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NOTES

Antitrust Law—Horizontal Division of Territories and Customer Restrictions

In a recent antitrust case, *United States v. Topco Associates, Inc.*,¹ the United States Supreme Court has taken the opportunity to clarify the legal status of horizontal trade restraints under the Sherman Anti-Trust Act²—to wit, they are illegal.

Two issues were before the Court in *Topco*: first, whether the formation of an association by small- and medium-sized grocery chains for the purpose of allocating exclusive sales territories among themselves in order to market privately branded products procured by the association violates section one of the Sherman Act; and secondly, whether the requirement established by *Topco*'s bylaws that all member firms receive special permission from the association before wholesaling association products violates section one of the Sherman Act. More succinctly, the question was whether the rule of reason³ or a *per se* rule⁴ should be applied to horizontal territorial and customer restraints. While a pure case of horizontal trade restraints uncomplicated by intentional price fixing arrangements had not been presented previously, the court's holding—that a *per se* rule is applicable—had been presaged repeatedly through dictum and implication.⁵

In the 1940's *Topco Associates, Inc.*, was formed by a group of small grocery chains. Some larger chains were already marketing lines of privately branded products and had thereby gained a competitive advantage. Privately branded products allow the owning chain to sell a high-quality product at a lower price and still realize as much or more profit as would be realized from the sale of a comparable nationally advertised brand. The privately branded products also confer upon the selling chain a certain amount of good will and permit it to enjoy the market power⁶ associated with complete dominion over a branded prod-

¹92 S. Ct. 1126 (1972).

²51 U.S.C. §§ 1-7 (1970). The pertinent provisions of the Act are set out in the text accompanying note 13 *infra*.

³*See, e.g.*, *Standard Oil Co. v. United States*, 221 U.S. 1, 60 (1911).

⁴*See, e.g.*, *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958).

⁵*See, e.g.*, *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 379 (1967); *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963). These cases were not precisely on point. *Schwinn* and *White* involved vertically imposed restraints. Still, in these as well as other cases, the Court went to great lengths to make clear its position concerning horizontal trade restraints. For example, in *White*, the Court stated that "horizontal territorial limitations . . . are naked restraints of trade with no purpose except stifling of competition." *Id.*

⁶This type of market power is generally referred to as monopolistic competition. *See, e.g.*, E. CHAMBERLAIN, *THE THEORY OF MONOPOLISTIC COMPETITION* (7th ed. 1956).

uct. This arrangement seems to be beneficial to everyone—the smaller producer has an expanded market, the selling chain enjoys increased profits, and the consumer pays lower prices. The only interests injured by this marketing scheme are those of the smaller retailers who do not have the resources to market privately branded products. The formation of Topco was the answer of one group of smaller chains to the competitive challenge of the larger chains.⁷

Topco is an association of approximately twenty-five small and medium-sized retail food chains operating in well over half the states. Except for their association with Topco for purchasing purposes, the food chains are completely independent of each other. None of the member firms operates under the Topco name, and there is no pooling of earnings, management, or advertising resources.⁸ Topco merely owns the brand names for a rather large line of foods and nonfood items which it makes available to its member retailers.⁹

Most of Topco's member firms are in a strong competitive position in their respective areas. The average market share of Topco's members amounts to approximately 6%, ranging from 1.5% in some territories to 16% in others.¹⁰ The members' combined retail sales in 1967 came to 2.3 billion dollars. This amount was exceeded by only three of the large national grocery chains.¹¹ The association now contracts with suppliers to make available to its members more than one thousand separate products.¹² All of this indicates that both collectively and separately the association and its members are a potent economic force.

Section one of the Sherman Act begins with the language: "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. . . ."¹³ In *Standard Oil Co. v. United States*, the Court stated that section one contemplated some test for examining trade restraints and that "the standard of reason which had been applied at the common law . . . was intended to be the measure used. . . ."¹⁴ Thus the rule of reason was developed by the courts because of their practical need for a working standard in default

⁷92 S. Ct. at 1128-32.

⁸*Id.* at 1129.

⁹*Id.* at 1128-32.

¹⁰*Id.* at 1130.

¹¹*Id.*

¹²*Id.* at 1129.

¹³15 U.S.C. § 1 (1970).

¹⁴221 U.S. 1, 60 (1911).

of a legislative test.¹⁵

There are many difficulties involved in making an investigation under the rule of reason. It requires an extended analysis by the courts of highly technical areas of the general economy and of the particular markets concerned.¹⁶ This consumes considerable court time and requires a fairly high degree of technical expertise. For example, the district court spent nearly three months in deciding *Topco* under the rule of reason. While the rule of reason has the advantage of flexibility, this very flexibility also prevents business enterprises from making reliable judgments about the legality of contemplated marketing activities.

The need for certainty in the law and the desirability of avoiding the many difficulties and complexities inherently involved in the application of the rule of reason have given rise to the development of a set of *per se* rules that are applied in determining antitrust liability in given situations.¹⁷ In *Northern Pacific Railway v. United States*, Justice Black, a proponent of the *per se* rules, explained their utility and operation as follows: "[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are *conclusively presumed* to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."¹⁸ In short, a practice held to be illegal *per se* under the Sherman Act is conclusively presumed to be unreasonable.¹⁹ Since the rule is basically a tool of convenience the courts have been careful to limit its application to agreements that are essentially anticompetitive. The agreements to which *per se* rules have been most generally applied are tying arrangements,²⁰ division of mar-

¹⁵See generally Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 74 YALE L.J. 775 (1965).

¹⁶In *Board of Trade v. United States*, 246 U.S. 231, 238 (1918), the Court tersely stated the scope of an investigation under the rule of reason. There the Court said that in determining the reasonableness of a particular restraint, the courts should look to "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 facts."

¹⁷*Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958). See generally Van Cise, *The Future of Per Se in Antitrust Law*, 50 VA. L. REV. 1165 (1964).

¹⁸356 U.S. 1, 5 (1958) (emphasis added).

¹⁹*United States v. McKesson & Robbins, Inc.*, 351 U.S. 305, 309-10 (1956).

²⁰A tying arrangement is the refusal of a firm to sell one product over which it has some control—for example, a patented product—without an unrelated product, "tied," to it. For cases involving discussion of this practice, see *United States v. Loew's, Inc.*, 371 U.S. 38 (1962); *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958); *International Salt Co. v. United States*, 332 U.S.

kets,²¹ group boycotts,²² and price fixing.²³

The District Court for the Northern District of Illinois decided *Topco* under the rule of reason. The court made extensive findings of fact concerning markets, market shares, history, and purpose and concluded that "[t]he Topco licensing provisions are not inherently unreasonable and have no substantial adverse effect on competition in the relevant market."²⁴ It determined that any reduction in competition among the member firms and even the complete elimination of competition in Topco brands were outweighed by the increased competition that the member firms are enabled to bring to bear on the large national and regional grocery chains.²⁵ The court seemed persuaded largely by testimony from Topco officials to the effect that the association would be ruined if not allowed to continue its restrictive practices.²⁶

On appeal,²⁷ the Supreme Court held that Topco's practice of providing licenses to member firms for the exclusive right to sell Topco products in their designated territories is a horizontal territorial restraint,²⁸ and, *per se*, a violation of the Sherman Act. Similarly, the restrictions placed upon the wholesaling of association products by members was held to be illegal. The Court rejected the implication in the district court's opinion that "good intentions" can take an agreement out of the *per se* rule²⁹ and concluded that no private group of individuals has the power to foreclose competition in one sector of the economy in order to promote competition in another sector.³⁰

392 (1947).

²¹Division of markets is the division of territories or the allocation of customers by competing firms. For cases involving discussion of this practice, see *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); *United State v. White Motor Co.*, 372 U.S. 253 (1963); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951); *United States v. Addyston Pipe & Steel Co.*, 175 U.S. 211 (1899).

²²Group boycotts are agreements among a group of firms not to deal with some firm or group of firms. For cases involving discussion of this practice, see *United States v. General Motors Corp.*, 384 U.S. 127 (1966); *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690 (1962).

²³Price fixing is an agreement among competitors to set prices at a given level. For cases involving discussion of this practice, see *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964); *United States v. Masonite Corp.*, 316 U.S. 265 (1942); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

²⁴*United States v. Topco Associates, Inc.*, 319 F. Supp. 1031, 1038 (N.D. Ill. 1970).

²⁵*Id.* at 1043.

²⁶*Id.* at 1042.

²⁷The appeal was made directly to the United States Supreme Court pursuant to § 2 of the Expediting Act of 1913, 15 U.S.C. § 29 (1970). 92 S. Ct. at 1128.

²⁸92 S. Ct. at 1135.

²⁹*Id.*

³⁰Mr. Justice Blackman wrote in a concurring opinion that while the application of a *per se*

In his dissenting opinion, Chief Justice Burger pointed out that no pure case involving a horizontal territorial restraint had ever been presented.³¹ For this reason, and because much of the language cited by the majority concerning horizontal territorial restraints was only dictum, he stated that the Court need not and should not apply a *per se* rule.³² The Chief Justice did not deal directly with the customer restrictions aspect of the case.

The dissenting opinion relied on *White Motor Co. v. United States*³³ and *United States v. Arnold, Schwinn & Co.*³⁴ but was somewhat misleading in its treatment of these cases. Both *White* and *Schwinn* involved restrictions of territories and customers imposed vertically by manufacturers on distributors and dealers. In *White*, the district court had applied a *per se* rule by way of summary judgment in favor of the Government. The Supreme Court reversed, but the reversal was probably motivated more by a desire on the part of the Supreme Court to have the issue decided after full disclosure of facts at trial than by disagreement with the district court on the applicability of the *per se* rule. This interpretation of *White* is reinforced by the Court's disposition of *Schwinn*, a case involving facts substantially identical to those in *White*. Even though the defendant, Schwinn, did not appeal the district court's holding that the territorial restraints there were *per se* illegal and despite the Government's failure, perhaps prompted by *White*, to argue for a *per se* rule as to the customer restrictions, the Court went ahead to say that "[u]nder the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it. Such restraints are so obviously destructive of competition that their mere existence is enough."³⁵ As to goods sold, the Supreme Court of the United States had this to say about *both* territorial and customer restrictions in *Schwinn*:³⁶

Once the manufacturer has parted with title and risk, he has parted with dominion over the product, and his effort thereafter to restrict

rule to the kind of cooperative buying arrangement presented by *Topco* gives an anomalous result, the rule is too firmly established and should now be changed only by Congress. *Id.* at 1136.

³¹*Id.* at 1137.

³²*Id.*

³³372 U.S. 253 (1963).

³⁴388 U.S. 365 (1967).

³⁵*Id.* at 379.

³⁶388 U.S. 365 (1967).

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 § 1 of the Sherman Act.³⁷

The Topco arrangement has the appearance of one brought about vertically because the restraints are technically imposed by the association upon the member retailers. In effect, however, these restraints are effected horizontally³⁸ by the member firms who created the association.³⁹ In *United States v. Sealy, Inc.*,⁴⁰ the Court was faced with an arrangement almost identical to that in *Topco* (*Sealy* also involved price fixing). Sealy, Inc., owned the trade marks for bedding products. It licensed manufacturers in different sections of the country to produce and market mattresses under the Sealy brand. The licensees were given exclusive territories; no one could be granted a license to manufacture and sell Sealy mattresses in a licensee's territory, and licensees were not permitted to market Sealy branded mattresses outside their designated territories. The Sealy licensees owned substantially all of Sealy's stock and completely controlled its operations.⁴¹ There, the Court stated, "If we look at substance rather than form, there is little room for debate. These must be classified as horizontal restraints."⁴²

In view of the language in *Schwinn* concerning a vertical restraint on territories and customers and in view of the characterization in *Sealy* of Topco-type arrangements as horizontal restraints, it should come as no surprise that the Court would hold the restraints in *Topco* to be illegal *per se*. Horizontal restraints are considered highly detrimental to competition because they are imposed by agreement between firms at the same level of trade—firms that should be directly competing with each other. It is for this reason that the courts have traditionally been more suspicious of horizontal restraints than of the vertical ones declared to be illegal in *Schwinn*. While the *Topco* result might have been predicted, the fact remains that the case illustrates the inflexibility of application of a *per se* rule. The majority in *Topco* seems to agree with

³⁷*Id.* at 382.

³⁸See Aycock, *Antitrust and Unfair Trade Practice Law in North Carolina—Federal Law Compared*, 50 N.C.L. REV. 199, 221-23 (1972).

³⁹Topco is completely controlled by its members who own all of the outstanding shares of stock. The board of directors is drawn exclusively from the executive officers of the member firms, and the executive officers of Topco are drawn exclusively from the Topco board of directors. There are restrictions upon the alienation of Topco stock by the members. 92 S. Ct. at 1129.

⁴⁰388 U.S. 350 (1967).

⁴¹*Id.* at 351-54.

⁴²*Id.* at 352.

the district court that the Topco arrangement may not be evil and may even be a positive good. Nevertheless, the agreement is illegal under the *per se* rule.

In *White*, the Court suggested that in cases involving failing businesses and newcomers, exceptions might be made to allow decision under the rule of reason rather than under a *per se* rule.⁴³ While *Topco* involved neither situation, perhaps another exception could be devised to cover cases like *Topco* involving a technically forbidden arrangement that may in fact be beneficial to the public from a competitive standpoint. Professor Oppenheim has made a proposal along these lines. He has suggested that a *prima facie* approach be used in the application of the *per se* rule.⁴⁴ Under this approach, the Government need only show the existence of the forbidden arrangement or practice to establish a *prima facie* case. Then the burden would shift to the defendant to show the reasonableness of, or justification for, the practice. The difficulty with this proposal is that the courts would still be required to "ramble through the wilds of economic theory,"⁴⁵ with the result that the purpose of the *per se* rule would be defeated.

Topco was decided correctly because the need for *per se* rules is obvious and because the very nature of a *per se* rule requires that it be applied blindly. To be sure, the rule could be extremely oppressive if it were haphazardly formulated; but the courts have carefully considered horizontal territorial restraints and customer restrictions in many different business settings and time after time have found them to be anticompetitive and without any redeeming value. The idea of competitors getting together, dividing up markets, and agreeing not to compete is repugnant to the spirit of the Sherman Act. *Topco* probably presents these restraints in the most appealing setting possible, but it is nevertheless apparent that the arrangement eliminates competition insofar as Topco brands are concerned and reduces the ability of nonmember small retailers to compete. While the Topco arrangement does allow the member firms to compete better with the larger chains, it is far from clear that this benefit to the public outweighs the damage caused by reduced competition.

It is not clear that the Topco-type arrangement has been badly damaged by the decision. The association still has the right to sell only

⁴³72 U.S. at 263-64.

⁴⁴Oppenheim, *Federal Antitrust Legislation: Guideposts to a Revised National Antitrust Policy*, 50 MICH. L. REV. 1139, 1158-61 (1952).

⁴⁵2 S. Ct. at 1134 N.10.

to member chains; and, because of geographical separation, the members are not natural competitors. But even if some direct competition should arise as a result of the expansion of some of the members, there remains a competitive advantage, albeit shared, over the nonmember chains operating in the area of overlap. Also, since the reason for the formation of the association was to provide the member *retail* chains with private labels so that they might better compete with the larger chains, it would seem that wholesaling should amount to a relatively insignificant part of the members' sales.

The significance of *Topco* is that it reaffirms the Court's commitment to *per se* rules of the illegality of certain agreements and practices under the Sherman Act and establishes to a certainty that horizontal territorial restraints and customer restrictions are *per se* illegal *even when not accompanied by price fixing*.⁴⁶ It appears that the Court has followed a more or less straight course in arriving at the *Topco* decision. When faced with this pure case of horizontal territorial restraints and customer restrictions, the Court did just what it had indicated it would do. Now, with *Topco* placed beside *Schwinn*, it seems clear that division of territories among competitors or restrictions upon the customers to whom they may sell are *per se* violations of the Sherman Act whether the arrangement is brought about horizontally or vertically.

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Constitutional Law: Conventional Reluctance or Doctrinal Departure? The Political Question Doctrine.

Shortly before the 1972 Democratic National Convention, the Supreme Court was asked to consider a suit, *O'Brien v. Brown*,¹ filed by California delegates who had been excluded from the Convention by a ruling of the Democratic Credentials Committee.² The Court, uncomfortably confined by lack of time, issued a brief opinion which both delayed action on the petition for certiorari and stayed the Court of

⁴⁶See generally *Case Comment, Horizontal Territorial Restraints and the Per Se Rule*, 28 *Wash. & Lee L. Rev.* 457 (1971).

¹92 S. Ct. 2718 (1972) (per curiam). The petition for certiorari was filed on July 6, 1972 and the full convention began July 10th.

²The 1972 Credentials Committee had issued its decision on June 29, 1972. *Brown v. O'Brien*, No. 72-1628, at 4 (D.C. Cir. July 5, 1972).