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THE PRESENT STATUS OF THE SHERMAN ACT

Robert W. Harbeson*

TWO circumstances may be advanced by way of justification for the present addition to the voluminous literature dealing with the Sherman Anti-Trust Act. First, the Supreme Court has in recent months handed down two decisions involving the application of the Sherman Act to the oil industry, which are of great importance both because of their sweeping application to marketing practices in that industry and because of the directness with which they raise certain issues of economic theory and policy. Second, the fiftieth anniversary of the Sherman Act on July 2, 1940 provides an appropriate occasion for a review of the development and present status of that law in the light of these recent decisions. We turn first to an analysis of the latter and thence to a discussion of the fundamental legal and economic issues involved.

In the first of the cases referred to, the government sought to restrain the Ethyl Gasoline Corporation from granting licenses to jobbers, under patents controlled by it, to sell and distribute lead-treated motor fuel, and also to restrain it from enforcing provisions in licenses to oil refiners which restricted their sale of the motor fuel to licensed jobbers. The Ethyl Corporation owns two patents covering a compound containing tetraethyl lead, which increases the efficiency of internal combustion engines by permitting higher compression without engine "knock," the degree of efficiency being represented by the so-called "octane" rating of the gasoline. It also has a patent claiming a motor fuel produced by mixing gasoline with the foregoing compound and another claiming a method of using the patented fluid in combustion motors. The company receives no royalty for the licenses

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—Ed.
which it grants to refiners and jobbers but derives its profit solely from the sale of the patented fluid to its refiner licensees. One-half of the company's stock is owned by the Standard Oil Company of New Jersey and the remainder by General Motors Corporation and the E. I. DuPont de Nemours Company.

The licenses to refiners prohibited the latter from selling treated gasoline to any except other licensed refiners, jobbers licensed by the Ethyl Corporation, and retail dealers and consumers. The refiners agreed, upon notice, to discontinue sales to other refiners and jobbers whose licenses the Ethyl Corporation had cancelled. Important features of the licenses were the specification of the maximum amount of the ethyl fluid to be used in the gasoline, the maximum octane rating of the refiners' best "regular" or non-premium gasoline, the minimum octane rating of their ethyl gasoline, and the price differential to be maintained between the "regular" and ethyl grades. The licenses also required the refiners to use equipment and processes for mixing the ethyl fluid with gasoline which were approved by public health authorities and specified the conditions under which the name of the Ethyl Corporation, its trademark or trade names, could be used in connection with advertising of the treated fuel.

Jobbers were generally required to apply for licenses through the refiners from whom they expected to purchase the treated gasoline, and were required to secure new licenses upon changing their source of supply. They received the right to sell within a specified territory regular and ethyl gasoline manufactured by a designated licensed refiner. The jobbers agreed to furnish the Ethyl Corporation monthly with a list of the places at which the motor fuel was sold under the licenses, to refrain from adulterating or diluting the treated fuel, to abide by public health regulations, and to observe requirements with respect to the use of the Ethyl Corporation's corporate and trade names similar to those imposed on the refiners. The jobbers' licenses could be cancelled at any time for failure to comply with their terms, and either party could cancel, with or without cause, on thirty days' written notice.

The foregoing licensing system affected the bulk of the business of refining and distributing motor fuel in the United States. The Ethyl Corporation licensed one hundred and twenty-three refiners, including all the major oil companies except the Sun Oil Company. These companies refine eighty-eight per cent of all the gasoline sold in the United States, the gasoline processed by them is seventy per cent of all the gasoline thus sold, and eighty-five per cent of all gasoline processed to obtain a high octane rating. Of twelve thousand jobbers doing business
in the United States, about eleven thousand were licensed by the Ethyl Corporation, and these handled a substantial portion of all the ethyl gasoline sold. The greater part of the latter product moves in interstate commerce.

The lower court held that "it was perhaps a permissible, though not a necessary conclusion that an agreement or understanding for the maintenance of prices existed between the appellant and the jobber licensees."¹ That court found it unnecessary to pass upon this question, however,

"since it found that the appellant's licensing practices affecting the jobbers, in conjunction with the agreements and cooperation of the licensed refiners, had been used by appellant as the means of excluding from the market the unlicensed jobbers who do not conform to the market policies and posted gasoline prices adopted by the major oil companies or the market leaders among them, and that appellant uses the control thus established to coerce adherence to those policies and prices generally by the licensed jobbers, and that this restriction upon the industry effected through the license contracts with refiners and jobbers was not within appellant's patent monopoly, and operated unreasonably to restrain interstate commerce in the processed gasoline."²

On the basis of these findings, the lower court invalidated the jobbers' licenses and the provision in the refiners' business restricting sale of the treated gasoline to licensed jobbers. It also held that the licensing system was unnecessary for the protection of the legitimate interests of the patentee in maintaining the quality of the treated gasoline and its use by jobbers with safety to public health.

On the other hand, the appellant Ethyl Corporation denied that it used the jobbers' licensing system to maintain prices and advanced two defenses of the system. It contended, first, that the restrictions imposed through the refiners' and jobbers' licenses were "all reasonably necessary for the commercial development of appellant's patents and for insuring a financial return from them, and are therefore within its patent monopoly."³ Second, it urged that the conditions attached to the refiners' and jobbers' licenses were necessary for the maintenance of the quality of the treated gasoline and for the protection of the public in its use of a product containing a dangerous poison.

¹ Quoted in Ethyl Gasoline Corp. v. United States, 309 U. S. 436 at 450, 60 S. Ct. 618 (1940).
² Id., 309 U. S. at 450-451.
³ Id., 309 U. S. at 451.
In Ethyl Gasoline Corporation v. United States, decided March 25, 1940, the Supreme Court sustained the lower court's decree. Justice Stone wrote the opinion for a unanimous court, Justices McReynolds and Roberts taking no part. The Court held that while the Ethyl Corporation under its patent rights could lawfully exclude any number of jobbers from participation in the national market for lead-treated gasoline, the Sherman Act prohibited, and the patent law did not sanction, use of that power in such a way as to regulate prices and suppress competition among the purchasers of the patented articles. The Court found that the appellant corporation's licensing system gave it power to accomplish those objectives, and that "the record supports the finding of the trial court that appellant has exercised that power continuously for a considerable period as a means of control over the price policies of the licensed jobbers."  

By way of explanation of the latter statement, Justice Stone pointed out that according to the stipulation of facts in the case the Ethyl Corporation since 1929 had investigated through field agents the "business ethics" of jobbers applying for licenses and had rejected such applications upon the adverse report of the agent; that the corporation admitted that the phrase "business ethics" denoted compliance with the marketing policies and prevailing prices determined by the major oil companies, among which was the Standard Oil Company of New Jersey, which owned half of the corporation's stock; and that  

"While not all applicants who have failed to maintain prices and marketing policies have been rejected, the record leaves no doubt that the appellant has made use of its dominant position in the trade to exercise control over prices and marketing policies of jobbers in a sufficient number of cases and with sufficient continuity to make its attitude toward price cutting a pervasive influence in the jobbing trade. . . . Large numbers of refiners and the majority of jobbers believe that the jobbers must maintain the required business ethics in order to obtain licenses, and a number of licensed jobbers believe that they are required by appellant's licensing practices to maintain prices and abide by the marketing practices of the major oil companies."

It is significant that the Ethyl Corporation kept no record of the ground of rejection of applications for licenses "admittedly because it is reluctant to preserve in its records 'the extent to which maintenance

4 309 U. S. 436, 60 S. Ct. 618 (1940).
5 Id., 309 U. S. at 453.
6 Id., 309 U. S. at 453, 454.
of prices and marketing policies by jobbers entered into the granting of licenses.'"' Thus price competition among jobbers was effectively suppressed without resort to contracts or agreements prescribing resale prices by jobbers, which would clearly have exposed the Ethyl Corporation to anti-trust prosecution.

While the Court had no difficulty in reaching the conclusion that the licensing system violated the prohibitions of the Sherman Act, there remained the question whether the arrangements could be validated, as the appellant contended, under the patent law. Justice Stone, in reviewing the leading cases, called attention to the fundamental principle that a patentee may grant licenses to make, use, or vend his product, subject to any restrictions which he wished to impose, save only those restrictions which would enlarge his monopoly beyond that conferred by the patent. Applying this principle to the case in hand it was held that

"by the authorized sales of the [treated] fuel by refiners to jobbers the patent monopoly over it is exhausted, and after the sale neither appellant nor the refiners may longer rely on the patents to exercise any control over the price at which the fuel may be resold." 8

The Ethyl Corporation neither owned nor sold the treated fuel, nor derived any royalties from its sale. Hence whatever benefits resulted from control over the marketing policies of the jobbers accrued primarily to the refiners and only indirectly to the appellant corporation in the enjoyment of its monopoly over the manufacture of the patented fluid. Thus the licensing conditions were used not to stimulate the commercial development and financial returns of the patent on the tetraethyl lead compound but to develop the business of the refiners and to exploit a second patent monopoly—that on the sale of the treated fuel—not embraced in the first. This was clearly illegal. The situation was distinguished from the case of a patentee exercising his right to refuse to sell, or to permit his licensee to sell, his patented product to price cutters. Here the licenses and patents had been used as a means of suppressing competition among jobbers and of controlling prices charged by them. The final conclusion of the Court was summed up as follows:

"Agreements for price maintenance of articles moving in interstate commerce are, without more, unreasonable restraints within the

7 Id., 309 U.S. at 454.
8 Id., 309 U.S. at 457.
meaning of the Sherman Act because they eliminate competition . . . and agreements which create potential power for such price maintenance exhibited by its actual exertion for that purpose are in themselves unlawful restraints within the meaning of the Sherman Act, which is not only a prohibition against the infliction of a particular type of public injury but 'a limitation of rights which may be pushed to evil consequences and therefore restrained.'

II

The second decision with which we are concerned in this paper is of even wider importance and is commonly known as the "Madison Oil Case," inasmuch as it was tried in the federal district court in Madison, Wisconsin. The government charged twenty-seven oil companies and fifty-six individuals, eventually reduced to twelve companies and five individuals, with conspiracy to restrain interstate commerce in gasoline in violation of section 1 of the Sherman Act. The indictment was returned in December, 1936, and charged that the defendants "combined and conspired together for the purpose of artificially raising and fixing the tank car prices of gasoline in the "spot markets" in the East Texas and Mid-Continent fields;" that they maintained gasoline prices at high and non-competitive levels agreed upon among themselves; and that since the prices charged to jobbers were made to depend on the spot market prices the foregoing action raised both the wholesale and retail prices of gasoline in the Mid-Western area. It was charged that the defendants effectuated the foregoing conspiracy by engaging in two concerted gasoline buying programs in the East Texas and Mid-Continent fields between February, 1935, and December, 1936. In the East Texas buying program, the East Texas Refiners' Marketing Association, formed in February, 1935, for the purpose of facilitating the sale of the gasoline to the defendant major oil companies, allocated orders for gasoline received from the defendants among the members of the association. In the Mid-Continent buying program, purchases were made by the defendants from independent refiners according to an agreed allotment, a committee representing the defendants assigning each of the latter to one or more independents for the purchase of the alloted quantity of gasoline. In this way there was purchased over half of the gasoline sold by the independents, an

9 Id., 309 U. S. at 458, citing cases.
11 Quoted, id., 310 U. S. at 166.
amount greater than the defendants would otherwise have purchased, while at the same time, at the instance of certain of the defendants, the independents curtailed their production of gasoline.

The background of the alleged conspiracy was the vast increase in production of crude oil and the extreme fluctuations in the price of both crude oil and gasoline during the decade ending in 1935. The great quantity of crude oil produced, beginning about 1926, caused a sharp drop in the price of both crude oil and gasoline, resulted in great waste of oil, and reduced the productive capacity of the oil fields. Oklahoma, Kansas and Texas attempted to deal with this problem by enacting proration laws, but in 1930 the great East Texas field was discovered, the supply of oil from which was so great as to drive prices of crude oil down to ten or fifteen cents a barrel and gasoline as low as two and one-eighth cents a gallon. The proration laws, especially that of Texas, were widely violated, the oil unlawfully produced being called "hot oil" and the gasoline manufactured therefrom "hot gasoline." Hot oil sold for substantially less than the legally produced oil, and hence the gasoline produced from it could be manufactured and sold for less than the cost of legally produced gasoline. It was said that independent refiners using legal crude were placed in an extremely difficult position, in that they were compelled to continue operations even though on an unprofitable basis in order to avoid losing their oil connections in the field and their regular customers. Since in general they had little storage capacity, they were compelled to sell the gasoline as they made it. Such gasoline came to be known as "distress gasoline," which the refiner could not store, for which he had no regular sales outlets, and which, therefore, had to be dumped on the market for whatever price it would bring.

During the first half of 1933 the market was flooded with "distress gasoline." In June of that year the National Industrial Recovery Act was passed, which authorized the President (in section 9c) to forbid the interstate or foreign shipment of petroleum produced or withdrawn from storage in violation of state laws. An Executive Order of the President on July 11, 1933 forbade such shipments, and on August 19, 1933 a code of fair competition for the petroleum industry was approved. Thereafter voluntary efforts of the industry, which, the defendants claimed, were nevertheless in accordance with the desire and approval of the Administrator of the Petroleum Code, succeeded in achieving partial and temporary stabilization of oil and gasoline prices. It was recognized, however, that little could be accomplished along this line until the continuing flow of hot oil and gasoline was
stopped. Therefore, the administrator, in October, 1934, set up a Federal Tender Board and issued an order making it illegal to ship crude oil or gasoline out of East Texas in interstate or foreign commerce unless accompanied by a tender issued by the board certifying that it had been legally produced or manufactured. The flow of hot oil and gasoline was checked and prices rose sharply, but the improvement was only temporary. The enforcement of the order was enjoined, and on January 7, 1935, the Supreme Court in *Panama Refining Co. v. Ryan*¹² held unconstitutional section 9c of the N.I.R.A., upon which the order was based. Following that decision, the problem of hot oil and gasoline once more became acute, and in order to deal with this situation, the Connally Act was passed and became effective February 22, 1935.¹³ This measure prohibited the shipment in interstate or foreign commerce of illegally produced oil and gasoline, replacing the arrangements which had been invalidated by the *Panama Refining* case. On the following March 7 the buying program which was alleged to constitute a conspiracy in restraint of trade was begun.

The defendants claimed immunity from prosecution under the Sherman Act on the ground that the buying programs constituted no more than a reasonable restraint of trade, since they were directed toward remedying a disorganized condition in the gasoline market, and that in any case the purchases had only a minor effect on gasoline prices. The rise in the latter was said to be caused primarily by such factors as the control of crude oil production, the operation of the Connally Act, and the increase in demand accompanying business revival. The defendants also relied upon the fact that during the N. I. R. A. period the purchases were made with the knowledge and tacit approval of the Petroleum Administrative Board, an advisory body established by the Administrator of the Petroleum Code.

The district court charged the jury that "where the members of a combination had the power to raise prices and acted together for that purpose, the combination was illegal," and that the foregoing defenses were irrelevant.¹⁴ The defendants were convicted. The circuit court of appeals reversed the trial court because "In its view respondents' activities were not unlawful unless they constituted an unreasonable restraint of trade."¹⁵ The case was remanded for a new trial in order

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¹⁵ Id., 310 U. S. at 211.
that the character of these activities and their effect on competition could be determined and the issue of their reasonableness submitted to the jury. Upon appeal the Supreme Court in *United States v. Socony-Vacuum Oil Company, Inc.*, 18 decided May 6, 1940, reversed the circuit court of appeals and upheld the trial court. Justice Douglas wrote the opinion for a majority of five, Chief Justice Hughes and Justice Murphy taking no part, while Justices Roberts and McReynolds dissented. The appeal involved, in addition to the question of the applicability of the Sherman Act, certain procedural questions with which we are not concerned in this paper.

Justice Douglas stated by way of introduction that the alleged conspiracy was not to be found in any formal contract or agreement but had to be developed from the extensive record in the case. The main issue before the Court was whether the reasonableness of the restraints imposed by the buying programs conferred immunity from prosecution under the Sherman Act. On this point, Justice Douglas reviewed the decisions from *United States v. Trans-Missouri Freight Assn.* 17 to the *Ethyl Gasoline* case, discussed above, and concluded that

"for over forty years this Court has consistently and without deviation adhered to the principle that price-fixing agreements are unlawful *per se* under the Sherman Act and that no showing of so-called competitive abuses or evils which those agreements were designed to eliminate or alleviate may be interposed as a defense."

The main reliance for this holding was *United States v. Trenton Potteries Co.*, 19 in which a combination controlling eighty-two per cent of the business of manufacturing and distributing vitreous pottery was convicted on account of an agreement to fix prices, and where the Court refused to recognize the contention that an agreement to fix prices was not illegal unless it unreasonably restrained interstate commerce. The defendants sought to distinguish the *Trenton Potteries* case from the one in question by pointing out that there the parties substituted an agreed-upon price for one determined by competition, that they had both the power and the purpose to suppress competition, and hence that the controlling factor in that decision was the destruction of competition rather than the reasonableness of the prices fixed. By contrast they claimed that in the present case there was no elimination of competition

18 310 U. S. 150, 60 S. Ct. 811 (1940).
17 166 U. S. 290, 17 S. Ct. 540 (1897).
in the spot tank car market, that they had tried to do no more than free competition from the effect of distress gasoline and that they had neither the power nor the purpose to set an arbitrary, non-competitive price. To this the Court replied that there was abundant evidence that the purpose of the buying programs was to raise prices and that they had at least contributed to the rise in, and stabilization of, gasoline prices in the Mid-Western area, which was sufficient proof of the existence of a conspiracy within the meaning of section 1 of the Sherman Act. The fact that the spot markets were still governed by some competition was held to be of no consequence, the Court saying:

"The whole scheme was carefully planned and executed to the end that distress gasoline would not overhang the markets and depress them at any time. And as a result of the payment of fair going market prices a floor was placed and kept under the spot markets. Prices rose and jobbers and consumers in the Mid-Western area paid more for their gasoline than they would have paid but for the conspiracy. Competition was not eliminated from the markets; but it was clearly curtailed, since restriction of the supply of gasoline, the timing and placement of the purchases under the buying programs and the placing of a floor under the spot markets obviously reduced the play of the forces of supply and demand." 20

In an extensive footnote, Justice Douglas distinguished between restraint of trade under section 1 of the Sherman Act and conspiracy to monopolize under section 2. He pointed out that "a conspiracy to fix prices violates § 1 of the Act though no overt act is shown, though it is not established that the conspirators had the means available for the accomplishment of their objective, and though the conspiracy embraced but a part of the interstate or foreign commerce in the commodity." 21 Only where the offense charged is conspiracy to monopolize under section 2 is it necessary to prove intent and power to accomplish the desired objective.

In support of the contention that their activities constituted no more than a reasonable restraint of trade and that only unreasonable restraints violated the Sherman Act, the respondents cited a series of decisions, including the Standard Oil, 22 American Tobacco, 23 Chicago

21 Id., 310 U. S. at 225, note 59.
22 Standard Oil Co. of New Jersey v. United States, 221 U. S. 1, 31 S. Ct. 502 (1911).
Board of Trade, Maple Flooring, Cement, Appalachian Coals and Sugar Institute cases. The Court dismissed the contention that the rule of reason announced in the Standard Oil and American Tobacco decisions applied to the present case with the brief comment that it had "no application to combinations operating directly on prices or price structures." Main reliance was placed by the respondents on the Appalachian Coals case. There certain producers of bituminous coal had formed an exclusive selling agency, one of the principal functions of which was to obtain the best possible price for the coal produced by its principals, and, if all the coal could not be sold, to apportion orders upon a stated basis. With certain exceptions it was to determine the prices at which sales would be made without consultation with its principals. Other functions of the agency were the establishment of a standard classification of coal, the promotion of the use of bituminous coal by advertising and by maintaining an engineering department to demonstrate the advantages of this fuel, and the operation of a credit department to determine the reliability of purchasers. The agency was formed during the depth of depression in 1932 to deal with a demoralized coal market, especially the problem of "distress coal," defined as coal shipped to market which was unsold at the time of delivery and which had therefore to be dumped on the market for whatever price it would bring.

The Court conceded that the element which the Appalachian Coals case and the case at bar had in common was "the presence in each of so-called demoralizing or injurious practices," illustrated by the similar problems of "distress coal" and "distress gasoline," but contended that the methods used in dealing with them were so divergent as to make the difference between legality and illegality. In the instant case there was a well organized buying program having as its "direct purpose and aim the raising and maintenance of spot market prices and of prices to jobbers and consumers in the Mid-Western area, by the

24 Board of Trade of City of Chicago v. United States, 246 U. S. 231, 38 S. Ct. 242 (1918).
30 Id., 310 U. S. at 216.
elimination of distress gasoline as a market factor." 31 By contrast, the Court thought that the main purpose of the selling agency in the Appalachian Coals case was improvement in marketing processes of the coal industry, through the collection, dissemination and utilization of all relevant information, and that whatever effects the establishment of the agency might have on prices were wholly incidental. In any case, the effect of the agency on prices was conjectural, since the plan had not been put into operation at the time of the decision, and the district court had been directed to institute further proceedings if the operation of the agency proved to be an undue restraint on interstate commerce. It was stated that the agency had neither the purpose nor the power to fix the price of coal in the consuming markets, and that the coal which it sold would be subject to the active competition of that sold by other producers.

The fact that the buying programs were conducted with the knowledge and acquiescence of federal officials afforded no defense, according to Justice Douglas, since admittedly no specific approval of the buying programs had been obtained under the N. I. R. A., and only such approval would give immunity from prosecution under the Sherman Act. Furthermore, even if such approval had been obtained, it would not have survived the expiration of the act on June 16, 1935. In a significant passage, he indicated that "the typical method adopted by Congress when it has lifted the ban of the Sherman Act is the scrutiny and approval of designated public representatives." 82 By way of illustration, he mentioned the adoption of the NRA codes with the approval of the President, the exemption from anti-trust prosecution of railway consolidations pursuant to orders of the Interstate Commerce Commission, the Maloney Act, providing for associations of brokers and dealers with the approval of the Securities and Exchange Commission, and the price control provisions of the Bituminous Coal Act of 1937 administered by the Bituminous Coal Commission.

The views of Justice Roberts, dissenting, are best indicated by the following excerpts from his opinion:

"There was substantial evidence that all the defendants agreed to, or did, was to act in concert to eliminate distress gasoline; that such gasoline was a competitive evil in that it tended to impair or destroy normal competition. There was substantial evidence that what they agreed to, and did, neither fixed nor controlled prices nor unreasonably affected normal competition and

31 Id., 310 U. S. at 216.
32 Id., 310 U. S. at 227, note 601.
that their conduct affected prices only in the sense that the purchase of distress gasoline at going prices permitted prices to rise to a normal competitive level. There was no evidence that, as charged in the indictment, they agreed to, or in fact did, fix prices. The Court of Appeals, as I think, correctly held 'that the substance of what was accomplished and agreed on was that the major companies would purchase from the independent refiners the latter's surplus gasoline at going market prices.'

"One of these firmly established principles [of earlier decisions] is that concerted action to remove a harmful and destructive practice in an industry, even though such removal have the effect of raising the price level, is not offensive to the Sherman Act if it is not intended and does not operate unreasonably to restrain interstate commerce; and such action has been held not unreasonably to restrain commerce if, as here, it involves no agreement for uniform prices but leaves the defendants free to compete with each other in the matter of price.

"I think Appalachian Coals, Inc. v. United States... a controlling authority sustaining the defendants' contention that the charge foreclosed a defense available to them under the Sherman Act. It is said that their combination had the purpose and effect of putting a floor under the spot market for gasoline. But that was precisely the purpose and effect of the plan in the Appalachian case. True, the means adopted to overcome the effect of the dumping of distress products on the market were not the same in the two cases, but means are unimportant provided purpose and effect are lawful."  

III

In order to evaluate the foregoing decisions it is necessary to understand thoroughly the difference between the economic and legal meanings of monopoly. In economics the term monopoly means control of the market; that is, the ability of a seller, by increasing or decreasing his output, to affect the price of the product sold. Until recent years monopoly was regarded as the antithesis of competition; the two were conceived to be qualitatively distinct. Moreover, the price system in general was regarded as conforming to this theoretical division; there was either competition or monopoly. The unrealistic character of this view of the economic organization is clearly brought out by an examination of the requisites of pure monopoly and pure

\[83\] Id., 310 U. S. at 260, 261, 261-262.

\[84\] An exception is the writings of the early mathematical economists on duopoly. For the modern theory, see E. H. Chamberlin, The Theory of Monopolistic Competition, 3d ed. (1938).
competition respectively. Strictly speaking, pure monopoly would involve control over the supply of all economic goods whatsoever by the same firm or agency. Competition of substitutes is thus excluded by definition. Obviously, monopoly in this sense does not exist. In practice pure monopoly is taken to mean exclusive control over the supply of a commodity for which there are no close substitutes. Even in this sense of the term the number of examples of pure monopoly outside the public utility field is small. At the opposite extreme, for pure competition to prevail, no buyer or seller, acting independently, could influence the price of the article sold. Very few examples of this type of market exist, the closest approximation being in staple crop agriculture.

Clearly the vast majority of all prices are determined under conditions intermediate between the foregoing extremes; that is, they reflect the joint operation of monopolistic and competitive influences, both of which are present in varying degrees in each case. There is a continuous gradation in degrees of market control intermediate between the extremes of pure monopoly and pure competition. This situation is described in modern economic theory by the terms oligopoly and monopolistic competition. Oligopoly refers to a situation in which the sellers of a given commodity are sufficiently few in number that “it is necessary for each one to take into account the effect that his own actions may have on the behavior of his rivals, and to act accordingly.” A condition of monopolistic competition exists “when there are many producers of a certain type of product, and when, at the same time, the substitution of the product of one firm for that of another is limited by product differentiation.” Frequently oligopoly and monopolistic competition are combined in a given case, but either one separately is sufficient to introduce monopolistic influences. In any event, price competition is disadvantageous from the standpoint of the individual firm and there is both opportunity and a strong incentive to turn competition into non-price channels.

The omnipresence of oligopoly and monopolistic competition, separately or in combination, introduces into the price system some elements which are desirable and others which are undesirable from the broadest public point of view. On the one hand, it may be pointed out, first, that in many industries the attainment of producing units of the

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85 In the following description of the economic meaning of monopoly the writer has drawn upon his paper, “The Public Interest Concept in Law and Economics,” 37 Mich. L. Rev. 181-208 (1938).
87 Id., 47.
most advantageous size would be impossible if the number of firms were large enough to permit pure competition to prevail. Second, it may be argued that, within limits, advertising expenditure and product differentiation increase the satisfaction of wants above what it would be under the standardization required for pure competition.

On the other hand, there is, first and obviously, the existence of monopoly profits scattered throughout the economic organization, as well as the facilitation of monopolistic agreements as the number of competitors declines. Second, under certain circumstances there is persistent overinvestment and excess capacity as a result of the failure of price competition to function. Costs and prices under such conditions would be above the competitive level although profits might not be in excess of a competitive rate. Third, product differentiation in many cases has been carried beyond the point which would prevail if consumers acted rationally and with full knowledge, with a resultant adverse effect on the national income. Fourth, monopoly elements permit price discrimination wherever markets can be separated. Finally, under oligopoly and monopolistic competition firms are able to define and pursue a policy with respect to such matters as price, investment, output and marketing arrangements. In many cases adverse results follow, as, for example, where the policy is to maintain rigid prices, which are recognized as aggravating business fluctuations.

Two implications of the foregoing analysis stand out. First, the protection of the public interest in matters of prices, costs and profits requires some type of supervision and control over virtually the entire price system. Second, the market relations characteristic of pure competition cannot in every case be used as a norm for such controls as may be set up over the existing system. It has been pointed out that, in certain respects and subject to appropriate controls, some elements of monopoly may be advantageous.

By contrast, as Professor Mason has pointed out, "The term monopoly as used in the law is not a tool of analysis but a standard of evaluation," by means of which public policy with respect to certain business practices might be developed. Partly because of the difficulty of using monopoly in the sense of control of the market as a standard of evaluation and partly for other reasons, monopoly has come to mean in the law the suppression of the freedom of an individual or firm to compete, by legal restraint, by agreements among competitors or by

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predatory tactics of rivals. While the dicta of the courts contain frequent reference to control of the market as indicative of monopoly, the evidence bearing on such control is almost entirely neglected in reaching the actual decisions. There is evidence that the courts in adopting this definition of monopoly were giving effect to the legislative understanding of the monopoly problem and to the intent of the Sherman Act. An examination of the debates on the latter measure indicates that the chief concern of Congress was to deal with industrial combinations which had secured a commanding position through predatory tactics, such as local price discrimination and the securing of railway rebates.

There are several reasons for the adoption by the law of the foregoing definition of monopoly.\textsuperscript{39} In the first place, in the earliest development of the law in the Elizabethan period in England monopoly came to be identified with an exclusive grant by the crown to individuals for the conduct of particular businesses, and the idea of exclusion, in the broad sense of restriction of competition, has been retained in the development of the law. Second, and probably of the greatest importance, it was necessary for the courts to have available tests capable of distinguishing between situations which were and were not in the public interest. If the economic definition of monopoly as control of the market were adopted and used as a standard of evaluation, there would be involved a complicated analysis of such factors as the behavior of prices and outputs, the relation of prices and costs, the share of the market controlled, the existence of such practices as price discrimination, and many others—a task which the courts would obviously be ill-equipped to undertake. By contrast, if monopoly were taken to mean restriction of competition, the tests of conformity to public interest would be comparatively simple. A third reason is that in an earlier period it is quite possible that restriction of competition through predatory tactics was more likely to be the means of securing control of the market than at present. Finally, before the Sherman Act most monopoly actions were brought by private interests, which were more likely to feel direct adverse effects from predatory tactics than from control of the market. Furthermore, injuries of this sort to private interests were more obvious than injuries to buyers or sellers by market control attained without such practices.

From the economic standpoint the legal conception of monopoly appears grossly inadequate. A very high degree of monopoly control, in the economic sense, would be possible without involving anything

\textsuperscript{39} Id., 45-46.
which the courts would call monopoly. In the first place, where a condition of oligopoly, as defined above, obtains, each seller must keep in mind that any change in his price will almost certainly be met by similar changes on the part of his rivals. Consequently, price changes tend to be infrequent, and a result similar to that which would have been reached by outright agreement is obtained, without collusion and without involving restraint of trade in the legal sense. Second, the amount of capital resources necessary to enter such industries as steel, automobiles and the like greatly hampers the entry of new firms and permits control of the market by those now in the field without resort to predatory tactics against potential competitors. Again, the use of trade marks and trade names to differentiate the product of the individual seller gives the latter some control over price, the degree of control depending upon his success, through intensive advertising, in differentiating his product in the minds of buyers. The economist refers to this as a condition of monopolistic competition, but the courts are unable to see any monopolistic element present, since there is no restriction of competition in the legal sense. It should be remarked in passing that the existence of monopolistic elements as a result of product differentiation is not regarded by the economist as necessarily or in every instance contrary to the public interest.

The foregoing comments serve to explain the rationale of the decisions in which the Supreme Court has permitted huge enterprises exercising important monopolistic influence to stand, as in the United States Steel and International Harvester cases, while on a number of occasions it has invalidated trade association and other collective activities imposing much weaker restraints on competition on the ground that they violated the prohibition on restraint of trade. Since mergers may take place for reasons other than the restriction of competition, the courts could not assume that all mergers were prima facie evidence of an attempt to monopolize. In view of the legal definition of monopoly, intent to monopolize would in such cases be indicated almost solely

by predatory tactics against present or potential competitors. On the other hand, under the same definition of monopoly, all contracts between competitors to limit competition would prima facie constitute restraint of trade.

Hence the rule of reason has for the most part been limited to distinguishing between mergers which are and those which are not guilty of predatory tactics. It has had a very restricted application in the case of agreements made by loose confederations of competitors. There have been only six cases in which this doctrine, or its equivalent, has been invoked to sanction agreements among competitors, namely the Maple Flooring, Cement, Chicago Board of Trade, Window Glass, "Cracking" Patents and Appalachian Coals cases. The application of the rule of reason in these decisions has been grounded primarily on the theory that the agreements involved were designed to regulate competitive methods rather than to regulate competition in the market. An example of this sort is the validation of the dissemination of information through trade associations, provided it is made available to all competitors and to customers and involves no coercive measures. This doctrine harmonizes with the legal conception of monopoly, since it favors arrangements which presumably facilitate rather than restrict freedom to compete. However, the regulation of competitive methods almost inevitably involves some degree of control of the market, and varying degrees of such control were ignored by the Court in the cases in which this doctrine was applied.

46 Board of Trade of City of Chicago v. United States, 246 U. S. 231, 38 S. Ct. 242 (1918).
50 See L. S. Lyon and V. Abramson, The Economics of Open Price Systems (1936). The following comment is very pertinent: "The enthusiasm with which a number of trade associations collect statistics, and the amounts of money members are willing to pay for them, are easily intelligible in terms of the theoretical conclusion that detailed knowledge of future trends makes monopolistic competition more effectively monopolistic and less competitive. This view of the economic function of statistics in trade association behavior is confirmed by observation of the place which informational services occupy in trade association activity. Where the trade consists of a few sellers, all relatively large in size, the informational services of the trade association are
In the *Appalachian Coals* case the Court while basing its approval of the arrangements involved on the theory that they were designed to improve the processes of producing and distributing coal, with only minor and incidental effects on the coal market, nevertheless seemingly opened the way for approval of activities bearing directly on price provided they did not interfere with the maintenance of effective competition.\(^{51}\) The Supreme Court accepted the distinction made by the lower court between concerted activity which merely "affected" prices and that which "fixed" them (in reality, varying degrees of monopolistic influence) and emphasized the absence of either power or intent on the part of the defendants to fix prices, and the pervasive competition which would continue to exist in the coal industry. In this connection it made the following significant comments:

"A cooperative enterprise—which carries with it no monopolistic menace, is not to be condemned as an undue restraint merely because it may affect a change in market conditions, where the change would be in mitigation of recognized evils and would not impair, but rather foster, fair competitive opportunities. ..."  
"If the mere size of a single embracing entity is not enough to bring a combination in corporate form within the statutory inhibition, the mere number and extent of the production of those engaged in a cooperative endeavor to remedy evils which may exist in an industry, and to improve competitive conditions, should not be regarded as producing illegality."\(^{52}\)

These remarks led to the expectation that the rule of reason would be given a broader application in cases involving loose confederations of competitors. The first statement quoted also indicated some possibility that the Court might adopt the economic tests in determining what constitutes an unreasonable control of the market, while the second revealed that the Court had not abandoned the traditional legal con-

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\(^{51}\) This is what Professor Handler calls the "concentric circle theory"; that is, the area of activity subjected to control is completely surrounded by a larger area of effective competition, so that in the Court's view there is no restraint of trade. See Handler, "The Sugar Institute Case and the Present Status of the Anti-trust Laws," 36 Col. L. Rev. 1 (1936).

ception of monopoly. Three years later, however, in the Sugar Institute cases, the Court, while reiterating approval of the interchange of information per se, invalidated many of the activities of the Institute because of the coercive tactics employed against members and customers. This decision, taken in conjunction with the Socony-Vacuum case, seems to indicate that, for the present at least, the Court intends to hold to the traditional legal definition of monopoly and to restrict very narrowly the application of the rule of reason in cases involving agreements among competitors.

We are now in a position to evaluate the decisions with which this paper is concerned. There will probably be general approval of the Court's action in the Ethyl Gasoline case in preventing the use of patents to fortify monopolistic influences in the gasoline market derived from the concentration of refining and marketing facilities in the hands of some twenty major companies. This case and the recent decision in Interstate Circuit v. United States, involving motion-picture copyrights, represent a commendable effort on the part of the Court to prevent the unwarranted extension of patent and copyright monopolies to types of conduct or lines of business not embraced within the proper scope of such monopolies. There is wide support for the view, however, that the Court is both unwilling and unable to provide the necessary amount of protection from abuse of the patent law, and that the problem calls for revision of both the patent law and the Sherman Act.

The Socony-Vacuum case illustrates some of the complexities which must be faced in developing legal controls in harmony with the requirements of a satisfactorily functioning economic order. With one possible qualification, the writer regards the decision as both legally and economically sound. On the legal side the refusal of the Court to sanction the concerted action of competitors involved in the buying program is strictly logical in view of the legal conception of monopoly as restriction of freedom to compete and is supported by the great preponderance of precedent. In rejecting the Appalachian Coals case as a precedent, the Court may have been influenced by the fact that the effect on prices of the plan there involved was conjectural, since it had not been put in operation. It may also have taken into account—and properly—the fact

that the sellers involved were a small minority of the total number and were confronted by powerful buyers, while in the *Socony-Vacuum* case the buying program was conducted by firms having a dominant position in the industry.

On the economic side the writer feels that, with one possible qualification, the decision was likewise sound. The price cutting, which the condemned activities sought to check, reflected the existence of both monopolistic and non-monopolistic imperfections and of excess capacity in the crude oil and gasoline markets. The plea that business men under these circumstances should be permitted to stabilize prices and to take steps to overcome price cutting cannot be countenanced, since it amounts to asking consumers not only to sanction monopolistic price-making but also to make good the losses attributable to excess capacity which the producers would otherwise have to bear by reason of their errors of judgment. This conclusion as applied to the petroleum industry is subject to the possible qualification that there may be some connection between stabilization of the price of gasoline and conservation of the crude oil supply. The connection lies in the fact that the fall of gasoline prices, if sufficiently drastic and prolonged, might eliminate a number of the weaker independent refiners or force them to shut down. This would greatly reduce the purchases of crude and would necessitate capping numerous high-cost wells, which in turn, through resulting subsurface changes, would permanently reduce the amount of recoverable oil or at least greatly increase the cost of its recovery. The validity and importance of this argument is difficult to assess, and full consideration of it would lead into the involved and hotly disputed question of the merits of proration laws. Some expert opinion minimizes the loss of oil through capping of wells, though it is not denied that the ultimate cost of recovering the oil may thereby be increased. Furthermore, how greatly a drastic and prolonged drop in gasoline prices would reduce the output of crude depends on the elasticity of demand for gasoline, a question on which exact information is as yet meager.

In view of the uncertain validity of the conservation argument, the writer feels that the Court was on sound ground economically in refusing to sanction the concerted activity involved in the *Socony-Vacuum* case. He is also of the opinion that the general principle followed by the Court of restricting narrowly its approval of agreements among competitors is in the public interest until criteria are developed

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for determining what types of market organization and business practices with regard to price and otherwise are socially desirable, and until provision is made for some kind of continuous supervision and control over business behavior.

In this connection, it may be pointed out that the Court in the Socony-Vacuum case especially emphasized that it was solely for Congress to decide whether, or to what extent, the Sherman Act should be relaxed in the case of trade association and other concerted activities of competitors.

"Congress has not left with us the determination of whether or not particular price-fixing schemes are wise or unwise, healthy or destructive," said Justice Douglas. "It has not permitted the age-old cry of ruinous competition and competitive evils to be a defense to price-fixing conspiracies. It has no more allowed genuine or fancied competitive abuses as a legal justification for such schemes than it has the good intentions of the members of the combination. If such a shift is to be made, it must be done by Congress. Certainly Congress has not left us with any such choice."

This statement reflects a commendable determination to avoid judicial encroachment on the legislative sphere and seems to represent a shift in attitude from some of the earlier decisions. It has been explained in the foregoing pages that the Court's tolerance of market control secured through mergers, so long as predatory tactics are not involved, is a result of the legal definition of monopoly, and that this in turn is consistent with the conception of the monopoly problem held by the framers of the Sherman Act.

The foregoing comments concerning the Socony-Vacuum case serve not only to describe the present status of the Sherman Act, but also to indicate the requirements of a satisfactory policy of industrial control. In the first place, it is clear that the Sherman Act must be revised in such a way as to give monopoly a legal meaning in terms of control of the market rather than in terms of restriction on freedom to compete. The mere existence of market controls, however, cannot be treated as necessarily contrary to the public interest and, hence, illegal. It has been pointed out that there is some degree of monopolistic influence present in almost all markets, and also that in some instances, and subject to appropriate controls, the maintenance of monopoly elements is in the public interest. Hence, the second and extremely difficult

requirement of public policy is the devising of criteria by which to distinguish between types of market organization and business practices which protect the interest of consumers and promote the satisfactory functioning of the economy and those which do not. Not much more than a beginning has been made in this task, but the professional economic literature dealing with this problem is increasing steadily and the material collected by the Temporary National Economic Committee should also prove helpful. Finally, provision must be made for the application of such standards of business behavior as are developed and for the continuous supervision and control of business conduct. Such control might be exercised through a Federal Trade Commission with enlarged powers, through government competition, through programs of subsidy and taxation, or in other ways. It is clear, however, that the courts are not adapted to this task; long ago “regulation by lawsuit” was discredited in the public utility field.

The foregoing suggestions with regard to a program of industrial control, far reaching as they are, raise a still larger issue. There is a grave question whether the degree of control implied in the foregoing suggestions would be administratively practicable and, what is most important of all, whether it would be consistent with the maintenance of political democracy. It has been aptly said that a good system of control must economize coercion. Undoubtedly conscientious enforcement of the anti-trust laws could accomplish much more than has hitherto been accomplished in the way of eliminating monopoly elements, the continuation and regulation of which is not required in the public interest. Undoubtedly also, much could and needs to be done in eliminating monopoly elements of the latter sort by revising our tariff, patent and incorporation laws. When all available methods of economizing coercion have been utilized, however, there will remain a vast area of industry in which varying degrees of monopoly will exist, which it is neither administratively practicable nor economically desirable to eliminate and which must therefore either be taken over by the government or subjected to some kind of supervision and control in the public interest.

The problem of industrial control is thus very different and far

more difficult than it was conceived to be by the framers of the Sherman Act. In their view, monopoly outside the public utility field was abnormal and exceptional, and the public interest could be adequately protected by maintaining freedom to compete by means of an anti-trust law. There is an important place for programs directed toward eliminating monopoly, indeed a larger place than is sometimes recognized, but there is a far larger place for efforts designed to supervise and regulate monopoly in the public interest. The problem of industrial control thus posed cannot be dodged, and upon our success in grappling with it will depend in large measure the maintenance of political democracy and the improvement of economic welfare in the immediate future.