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Anti-trust Laws -- Requirements Contracts -- Tests of Illegality

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unduly prejudicial to them and unduly preferential to their competitors, and entered an order requiring that their rates not exceed the rates charged other competitors in the same general origin territory.

Decisions of the ICC are not necessarily final and may be taken before the federal courts. But once it is determined that the Commission is acting within its statutory authority, the court's power to review its findings of fact and rulings is extremely limited.[14] Congress intended to commit these problems to a permanent expert body and the courts recognize that they have neither the "technical competence nor the legal authority to pronounce upon the wisdom of the course taken by the Commission."[15] Numerous examples of court deference to the administrative expertise of the Interstate Commerce Commission reveal a marked indisposition even to consider the amount of weight given to each of the factors used in determining the justifiableness of a rate, and this proposition seems particularly applicable where the problem involved concerns fixing of rates for competing areas.[16]

By reaffirming in the instant case its policy of rare interference with the Commission's rulings, the court facilitates the reaching of the soundest possible solution to a problem for which it can hardly be hoped to find a perfect one.

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Anti-trust Laws—Requirements Contracts—Tests of Illegality

Section 3 of the Clayton Act[1] declares, *inter alia,* that "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 . . . whether patented or unpatented . . . on the condition, agreement or understanding that the lessee or purchaser thereof shall not use or deal in the goods . . . of a competitor . . . of the lessor or seller, where the effect of such lease, sale, or contract for sale . . . may be to substantially lessen competition or tend to create a monopoly in any line of commerce."

Since its passage in 1914, the United States Supreme Court, while not always denominating them, has had occasion to deal with two sepa-

[14] I. C. C. v. Mechling, 330 U.S. 567 (1947); United States v. Chicago Heights Trucking Co., 310 U.S. 344 (1939).

[15] Board of Trade of Kansas City v. United States, 314 U.S. 534, 548 (1942).

[16] United States v. Ill. Central R. R., 263 U.S. 515 (1924). Also see the statement of Mr. Justice Douglas in the instant case: "We would depart from our competence and our limited function in this field if we undertook to accommodate the factors of transportation conditions, distance and competition differently than the Commission has done in this case. That is a task peculiarly for it." 69 S. Ct. 278, 289.

[1] 38 STAT. 731 (1914), 15 U. S. C. §14 (1946).

rate and distinct types of contracts[2] which have been attacked as violative of that statute.

The first case to reach the court, *Standard Fashion Co. v. Magrane-Houston Co.*,[3] involved the so-called exclusive dealing arrangement[4] whereby the purchaser agrees to buy all his requirements of a certain product or products from the seller and the seller agrees to fully supply the purchaser. The Fashion company, through such contracts, controlled 40% of the pattern agencies in the country.

The court pointed out that the statute did not prohibit all contracts that created a mere possibility that competition would be lessened, but that a *probable, substantial* lessening had to be shown. However, because the defendant occupied such a dominant position in the industry, it felt that the lower courts were justified in finding that the challenged contracts substantially lessened competition in that they foreclosed competitors of the seller from a large portion of a total market and were, therefore, illegal.

Shortly thereafter the validity of the other type of contract, the tying agreement, was brought into question in the case of *United Shoe Machinery Co. v. United States.*[5] Defendant-patentee leased its patented shoe machinery subject to the requirement that it be used only with other machinery also leased by defendant and that the lessee buy all its supplies from the lessor. Defendant controlled 95% of the business in the industry. *Held:* "Such restrictive and tying agreements must necessarily lessen competition and tend to monopoly. . . . When it is considered that the United Company occupies a dominating position in supplying shoe machinery of the classes involved, these covenants, signed by the lessee and binding upon him, effectually prevent him from acquiring the machinery of a competitor of the lessor. . . ."[6]

In both cases, then, the Supreme Court placed emphasis on evidence that defendant occupied a dominant position in the industry. Until the decision in *International Salt Co. v. United States*[7] this continued to be so. Domination of the market was regarded "as sufficient in itself to support the inference that competition had been or probably would be lessened"[8] by use of the restrictive contract, whether a requirements

[2] Technically, a third type of contract has been attacked in one case. Federal Trade Commission v. Curtis Publishing Co., 260 U.S. 568 (1923), in which an agency contract was challenged as being an exclusive dealing arrangement.

[3] 258 U.S. 346 (1922).

[4] Variously called the "requirements contract," Standard Oil Co. of California v. United States, 69 S. Ct. 1051 (1949); and the "exclusive supply contract," Stockhausen, *The Commercial and Anti-Trust Aspects of Term Requirements Contracts*, 23 N. Y. U. L. Q. Rev. 412, 416 (1948).

[5] 258 U.S. 451 (1922).

[6] *Id.* at 457, 458.

[7] 332 U.S. 392 (1947).

[8] *See* Standard Oil Co. of California v. United States, —— U.S. ——, 69 S. Ct. 1051, 1056 (1949).

or tying agreement. Thus, requirements contracts were held violative of section 3 where defendants employing them did 90%,[9] 60%,[10] 50%[11] and 40%[12] of the business, as were tying clause arrangements where defendants controlled 95%[13] and 81%.[14]

On the other hand, where defendant did but one per cent of the business in the industry, it was held that its requirements contracts were not illegal and the court was significantly careful to point out that in other respects the case fell "fairly within the recent decision of . . . Standard Fashion Co. v. Magrane-Houston Co."[15]

Later, however, the circuit courts discarded the requirement of a showing of dominance in the tying clause cases. Although their users protested that they were either required for the protection of good will[16] or commercially necessary because of contract commitments of repair,[17] the tying agreements were made very vulnerable by the substitution of the more easily satisfied "quantitative" test.[18] Under this standard, a defendant's comparative position in the industry became unimportant if it could be shown that the volume of business done by him was quantitatively large. In the *International Salt* case the Supreme Court unqualifiedly endorsed this view, declaring the tying devices "unreasonable, *per se*" where "any substantial market" is involved.[19]

After the *International Salt* decision, then, the state of the law could be summarized as follows: In both requirements and tying clause agreements a probable substantial lessening of competition had to be shown

[9] Fleischmann Co., 1 F. T. C. 119 (1918).

[10] Fashion Originators' Guild of America v. Federal Trade Commission, 312 U.S. 457 (1940).

[11] Q. R. S. Music Co. v. F. T. C., 12 F. 2d 730 (7th Cir. 1926).

[12] Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346 (1922); Butterick Co. v. F. T. C., 4 F. 2d 910 (2d Cir. 1925), *cert. denied*, 267 U.S. 602 (1925).

[13] United Shoe Machinery Co. v. United States, 258 U.S. 451 (1922).

[14] International Business Machines Corp. v. United States 298 U.S. 131 (1936).

[15] B. S. Pearsall Butter Co. v. F. T. C., 292 Fed. 720, 721 (7th Cir. 1923).

[16] International Business Machines Corp. v. United States, 298 U.S. 131 (1936); Pick Mfg. Co. v. General Motors Corp., 80 F. 2d 641 (7th Cir. 1935), *aff'd per curiam*, 299 U.S. 3 (1936). The contention that the tying clause was necessary to protect good will was upheld in Pick Mfg. Co. v. General Motors Corp., *supra*; *cf.* F. T. C. v. Sinclair Refining Co., 261 U.S. 463 (1923).

[17] International Salt Co. v. United States, 332 U.S. 392 (1947); Judson L. Thomson Mfg. Co. v. F. T. C., 150 F. 2d 952 (1st Cir. 1945).

[18] This test required only a showing that the tying clauses covered a substantial market, measured quantitatively. Signode Steel Strapping Co. v. F. T. C., 132 F. 2d 48, 54 (4th Cir. 1942): "If a dealer by such unfair trade practice as is here involved restrains competition with respect to his customers, he ought not be permitted to continue it because his portion of the national business is small . . ." (Where defendant did but from 5% to 7% of the business in the trade.); Oxford Varnish Corp. v. Ault & Wiborg Corp., 83 F. 2d 764, 766 (6th Cir. 1936): "The ratio borne by the defendant's volume of business to the paint and varnish industry is not, we think, the measure by which monopolistic tendency of its contracts is to be determined." (Where defendant did but one-half of one per cent of the business in the trade.); *accord*, Judson L. Thomson Mfg. Co. v. F. T. C., 150 F. 2d 952 (1st Cir. 1945).

[19] 332 U.S. 392, 396 (1947).

to satisfy section 3 of the Clayton Act.[20] Where the former type was concerned nothing less than the inference of a substantial lessening, arising out of the employment of such contracts by companies dominant in their industry would satisfy the requirement, whereas in the latter, a showing that defendant did a quantitatively substantial business would give rise to the same inference and render the contracts illegal.

The justification for dealing less harshly with requirements contracts than with tying clause arrangements has been discussed by many writers.[21]

Whereas both types of agreements lessen competition in the sense that they deprive the seller or lessor's competitors of access to the market provided by the purchaser or lessee for the duration of the agreement, the requirement contracts, as contrasted with the tying agreements, do have legitimate business purposes. They benefit the buyer in that they assure him of a constant and adequate supply and thereby relieve him of the necessity of storing commodities for which his demand varies. Furthermore, by protecting him against rises in prices, they enable him to engage in long-term planning on the basis of known costs. The seller is also benefited in that he is assured of his demand and consequently may cut down on his selling expenses. If he is a newcomer to the field, he may estimate what capital expenses are justified by estimating, on the basis of such contracts, what the demand for his product will be. Still more important is the fact that if competition for the patronage of the ultimate consumer is present, the benefits accruing to the contracting parties must necessarily be passed on to the general public in the form of lower costs and better service.

On the other hand, tying agreements have been used only for the suppression of competition. They are the means of coercing the lessee who needs the patented article into buying all his supplies from the patentee, and thereby, in effect, extending the patent-sanctioned monopoly to unpatented goods which are tied to it. Benefits from the arrangement will rarely accrue either to the lessee or the public, and in the usual case both will suffer since the monopolist has the power to charge what the traffic will bear.

Whether or not this preferential treatment of requirements contracts was justified, the late case of *Standard Oil Co. of California v. United States*[22] has made it clear that they will no longer be accorded it. In that case, defendant, doing business in seven western states, sold 23% of the gasoline purchased in that area during the year 1946. The majority of these sales were made through company-owned service sta-

[20] Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346, 356 (1922).

[21] *E.g.*, Stockhausen, *The Commercial and Anti-Trust Aspects of Term Requirements Contracts*, 23 N. Y. U. L. Q. Rev. 412 (1948).

[22] 69 S. Ct. 1051 (1949).

tions or to industrial users, and the percentage of the total purchases from all suppliers which were made pursuant to defendant's exclusive supply contracts was but 6.7%. However, the dollar volume of Standard's business in the same year was large, amounting to over $58 million.

The District Court,[23] when presented with these figures, could discover scant authority among the requirements contract cases for a finding that they showed any substantial lessening of competition. Percentages had always controlled, and, as noted above, there was no requirements case where a defendant had been found to occupy a market position sufficiently dominant to make its interference substantial in the absence of a showing that it had done at least 40% of the business in the industry.[24] However, the court was of the opinion that the tying clause case of *International Salt Co. v. United States* controlled,[25] and, finding sales under the exclusive supply contracts quantitatively large, determined that they were illegal. In so doing, it refused to hear testimony as to the commercial merits of the exclusive dealing arrangements or to make findings as to whether Standard's competitive position had improved or deteriorated under the system.[26]

The Supreme Court, after reviewing all section 3 cases with which it had dealt prior to the *International Salt* case, concluded that none controlled since they had stressed the dominant position of defendant in the market and Standard did not occupy such a position. Moreover, the court conceded the economic advantages of the requirements contract and admitted that "since these advantages . . . may often be sufficient to account for their use, the coverage by such contracts of a substantial amount of business affords a weaker basis for the inference that competition may be lessened than would similar coverage by tying clauses. . . ."[27] It therefore felt that it "could not dispose of this case merely by citing International Salt Co. v. United States"[28] which involved the tying agreement.

So, instead of relying on that case, it turned to the statute itself and observed that since the requirements contract is one for the "sale of goods . . . on the condition . . . that the . . . purchaser thereof shall not

[23] United States v. Standard Oil Co. of California, 78 F. Supp. 850 (S. D. Cal. 1948), *aff'd*, 69 S. Ct. 1051 (1949).

[24] See notes 9-15 *supra*.

[25] While perhaps the court felt that the "dominance" test could be met in this case by virtue of the fact that other major suppliers in the area also employed the exclusive supply device and, considered collectively, dominated the market, it rested its decision on the quantitative test, saying, ". . . as I read the latest cases of the Supreme Court, I am compelled to find the practices here involved to be violative [of section three]. For they affect injuriously a sizeable part of interstate commerce . . ." United States v. Standard Oil Co. of California, 78 F. Supp. 850, 875 (S. D. Cal. 1948), *aff'd*, 69 S. Ct. 1051 (1949).

[26] Standard Oil Co. of California v. United States, 69 S. Ct. 1051, 1054 (1949). 1051, 1054 (1949).

[27] *Id.* at 1059.

[28] *Ibid.*

use or deal in the goods . . . of a competitor or competitors of the . . . seller,"[29] it must fall within the prohibitions of section 3 if "the effect of such . . . contract . . . may be to substantially lessen competition or tend to create a monopoly in any line of commerce."[30]

The court was of the opinion that in determining this "effect" it could give no consideration to the commercial merits and demerits of the contract involved, because it was not faced "with a broadly phrased expression of general policy [leaving it free to apply a more lenient test of illegality to requirements contracts], but merely a broadly phrased qualification of an otherwise narrowly directed statutory provision,"[31] and that the congressional intent behind the legislation had been to outlaw all exclusive dealing contracts which foreclose competion in a quantitatively substantial share of the line of commerce affected.

So interpreted, the statute did not leave room for evidence as to defendant's competitive position in the industry nor for testimony as to the commercial justification of the contract in the particular case. Consequently, the judgment below was affirmed.

Whatever arguments may be advanced against it, the decision in the *Standard Oil* case makes it clear that all restrictive contracts, whether of the tying or requirements variety, are illegal, without regard to surrounding circumstances and without resort to inference, if used by a defendant doing a quantitatively substantial volume of business.[32]

Section 3 does not, of course, deal with the ordinary long-term contract in which the purchaser agrees to buy a denominated amount of goods from the seller rather than all his requirements. Neither does it affect contracts of agency wherein the agent gets all his requirements from the principal. Moreover, the tying clause and requirements contract would likewise seem to be legal if its employer does not do a substantial volume of business in dollars and cents. Thus the small businessman can continue to use them in safety, *if* he can be sure that he is small enough. The difficulty is in the determination of where the line will be drawn between substantiality and insubstantiality.

ROBERT PERRY, JR.

[29] 38 STAT. 731 (1914), 15 U. S. C. §14 (1946).
[30] *Ibid.*
[31] Standard Oil Co. of California v. United States, 69 S. Ct. 1051, 1061 (1949).
[32] "We conclude, therefore, that the qualifying clause of section 3 is satisfied by proof that competition has been foreclosed in a substantial share of the line of commerce affected." *Id.* at 1062.