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OVERVIEW

During the past term, the Tenth Circuit Court of Appeals reviewed two cases involving fundamental antitrust issues. Specifically, the court focused on the general bounds of the predatory pricing concept in the Tenth Circuit[1] and upon the ramifications of *Continental T. V., Inc. v. GTE Sylvania, Inc.* for the territorial marketing system used by the Adolph Coors Company.[2] Both of the cases to be discussed represent the court's struggle with two developing analytical frameworks that may have far reaching impact for antitrust litigation in the Tenth Circuit.

I. PREDATORY PRICING: *Pacific Engineering & Production Co. v. Kerr-McGee Corp.*, 551 F.2d 790 (10th Cir.), *cert. denied*, 97 S. Ct. 234 (1977)

Pacific Engineering & Production Co. v. Kerr-McGee Corp.[3] involved a suit by a manufacturer of a rocket fuel chemical, Pacific Engineering, against its competitor, Kerr-McGee.[4] The trial court found Kerr guilty of monopolizing and attempting to monopolize in violation of section 2 of the Sherman Act,[5] and of price discrimination in violation of section 2(a) of the Robinson-Patman Act.[6] The Tenth Circuit reversed the trial court's award to Pacific Engineering [PE] of treble damages of $4,590,594.00 and attorneys' fees of $528,000.00 on the basis that the antitrust laws were inapplicable to the facts before the court.

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[1] Pacific Engineering and Prod. Corp. v. Kerr-McGee Corp., 551 F.2d 790 (10th Cir.), *cert. denied*, 97 S. Ct. 234 (1977). *See* notes 3-26 and accompanying text *infra*.

[2] Adolph Coors Co. v. A&S Wholesalers, Inc., Nos. 76-1227 and 76-1228 (10th Cir., March 16, 1977) (Not for Routine Publication). *See* notes 27-43 and accompanying text *infra*.

[3] 551 F.2d 790 (10th Cir.), *cert. denied*, 97 S. Ct. 234 (1977).

[4] Kerr counterclaimed against PE for engaging in a group boycott by agreeing with two major buyers to take "stay alive" orders. The trial court dismissed the counterclaim and the Tenth Circuit upheld the dismissal on the basis that the findings of fact were not clearly erroneous. 551 F.2d at 799.

[5] 15 U.S.C. § 2 (1970) states that: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire . . . to monopolize . . . shall be deemed guilty of a felony . . . ."

[6] *Id.* § 13(a) (1970) states that: "It shall be unlawful for any person . . . to sell, or contract to sell, goods . . . at prices lower than those exacted by said person elsewhere in the United States for the purposes of destroying competition . . . ."

Kerr and Pacific Engineering manufactured a chemical used in rocket fuel. The major buyers of the chemical, of which there were only three,[7] were manufacturers of missiles for the federal government. Thus, demand was fixed by the government. At one time there were four companies manufacturing the chemical, but due to the reduction in the space program budget, only Kerr and PE were still engaged in production by 1966.

Citing *United States v. Grinnell*, the court recognized that the traditional elements of a monopolization claim are possession of monopoly power in the relevant market and the willful acquisition or maintenance of that power, as distinguished from power derived from a superior product, business acumen, or historic accident.[8] The court also relied upon the general rule that a finding of an attempt to monopolize requires proof of both a specific intent to monopolize and a dangerous probability of successful monopolization.[9] However, instead of applying these rules to the facts, the court identified the crucial issue as whether or not the defendant had engaged in predatory price cutting.[10]

The court found the defendant's prices to be below its total cost. Below-cost pricing is often one indication of predatory intent.[12] However, the court construed the Supreme Court's statement that below-cost pricing *may* be considered predatory as not constituting a definitive standard for determining the existence of predatory pricing. According to the court, under some circumstances, below-cost pricing might even be considered beneficial.[13]

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[7] The court noted that any price-cutting must to some extent be attributed to the three major buyers' method of soliciting bids. Preliminary bids would establish a ceiling price. Often they would tell a bidder that he should go lower if he wanted to get the bid. Sometimes this resulted in the low bidder underbidding himself. *Id.* at 792.

[8] *See* United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1965). For subsequent adoptions of the *Grinnell* test, see also United States v. Empire Gas Co., 537 F.2d 296, 302-07 (8th Cir. 1976), *cert. denied*, 430 U.S. 915 (1977); Morton Bldgs. of Neb., Inc. v. Morton Bldgs., Inc., 531 F.2d 910, 918 (8th Cir. 1976).

[9] *See* E.J. Delaney Corp. v. Bonne Bell, Inc., 525 F.2d 296 (10th Cir. 1975), *cert. denied*, 425 U.S. 907 (1976).

[10] 551 F.2d at 796. Since the plaintiff's claim of monopolization was based primarily on the defendant's pricing tactics, the court apparently felt the intent behind such pricing to be determinative.

[11] Total cost equals fixed costs (management expenses, depreciation property taxes, etc.) plus variable costs (labor, material, fuel, and any other cost which varies with output). 551 F.2d at n.2.

[12] Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 696 n.12 (1967).

[13] 551 F.2d at 796. It should be noted that the court gave no examples of beneficial below cost pricing.

The court acknowledged that there was ample evidence that the defendant knew PE could not survive at the low price level. The defendant had conducted extensive surveillance of the plaintiff's activities and was well informed of the plaintiff's plight, especially with respect to its financial situation.[14]

The evidence showed that Kerr once offered to "dump" a nonexistent surplus of the chemical to a PE customer at extremely low prices. It also appeared that the defendant raised its prices when the collapse of PE seemed certain, only to lower them when PE seemed to recover. Kerr's market share had also increased steadily since 1966.[15]

The court ignored this evidence and instead turned its attention to the "crucial" fact that Kerr's prices were above its average variable cost.[16] The court cited *Telex Corp. v. IBM Corp.*[17] for the proposition that section 2 of the Sherman Act does not prohibit "reasonable" price fluctuations. The court agreed with Professors Areeda and Turner[18] that marginal costs or average variable costs are the appropriate standards for determining the existence of a predatory intent as opposed to a "reasonable" fluctuation.[19]

The court preferred to ignore the traditional application of antitrust law to such facts[20] and instead utilized what can be called an "economic reality" approach to the issue. Both companies were operating below capacity.[21] Small price cuts were appar-

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[14] *Id.* at 792-93. The court noted that Pacific Engineering was a one-product company and was vastly undercapitalized.

[15] *Id.* at 793-94.

[16] Average variable cost is the sum of all variable costs divided by output. *Id.* at 792 n.3. The court also pointed out that in this industry the marginal costs decrease as output increases. *Id.* at 796 n.7.

[17] 510 F.2d 894, 927 (10th Cir.), *cert. dismissed*, 423 U.S. 802 (1975).

[18] Areeda & Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975).

[19] The court noted that "there is no indication of when downward price changes cease to be reasonable." 551 F.2d at 797.

[20] *See* United States v. Container Corp., 393 U.S. 333 (1969) and United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940), both supporting the position that price leadership is to be condemned. The court also cited Theatre Enterprises, Inc. v. Paramount Film Distrib. Corp., 346 U.S. 537 (1954) and Cackling Acres, Inc. v. Olson Farms, Inc., 541 F.2d 242 (10th Cir. 1976) for the general rule that parallel pricing may involve many of the same vices. 551 F.2d at 796.

[21] Recognizing that price leadership would invoke all the disadvantages of monopoly, the court believed that invocation of the antitrust laws would encourage, rather than discourage this result. 551 F.2d at 796.

ently effective in increasing market share. PE was obviously in an unsound condition. The court stated that it found the destruction of Pacific Engineering via price-cutting and the resulting monopoly economically preferable to a price leadership oligopoly. According to the court, price leadership would result in a selling price higher than it would be in a monopoly situation.[22] Therefore, the court held that under the circumstances of the case, below-cost pricing was more consistent with the competitive goals of the antitrust laws than to prevent such price-cutting to save a floundering company. In the court's estimation, such pricing was "rational, competitive behavior" rather than predatory action.[23] However, the court did limit its holding by stating that even under the facts of this case prices could have been set so low as to be considered predatory.[24] Apparently this limitation means pricing below average variable costs or marginal costs may be construed as predatory.

Robinson-Patman Charges— The allegations of discrimination under the Robinson-Patman Act[25] were based upon the fact that the defendant sold to a number of small-volume purchasers, constituting a relatively small percentage of the market, at scheduled prices which were higher than the bids submitted to the large-volume buyers. The court stated that the Robinson-Patman Act should be interpreted no differently than the Sherman Act. The court then dismissed the price discrimination charges on the basis that it had already determined that the defendant was engaging in lawful competition without any predatory intent and thus there was no injury to competition under Robinson-Patman.

The court recognized that its decision would result in the demise of many small businesses in the face of the pressures applied by their larger competitor. The court summarized its policy by stating that "[b]igness . . . is not a disqualification to compete."[26] In this case the Tenth Circuit was obviously concerned with the economic realities of business. The antitrust laws were not to be applied, however, in order to save a company which the court viewed as doomed. It is obvious that the court consid-

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[22] *Id.*

[23] *Id.* at 797.

[24] *Id.*

[25] 15 U.S.C. § 13(a) (1970).

[26] 551 F.2d at 799.

ered the plaintiff an unsound, ineffective competitor and a burden on society who should be purged from the marketplace by any means, even those questionable from an antitrust viewpoint. The opinion demonstrates a bias for those who can and do compete. This case seems to place an additional burden on the shoulders of the smaller competitor plaintiff: he must be able to show that he is a sound business and thus "worthy" of the protection of the antitrust laws.

II. Rule of Reason: *Adolph Coors Co. v. A&S Wholesalers, Inc.*, Nos. 76-1227 and 76-1228 (10th Cir., March 16, 1977) (Not for Routine Publication)

One of the most significant antitrust cases decided by the Tenth Circuit Court of Appeals during 1977 was *Adolph Coors Co. v. A&S Wholesalers, Inc.*[27] Of primary importance in this case was the Tenth Circuit's interpretation of the Supreme Court decision, *Continental T.V., Inc. v. G.T.E. Sylvania, Inc.*,[28] viewed in

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[27] Nos. 76-1227 and 76-1228 (10th Cir. March 16, 1977)(Not for Routine Publication). Adolph Coors Company [Coors] initiated a suit in 1973 seeking to enjoin A&S Wholesalers, Inc. [A&S] from purchasing Coors beer from Colorado retailers and transporting it to North Carolina for resale to retail outlets. On June 5, 1973, A&S filed an amended answer and counterclaim alleging that Coors had violated sections 1 and 2 of the Sherman Act (*see* note 6 *infra*) in that Coors, Coors Distributing Company, and other unknown persons had combined and conspired to impose customer and territorial restrictions upon independent distributors, wholesalers, and retailers in the sale of Coors beer. A&S requested damages and injunctive relief. Both parties appealed from the district court's order dismissing Coors' complaint and A&S's counterclaim, and dissolving the preliminary injunction. *Id.* at 2.

[28] 97 S. Ct. 2549 (1977). Prior to this decision vertical restrictions were governed by the *per se* rule announced in United States v. Arnold Schwinn & Co., 388 U.S. 365 (1967).

In *Continental T.V., Inc.*, the Supreme Court concluded that:

> [T]he appropriate decision is to return to the rule of reason that governed vertical restrictions prior to *Schwinn*. When competitive effects are shown to result from particular vertical restrictions they can be adequately policed under the rule of reason, the standard traditionally applied for the majority of anticompetitive practices challenged under Section 1 of the Act.

Id. at 2562.

An often cited statement of the rule of reason is that of Justice Brandeis in Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918):

> The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant

the wake of an earlier Tenth Circuit decision *Adolph Coors Co. v. FTC.*[29] Also of note was the Tenth Circuit's recognition of the applicability of federal antitrust laws to the regulation of liquor traffic, despite the twenty-first amendment's vesting of the regulations of such traffic within the borders of the respective states to the states.

The facts in A&S Wholesalers are of some significance because of the uniqueness of Coor's operation. Coors is the fourth largest brewery in terms of national consumption. In order to guarantee the integrity of its product, Coors has historically limited resale by its 167 distributors to ten and one-half of the western states. A distinctive feature of Coors is that it is the only "shipping brewery", i.e., Coors transports its product from its plant at Golden to the various distributors. The primary method employed by the brewery to maintain product integrity has been the implementation of a closely monitored program of refrigeration and rotation by the distributors.[30]

In 1974, the Tenth Circuit in *Adolph Coors v. FTC*[31] held that the territorial restrictions on resale imposed by Coors were violative of section 1 of the Sherman Act;[32] in light of the *per se* rule for vertical restrictions announced in *United States v. Arnold Schwinn & Co.*[33] The court, in dicta, noted:

> facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of the intent may help the court to interpret facts and to predict consequences.

Id. at 4831 n.15.

[29] 497 F.2d 1978 (10th Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975). The Tenth Circuit, bound by the *Schwinn per se* rule, concluded that Coors' territorial restrictions were violative of the Sherman Act. However, there were indications that the court wished to rule otherwise. *Id.* at 1187.

[30] Nos. 76-1227 and 76-1228 at 6.

[31] 497 F.2d at 1187.

[32] 15 U.S.C. § 1 (1970). This section provides, in pertinent 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 . . . ."

[33] 388 U.S. 365 (1967). The Supreme Court held that:

> Once the manufacturer has parted with title and risk, he has parted with dominion over the product, and his effort thereafter to restrict territory or persons to whom the product may be transferred, whether by explicit agreement or by silent combination or understanding with his vendee is a *per se* violation of Section 1 of the Sherman Act.

Id. at 382.

> Although we are compelled to follow the Schwinn *per se* rule, we believe that the *per se* rule should yield to situations where a *unique product requires territorial restrictions to remain in business*. . . . Perhaps the Supreme Court may see the wisdom of grafting an exception to the *per se* rule when a product is unique and where the manufacturer can justify its territorial restraints under the rule of reason. White Motor Co. v. United States, 372 U.S. 253 (1963) (emphasis added).[34]

This language demonstrates that the Tenth Circuit sought to protect Coors' interest in its "unique" product, but was precluded from doing so because of the continued vitality of the *Schwinn per se* rule for vertical restrictions.

The ruling for which the Tenth Circuit had been waiting came on June 23, 1977, when the Supreme Court decided *Continental T.V., Inc. v. GTE Sylvania, Inc.*[35] Justice Powell adopted the rule of reason test for vertical restrictions[36] and expressly overruled the *Schwinn per se* rule.[37]

It was in the aftermath of *GTE Sylvania* that the Tenth Circuit was called upon to decide *Adolph Coors Co. v. A&S Wholesalers, Inc.*[38] In this case, A&S contended that Coors' efforts at firm and resolute enforcement of territorial restrictions on resale of its products constituted a *per se* violation of section 1 of the Sherman Act. The court noted that, with the overruling of the *Schwinn per se* doctrine, the vertical restrictions and controls imposed by Coors would have to be tested under "the *rule of reason*, that is, whether they are required in order to protect

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[34] 497 F.2d at 1187.

[35] 97 S. Ct. 2549 (1977).

[36] *See* note 2 *supra*.

[37] For a full description of the *Schwinn per se* rule, see note 7 *supra*. Regarding *Continental T.V., Inc.*, Mr. Handler notes that:

> [T]he Court could have confined its ruling to the narrow facts of record, as Justice White proposed in his concurrence, instead, it adopted a rationale applicable to all vertical restraints without limitation. The Court did not hesitate to overrule *Schwinn*, a mischievous precedent which rested on a nonexistent principle of ancient property law, which was historically incorrect, indefensible as a matter of logic, and unjustifiable as a matter of economics.

(Citations omitted).

See, M. Handler, *Changing Trends in Antitrust Doctrines: An Unprecedented Supreme Court Term - 1977*, RECORD OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK 530, 532 (Nov. 1977).

[38] Nos. 76-1227 and 76-1228 at 13.

and insure the 'quality and integrity' of its beer product."[39] Recognizing the need for a full evidentiary hearing at the trial level to examine the impact of the rule of reason on Coors' vertical restrictions, the case was remanded to the trial court. In light of the statements in *Adolph Coors Co. v. FTC*, it is likely that this time Coors' interests in its "unique" product will be afforded some degree of protection.

The Tenth Circuit did, however, dispose of Coors' contention that the twenty-first amendment vested the regulation of liquor traffic within the borders of the respective states to the states, and "this, by necessary implication, denies application of federal antitrust laws which would defeat state policy governing the traffic of alcoholic beverages."[40] The Colorado statutes do seem to sanction vertical restrictions which have the effect of eliminating interterritorial competition between Coors' *wholesalers*.[41] However, there are no statutes sanctioning the type of vertical *customer* or territorial restrictions imposed by Coors. The Colorado state courts have not yet been forced to address the interplay between the Colorado statutes and Coors' twenty-first amendment contentions. In view of the lack of controlling state decisions or precedents, the Tenth Circuit afforded the federal district judge's views great weight.[42] The appellate court thus concluded that the trial court did not err in its conclusion that "the state's power to regulate liquor traffic under the twenty-first amendment provides the plaintiff with no defense to the antitrust claim here asserted."

In summary, the court's adoption of the "rule of reason" test, as used in deciding *GTE Sylvania*, marked the demise in the Tenth Circuit of the *Schwinn per se* rule for vertical restrictions. Vertical restrictions will now be tested under the rule of reason standard.[43] Under this new standard, the Tenth Circuit may have greater leeway in fashioning legal protection for manufacturers like Coors. In view of the court's statements in *Adolph Coors Co. v. FTC*, it appears likely that the court not only may, but will,

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[39] *Id.* at 18.

[40] COLO. REV. STAT. §§ 12-47-108(2), 124(4).

[41] *See* Volis v. Puritan Life Ins. Co., 548 F.2d 895 (10th Cir. 1977); Joyce v. Davis, 539 F.2d 1262 (10th Cir. 1976); Warde v. Davis, 494 F.2d 655 (10th Cir. 1974).

[42] Nos. 76-1227 and 76-1228 at 18.

[43] *See* note 2 *supra*.

do so. Therefore, as a result of the combination of *GTE Sylvania* and *Adolph Coors Co. v. A&S Wholesalers, Inc.*, it may become extremely difficult for both retailers and distributors to prove antitrust violations for vertical restrictions in the Tenth Circuit.

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