Id.* at 1038.

74. *Id.*

deny rehearing en banc. To some extent, their contentions and objections overlap, and where applicable, will be discussed simultaneously.

First, both dissenting judges felt that allowing the double inference of specific intent and dangerous probability was a departure from the rule that these inferences are proper only if the conduct was clearly threatening or exclusionary.<sup>75</sup>

Second, both judges attacked the majority's depiction of the relative roles of judge and jury in attempted monopolization litigation. Judge Peck stated that the concept of variable cost is difficult enough for experts and legal specialists to define, and may simply confuse a jury of lay persons.<sup>76</sup> Leaving this determination to the jury with appropriate instructions would open the way for jurors to "infer pricing below average variable costs from the jurors' preliminary view of the predatory nature of the defendant's conduct, instead of vice-versa."<sup>77</sup> Judge Wallace objected to allowing the jury to determine AVC for this reason, but noted that because this is now a matter for the jury, trial judges will be prevented from ever taking a case from the jury and disposing of unmeritorious suits in the early stages of trial.<sup>78</sup>

Judge Wallace's dissent stated his more basic disagreement with the majority. His reading of recent Ninth Circuit precedent was that a showing of below MC or AVC pricing was a prerequisite to a predatory pricing claim.<sup>79</sup> His dissent observed that the majority's opinion, in recognizing the broad subjective rule that prices will be predatory depending upon the anticipated benefit, abandoned the MC rule and substituted in its place "a subjective and amorphous test involving a shifting burden of proof which leaves to the jury . . . decisional authority on attempted monopolization claims."<sup>80</sup> This leaves open the possibility that plaintiffs may state a prima facie case without even alleging below MC or AVC prices. Although Judge Wallace recognized the validity of exceptions to the requirement that prices be set be-

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75. *Id.* at 1059 (Peck, J., dissenting); *id.* at 1060 (Wallace, J., dissenting).

76. *Id.* at 1059.

77. *Id.*

78. *Id.* at 1064.

79. *Id.* at 1062.

80. *Id.* at 1060.

low MC or AVC,<sup>81</sup> he reasoned that the majority's decision went too far, and endorsing the MC rule and its exceptions would have provided a more consistent and workable approach.<sup>82</sup>

#### D. ANALYSIS

Under *Inglis*, the burden of proof shifts to the defendant upon plaintiff's showing that defendant engaged in below AVC or MC pricing. Perhaps more significantly, plaintiffs may more often have their cases decided by the jury in light of the recognition that prices above AVC, but below ATC, may be predatory. This is an apparent expansion of the type of conduct that will support a claim of attempted monopolization. Notwithstanding the dissents' claim that the holding is a departure from precedent, it may be justified as reconcilable with precedent, and a wise policy choice.

All of the cases relied upon by the dissents as *requiring* a showing of below AVC or MC contain qualifying language,<sup>83</sup> or can be distinguished on their facts.<sup>84</sup> Moreover, it had previously

81. *Id.* at 1062.

82. *Id.* at 1063. Of particular concern to Judge Wallace was the recent decision in *Murphy Tugboat Co. v. Shipowners & Merchants Towboat Co.*, 467 F. Supp. 841 (N.D. Cal. 1979). There, a JNOV was entered against plaintiff for failure to allege prices below AVC or MC. Defendant provided ship assisting services and piloting by an agreement with his employees; defendant provided this package of services for less than they otherwise might have been provided. It was apparent that defendant's prices exceeded average variable cost, exceeded the prices charged by plaintiff, and even produced a net profit. 467 F. Supp. at 861 n.16.

83. *See Hanson*, *supra* note 44, at 1358-59. The court recognized below MC or AVC pricing as a prerequisite to a prima facie case of predation, but also recognized two exceptions to the rule: some prices below MC may have a legitimate business reason, and prices above AVC or MC could be predatory if they were below its short run profit maximizing price and there were significant barriers to entry of the market. *See also Janich*, *supra* note 20, at 857 ("an across-the-board price set at or above marginal cost should not ordinarily form the basis for an antitrust violation.") (emphasis added); *California Computer*, *supra* note 19, at 740 n.19 (plaintiff failed to prove prices below MC or AVC, "which ordinarily is required to show predatory pricing.").

84. *Murphy Tugboat*, *supra* note 82. The majority read that case as alleging "nothing more than the fact that the agreement between defendant and its employees left defendant's prices lower than they otherwise might have been. The holding that such an allegation cannot establish an unreasonable restraint of trade . . . certainly does not foreclose the inquiry which we have undertaken here." 668 F.2d at 1034 n.27. That inquiry, specifically, was whether a case of predatory pricing "can ever be established without proof of pricing below marginal or average variable cost." *Id.*

In *Pierce Packing Co. v. John Morrell & Co.*, 633 F.2d 1362 (9th Cir. 1980), plaintiff was precluded from raising the question of *above* AVC or MC prices as predatory when they are below short term profit maximization and significant barriers to entry exist, due



been recognized that the original MC rule would require refinement as future cases arose.<sup>85</sup>

Even were the *Inglis* decision an actual departure from precedent, it may be justified from an antitrust policy perspective. The dissents feared that complete authority would be vested in the jury, and trial judges would be precluded from taking the decision from the jury. According to Judge Wallace, this is unsound policy for it will reduce the ability of trial judges to dismiss unmeritorious suits in times of "burgeoning anti-trust litigation"<sup>86</sup> and consequently burden the district courts. While more cases may get to the jury because conduct that would support a claim now includes all pricing below ATC, it may be that these cases will be offset by those taken from the jury as a result of the shifting burden of proof.

Another policy consideration that lends support to the rule announced by the majority is the nature of capital intensive antitrust defendants such as larger steel or auto manufacturers. In these and other areas, variable cost may represent a relatively small percentage of ATC, making the possibility that any given manufacturer will price below its AVC very slight. Plaintiffs engaged in this type of suit will be less likely to incur a directed verdict or JNOV, but will not be afforded the benefit of a shift in the burden of proof, and will be left to other means to show that the benefit of the conduct was dependent upon an enhanced market position and recoupment of short term losses.

The majority also held that the determination of fixed and variable costs are a matter for the jury despite the recommendation by Areeda and Turner<sup>87</sup> that arbitrary cost categories be maintained. Although this rule sacrifices to some extent the ease of administration of the AVC rule, it is consistent with the majority's attempt to "eschew dogmatic adherence to a particular, rigid test."<sup>88</sup>

Some increases in production may require a commensurate

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to its failure to raise the objection to the jury instructions at trial. *Id.* at 1033 n.27.

85. *California Computer*, *supra* note 19, at 743.

86. *Inglis*, 668 F.2d at 1063.

87. 3 P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 715c, at 173-74 (1978).

88. 668 F.2d at 1031 n.18.

that a complaint alleging that the state bar committed an anti-trust violation in its grading of a bar examination stated a cause of action.

Plaintiff took the Arizona bar examination in February 1974. Two months later he was informed that he had failed.<sup>2</sup> Plaintiff then filed an antitrust action against the State Bar of Arizona, the State Bar Committee on Examinations and Admissions, and the members of the Committee, alleging that the Bar illegally restricted competition among attorneys practicing in Arizona by limiting the number of attorneys who receive a passing grade on the bar exam.

Plaintiff's specific complaint was that the Bar did not grade on the indicated zero to one hundred scale, but instead used a "raw score" system. Plaintiff alleged that the Bar determined the number of attorneys to be admitted, then set the passing score accordingly. He contended that this method of grading resulted in the arbitrary exclusion of himself and others from the practice of law and thus unlawfully restrained trade by reducing the number of competing attorneys. On appeal from a dismissal, the Ninth Circuit reversed the district court's holding that the Bar enjoyed absolute immunity under antitrust laws<sup>3</sup> and that jurisdictional requirements were unsatisfied.<sup>4</sup>

The Ninth Circuit's decision not to immunize the state bar from the antitrust laws symbolizes its increasing willingness to apply the Sherman Antitrust Act whenever concerted conduct restrains trade, regardless of the identity of the defendant or the laudable purposes asserted. This note will explore the basis for the court's decision and discuss its significance in terms of what

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2. Plaintiff's petitions for review by the Arizona Supreme Court and for certiorari by the Supreme Court were denied. *Ronwin v. Committee on Examinations & Admissions*, 419 U.S. 967 (1974). Plaintiff was denied permission to retake the bar examination because the Arizona State Bar found that he was "mentally and physically unable to engage in active and continuous practice of law." The finding was affirmed by the Arizona Supreme Court in *Application of Ronwin*, 113 Ariz. 357, 555 P.2d 315 (1976), *cert. denied*, 430 U.S. 907 (1977).

3. The amended opinion reversed the decision to dismiss as to the individual committee members. Because no specific allegations of wrongdoing were made against the Bar, the dismissal for failure to state a claim was proper as to the Bar. 686 F.2d at 694 n.1.

4. Plaintiff also moved for recusal of the judge. Denial of that motion was affirmed on appeal. 686 F.2d at 700-01.

can be justified as a necessary regulation of the legal profession.

## B. BACKGROUND

### *The State Action Exemption*

The advent of industrialization, and the vast accumulation of wealth that accompanied it, necessitated statutory law to both preserve the tradition of free economic competition and ensure equality of opportunity to actual and potential competitors.<sup>5</sup> The Sherman Antitrust Act<sup>6</sup> was intended to stimulate competition by prohibiting unreasonable restraints of trade and monopolization.<sup>7</sup> One of the few judicially created exemptions to the Sherman Act is the "state action" exemption, which absolves the sovereign actions of a state or its agencies from antitrust liability. Although the principle underlying this exemption emerged shortly after passage of the Act,<sup>8</sup> the state action immunity doctrine was not enunciated until 1943 in *Parker v. Brown*.<sup>9</sup> In *Parker*, the Supreme Court held that a state statute authorizing a marketing program which allegedly restrained competition was not within the intended scope of the Sherman Act.<sup>10</sup> Examining the legislative history of the Sherman Act, the Court concluded that the Act prohibited "business combinations" but not official acts of government undertaken by a state in its sovereign capacity.<sup>11</sup>

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5. The monopolistic tendencies of "trusts" and "combinations" of business and of capital organized and directed "to control the market by suppression of competition in the marketing of goods and services became a matter of public concern." *Apex Hosiery v. Leader*, 310 U.S. 469, 492-93 (1940).

6. Sherman Antitrust Act § 1, 15 U.S.C. § 1 (1976) provides in part: "Every contract, combination in the form of a trust or otherwise, or conspiracy in the restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal . . . ."

7. The end sought by the Act was the prevention of restraints on free competition in business and commercial transactions which tend to restrict production, raise prices or otherwise control the market to the detriment of purchasers or consumers of goods and services, all of which had come to be regarded as a special form of public injury. 310 U.S. at 493.

8. The principle was suggested but not fully explored in *Lowenstein v. Evan*, 69 F. 908 (4th Cir. 1885).

9. 317 U.S. 341 (1943).

10. In *Parker*, a raisin producer-packer challenged a state program designed to restrict competition among growers and thereby stabilize prices in the raisin market. The Court held that the state "as sovereign, imposed the restraint as an act of government which the Sherman Act did not undertake to prohibit." *Id.* at 352.

11. *Id.* at 350-51.

Thirty two years following *Parker*, the potential reach of the state action doctrine was narrowed in *Goldfarb v. Virginia State Bar*.<sup>12</sup> The Court held that action merely authorized by the state was outside the state action exemption.<sup>13</sup> The state, acting in its sovereign capacity, must *compel* the engaging in anticompetitive activities to warrant application of the *Parker* exemption.<sup>14</sup>

The *Goldfarb* compulsion requirement was affirmed in *Bates v. State Bar of Arizona*.<sup>15</sup> The Court deemed it significant to consider whether the particular state policy was clearly and affirmatively expressed and whether the state was active in supervising the policy's implementation.<sup>16</sup>

The Court in *City of Lafayette v. Louisiana Power & Light Co.*<sup>17</sup> and *California Liquor Dealers v. Midcal Aluminum*<sup>18</sup> announced a definitive two step test to establish *Parker* state action immunity. First, anticompetitive activities are exempt from antitrust laws when they are "clearly articulated and affirmatively expressed as state policy." Second, the functioning of the policy must be actively supervised by the state itself.<sup>19</sup> *Midcal*

12. 421 U.S. 773 (1975). In *Goldfarb*, plaintiffs contracting to buy a home were required to obtain title insurance, which necessitated a title examination that could be legally performed only by a member of the Virginia State Bar. Plaintiffs could not find a lawyer willing to charge a fee lower than the schedule dictated. *Id.* at 776. In a suit alleging price fixing in violation of the Sherman Act, the Court held that the Bar was not immune from antitrust laws and that the minimum fee schedule illegally restrained competition among attorneys practicing in the state. *Id.* at 791-93.

13. The defendant State Bar maintained that its actions were "prompted" by a state agency. The Court found no state law requiring defendant's activities and ruled that a mere "prompting" was insufficient to satisfy exemption under the *Parker* doctrine. 421 U.S. at 790-91.

14. *Id.* at 791.

15. 433 U.S. 350 (1977).

16. *Id.* at 362. The *Bates* Court held that a state supreme court disciplinary rule prohibiting advertisements by attorneys reflected a clear articulation of the state's policy with regard to professional behavior sufficient to compel compliance. Moreover, the state supervision was active as the rule was subject to pointed reexamination by the policy maker, the Arizona Supreme Court. *Id.* at 359-63.

17. 435 U.S. 389 (1978).

18. 445 U.S. 97 (1980).

19. *Midcal*, 435 U.S. at 410; *Lafayette*, 445 U.S. at 105. The *Midcal* Court held that California's resale price maintenance and price posting statutes for the wholesale wine trade were not shielded by the state action exemption. As there existed no special antitrust immunity, the wine pricing system, "designed to maintain prices . . . and to prevent competition among those who traded in [competing goods]" violated the Sherman Act. 445 U.S. at 102-03, quoting *Doctor Miles Medical Co. v. John D. Park & Sons Co.*,

emphasized that the national policy in favor of competition mandates that *both* requirements of the test be met.<sup>20</sup>

Both *Midcal* and *Lafayette* noted that “antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms.”<sup>21</sup> *Midcal* urged recognition of the importance of the Sherman Act’s pro-competition policy<sup>22</sup> as representing the fundamental principle governing commerce in the country.<sup>23</sup>

### *The Learned Profession Exemption*

Another exemption emerged from a judicial recognition of a limited exclusion of “learned professions” from the scope of antitrust laws.<sup>24</sup> The legislative history of the Sherman Act<sup>25</sup> contains no reference to the Act’s applicability to those areas likely to be incompatible with the “trade or commerce” limitation, such as law, medicine or other learned professions.<sup>26</sup>

In *Goldfarb* the Supreme Court denied that the learned professions are entitled to an absolute exemption from antitrust laws but indicated the possibility that they might receive some

220 U.S. 373, 407 (1911).

20. In *Midcal*, the state policy was clear in its purpose to maintain prices. But the state did not establish or regulate the price schedules, nor did it review their reasonableness. The Court stated that the “national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement.” 445 U.S. at 106.

21. 445 U.S. at 110; 435 U.S. at 398 n.16, quoting *United States v. Topco Ass’n, Inc.* 405 U.S. 596, 610 (1972).

22. 445 U.S. at 111.

23. 435 U.S. at 398.

24. This exclusion is based upon the special form of regulation imposed upon the professions by the states and the incompatibility of certain competitive practices with such professional regulation. *Goldfarb*, 421 U.S. at 779-80.

25. See *Apex Hosiery v. Leader*, 310 U.S. 469, 489 (1940); *Standard Oil v. United States*, 221 U.S. 1, 50 (1911).

26. However, it is generally agreed that Congress used the language “trade or commerce” for a specific reason unrelated to intending an autonomous restriction on the Act’s purview. *Apex Hosiery*, 310 U.S. at 490. The Supreme Court has stated that “‘trade or commerce’ covers any occupation, employment or business . . . carried on for the purpose of profit or gain.” *United States v. National Ass’n of Real Estate Boards*, 339 U.S. 485, 490-91 (1950).

special treatment.<sup>27</sup> The Court did not articulate the nature of this special treatment but did emphasize the interests of the states in regulating such professions.<sup>28</sup> Consequently, lower courts faced with formulating a more precise definition of the learned professions exemption have often relied on the related state action exemption.<sup>29</sup>

### *Jurisdictional Requirement*

The Sherman Act deals in terms of restraints of trade or commerce "among the several states."<sup>30</sup> If there is no restraint of interstate commerce, there is no violation of the Sherman Act. The jurisdictional requirement of the Sherman Act may be satisfied by proving that (1) the activities in question are actually "in interstate commerce" or (2) if the activities are local in nature, they substantially "affect" interstate commerce.<sup>31</sup>

The leading Supreme Court decision applying the "in commerce" test is *Goldfarb*.<sup>32</sup> There, the Court approached the jurisdictional issue in a practical sense, stressing that legal services were coincidental with commercial intercourse and in terms of

27. In an oft quoted footnote, the Court stated that:

The fact that a restraint operates upon a profession as distinguished from a business is, of course, relevant in determining whether that particular restraint violates the Sherman Act. It would be unrealistic to view the practice of professions as interchangeable with other business activities, and automatically to apply to the professions antitrust concepts which originated in other areas. The public service aspect, and other features of the professions, may require that a particular practice, which could properly be viewed as a violation of the Sherman Act in another context, be treated differently. We intimate no view on any other situation than the one with which we are confronted today.

421 U.S. at 788-89 n.17.

28. 421 U.S. at 792-93.

29. See *State of Arizona v. Maricopa County Medical Society*, 643 F.2d 553, 556 (9th Cir. 1980); *Feminist Woman's Health Center, Inc. v. Mohammad*, 586 F.2d 530 (5th Cir. 1978), cert. denied, 444 U.S. 924 (1979). See generally Bauer, *Professional Activities and the Antitrust Laws*, 50 NOTRE DAME LAW. 570 (1975).

30. See *supra* note 6.

31. *McLain v. Real Estate Board Inc.*, 444 U.S. 232, 241 (1980).

32. 421 U.S. 773 (1975). In *Goldfarb*, the Court found jurisdiction, noting that in terms of restraining competition and harming consumers, the price fixing of title examination searches was unusually damaging. A title examination was indispensable in the process of financing a realty purchase, and because only a licensed attorney could legally examine title, consumers could not turn to alternative sources. *Id.* at 782.

commercial continuity, they were essential.<sup>33</sup> The Court therefore concluded that because lawyers play an integral role in commercial intercourse, anticompetitive activities by lawyers may exert a restraint on commerce.<sup>34</sup>

In *McLain v. Real Estate Board Inc.*,<sup>35</sup> the Court addressed the alternative “effect on commerce” test. To invoke jurisdiction under this test the existence of a demonstrable nexus between the defendant’s activity and the restraint of interstate commerce must be established.<sup>36</sup> It is the unreasonableness of the restraint and its effect on interstate commerce and not the amount of commerce which establishes the causal connection necessary to assert an antitrust violation.<sup>37</sup> *McLain* also adopted a pragmatic approach in holding that “as a matter of practical economics” the challenged activity had a substantial effect on the interstate commerce involved.<sup>38</sup>

### C. THE COURT’S REASONING

#### 1. *The Majority*

##### *Antitrust Immunity*

The Ninth Circuit in *Ronwin* relied on the two step test enunciated in *Midcal* to conclude that the challenged grading procedure failed to warrant antitrust immunity. First, like the bar association in *Goldfarb*, the Arizona Bar had no statute or Supreme Court rule that required the grading procedure. Second, the general delegation of duty by the Arizona Supreme Court to the Bar for examining applicants to determine whether they had the “necessary qualifications” did not compel the Bar to implement its grading procedure.<sup>39</sup>

As the Court stated in *Goldfarb*, the threshold inquiry in determining if an anticompetitive activity is immune from antitrust laws is whether the activity is required by the state acting

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33. *Id.* at 783-84.

34. *Id.* at 785.

35. 444 U.S. 232 (1980).

36. *Id.* at 246.

37. *United States v. Yellow Cab Co.*, 332 U.S. 218, 225 (1947).

38. 444 U.S. at 246. In *McLain*, a price fixing conspiracy between real estate brokers was found to affect both the frequency and terms of residential sales transactions because of an inextricable dependency on interstate financing. *Id.*

39. 686 F.2d 692, 696.

as a sovereign.<sup>40</sup> Thus, the *Ronwin* court focused on whether the state, acting through the Arizona Supreme Court, had an active hand in formulating and regulating the grading procedure. Finding *Bates* distinguishable on its facts from those in *Ronwin*, the court found that the state bar acted independently and without any active supervision by the state policy maker, the Arizona Supreme Court. There was no state policy, clearly articulated or otherwise, stipulating how bar exams were to be graded.<sup>41</sup>

The court further found that its conclusion was not inconsistent with the prior Ninth Circuit decisions in *Hackin v. Lockwood*,<sup>42</sup> *Chaney v. State Bar of California*,<sup>43</sup> and *Brown v. Board of Bar Examiners*.<sup>44</sup> While all three cases involved challenges to bar grading procedures, such claims were based on constitutional, not antitrust principles. *Hackin* held that the Arizona state bar was an improper defendant because it was not responsible for promulgating or changing the rules governing admission to practice law.<sup>45</sup> In *Ronwin* however, there existed *no* rule governing bar grading procedure.

In *Brown*, a challenge to a requirement that bar applicants graduate from accredited law schools, the court held that no subject matter jurisdiction existed.<sup>46</sup> But the jurisdictional limitation stemmed from the express language of the constitutional provision relied upon, not because plaintiff was challenging a bar admission policy. The majority in *Ronwin* relied on the *Goldfarb* decision, that a minimum fee schedule enforced by the state bar violates section one of the Sherman Act, to conclude that plain-

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40. 421 U.S. at 790.

41. *Id.* at 696.

42. 361 F.2d 499 (9th Cir. 1966).

43. 386 F.2d 962 (9th Cir. 1967).

44. 623 F.2d 605 (9th Cir. 1980).

45. 361 F.2d at 500-01. Plaintiff, a graduate of an unaccredited law school could not take the bar because a state rule allowed only graduates of accredited law schools to take the exam. *Id.* at 500. Plaintiff's suit against the State Bar of Arizona was held improper because the accreditation rule was directly promulgated and enforced by the state supreme court. *Id.* at 500-01.

46. In *Brown*, the district court granted a preliminary injunction ordering defendants to allow plaintiff, a graduate of an unaccredited law school, to take the bar exam despite a Nevada Supreme Court rule requiring applicants to be graduates of accredited law schools. The court of appeals held that plaintiff failed to meet jurisdictional requirements as she presented a complaint of individual constitutional deprivation and sought only individual redress. An attack on the overall administration of the accreditation rule would have been cognizable in district court. 623 F.2d at 610.



tiff's complaint established jurisdiction under federal antitrust laws.<sup>47</sup>

In *Chaney*, the Ninth Circuit stated that the requirement that bar applicants pass an examination in essay form did not involve any issue of constitutional substance.<sup>48</sup> The *Ronwin* majority found no inconsistency between its holding and that in *Chaney* because *Chaney* clearly concerned the finality and nature of the plaintiffs's claim and bore no relevance to the issues of state action or proper parties.<sup>49</sup>

The majority then found that assuming the Bar was actively supervised by the Arizona Supreme Court, that factor alone would be insufficient to justify applying the state action exemption.<sup>50</sup> The national policy in favor of competition should not be thwarted absent a clear articulation by the Arizona Supreme Court that it had adopted a policy of limiting the number of attorneys admitted each year to the Arizona Bar.<sup>51</sup> Without such a declaration of regulatory purpose, the court held that plaintiff must be given an opportunity to prove that the Bar policy was designed to limit the number of attorneys as opposed to insuring that attorneys have the "necessary qualifications" to practice law.<sup>52</sup>

### *Jurisdiction Under the Sherman Act*

Having concluded that the Bar was not immune from anti-trust action, the majority reasoned that on remand, plaintiff might meet the jurisdictional requirements by establishing that the grading procedure evidenced a demonstrable nexus with restraint of interstate commerce.<sup>53</sup> Plaintiff argued that because

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47. 686 F.2d at 698 n.6.

48. In *Chaney*, plaintiff, a law school graduate, twice failed the California bar exam. Although he was eligible to take the exam a third time, he chose to sue the state bar alleging that its use of hypothetical fact problems requiring essay answers deprived him of his constitutional rights. 386 F.2d at 963. In affirming dismissal of the complaint, the court stated that the existence of the admission qualification had a rational connection with the capacity to practice law, for it inherently involved a primary basis of general legal service. *Id.* at 964.

49. 686 F.2d at 698 n.6.

50. *Cf.* *California Liquor Dealers v. Midcal Aluminum*, 445 U.S. at 105.

51. 686 F.2d at 698.

52. *Id.* at 698.

53. *Id.* at 699.

the services of Arizona lawyers were required by people living outside Arizona, denial of admission to the bar was not a matter confined to state lines. Because the Bar's grading procedure artificially limited the number of lawyers admitted to practice in Arizona, the price paid by out-of-state clients for legal services performed by Arizona lawyers was higher than if the number of lawyers was not restricted.<sup>54</sup>

The majority concluded that plaintiff could establish jurisdiction under either the "in commerce" or the "effect on commerce" test. Although plaintiff did not specifically state which interstate transactions require legal services nor indicate how substantial an effect on interstate commerce results from limiting the number of lawyers, the majority predicted that if he could conceivably establish that legal services constitute an indispensable and inseparable component of certain interstate transactions, the "in commerce" test could be met.<sup>55</sup> Similarly, plaintiff did not allege that there were an appreciable number of interstate transactions taking place in Arizona or that limiting the number of lawyers had a substantial effect on the number and size of the transactions. However, the majority stated that if he could substantiate the impact of the grading procedure, jurisdiction could be established under the "effect on commerce" test.<sup>56</sup>

## 2. *The Dissent*

The dissent contended that the precedents established in *Hackin*, *Brown* and *Chaney* mandated that the proper defendant in an action challenging a state bar's grading procedures is the state supreme court. Because plaintiff complained of the failure of the supreme court to admit him, and admission to the bar is within the province of the supreme court, not the state bar, the dissent concluded that the supreme court was the proper defendant.<sup>57</sup>

Furthermore, the dissent accused the majority of creating an antitrust cause of action where the only appropriate chal-

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54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.* at 702.

lenge was a constitutional one. The dissent interpreted *Brown* as holding that because bar admission procedures are purely a matter of local concern, the only constraints on the state's exclusive jurisdiction are constitutional in nature.<sup>58</sup>

The dissent also charged that the majority disregarded the tradition of deference to state discretion in admission procedures. Because such deference never existed toward the state's ability to regulate fees, the majority's reliance on *Goldfarb* was misplaced. The majority applied erroneous standards to determine whether a state agency was exempt from antitrust laws. The dissent regarded the regulation of bar admissions as an integral governmental function.<sup>59</sup> For that reason, the Arizona Supreme Court oversees bar admissions and delegates authority to examine the fitness and competence of bar applicants.<sup>60</sup> Therefore, the dissent concluded that the state supreme court had merely entrusted the grading of examinations to the bar. The dissent found that the court incorrectly distinguished *Bates* by concluding that the state bar, as opposed to the supreme court, was committing the alleged anticompetitive act, and that there was no clearly articulated policy regarding grading procedures.

The dissent attacked the first characterization by asserting that the Ninth Circuit had thrice reiterated<sup>61</sup> that the state supreme court is the proper party when grading procedures are challenged.<sup>62</sup> The second characterization was unfounded as the two step *Midcal* test was met. The Arizona Supreme Court authorized the Bar to grade examinations, but the Bar acted as a mere instrumentality of the court. The state supreme court itself ultimately approved every bar application. By approving the challenged procedures of accepting recommendations for admissions based on those procedures, the state impliedly validated the Bar's grading system.<sup>63</sup> This implied validation rendered *Bates* rather than *Goldfarb* more directly analogous to *Ronwin*.<sup>64</sup>

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58. *Id.* at 703.

59. See *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. at 424.

60. The dissent maintained that if the state's agents abuse their authority, the proper remedy is not an antitrust but a constitutional attack. 686 F.2d at 703-04.

61. See *Hackin*, *supra* note 42; *Chaney*, *supra* note 43; *Brown*, *supra* note 44.

62. 686 F.2d at 703.

63. *Id.* at 707.

64. In *Goldfarb*, the alleged anticompetitive activity was the promulgation of a fee schedule by the state bar. The Court found the state bar was not immune because this

In *Ronwin*, the challenged activity was the grading of examinations on a curve. The alleged anticompetitive result of artificially limiting the number of attorneys was to monopolize. The dissent concluded that the majority erroneously subjected the state bar to antitrust laws by focusing on the alleged result and ignoring the immunity issue decided in *Bates*.<sup>65</sup>

The dissent contended that the Supreme Court's decision in *Community Communications Co., Inc. v. City of Boulder*,<sup>66</sup> although involving an action by a city, supported conferring antitrust immunity to the Arizona State Bar. In *City of Boulder*, the Court held that the state's "mere neutrality" toward municipal actions was not a clear articulation of state policy. The actions of the municipalities were not "comprehended within the powers granted," since the term "granted" necessarily implies an affirmative addressing of the subject by the state.<sup>67</sup> In no way had the Arizona Supreme Court taken a position of "neutrality" allowing the Bar to do as it pleased. To the contrary, it had affirmatively addressed the grading of exams by granting to the Bar the power to examine applicants and recommend admission of those qualified.<sup>68</sup>

As to the issue of jurisdiction, the dissent attacked the fact that plaintiff's complaint neither identified a relevant market nor alleged a substantial impact on such a market.<sup>69</sup> The dissent contended that as there was no possibility that he might prove substantial impact, plaintiff did not warrant an opportunity to demonstrate the elements of his case.<sup>70</sup>

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illegal price fixing was expressly disclaimed by the state supreme court. 421 U.S. at 781. *Bates*, on the other hand, concerned a prohibition against advertising. The alleged result was to monopolize. The defendant bar association was held to be immune because the state supreme court itself promulgated the rule. 433 U.S. at 362.

65. 686 F.2d at 707.

66. 102 S. Ct. 835 (1982).

67. *Id.* at 843 (emphasis in original).

68. *Ronwin*, 686 F.2d at 707.

69. *Id.* at 708.

70. The dissent concluded that on the facts of the case, plaintiff could not establish that the curved grading system had more than a trivial impact on interstate commerce. The ability of applicants to reapply permits them to remain within the potential stream of commerce. *Id.*

## D. SIGNIFICANCE

The Supreme Court in *Goldfarb* stated that the threshold inquiry in determining if anticompetitive activity is state action, outside the purview of the Sherman Act, is whether that activity is required by the state acting as sovereign. But this is only the first, not the final step of inquiry.<sup>71</sup> The very word "threshold" suggests that something more than a sovereign command may be necessary to invoke state action immunity.

*Goldfarb* acknowledged that the interest of the state in regulating lawyers is especially great since lawyers are essential to the primary governmental function of administering justice and have historically been "officers of the Courts."<sup>72</sup> Restricting the practice of law to persons licensed by the state is both a legitimate and necessary exercise of the state's inherent regulatory power.<sup>73</sup> The regulatory purpose is to further the primary duty for which the profession exists: to serve the public.<sup>74</sup> By both insuring that persons rendering legal services are qualified to do so and imposing upon lawyers a degree of accountability to the state, the regulatory purpose is served.<sup>75</sup>

But in order for a particular regulation to survive a Sherman Act challenge, it must contribute directly to improving service to the public. That which only suppresses competition between practitioners will fail the challenge. This interpretation permits a harmonization of the ends that both the profession and the Sherman Act serve.

The dissent correctly reiterated this principle but failed to recognize that the issue in *Ronwin* was how the state action exemption should be applied to the regulation of admission into the legal profession. The significance of the *Ronwin* decision is

71. See *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. at 425.

72. *Goldfarb v. Virginia State Bar*, 421 U.S. at 792. The *Goldfarb* Court found that states have a compelling interest in the practice of professions within their boundaries, and as part of their power to protect public health, safety and other valid interests, they have broad power to establish standards for licensing practitioners and regulating the practice of professions. *Id.*

73. *Surety Title Ins. Agency, Inc., v. Virginia State Bar*, 431 F. Supp. 298, 307 (E.D. Virg. 1977), *vacated*, 571 F.2d 205 (1978).

74. *Boddicker v. Arizona State Dental Ass'n*, 549 F.2d 626, 632 (9th Cir.), *cert. denied*, 434 U.S. 825 (1977).

75. 549 F.2d at 632.

the court's focus on the relationship between the anticompetitive activity and the regulatory purpose to be met. This focus may well be used to confront the "special treatment" dilemma left by *Goldfarb*<sup>76</sup> and to implement a more realistic approach to the legality of professional regulation.

The Supreme Court has stated that a state may not immunize anticompetitive activity from antitrust laws merely by authorizing it.<sup>77</sup> The *Ronwin* majority accordingly questioned whether a subsequent Arizona Supreme Court rule requiring a "proposed formula" for grading bar examinations would necessarily afford state action immunity.<sup>78</sup>

Under *Goldfarb*, the relevant inquiry would be whether there is any "public service aspect" or any "other feature" of the legal profession which justifies anticompetitive activity.<sup>79</sup> The *Ronwin* court however, by emphasizing the national policy in favor of competition, subjected professional regulation to the same legal analysis as similar conduct by those engaged in purely commercial enterprises.<sup>80</sup> The court focused on the nexus between the grading procedure and the professional duty of public service. Recognizing that this link was tenuous, the majority concluded that the state action exemption did not apply.

The dissent manifested the tenuousness of this relationship by asserting that the state "impliedly validated" the Bar's grading procedure. An implied validation does not constitute a clearly articulated policy compelled by the state.<sup>81</sup> The dissent

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76. See *Goldfarb*, 421 U.S. 773, 788 n.17.

77. *Parker v. Brown*, 317 U.S. 341, 351 (1943).

78. Defendants contended for the first time on rehearing that effective January 5, 1974, the Arizona Court adopted Rule 28(c)(VII)(B) to include a requirement that the Bar file with the Court thirty days before each examination the proposed formula for grading the entire examination. The analysis might have been different had this provision been brought to the attention of the district court. *Ronwin*, 686 F.2d at 697.

79. See Robinson, *Recent Antitrust Developments: 1975*, 76 Col. L. Rev. 191, 200 (1976).

80. The Supreme Court in *Goldfarb* stated: "It is no disparagement of the practice of law as a profession to acknowledge that it has a business aspect, . . . ." 421 U.S. at 788.

81. Ostensibly, the dissent was seeking the protection of the learned professions exemption which emphasizes a relative weighing of the harms and benefits of a challenged activity, absent the compulsion requirement. Even under this alternate theory, an "implied validation" does not justify the Bar's grading procedure as there was no direct contribution to the regulatory purpose of serving the public.

ignored the heavy presumption against implicit exemptions.<sup>82</sup> Countervailing policies must be demonstrated to sufficiently overcome the presumption.<sup>83</sup>

Under *Ronwin*, the justification for such policies would be evaluated with respect to their dependence on the challenged activities. The majority applied this relational test to determine whether the Bar truly acted with dedication to their assigned task of determining the "necessary qualifications" of applicants by separating the competent from the incompetent applicants. By setting the passing score according to the number of applicants to be admitted, the Bar arbitrarily eliminated otherwise competent applicants. Because all competent applicants were not admitted, the regulatory purpose was not served. Restricting the practice of law by limiting the number of those licensed served only to unreasonably suppress competition among lawyers. The result was an illegal restraint of trade.<sup>84</sup>

The majority further upheld the national policy favoring competition by predicting that plaintiff could establish that this restraint had a sufficient impact on interstate commerce to invoke the Sherman Act. Recognizing that interstate commerce is an intensely practical concept drawn from the normal and accepted course of business<sup>85</sup> and that legal services play an integral role in that stream of commerce, the court rejected the position that history has accorded the legal profession "a role all its own."<sup>86</sup> Instead of retreating to the "learned professions" doctrine, *Ronwin* offers a foundation for the development of a more realistic approach to the issue of professional regulation. *Ronwin* does not, as the dissent maintained, disregard the traditional deference to state discretion in admission procedures. Rather, by demanding that regulatory policies be legitimately met, the court has supported the premise that the legal profession exists

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82. See *City of Lafayette*, 435 U.S. at 399; *Goldfarb*, 435 U.S. at 787.

83. 435 U.S. at 400.

84. See, e.g., *Apex Hosiery v. Leader*, 310 U.S. 469, 500 (when purchasers or consumers are deprived of the advantages which they derive from free competition, there is an antitrust violation).

85. *United States v. Yellow Cab Co.*, 332 U.S. 218, 231 (1947).

86. *Schwartz v. Board of Bar Examiners*, 353 U.S. 232, 247 (1957).

to serve the public.

*Katherine Morrow Hafferkamp\**

## OTHER DEVELOPMENTS IN ANTITRUST LAW

### A. REFINING THE BOUNDS OF THE STATE ACTION EXEMPTION

In several recent cases, the Ninth Circuit examined the *Parker* state action exemption,<sup>1</sup> expanding the scope of the exemption to parties who promote a clearly articulated state policy.

In *Miller v. Oregon Liquor Control Comm'n*,<sup>2</sup> plaintiffs, owners of a cafe and tavern, sued the Oregon State Liquor Commission and liquor wholesalers, alleging that the pricing practices promulgated and enforced by the Commission violated the Sherman Act.<sup>3</sup> Without expressing any opinion as to whether the practices in fact constituted antitrust violations, the Ninth Circuit reversed the district court's holding that Oregon's involvement in regulation and control of the liquor industry<sup>4</sup> was sufficient to establish immunity from federal antitrust law under the state action exemption.

The Ninth Circuit concluded that the Oregon law did not meet the state supervision requirement of the exemption. As in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum*,<sup>5</sup> the state neither established prices, monitored, nor reviewed the

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1. The leading case establishing the state action exemption from antitrust liability is *Parker v. Brown*, 317 U.S. 341 (1943). The *Parker* doctrine provides that parties who act under the direction of a state government should not incur federal antitrust liability. The Supreme Court, in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum*, 445 U.S. 97 (1980), held that immunity under *Parker* requires that (1) the challenged restraint must be one clearly articulated and affirmatively expressed as state policy; and, (2) the policy must be actively supervised by the state itself. *Id.* at 105.

2. 688 F.2d 1222 (9th Cir. 1982) (per Wallace, J.; the other panel members were Browning and Boochever, JJ.) (as amended on denial of rehearing, Sept. 27, 1982).

3. Sherman Antitrust Act, 15 U.S.C. § 1 (1976).

4. See OR. ADMIN. R. 845-10-210 (1980), OR. ADMIN. R. 845-6-090 (1981).

5. 445 U.S. 97 (1980).



reasonableness of the price schedules. Because there was no "pointed reexamination" of the pricing program, the Oregon law was distinguishable from other states' laws completely controlling the distribution of liquor, which had been granted antitrust immunity.<sup>6</sup> Such comprehensive regulation is immune under *Parker* because "the state has substituted its own supervision for the economic constraints of the competitive market."<sup>7</sup> In *Miller*, however, regardless of whether the law was one clearly articulated and affirmatively expressed as state policy, Oregon's mere authorization and enforcement of the pricing program was insufficient to establish antitrust immunity.

In *Benson v. Arizona State Board of Dental Examiners*,<sup>8</sup> plaintiffs challenged Arizona's regulation of the practice of dentistry. Arizona's regulatory scheme distinguishes between "licenses" to practice dentistry, which are granted only to those who pass the state's dentistry examination, and "restricted permits", for which that examination is not a prerequisite. Holders of restricted permits are allowed to practice dentistry, but only as unsalaried employees of charitable dental clinics. Plaintiffs, all of whom held licenses to practice dentistry in other states, contended that the scheme violated federal and state antitrust laws.<sup>9</sup> Plaintiffs alleged that the Board had combined with Arizona dentists and dentists' organizations to restrain and monopolize the practice of dentistry in the state by restricting entry into the profession, limiting the number of dentists and fixing prices. The Ninth Circuit held that the Board was immune from antitrust liability under the state action exemption.<sup>10</sup>

Because the system was clearly articulated in state statutes<sup>11</sup> and was actively supervised by a state agency, the Ninth Circuit found both of the *Midcal* criteria<sup>12</sup> satisfied. The court

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6. 688 F.2d at 1226. See, e.g., VA. CODE § 4-15 (1979).

7. 688 F.2d at 1225, quoting P. AREEDA & D. TURNER, I ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION 73 (1978).

8. 673 F.2d 272 (9th Cir. 1982) (per Pregerson, J.; the other panel members were Ferguson, J. and Orrick, D.J., sitting by designation) (as amended, May 17, 1982).

9. Plaintiffs also alleged violations of their constitutional rights of due process, equal protection and interstate travel. The court found those allegations to be without merit. *Id.* at 276-78.

10. *Id.* at 276.

11. See ARIZ. REV. STAT. ANN. §§ 32-1201—32-1290 (1976).

12. See *supra* note 1.

emphasized that the detailed nature of the statutory scheme illustrated the Arizona legislature's intent to affirmatively mandate a state policy for the regulation of dentistry.<sup>13</sup> Supervision by the Board of Dental Examiners for licensing was found to be the equivalent of supervision by the Arizona Supreme Court of the state's ban on attorney advertising in *Bates v. State Bar of Arizona*.<sup>14</sup> The Ninth Circuit rejected plaintiff's assertions that the Board acted outside the scope of the legislature's directives and therefore state action immunity was inapplicable. The Board needed only to show that the authority it was given implied that the legislature contemplated the *kind* of action taken.<sup>15</sup>

The Ninth Circuit further found that the Arizona dental regulations satisfied a second criterion mandated by *Bates* for applying the state action exemption: existence of a strong state interest in the challenged restraint. *Bates* emphasized that states have a vital interest in protecting the public by regulating the legal profession, and that such regulation had been a traditional state function.<sup>16</sup> The *Benson* court found the regulation of dentistry, as a healing profession, equally a traditional state function to protect the public.<sup>17</sup>

In *Turf Paradise, Inc. v. Arizona Downs*,<sup>18</sup> the issue was whether an agreement between competitors at the same level of the market structure to share the use of a racetrack facility essential to their horseracing business constituted a "horizontal restraint",<sup>19</sup> and was therefore a per se violation of the antitrust

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13. 673 F.2d at 275 n.4. Arizona statutes, *supra* note 11, established the Board, conferred upon it the power to regulate the practice of dentistry and control admission thereto, and commanded it to administer examinations "on both theory and clinical proficiency" as a prerequisite for dental licenses and establish the system of restricted permits. *Id.* at 275.

14. 433 U.S. 350 (1977).

15. 673 F.2d 272, 276 n.8 (emphasis in *Benson*).

16. 433 U.S. at 361-62.

17. 673 F.2d at 275 n.6. The court distinguished *Benson* from *Community Communications Co. v. City of Boulder*, 102 S. Ct. 835 (1982), in that Arizona's legislature affirmatively mandated the challenged policies, rather than adopting a neutral stance toward regulation of dentists. 673 F.2d at 275 n.4.

18. 670 F.2d 813 (9th Cir. 1982) (per Sneed, J.; the other panel members were Wright, J. and Poole, J., concurring specially) (as amended, Feb. 26, 1982), *cert. denied*, 102 S. Ct. 2308 (1982).

19. 670 F.2d at 820.

laws. The Ninth Circuit held that it was not. Although the Ninth Circuit expressed its interest in promoting competition, the court reasoned that finding a violation in this case would effectively reduce competition.<sup>20</sup> The court recognized that the plaintiff's real objective was to increase its own control over the facility, not to increase the extent to which all competitors share in the use of the facility. Alternatively, the court held that the allocation provisions of the agreement were immune from anti-trust law under *Parker*.<sup>21</sup>

Citing the *Midcal* criteria and its recent application by the Supreme Court, the Ninth Circuit found that application of the *Goldfarb v. Virginia State Bar*<sup>22</sup> "compulsion" test was not required.<sup>23</sup> Rather, the relevant inquiry when regulated industries "involve a blend of public and private decisionmaking"<sup>24</sup> is the degree to which the state or its agency has put "its own weight on the side of [the challenged regulation]."<sup>25</sup> Arizona statutes limit the number of days allowed for horseracing and allocated those days to the most qualified applicants through issuance of permits.<sup>26</sup> The Ninth Circuit recognized that the underlying public policy evidenced by the state's regulation was a strong interest in controlling horseracing because it is incident to gambling.<sup>27</sup> The Ninth Circuit found allocation by private agreement integrated within this statutory scheme. Therefore, such allocation was included in the state's clearly articulated policy to replace unfettered competition in application for racing dates with regulation.<sup>28</sup>

The Ninth Circuit further held that the state's obligation to "thoroughly investigate" permit applications constituted active state supervision. Because an applicant must meet *all* the relevant criteria, the state in effect did review the "reasonableness"

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20. *Id.*

21. *Id.* at 822.

22. 421 U.S. 773 (1975).

23. 670 F.2d 813, 823 n.8.

24. *Id.*, quoting *Cantor v. Detroit Edison Co.*, 428 U.S. 579, 592 (1976).

25. 670 F.2d at 823 n.8. See *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 357 (1974).

26. *Id.* at 824. See ARIZ. REV. STAT. ANN. § 5-108-01 (1974 & Supp. 1980-81).

27. 670 F.2d at 825.

28. *Id.*

of the private date allocation.<sup>29</sup>

The *Miller* court confined its analysis to the state supervision requirement of the state action exemption. The view that immunity should be granted only when the state has substituted its own supervision for the constraints of the competitive market also guided the Ninth Circuit in *Benson* and *Turf Paradise*. But the *Benson* and *Turf Paradise* opinions emphasized that when a strong state interest underlies the policy articulated, the vitality of that interest may reduce the need to meet the second *Midcal* criterion, i.e., active supervision by the state of the challenged activity.

In *Benson*, although the statute did not itself enumerate all the requirements that the Board imposed, the Ninth Circuit refused to conclude that the Board exceeded its authority.<sup>30</sup> As long as the Board took the kind of action which furthered the state interest in regulating the medical professions, its ability to refer to specific detailed legislative authorization was unnecessary.

Similarly, in *Turf Paradise*, the Ninth Circuit stressed the strong state interest involved. The private parties were not compelled to impose the challenged regulation. The state only "in effect" supervised the private regulation. But because the state clearly intended to avoid the consequences of unrestricted competition in what was essentially a gambling operation, private regulation in furtherance of such an interest received state action immunity. In contrast, the Ninth Circuit in *Miller* was content to require strict adherence to the state supervision requirement because there was no strong public sentiment surrounding the regulation of the liquor industry. The situation in *Miller* was purely economic and the court was not moved to consider public policy.

The pattern to be derived from these three cases is that the Ninth Circuit will impose an objective standard unless the issue at bar concerns an area in which the state has a vital interest. Deference may then be given to that interest regardless of

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29. *Id.*

30. 673 F.2d at 275-76.

whether there is active supervision by the state.

#### B. THE SEPARATE NATURE OF TWO PRODUCTS IN AN ALLEGED TYING ARRANGEMENT

An illegal tying arrangement involves a seller who refuses to sell one product (the tying product) unless the buyer also purchases a second product (the tied product) from the seller. Such arrangements are proscribed by the Sherman Antitrust Act<sup>31</sup> and the Clayton Act<sup>32</sup> since this type of aggregation impedes market competition on the merits of the tied product. To establish the existence of a tying arrangement, there must be two separate products involved, with the sale of one conditioned upon the purchase of the other; the seller must engage in a modicum of coercive conduct toward the buyer; the seller must possess economic power in the market for the tying product; and a not insubstantial amount of commerce must be affected by the arrangement.<sup>33</sup> In three recent decisions, the Ninth Circuit addressed the first of these elements, the separate nature of the two products in an alleged tying arrangement.

In *Krehl v. Baskin-Robbins Ice Cream Co.*,<sup>34</sup> a class action antitrust suit was brought by franchised store owners who were bound by an agreement with Baskin-Robbins Ice Cream Co. (BRICO) and area franchisors. The agreement permitted franchised store owners to sell only Baskin-Robbins ice cream products purchased from the area franchisor in whose territory the store is located. BRICO licensed the area franchisors to use Baskin-Robbins trademarks and formulae to manufacture Baskin-Robbins ice cream and establish franchised stores. The plaintiffs alleged that the sale of the franchised store was illegally tied to the purchase of the seller's ice cream.<sup>35</sup>

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31. Sherman Antitrust Act, 15 U.S.C. § 1 (1976).

32. Clayton Act, 15 U.S.C. § 3 (1975).

33. See *Hirsch v. Martindale-Hubbell, Inc.*, 674 F.2d 1343, 1346-47 (9th Cir. 1982), and cases cited therein.

34. 664 F.2d 1348 (9th Cir. 1982) (per Ely, J.; the other panel members were Reinhardt, J., and Cordova, D.J., sitting by designation) (rehearing and rehearing en banc denied, Feb. 24, 1982).

35. Plaintiff also alleged that BRICO's "dual distribution" system operated as an unlawful horizontal market allocation and that BRICO and its area franchisors conspired to fix prices. The court found that the plaintiff failed to establish either of these claims. *Id.* at 1354-58.

The court first looked to the nature of the products involved in the alleged aggregation. The franchised stores were characterized by the license to use BRICO's trademark, so the trademark allegedly operated as the tying product and the ice cream as the tied product. In an earlier case, *Siegal v. Chicken Delight*,<sup>36</sup> the Ninth Circuit had found that, under certain circumstances, a trademark may be sufficiently unrelated to the alleged tied product to warrant treatment as a separate item.<sup>37</sup> However, the court found the facts of *Siegal* to be inapposite and held that the Baskin-Robbins trademark was not distinguishable as a separate product from Baskin-Robbins ice cream.

The difference between *Siegal* and the instant case lay in the franchising structure. In *Siegal*, the franchisor had a business format franchise system created merely to conduct business under a common tradename. In such a system there is a remote connection between the trademark and the products the franchisors are compelled to purchase. The trademark, the tying product, was used to compel the purchase of items such as paper cups which were commonly available elsewhere at lower prices. Consumers had no reason to associate the trademark with the tied goods. Because a trademark represents goodwill and standards of quality, the source of component products does not matter so long as the standards of quality are met.<sup>38</sup>

On the other hand, BRICO operated on a distribution franchise system. The franchised stores served as "conduits through which the trademarked goods of the franchisor flow to the ultimate consumer."<sup>39</sup> The product was prepared by the franchisor or licensees<sup>40</sup> according to detailed specifications. Thus the trademark served not only to identify the business format, but it also represented the quality of the product. The trademark and the product were inextricably linked in the mind of the consumer. The court noted that it would be consumer

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36. 448 F.2d 43 (9th Cir. 1971).

37. *Id.* at 48-49.

38. 664 F.2d at 1353.

39. *Id.*

40. The court rejected the contention that even though Baskin-Robbins ice cream is manufactured by licensees instead of BRICO, the trademark must be a separate product because "the trademark still serves only to identify that distinctive ice cream is made in accordance with secret formulae and processes developed by BRICO." *Id.* at 1353-54 n.14.

fraud to sell a less expensive brand of ice cream under the BRICO trademark.<sup>41</sup>

Since the BRICO trademark identifies the ice cream sold in the franchised stores, the ice cream and the trademark do not exist independent of one another. An illegal tying agreement under the antitrust laws requires as its first element the existence of two distinct products,<sup>42</sup> therefore the BRICO trademark could not be illegally tied to the ice cream sold in its franchised stores.<sup>43</sup>

*Hamro v. Shell Oil Co.*<sup>44</sup> presented the Ninth Circuit with a similar fact situation. Plaintiff, a service station operator, brought suit under the Cartwright Act, the California antitrust statute.<sup>45</sup> The plaintiff operated his service station under lease and dealer agreements with Shell. The complaint alleged that the lease was conditioned upon the purchase of gasoline from the oil company. However, the court found that the lease was not based on any purchasing condition nor did the lease require the lessee to enter a dealer agreement with Shell.<sup>46</sup>

The dealer agreement signed by the plaintiff did not require that he purchase Shell gasoline, and it further stipulated that the plaintiff could not use the Shell trademark unless he purchased gasoline from Shell. Citing *Baskin-Robbins*, the Ninth Circuit found that the Shell trademark is not a product separate from Shell gasoline.<sup>47</sup> Therefore, an illegal tying arrangement could not exist using a "source trademark" and the product it represents.<sup>48</sup>

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41. *Id.* at 1354 n.15.

42. *Id.* at 1352.

43. *Id.* at 1354.

44. 674 F.2d 784 (9th Cir. 1982) (per Canby, J.; the other panel members were Fletcher, J. and Copple, D.J., sitting by designation) (as amended on denial of rehearing, Aug. 25, 1982).

45. CAL. BUS. & PROF. CODE §§ 16600 *et seq.*, 16720, 16726, 16727 (West 1964). The court found that these codes were modeled after the Sherman Antitrust Act so that federal case law could be used to interpret the California statute. *See* 674 F.2d at 786-87. Plaintiff also presented claims for intentional interference with business advantage and unlawful price discrimination. The court held for the defendant on all the claims presented. *Id.* at 786.

46. *Id.* at 787.

47. *Id.*

48. *Id.* at 788.

Although no trademark was involved, the separate products issue was also decisive in a third case, *Hirsh v. Martindale-Hubbell, Inc.*<sup>49</sup> Plaintiff, an attorney, brought suit under the Sherman and Clayton Acts alleging two illegal tying arrangements in connection with the defendant's directory of attorneys. The directory offers two types of advertisements to attorneys, apart from the regular listings: informative cards and professional cards. Attorneys wishing to purchase informative or professional cards must also subscribe to the directory. In order to buy a professional card, one must also purchase an informative card. The defendant allowed narrow exceptions to these requirements for foreign attorneys and those sharing office space with a subscribing attorney.<sup>50</sup> The plaintiff alleged that the sale of informative cards was illegally tied to the sale of the directory and that the sale of professional cards was illegally tied to the sale of informative cards. The lower court had granted summary judgment in favor of the defendant.<sup>51</sup>

The Ninth Circuit first analyzed the relationship between the informative cards and the directory to determine whether the separate products element of a tying arrangement had been satisfied. Since the purpose of the antitrust laws is to prevent efforts to impede competition without regard to the merits of the product, the court looked at the effect of the relationship. The court found that because effective advertising requires both listings and circulation, the requirement that attorneys advertising in the directory also subscribe to it results in a wider dissemination of the listings.<sup>52</sup> The quality of the advertising within the directory is thus improved, which is the opposite of an effort to impede competition on the merits of the product. This "synergistic relationship" between the informative cards and the directory itself precludes a finding that they are separate products. Such an arrangement promotes consumer welfare by contributing to the quality of the product.<sup>53</sup>

The informative cards were also found to be inseparable

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49. 674 F.2d 1343 (9th Cir. 1982) (per Ely, J.; the other panel members were Hug and Alarcon, JJ.) (rehearing and rehearing en banc denied, June 15, 1982).

50. 674 F.2d at 1345-46.

51. *Id.* at 1346.

52. *Id.* at 1348.

53. *Id.*



from the professional cards for the purposes of the tying arrangement analysis. In order to be separate products, there must be separate markets for each. The court found that since both cards constituted legal advertising, they had identical audiences and the same competitors. Thus there was no danger to free competition to allow the sale of one to be conditioned upon the purchase of the other.<sup>54</sup>

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54. *Id.* at 1350.