

EXCLUSIVE DEALING, TYING AND RECIPROCITY —A REAPPRAISAL

RICHARD E. DAY*

Justice Holmes' observation that "the life of the law has not been logic, it has been experience,"¹ could have been written with today's antitrust lawyer in mind. Although experience has lived up to its reputation as a "dear" teacher in antitrust, it can claim the title of "best" teacher only by default. Despite an incubation period spanning more than three-quarters of a century, the courts, enforcement agencies, lawyers and businessmen are still brooding over the nature and meaning of antitrust. Instead of evolving precise standards, or refining meaningful guidelines, decisions commonly have hatched new confusion and have unsettled areas which had been generally understood to be well settled. Nowhere has this fact been more apparent than in the law relating to restrictive dealing arrangements between suppliers and their customers—specifically, so-called exclusive dealing, tying and reciprocity.²

I. THE LABEL LABYRINTH

A major cause of this confusion has been a blind preoccupation with labels in an effort to simplify, or eliminate entirely, problem-solving on an *ad hoc* basis—often leading to what Justice Fortas (prior to his appointment to the bench) referred to as the "no-think school" of antitrust jurisprudence.³ Traditionally, tying is defined as the sale or lease of one commodity on the condition that one or more separate and distinctly different commodities are also purchased or leased. Exclusive dealing is defined as the sale or lease of a commodity on the condition that the purchaser/lessee not deal in such commodities of a competitor, that is, that he agree to deal exclusively in the commodities of the seller/lessor. Reciprocity is said to involve a purchase conditioned on a reciprocal sale—commonly expressed as the understanding that "I will buy from you if you will buy from me," or more pointedly, "I will not buy from

* Professor of Law, the Ohio State University.

¹ O. W. HOLMES, *THE COMMON LAW* 1 (1881).

² Evidence of the extent of the confusion and controversy in this area of antitrust law may be found in the prodigious amount of writings it has generated over the years. Comprehensive bibliographies relevant to each of the restrictive dealing topics discussed in this paper may be found in S. OPPENHEIM AND G. WESTON, *FEDERAL ANTITRUST LAWS* (1968).

³ Fortas, 23 A.B.A. ANTITRUST SECTION 323, 328 (1963).

you *unless* you buy from me." The failure to recognize the functional similarities as well as the distinctions between these various distribution practices and the relation of each to the others has contributed unnecessarily to the problem of establishing workable standards of legality.

Placed in their proper context, all of these practices may be viewed as means to accomplish partial integration of the parties—integration, in the sense that control over the operations of separate entities is consolidated; partial, to the extent that the resulting control is incomplete. Historically, mainly because of the limited thrust of Clayton Act section 3,⁴ the primary antitrust concern has been with such integration of the forward-vertical type—restrictions imposed on a buyer by his seller. However, these practices may be of the backward-vertical type—restrictions imposed on a seller by his buyer—or reciprocal backward and forward restrictions that mutually circumscribe the marketing practices of both parties.

These three restrictive dealing practices also have in common the use of bargaining power in the sale, purchase, or lease of one product as "leverage" either to secure the purchase, sale, or lease of an additional product or products or to require the covenantee not to deal with competitors of the covenantor. To call one, but not the others, "tying" is therefore deceptively misdescriptive. The distinguishing feature is not that "leverage" is used for tying, but that in so-called "tie-ins" the dealing in one product is conditioned on dealing in a *different* product rather than in more of the *same* product as in "exclusive dealing," or in different products sold by the respective parties to each other as in "reciprocity." It would be more accurate to say that each of these three practices is merely a different form of "tying" accomplished through a different application of leverage.

The term "exclusive dealing" is no less misdescriptive. First, the evil common to each of these restrictive dealing practices is said to be the elimination of freedom of choice in the restricted covenantor to deal in competing products "on their merits," and the resulting foreclosure of the covenantee's competitors from compe-

⁴ 15 U.S.C. § 14 (1964):

It shall be unlawful for any person . . . to lease or make a sale or contract for sale of goods . . . on the condition . . . that the lessee or purchaser thereof shall not use or deal in the goods . . . of a competitor or competitors 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. (emphasis added.)

tion in the "tied" products. Therefore, because each is condemned for its "foreclosure" effect, all are properly described as different forms of exclusive dealing. Second, confusion is compounded when the term "exclusive dealing" is used to distinguish restrictions on the buyer from restrictions on the seller. Again, both are forms of exclusive dealing. More descriptive labels would be either "exclusive buying" or "requirements contracts," for restrictions on buyers, and either "exclusive selling" or "output contracts," for restrictions on sellers. Finally, to the extent that the word "exclusive" denotes absolute foreclosure it is inaccurate when applied to partial, rather than full, output or requirements restrictions. The degree of exclusivity will vary according to the scope of the restrictions: The longer they run, the greater the geographical area covered, and the more products and parties "tied up" by such arrangements with the same or competing parties, the greater the possibility that competition will be substantially foreclosed.

Although it is obvious that these restrictive dealing practices may be used alone or in many different combinations with widely differing purposes and competitive effects, the Federal Trade Commission and the courts have persistently adhered to the traditional classifications and definitions, with the result that the standard of legality has often depended upon the label attached to the particular conduct under consideration. Tying and, by analogy, reciprocity have received harsher treatment than exclusive dealing arrangements, mainly because of a judicially modified "extension-of-monopoly" theory of tying which is inapplicable to exclusive dealing.

II. EVOLUTION OF THE LAW

A. Tying—*The Quantitative Substantiality Test*

Stated simply, under the extension-of-monopoly theory, monopoly power in one (tying) market is said to be used as a lever to foreclose competition in, or to extend the monopoly to, a second (tied) market by conditioning the sale or lease of the monopoly (tying) product on the purchase or lease of a second (tied) product. The genesis of the extension-of-monopoly theory of tying may be traced at least as far back as the Supreme Court's 1917 decision in *Motion Picture Patents Co. v. Universal Film Mfg. Co.*,⁵ in which the Court reversed its prior position to hold that it is beyond the scope of the statutory patent monopoly, and is therefore patent misuse, to tie unpatented supplies to the sale or lease of a patented machine.

⁵ 243 U.S. 502 (1917).

The idea that it is an unjustified extension of a patent to use the statutory monopoly as a lever to foreclose competition in a different (tied) market was subsequently utilized to find antitrust violations, reaching its apex in the virtually *per se* test promulgated in *International Salt Co. v. United States*.⁶ International had leased its patented salt-dispensing machines on the condition that the lessees purchase from it all of their salt requirements for use in the leased machines. In unanimously upholding a judgment that International's patent tying arrangement violated both Clayton Act section 3 and Sherman Act section 1,⁷ the Court stated that it is "unreasonable, *per se*, to foreclose competitors from any substantial market."⁸ The requisite "substantial" foreclosure was found in the fact that the volume of business affected was about 500,000 dollars in salt annually.⁹ The essentially *per se* nature of this "quantitative substantiality" test is evident from the fact that no effort was made to determine whether International possessed a dominant position in the tying market (salt machines), or whether it had foreclosed a substantial percentage *share* of the tied market (salt) generally.¹⁰

In non-patent tying cases, the controversy continued to center on the degree of power in the tying product, or the amount of foreclosure in the tied product, necessary to establish a violation. The Court initially indicated that different tests would apply under the Sherman and Clayton Acts. As stated by Justice Clark, for the five-to-four majority in *Times-Picayune Publishing Co. v. United States*:

When the seller enjoys a monopolistic position in the market for the "tying" product, or if a substantial volume of commerce in the "tied" product is restrained, a tying arrangement violates the narrower standards expressed in § 3 of the Clayton Act be-

⁶ 332 U.S. 392 (1947).

⁷ 15 U.S.C. § 1 (1964):

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

⁸ 332 U.S. 392, 396 (1947).

⁹ *Id.* at 395.

¹⁰ As the Court later pointed out,

It was not established that equivalent machines were unobtainable, it was not indicated what proportion of the business of supplying such machines was controlled by defendant, and it was deemed irrelevant that there was no evidence as to the actual effect of the tying clauses upon competition.

Standard Oil Co. v. United States, 337 U.S. 293, 305 (1949). In fact, International offered to prove, and the Government did not controvert, that satisfactory substitutes for its salt machines were available from competitors, but the Court deemed such proof irrelevant. See Northern Pacific Ry. Co. v. United States, 356 U.S. 1, 10 n.8 (1958).

cause from either factor the requisite potential lessening of competition is inferred. And because for even a lawful monopolist it is "unreasonable, *per se*, to foreclose competitors from any substantial market," a tying arrangement is banned by § 1 of the Sherman Act whenever *both* conditions are met.¹¹

Any thought that mere "product differentiation" alone would supply the requisite leverage was flatly rejected. According to Justice Clark:

[T]he essence of illegality in tying agreements is the wielding of monopolistic leverage; a seller exploits his dominant position in one market to expand his empire into the next. Solely for testing the strength of that lever, the whole and not part of a relevant market must be assigned controlling weight.¹²

Thus, according to *Times-Picayune*, whereas a patent may be "prima facie evidence of [market] control," in other cases the determination of dominance in the tying product "must rest on comparative marketing data."¹³

This apparent gap between the tests for patent and non-patent tying cases was closed in *Northern Pacific Ry. Co. v. United States*,¹⁴ where Justice Black, speaking for the five-to-four majority, held that both types of cases were equally subject to the "per se" test of *International Salt*. Indeed, he felt that in the latter case, "[i]f anything, the Court held the challenged tying arrangements unlawful *despite* the fact that the tying item was patented, not because of it."¹⁵ Although his opinion loosely refers to tying as "per se" illegal, Justice Black made it clear that more is required than merely proving the existence of tying:

Of course where the seller has no control or dominance over the tying product so that it does not represent an effectual weapon

¹¹ 345 U.S. 594, 608-09 (1953).

¹² *Id.* at 611.

¹³ *Id.* Significantly, the basic disagreement expressed in Justice Burton's dissenting opinion (joined by Justices Black, Douglas and Minton) was not in the majority's dual test, but in its factual finding that *Times-Picayune* did not enjoy a "dominant position" in the New Orleans newspaper advertising market by "including all three [morning and evening] papers, as a single market." *Id.* at 628. Justice Burton felt that morning newspaper advertising was a separate market from evening advertising, and viewed *Times-Picayune* as exercising its monopoly power in the only morning paper as a lever to foreclose advertising competition with its evening paper by using a "combination rate" to tie the sale of advertising in its morning paper to simultaneous advertising in its evening paper.

¹⁴ 356 U.S. 1 (1958).

¹⁵ *Id.* at 9.

to pressure buyers into taking the tied item any restraint of trade attributable to such tying arrangements would obviously be insignificant at most. As a simple example, if one of a dozen food stores in a community were to refuse to sell flour unless the buyer also took sugar it would hardly tend to restrain competition in sugar if its competitors were ready and able to sell flour by itself.¹⁶

On the other hand, the references in *Times-Picayune* to "monopoly power" and "dominance" in the tying product were interpreted by Justice Black as requiring only "sufficient economic power to impose an appreciable restraint on free competition in the tied product."¹⁷

In *Northern Pacific*, the railroad had included "preferential routing" clauses in its contracts of sale or leases of land along its tracks. These clauses required the vendee or lessee to ship via Northern all commodities produced or manufactured on the land, at least where its rates and services were equal to those of competing carriers. No attempt was made to define the nature or scope of the relevant tying (land) market, nor to determine Northern's relative share of that market. Apparently it was assumed that the inherent "uniqueness" of each parcel of land, and the "host" of tying clauses involved in the sale or lease of "at least several million acres," provided "sufficient economic power" to impose the proscribed restraint.¹⁸

Curiously, the Court ignored the question of competitive effect in the tied market—transportation, or transportation of commodities from the tying land. The Court did not indicate the degree to which competition in transportation was foreclosed, the number of rail-

¹⁶ *Id.* at 6-7.

¹⁷ *Id.* at 11.

¹⁸ According to Justice Black, "the very existence of this host of tying arrangements is itself compelling evidence of the defendant's great power, at least where, as here, no other explanation has been offered for the existence of these restraints." *Id.* at 7-8. The theory that each parcel of land, having "unique" attributes, necessarily supplied "sufficient economic power" was disputed by Justice Harlan in his dissent. He would have required

evidence of the relative strength of appellants' landholdings *vis-à-vis* that of others in the appropriate market for land of the types now or formerly possessed by appellants, or the "uniqueness" of appellants' landholdings in terms of quality or use to which they may have been put, and of the extent to which the location of the lands on or near the Northern Pacific's railroad line, or any other circumstances, put the appellants in a strategic position as against other sellers and lessors of land. *Id.* at 16.

See Turner, *The Validity of Tying Arrangements Under the Antitrust Laws*, 72 HARV. L. REV. 50, 52-54 (1958); Austin, *The Tying Arrangement: A Critique and Some New Thoughts*, 1967 WIS. L. REV. 88, 109.

roads (or of other forms of transportation), if any, that competed with Northern in servicing the land, all of which was adjacent to its tracks, or what commodities, or how much of each, were shipped from the tying land. The conspicuous absence of proof of any of these questions, without objection from an otherwise vigorous dissent,¹⁹ suggests that the Court, both majority and dissent, considered the only material issue to be one of "sufficient economic power" to impose the tying restriction. Minimally, this would amount to eliminating, sub silentio, the *Times-Picayune* distinction between the Clayton and Sherman Act tests for tying. No longer would the Sherman Act require a showing of *both* the proscribed power and effect, but proof of power alone would suffice, as under the Clayton Act's incipency standard. Considering the apparent ease of proving the requisite power under the majority view, the net effect of *Northern Pacific* is that tying arrangements are virtually per se illegal under the Sherman Act as well as under the Clayton Act.

This conclusion is reinforced by the Court's most recent decision involving movie block-booking. In *United States v. Loew's Inc.*,²⁰ the Court held that conditioning the license or sale of copyrighted feature films upon the acceptance by a television station of a package containing unwanted or inferior copyrighted films was an unlawful tying arrangement under section 1 of the Sherman Act. Similar tying arrangements between film distributors and movie theaters previously had been banned in *United States v. Paramount Pictures, Inc.*,²¹ by analogy to the patent tying cases. Appellants in *Loew's* sought to distinguish the *Paramount* holding on the ground that the "uniqueness" attributable to copyrighted films in that case was lost when sold for television use. Such films were said to constitute less than eight percent of television programming and were "reasonably interchangeable" with other program material, including other feature films. Consequently, they argued that the evidence

¹⁹ For the dissenters, Justice Harlan contended that more was required than merely the "ad hoc 'dominance'" possessed by any seller in his own tying product to establish the requisite "market control." 356 U.S. at 15-16. While agreeing that "monopoly power" was not needed, he felt that the "economic power" sufficient to supply this leverage would be a matter of proof, based upon such factors as

significant percentage control of the relevant market, desirability of the product to the purchaser, use of tying clauses which would be likely to result in economic detriment to vendees or lessees, and such uniqueness of the tying product as to suggest comparison with a monopoly by patent. *Id.* at 19.

²⁰ 371 U.S. 38 (1962).

²¹ 334 U.S. 131 (1948).

did not support a finding of "sufficient economic power" in the tying product.

In rejecting this contention, Justice Goldberg concluded for the Court that the existence of competing substitutes for the tying product was insufficient to alter the distinctiveness of the copyrighted films. As explained by Justice Goldberg, "the crucial economic power may be inferred from the tying product's desirability to consumers or from uniqueness in its attributes."²² Particularly revealing is the footnote expansion of this theory:

Since the requisite economic power may be found on the basis of either uniqueness or consumer appeal, and since market dominance in the present context does not necessitate a demonstration of market power in the sense of § 2 of the Sherman Act, it should seldom be necessary in a tie-in sale case to embark upon a full-scale factual inquiry into the scope of the relevant market for the tying product and into the corollary problem of the seller's percentage share in that market.²³

If the test in the tying-product market is merely one of "uniqueness or consumer appeal," should a similarly narrow definition of the line of commerce be followed in determining the amount of foreclosure in the tied-product market? If the "uniqueness" test for copyrighted tying films were applied to the copyrighted tied films, there could be no foreclosure of competition resulting from the tie-in because, by that standard, there could be no competition with the "unique" tied films to be foreclosed.²⁴ Here, however, the Court demonstrated its agility by defining the tied-product market more broadly to encompass other programming material, including other copyrighted films, thereby enabling it to find the requisite foreclosure of competition in the tied-product market. According to Justice Goldberg, "the distinctiveness of the copyrighted tied product is not inconsistent with the fact of competition, in the form of other programming material and other films, which is suppressed by the tying arrangements."²⁵ Having defined the tying-product market narrowly enough to establish "power," and the tied-product market broadly enough to demonstrate possible foreclosure of competition, the

²² 371 U.S. at 45.

²³ *Id.* at 45 n.4.

²⁴ See Adams, *The Legality of Compulsory Package Licensing of Patents*, 12 ANTI-TRUST BULL. 773, 782-83 (1967).

²⁵ 371 U.S. at 49.

Court then fell back on a loose "quantitative" test for finding the proscribed effect.²⁶

The net result of *Loew's* is a test as near to per se illegality as one can get without denying the possibility of any exception. Although Justice Goldberg left open the possibility of "rare circumstances" in which the per se test might not apply under the Sherman Act to tying arrangements involving patented or copyrighted products, he found it "difficult to conceive of such a case."²⁷ Indeed, under the flexible criteria of *Loew's*, it would be difficult to conceive of any tying arrangement which logically could not be found to be illegal upon a minimal showing of a "distinctive" tying product and a "not insubstantial" amount of commerce in the tied product.

B. *Exclusive Dealing—The Comparative Substantiality Test*

The question whether the "quantitative substantiality" test of *International Salt* also would apply to requirements contracts was faced in the Court's celebrated *Standard Stations* decision, *Standard Oil Co. v. United States*.²⁸ In upholding the district court's finding of a Clayton Act violation, Justice Frankfurter, for the five-to-four majority, stated the issue to be

whether the requirement of showing that the effect of the agreements "may be to substantially lessen competition" may be met simply by proof that a substantial portion of commerce is affected or whether it must also be demonstrated that competitive activity has actually diminished or probably will diminish.²⁹

Although he recognized that, under certain circumstances, re-

²⁶ The 25 contracts found to have been illegally block booked involved payments to appellants ranging from \$60,800 in the case of Screen Gems to over \$2,500,000 in the case of Associated Artists. A substantial portion of the licensing fees represented the cost of the inferior films which the stations were required to accept. *Id.*

Thus, the actual value of the tied films was not determined. The government itself maintained that the evidence established that many were "unsalable" or "unusable." Brief for United States at 36. If the tied films were of such low value, it may be questioned whether the license fees for the entire packages represented more than an insubstantial dollar amount, and whether a substantial amount of competition in the tied product market was affected even under an expanded test of "quantitative substantiality." See Adams, *supra* note 24, at 781-82.

²⁷ 371 U.S. at 49-50.

²⁸ 337 U.S. 293 (1949).

²⁹ *Id.* at 299.

quirements contracts could be harmless, or even beneficial, Justice Frankfurter believed that

to demand that bare inference be supported by evidence as to what would have happened but for the adoption of the practice . . . or to require firm prediction of an increase of competition as a probable result of ordering the abandonment of the practice, would be a standard of proof, if not virtually impossible to meet, at least most ill-suited for ascertainment by courts.³⁰

He concluded, therefore, that "the qualifying clause of § 3 is satisfied by proof that competition has been foreclosed in a substantial *share* of the line of commerce affected."³¹

Although the *Standard Stations* test is often referred to as "quantitative," the language just quoted as well as the evidence underlying the decision indicates that it is not "quantitative" in the *International Salt* sense (*i.e.*, an absolute, dollar amount) but is one of *comparative* substantiality (*i.e.*, relative percentage share of market foreclosure). Such a "comparative substantiality" test, though short of a full-scale Rule-of-Reason inquiry into market performance, certainly provides a more qualitative measure of actual and probable foreclosure than does the simplistic quantitative test. Furthermore, in predicting the probable effects of the requirements contracts in *Standard Stations* the Court stressed the following additional factors: that Standard was a "major" competitor, though not "dominant;" that the discrepancy in bargaining power of Standard *vis-à-vis* the dealers indicated "coercion" of the latter; that "all the other major suppliers have also been using requirements contracts, and . . . that the relative share of the business which fell to each has remained about the same during the period of their use." The combination of these factors, *in addition* to the foreclosure of a comparatively substantial share of the tied-product market, gave rise to the inference "that their effect has been to enable the established suppliers individually to maintain their own standing and at the same time *collectively, even though not collusively*, to prevent a late arrival from wresting away more than an insignificant portion of the market."³²

That *Standard Stations* did not establish a *per se*, or absolute, quantitative substantiality test for requirements contracts is substantiated by the Court's 1953 decision in *FTC v. Motion Picture Advertising Serv. Co.*³³ In upholding the Commission's cease and de-

³⁰ *Id.* at 309-10.

³¹ *Id.* at 314 (emphasis added).

³² *Id.* at 308-09 (emphasis added).

³³ 344 U.S. 392 (1953).

sist order under section 5 of the Federal Trade Commission Act,³⁴ Justice Douglas, for the seven-to-two majority, accepted the Commission's finding that standard, one-year, exclusive-dealing contracts with motion-picture exhibitors of advertising films "would not be an undue restraint upon competition, in view of the compelling business reasons for some exclusive arrangement."³⁵ In language suggestive of the Rule-of-Reason approach, he noted that "[t]he point where a method of competition becomes 'unfair' within the meaning of the Act will often turn on the exigencies of a particular situation, trade practices, or the practical requirements of the business in question."³⁶ Justice Douglas did not even mention *Standard Stations*, wherein such justifications were apparently considered immaterial.

Justice Frankfurter, in his dissent, went even further than the majority by criticizing the one-year limitation on the exclusive dealing contracts. He interpreted his prior opinion for the majority in *Standard Stations* as not supporting a finding of undue restraint in the exclusive-dealing contracts covering periods beyond one year.³⁷ In particular, he noted the lack of evidence regarding (1) the number of contracts extending beyond the one-year "reasonable" period; (2) the percentage share of the market foreclosed by these contracts; (3) economic duress from unequal bargaining power of the seller vis-à-vis the exhibitors; (4) the effect on the exhibitors of the contracts covering the advertising which, unlike *Standard Stations*, was "not the central business of the theaters and apparently account[ed] for only a small part of the theaters' revenues"; and (5) the degree of "exclusiveness" of the contract provisions.³⁸

The Court's final move in the direction of a qualitative approach to requirements contracts came in *Tampa Electric Co. v. Nashville Coal Co.*³⁹ Justice Clark, for the seven-to-two majority, outlined the procedure to be followed in "exclusive dealing" cases:

First, the line of commerce, *i.e.*, the type of goods, wares, or merchandise, etc., involved must be determined, where it is in controversy, on the basis of the facts peculiar to the case. *Sec-*

³⁴ 15 U.S.C. § 45 (1964):

Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful.

³⁵ 344 U.S. 392, 396 (1953).

³⁶ *Id.*

³⁷ *Id.* at 398-403.

³⁸ *Id.* at 398, 401-03.

³⁹ 365 U.S. 320 (1961).

ond, the area of effective competition in the known line of commerce must be charted by careful selection of the market area in which the seller operates, and to which the purchaser can practicably turn for supplies. In short, the threatened foreclosure of competition must be in relation to the market affected

Third, and last, the competition foreclosed by the contract must be found to constitute a substantial share of the relevant market. That is to say, the opportunities for other traders to enter into or remain in that market must be significantly limited⁴⁰

In flatly rejecting a dollar figure as the test, Justice Clark adopted qualitative criteria for measuring the effect on competition:

To determine substantiality in a given case, it is necessary to weigh the probable effect of the contract on the relevant area of effective competition, taking into account the relative strength of the parties, the proportionate volume of commerce involved in relation to the total volume of commerce in the relevant market area, and the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein. It follows that a mere showing that the contract itself involves a substantial number of dollars is ordinarily of little consequence.⁴¹

Significantly, although the relevant market was defined in such a way as to make the percentage foreclosure of competition relatively insubstantial, Justice Clark did not attempt to distinguish *Standard Stations* on that ground but went on to consider mitigating circumstances to justify the requirements contract. In distinguishing prior holdings he pointed out that here the seller did not possess "a dominant position in the market"; that the contracts did not cover "myriad outlets with substantial sales volume, coupled with an industry-wide practice of relying upon exclusive contracts"; and that it was not "a plainly restrictive tying arrangement."⁴² Instead, quoting from the economic distinctions suggested but seemingly rejected in *Standard Stations*, he concluded that

we seem to have only that type of contract which "may well be of economic advantage to buyers as well as to sellers." In the case of the buyer it "may assure supply," while on the part of the seller it "may make possible the substantial reduction of sell-

⁴⁰ *Id.* at 327-28.

⁴¹ *Id.* at 329.

⁴² *Id.* at 334.

ing expenses, give protection against price fluctuations, and . . . offer the possibility of a predictable market."⁴³

Referring to the twenty-year period of the requirements contract, "singled out as the principal vice," Justice Clark thought that "at least in the case of public utilities the assurance of a steady and ample supply of fuel is necessary in the public interest."⁴⁴

The Court's flexible approach to requirements contracts, as opposed to tying, is more evident when it is remembered that Tampa's requirements contracts were upheld under the Clayton Act section 3 incipency test, and that the one-year limitations in such contracts were approved in *Motion Picture Advertising* under the even broader test of FTC Act section 5. This distinction was pointed up in Justice Clark's conclusion:

We need not discuss the respondents' further contention that the contract also violates § 1 and § 2 of the Sherman Act, for if it does not fall within the broader proscription of § 3 of the Clayton Act it follows that it is not forbidden by those of the former.⁴⁵

Although *Tampa Electric* revived the element of flexibility missing in a rigid quantitative substantiality test, it failed to establish meaningful guidelines for future conduct. The opinion not only suffers from vague generalities, but the Court's own ad hoc appraisal lacks "clear reasoning" regarding the question whether in fact the requirements contract was needed under the circumstances, or whether more reasonable alternatives were available to accomplish the legitimate purposes.⁴⁶

A far more pertinent criticism of the *Tampa Electric* opinion is its failure to recognize the arrangement for what it really was—a reciprocal output-requirements contract. Ironically, the Court was not asked to enforce the exclusive-buying restrictions. To the contrary, the buyer was attempting to enforce the seller's obligation to furnish its coal requirements as provided in the twenty-year supply contract. In other words, the seller sought to avoid what in fact was its partial *output* obligation by claiming the contract was an unlawful *requirements* contract. Under these circumstances it would have been appropriate for the Court to have concluded that the legality of

⁴³ *Id.* (citation omitted).

⁴⁴ *Id.*

⁴⁵ *Id.* at 335 (citation omitted).

⁴⁶ Bok, *The Tampa Electric Case and the Problem of Exclusive Arrangements Under the Clayton Act*, 1961 SUP. CT. REV. 267, 283-84.

the buyer restrictions were irrelevant in an action by the buyer to enforce different and severable contractual obligations on the seller.⁴⁷ Here, again, the Court apparently was ensnared in the label labyrinth of the "no-think" school. The result may have been correct, but the rationale certainly leaves something to be desired.

It is singularly unfortunate that the Court did not consider the restrictive selling, or partial output, limitation in *Tampa Electric* in view of the sparse authority on the proper treatment of such backward-integration restraints. The Court's 1944 decision in *United States v. Bausch & Lomb Optical Co.*⁴⁸ remains the only one in which it directly considered the question. An agreement giving the distributor, Soft-Lite, the exclusive right to purchase for resale pink-tinted lenses manufactured by Bausch & Lomb was upheld, without opinion, by an equally divided Court. In the district court, Judge Rifkind, in holding that this exclusive selling agreement did not violate section 1 of the Sherman Act, stated:

[T]he main purpose of the contract is to provide a source of supply for Soft-Lite. The restraining covenant is for the protection of the purchaser who is spending large sums to develop his good will and enlarge the public patronage of a relatively new article of commerce. The arrangement, though not a partnership in legal form, is functionally a joint enterprise in which one will produce and the other market the commodity.⁴⁹

Judge Rifkind also noted that not only were there other competing lenses in the market, but that competition had actually increased by competitors' emulation of the success of Soft-Lite in its promotion of defendant's product.⁵⁰

Since *Bausch & Lomb*, it has generally been assumed that such selling agreements by a single seller are legal, absent monopolization, a concerted boycott, or a horizontal conspiracy. Otherwise, judicial concern for possible anticompetitive effects has arisen only where exclusive selling involved some reciprocal restriction on the buyer—notably, exclusive buying, exclusive territorial arrangements, or customer allocation restrictions.⁵¹

⁴⁷ See, e.g., *Kelly v. Kosuga*, 358 U.S. 516 (1959); *Beloit Culligan Soft Water Service, Inc. v. Culligan, Inc.*, 274 F.2d 29 (7th Cir. 1959); *New York Automatic Canteen Corp. v. Automatic Canteen Co.*, 1963 Trade Cas. ¶ 70,625 (S.D.N.Y. 1962).

⁴⁸ 321 U.S. 707 (1944).

⁴⁹ *United States v. Bausch & Lomb Optical Co.*, 45 F. Supp. 387, 398 (S.D.N.Y. 1942).

⁵⁰ *Id.* at 399.

⁵¹ The district court in *United States v. White Motor Co.*, 194 F. Supp. 562 (N.D. Ohio 1961), recognized the difference in treatment afforded output restrictions

C. Reciprocity

The applicable test of legality for reciprocity is a relatively new and undeveloped area of judicial inquiry. The Commission issued three cease and desist orders in the 1930's, finding coercive reciprocal buying to be an unfair method of competition under section 5 of the Federal Trade Commission Act.⁵² Despite a continuing existence of the practice in one form or another, the only judicial consideration of the legality of reciprocity contracts (outside the merger field) is a 1966 district court decision, *United States v. General Dynamics Corp.*⁵³

Renewed interest in the area was generated by the Supreme Court's condemnation of reciprocity in upholding the Commission's invalidation of a merger in *FTC v. Consolidated Foods Corp.*⁵⁴ Citing the tying cases—*International Salt* and *Northern Pacific*—Justice Douglas, for the Court, stated that

the "reciprocity" made possible by such [a conglomerate] acquisition is one of the congeries of anticompetitive practices at which the antitrust laws are aimed. The practice results in "an irrelevant and alien factor," . . . intruding into the choice among competing products, creating at the least "a priority on the business at equal prices."⁵⁵

on sellers, as opposed to resale restrictions on buyers (as well as the confusion inherent in loose labeling):

The terms "exclusive contracts," "exclusive territories," or "exclusive dealerships," frequently are used to mean (1) agreements by a manufacturer with its distributors or dealers that the manufacturer will not sell to any others within their respective "exclusive territories," or (2) (as in this case) agreements by distributors and dealers with their manufacturer or supplier that they will not sell to purchasers located outside their respective assigned "exclusive territories." It is most important to keep in mind these conflicting definitions because agreements in the first category have been upheld as reasonable when ancillary to the sale of goods for resale because they protect the vendee's property rights in his resale business from being destroyed or damaged by the actions of his vendor who is in a position to undersell, or establish a competitor of, his vendee. *Id.* at 578.

See also Brief for the United States at 24-25 n.12, *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); see generally Day, *Exclusive Territorial Arrangements Under The Antitrust Laws—A Reappraisal* 40 N.C.L. Rev. 223, 229-35 (1962). But cf. *Hershey Chocolate Corp. v. FTC*, 121 F.2d 968 (3d Cir. 1941).

⁵² *California Packing Corp.*, 25 F.T.C. 379 (1937); *Mechanical Mfg. Co.*, 16 F.T.C. 67 (1932); *Waugh Equip. Co.*, 15 F.T.C. 232 (1931).

⁵³ 258 F. Supp. 36 (S.D.N.Y. 1966).

⁵⁴ 380 U.S. 592 (1965).

⁵⁵ *Id.* at 594.

Although Justice Douglas declined to rule that a probability of reciprocal buying as a result of an acquisition, "no matter how small," would violate Clayton Act section 7,⁵⁶ he concluded that "where, as here, the acquisition is of a company that commands a substantial share of a market, a finding of probability of reciprocal buying by the Commission, whose expertise the Congress trusts, should be honored, if there is substantial evidence to support it."⁵⁷

In *General Dynamics*, Judge Cannella recognized the deceptive-label trap in noting that "reciprocity" is not a term of "fixed meaning," but rather encompasses a "host of commercial practices," including reciprocal buying, which "covers a wide variety of relationships" ranging from "overt coercion to a mutual patronage agreement wholly without such overtones."⁵⁸ In the case of coercive reciprocal buying the analogy to tying was said to be obvious: the "transference of purchasing power to inflate sales in other markets accomplishes the same result condemned in 'tying-in' arrangements, viz., a frustration of competitive criteria in determining which firms receive which purchasing orders."⁵⁹ Less obvious, but according to Judge Cannella equally valid, is the analogy of mutual patronage to tying. Countervailing "purchasing power is used by both parties as a sales generating device, although no force is exerted from any quarter."⁶⁰ This analysis is significant for its hypothesis that it is not the "abuse" of coercive leverage by one party on another which is condemned, but the foreclosure of competition as a consequence of market power possessed by either or both parties to the agreement.

Turning to the evidence, Judge Cannella found that there was a failure of proof of agreement in the bulk of reciprocal dealings and that, in those instances where agreement was established, the total amount of proven restrained trade totalled only \$177,225. Although the 500,000 dollars in *International Salt* was said to have "no magical significance," he nevertheless (mistakenly⁶¹) noted that it was the lowest figure to date that had been designated as "not insubstantial" and concluded that since the government had already established that the merger itself violated the Sherman Act, "this

⁵⁶ 15 U.S.C. § 18 (1964).

⁵⁷ 380 U.S. at 600.

⁵⁸ 258 F. Supp. at 57.

⁵⁹ *Id.* at 66.

⁶⁰ *Id.*

⁶¹ See note 26 *supra* and text accompanying note 18 *supra*.

aspect of this case is an inappropriate vehicle for finding an amount considerably less than \$500,000 as 'not insubstantial.'"⁶²

III. RESTRICTIVE DEALING AS UNFAIR COMPETITION

The use of the tying analogy in *Consolidated Foods* and *General Dynamics* is symptomatic of a trend to avoid the label barrier by evolving a general "leverage" doctrine beyond the nominal theories of tying, exclusive dealing and reciprocity. This approach has been adopted by the Commission in challenging "quasi" tying conduct as an unfair method of competition under section 5 of the Federal Trade Commission Act.⁶³ Section 5 has the advantage of expansive flexibility, and applicability to incipient violations of the Sherman and Clayton Acts. As explained by the Court in *Motion Picture Advertising*:

The "unfair methods of competition," which are condemned by § 5(a) of the Act, are not confined to those that were illegal at common law or that were condemned by the Sherman Act. Congress advisedly left the concept flexible to be defined with particularity by the myriad of cases from the field of business. It is also clear that the Federal Trade Commission Act was designed to supplement and bolster the Sherman Act and the Clayton Act—to stop in their incipiency acts and practices which, when full blown, would violate those Acts, as well as to condemn as "unfair methods of competition" existing violations of them.⁶⁴

The scope of section 5 is thus three dimensional: (1) minimally, all restraints in commerce which would violate the other antitrust acts are within its coverage; (2) the incipiency test of section 5 may prohibit conduct of the type included within the coverage of the other antitrust laws even though it does not meet their standards of actual or potential anticompetitive effects; and (3) conduct of a type not included in the other antitrust laws may be prohibited. The outer boundaries of the latter two dimensions of section 5 remain undefined.

A recent example of the Commission's section 5 approach is found in *FTC v. Brown Shoe Co.*⁶⁵ For at least thirty years prior to the Commission's 1959 complaint, Brown had undertaken a program for "Brown Franchise Stores" whereby it granted special ser-

⁶² 258 F. Supp. at 66-67.

⁶³ 15 U.S.C. § 45 (1964), text quoted note 34 *supra*.

⁶⁴ 344 U.S. 392, 394 (1953) (citations omitted).

⁶⁵ 384 U.S. 316 (1966).

vices and benefits to its independent retail shoe store customers as an inducement for them to concentrate on the Brown shoe line, and to refrain from stocking and selling competing shoes. The Commission's cease and desist order was based on a quasi-tying theory:

Respondent's practice of conditioning the benefits of membership in the plan to adherence to the restrictive terms of the franchise agreement for the purpose of foreclosing other manufacturers from selling to its franchisees is akin to the operation of tying clauses generally held as inherently anticompetitive.⁶⁶

In setting aside the order and dismissing the complaint, Judge Vogel, for the Ninth Circuit, rejected the Commission's tying analogy, stating:

While it is clear that a "not insubstantial" amount of interstate commerce is involved here, that fact alone does not make petitioner's program an "unfair" method of competition nor may the selling activities of petitioner be described as "deceptive acts or practices." In *Brown* there was no "sale" of the *tying* product (franchise services); there is no evidence that Brown's "power or leverage" in the tying product was such as to force the purchase of the "tied products" (shoes). This case presents a situation where the seller, Brown, has no control or dominance over the tying product, services; consequently, the Brown franchise program is not an "effectual weapon" to pressure buyers into taking the tied item, shoes.⁶⁷

Judge Vogel also disagreed with the Commission's alternative reliance on the Supreme Court's merger decision in *Brown Shoe Co. v. United States*⁶⁸ as establishing proof of sufficient probable anti-competitive impact to violate the Clayton Act's incipiency test. Noting that the contractual franchise plan permitted the independent retailers to withdraw at any time, he concluded that the plan amounted to no more than the legitimate exercise of customer selection and sales promotion to secure dealer "loyalty."⁶⁹

On appeal, Justice Black, for a unanimous Court, stated the issue to be

whether the Federal Trade Commission can declare it to be an unfair practice for Brown, the second largest manufacturer of shoes in the Nation, to pay a valuable consideration to hundreds of retail shoe purchasers in order to secure a contractual promise from them that they will deal primarily with Brown

⁶⁶ *Brown Shoe Co.*, 62 F.T.C. 679, 715 (1963).

⁶⁷ *Brown Shoe Co. v. FTC*, 339 F.2d 45, 54 (9th Cir. 1964).

⁶⁸ 370 U.S. 294 (1962).

⁶⁹ 339 F.2d at 56.

and will not purchase conflicting lines of shoes from Brown's competitors.⁷⁰

In upholding the Commission's finding of violation, "on the record here," Justice Black rejected Brown's contention that the Commission should be required to prove that the effect of its restrictive arrangements "may be to substantially lessen competition or tend to create a monopoly" as required by Clayton Act section 3. Referring to *Motion Picture Advertising*, he reaffirmed the Commission's "power under § 5 to arrest trade restraints in their incipiency without proof that they amount to an outright violation of § 3 of the Clayton Act or other provisions of the antitrust laws."⁷¹

By compounding the Clayton Act's incipiency standard with that of the FTC Act, *Brown Shoe* appears to be an open invitation to the Commission to attack restrictive dealing practices (including quasi-tying), as well as other "trade practices which conflict with the basic policies of the Sherman and Clayton Acts even though such practices may not actually violate these laws"⁷²—in other words, regardless of their effect on competition. However, dicta notwithstanding, it should be noted that the record did disclose the quantitatively substantial foreclosure necessary to prove a (quasi) tying violation, if not an unlawful requirements arrangement.⁷³ Considering the almost per se treatment of restrictive dealing practices generally, it may be questioned whether even the broadest reading

⁷⁰ 384 U.S. at 320.

⁷¹ *Id.* at 322.

⁷² *Id.* at 321.

⁷³ The court noted:

[A]dmissions of Brown as to the existence and operation of the franchise program were buttressed by many separate detailed fact findings of a trial examiner, one of which findings was that the franchise program effectively foreclosed Brown's competitors from selling to a substantial number of retail shoe dealers. *Id.* at 318-19.

Particularly revealing is the Court's footnote to this observation:

In its opinion the Commission found that the services provided by Brown in its franchise program were the "prime motivation" for dealers to join and remain in the program; that the program resulted in franchised stores purchasing 75% of their total shoe requirements from Brown—the remainder being for the most part shoes which were not "conflicting" lines, as provided by the agreement; that the effect of the plan was to foreclose retail outlets to Brown's competitors, particularly small manufacturers; and that enforcement of the plan was effected by teams of field men who called upon the shoe stores, urged the elimination of other manufacturers' conflicting lines and reported deviations to Brown who then cancelled under a provision of the agreement. *Id.* at 319 n.2.

of the Court's dicta in *Brown Shoe* would alter the law significantly, if at all.

The prime example of the Commission's quasi-tying theory is found in the extended and involved proceedings against the sales-commission method of marketing automobile tires, batteries and accessories (TBA). Under this distribution arrangement, an oil company receives a sales commission for assisting a tire company in promoting the sale of the latter's TBA products to the oil company's wholesale and retail outlets. In 1956, the Commission issued three almost identical complaints, each pairing an oil company with a tire company (Texaco with Goodrich, Shell with Firestone and Atlantic with Goodyear), charging that their TBA sales-commission plans violated section 5.⁷⁴

The same hearing examiner heard all three cases, deciding that the sales-commission method of selling TBA was lawful but that Atlantic and Shell had unlawfully used overt coercion to force their outlets to buy the "sponsored" TBA products.⁷⁵ The Commission adopted the examiner's findings of overt coercion but further held in both cases that the adverse competitive effects made the sales-commission method of selling unlawful, even absent a tying agreement or overt coercion. According to the Commission, the sales-commission arrangement is "a classic example of the use of economic power in one market (here, gasoline distribution) to destroy competition in another market (TBA distribution)."⁷⁶ Although the Commission found that Texaco had sufficient economic power to cause its outlets to purchase substantial amounts of sponsored TBA "even without the use of overt coercive tactics," it remanded for lack of "sufficient market data" to enable it to assess the competitive effects of the sales-commission method of selling TBA.⁷⁷ On remand, the examiner found the Texaco plan unlawful, and the Commission affirmed on reasoning similar to that of the other two cases. It then issued broad orders in all three proceedings enjoining the use of the sales-commission plans (1) by respondents with each other, (2) by each oil company with any other TBA supplier, and (3) by each tire company with any other oil company.⁷⁸ The real novelty

⁷⁴ Goodyear Tire & Rubber Co., 58 F.T.C. 309 (1961); Firestone Tire & Rubber Co., 58 F.T.C. 371 (1961); B. F. Goodrich Co., 58 F.T.C. 1176 (1961).

⁷⁵ Cases cited *supra* note 74.

⁷⁶ Goodyear Tire & Rubber Co., 58 F.T.C. 309, 367 (1961).

⁷⁷ B. F. Goodrich Co., 58 F.T.C. 1176, 1178-79 (1961).

⁷⁸ B. F. Goodrich & Texaco, Inc., 62 F.T.C. 1172, 1179 (1965).

of these rulings is that, although courts had previously disfavored this method of promoting TBA sales, they had gone no further than to enjoin overt coercive acts.⁷⁹ To the Commission, the "overt acts of coercion" were "mere symptoms of a more fundamental restraint of trade inherent in the sales commission itself."⁸⁰

On appeal, in *Goodyear Tire & Rubber Co. v. FTC*,⁸¹ the Seventh Circuit affirmed the Commission's *Atlantic* opinion and order; in *Texaco, Inc. v. FTC*,⁸² the District of Columbia Circuit reversed the Commission's *Texaco* decision and ordered the complaint dismissed; and the Fifth Circuit withheld its decision on the appeal in *Shell* pending final action by the Supreme Court in the companion cases, which had been granted certiorari.⁸³

In the Supreme Court *Atlantic* did not dispute the findings of or the injunction against overt coercion, and the Court did not discuss these findings in detail.⁸⁴ However, in addition to finding "warrant in the record" for the Commission's conclusion that *Atlantic* possessed economic power, or leverage, over its outlets, Justice Clark, for the majority, emphasized that "that lever was bolstered by actual threats and coercive practices."⁸⁵ The foreclosure effect was likened to that of a tying arrangement, and Justice Clark affirmed the Commission's finding "that the effect of the plan was *as though* *Atlantic* had agreed with *Goodyear* to require its dealers to buy *Goodyear* products and had done so."⁸⁶ With this ultimate finding he then applied the quantitative substantiality test, concluding that "it is beyond question that the effect on commerce was not insubstantial" where more than 50 million dollars of sponsored TBA was sold during the relevant six-year period and more than 5,500 outlets were affected.⁸⁷

As noted in the dissenting opinions of Justice Stewart (joined by Justice Harlan) and Justice Goldberg, the Commission's opinion

⁷⁹ See e.g., *Osborn v. Sinclair Ref. Co.*, 286 F.2d 832 (4th Cir. 1960), cert. denied, 366 U.S. 963 (1961); *United States v. Sun Oil Co.*, 176 F. Supp. 715 (E.D. Pa. 1959). But cf. *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964); *Broussard v. Socony Mobil Oil Co.*, 350 F.2d 346 (5th Cir. 1965). See also 63 MICH. L. REV. 713 (1965).

⁸⁰ *Goodyear Tire & Rubber Co.*, 58 F.T.C. 309, 348 (1961).

⁸¹ 331 F.2d 394 (7th Cir. 1964), aff'd sub nom., *Atlantic Ref. Co. v. FTC*, 381 U.S. 357 (1965).

⁸² 336 F.2d 754 (D.C. Cir. 1964).

⁸³ *Shell Oil Co. v. FTC*, 360 F.2d 470 (5th Cir. 1966).

⁸⁴ *Atlantic Ref. Co. v. FTC*, 381 U.S. 357 (1965).

⁸⁵ *Id.* at 369.

⁸⁶ *Id.* at 370 (emphasis in original).

⁸⁷ *Id.*

in *Atlantic* and its affirmance by the Court provide little in the way of practical guidelines, and leave many significant questions unanswered. Although the Commission had limited its attack to the commission-sales method of TBA distribution, the basis of its reasoning was that Atlantic possessed "sufficient economic power" over its wholesale and retail outlets "to cause them to purchase substantial quantities of sponsored TBA even without the use of overt coercive tactics or of written or oral tying agreements, and this power is a fact existing independently of the particular method of distributing or sponsoring TBA used by Atlantic."⁸⁸ In other words, as Justice Stewart pointed out, Atlantic's "competitive advantage" or "leverage" was "the inevitable result of the market structure"; i.e., the "imbalance of economic power" between Atlantic and its distributors.⁸⁹ Once this major premise is accepted, its logical minor premise is that the Commission's order represents "a step toward the total exclusion of Atlantic from the marketing of tires, batteries, and accessories."⁹⁰ The syllogism is completed by the necessary conclusion that

[h]enceforth, large concerns marketing their products through smaller distributors stand vulnerable to the charge that their methods of competition are unfair because they have done no more than add a complementary product to those already sold through their distributors.⁹¹

The confusion over the meaning of *Atlantic* is evident in the subsequent courts of appeals' decisions in *Shell* and *Texaco*. In each of these cases the Commission contended that under *Atlantic* a TBA sales-commission system is per se unlawful, while respondents argued that *Atlantic* should be limited to its facts, including the findings of overt acts of coercion. In *Shell*, Judge Wisdom, for the Fifth Circuit, took the position that *Atlantic* "approached only to the brink of holding TBA sales commission contracts per se unlawful."⁹² Specifically, he found "three essential components" in *Atlantic*:

- (1) the oil company's dominant economic power over its dealers;
- (2) the exercise of that power over its dealers;
- (3) the anti-competitive effects of using that power.⁹³

⁸⁸ *Id.* at 379 (dissenting opinion of Stewart, J.) (emphasis added).

⁸⁹ *Id.* at 380-81.

⁹⁰ *Id.* at 380.

⁹¹ *Id.* at 381.

⁹² 360 F.2d at 477.

⁹³ *Id.*

Understandably, the dispute centered on the second element—what is the “exercise” of economic power? Although Judge Wisdom noted that many “acts of persuasion or promotion” used by Atlantic were matched by Shell, he found no substantial evidence of overt coercion. However, not only did he deem it unnecessary to establish overt coercion, but proof of its absence was taken as evidence that the sales-commission plan is “inherently coercive and results in foreclosure of competition in the TBA market.”⁹⁴ This was said to follow from the “inherent leverage” resulting from the industry “market structure.” In what might be termed “psychological coercion,” Judge Wisdom described the natural tendency of the dealers to curry the goodwill of Shell in order to gain favors, and to avoid possible punishment, real or imagined. “When he hears that Shell will benefit from his patronage of sponsored TBA outlets, the velvet glove of request has within it the mailed fist of command.”⁹⁵

In *FTC v. Texaco, Inc.*,⁹⁶ the Supreme Court summarily vacated the court of appeals’ decision (which had vacated the Commission’s opinion and order for lack of any finding of overt coercion) and remanded for redetermination “in light of” its decision in *Atlantic*. The Commission’s petition for certiorari had alleged that “Texaco has sufficient economic power over its wholesale and retail petroleum distributors to cause them to purchase substantial amounts of TBA *even without the use of overt coercive tactics.*”⁹⁷ This action by the Court was taken by Judge Wisdom in *Shell* as further evidence that overt coercion is not an essential element of a section 5 violation.⁹⁸

The District of Columbia Circuit, reconsidering *Texaco*, disagreed.⁹⁹ On remand, the Commission entered an order and filed its opinion holding that the Texaco plan was indistinguishable in fundamental operation and competitive effect from the one held unlawful in *Atlantic*.¹⁰⁰ On the second appeal to the District of Columbia Circuit, the Commission again contended that the TBA sales-commission is inherently unlawful without regard to evidence

⁹⁴ *Id.* at 487.

⁹⁵ *Id.*

⁹⁶ 381 U.S. 739 (1965).

⁹⁷ Quoted in *Shell Oil Co. v. FTC*, 360 F.2d 470, 478 (5th Cir. 1966).

⁹⁸ *Id.*

⁹⁹ *Texaco, Inc. v. FTC*, 383 F.2d 942, 946-47 (D.C. Cir. 1967), *cert. granted* 390 U.S. 979 (1968).

¹⁰⁰ *B. F. Goodrich & The Texas Co.*, [1965-1967 Transfer Binder] *TRADE REG. REP.* ¶ 17,424 (FTC 1965).

of overt coercion. Judge Burger, for the court, agreed with the Fifth Circuit's holding in *Shell* that *Atlantic* did not establish a per se rule, and that it was based upon the three essential components outlined by Judge Wisdom.¹⁰¹ However, Judge Burger could "glean nothing from the utterances of the Supreme Court which alters the basic rule that a finding of coercion is the threshold requirement of a determination of exercise of dominant economic power."¹⁰² In his view, if the Court in *Atlantic* had meant to hold that the use of "mere salesmanship without any coercion" was an unlawful exercise of economic power, there would have been no reason to remand for further consideration and the Court would have simply reversed the initial appellate decision and reinstated the Commission's order.¹⁰³ Accordingly, he held that, in the absence of evidence or a Commission finding of overt coercion, the *Texaco* order and opinion should again be set aside and remanded to the Commission with directions to dismiss the complaint.¹⁰⁴ The Supreme Court has granted certiorari,¹⁰⁵ and hopefully this crucial point of contention shall be cleared up at last.

IV. UNILATERAL RESTRICTIVE DEALING PRACTICES UNDER THE SHERMAN ACT

Adoption of the economic leverage theory advocated by the Commission in the TBA trilogy might have even broader implications under section 2 of the Sherman Act¹⁰⁶ than it does under section 5 of the FTC Act. One of the perennial problems in restrictive dealing cases under Clayton Act section 3¹⁰⁷ and Sherman Act section 1¹⁰⁸ has been the necessity for proving the existence of a lease, sale or contract of sale (as required by the former) or a contract, combination or conspiracy (as required by the latter). This problem has been particularly acute in the area of unilateral refusals to deal with anyone not adhering to a pre-announced restrictive dealing policy. Admittedly, inroads have been made on the scope

¹⁰¹ *Texaco, Inc. v. FTC*, 383 F.2d 942 (D.C. Cir. 1967).

¹⁰² *Id.* at 946.

¹⁰³ *Id.* at 947.

¹⁰⁴ *Id.* at 951.

¹⁰⁵ 390 U.S. 979 (1968).

¹⁰⁶ 15 U.S.C. § 2 (1964):

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce . . . shall be deemed guilty of a misdemeanor

¹⁰⁷ 15 U.S.C. § 14 (1964), text quoted at note 4 *supra*.

¹⁰⁸ 15 U.S.C. § 1 (1964), text quoted at note 7 *supra*.

of the businessman's right to unilaterally select those with whom he will deal. Thus, cooperative enforcement efforts, or acquiescence to threats or other coercive acts may supply the circumstantial evidence needed to imply an unlawful combination.¹⁰⁹ Where applicable, the intra-enterprise conspiracy doctrine provides another means of establishing the necessary concerted action.¹¹⁰ However, the basic anti-trust doctrine, that one has a privilege to select those with whom he will deal, established in the Supreme Court's 1919 decision in *United States v. Colgate & Co.*,¹¹¹ has yet to be overruled, leaving at least a vestigial area for unilaterally implementing a restrictive dealing policy outside the proscriptions of either Clayton Act section 3 or Sherman Act section 1.¹¹²

Despite sparse authority, there is nothing new or novel in the idea that monopolization or an attempt to monopolize in violation of section 2 may result from the use of monopoly power in one market to foreclose competition in another. The basic theory was advanced by the Supreme Court twenty years ago in *United States v. Griffith*.¹¹³ The Department of Justice had attacked the practice of affiliated motion picture exhibitors of executing "master agreements" with film distributors covering films to be released during an entire season. The agreements, executed to cover an entire circuit of theatres, were said to have as their purpose and effect the acquisition of certain exclusive privileges, including the preemption of film selection and the receipt of "clearances" over competing theatres. The vice of the master agreements was said to be the use of the monopoly power of those theatres in the circuit which had a monopoly in their geographic market to foreclose competition in those markets where there were competing theatres—the familiar extension-of-monopoly theory.

Justice Douglas, for the six-to-one majority, acknowledged that large-scale buying is not per se unlawful.¹¹⁴ However, he stated that it may not be used to monopolize or to attempt to monopolize, or to "stifle competition by denying competitors less favorably situated

¹⁰⁹ *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960).

¹¹⁰ *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211 (1951); *United States v. Timken Roller Bearing Co.*, 83 F. Supp. 284 (N.D. Ohio 1949), *aff'd* 341 U.S. 593 (1951).

¹¹¹ 250 U.S. 300 (1919).

¹¹² *See, e.g., Amplex of Maryland, Inc. v. Outboard Marine Corp.*, 380 F.2d 112 (4th Cir. 1967), *cert. denied*, 398 U.S. 1036 (1968).

¹¹³ 334 U.S. 100 (1948).

¹¹⁴ *Id.* at 108.

access to the market."¹¹⁵ Indeed, at another point he cited *International Salt* for the proposition that it is "unreasonable, *per se*, to foreclose competitors from any substantial market," concluding that "the use of monopoly power, however lawfully acquired, to foreclose competition, to gain a competitive advantage, or to destroy a competitor, is unlawful."¹¹⁶ In language presaging the Commission's TBA "inherently" illegal theory, Justice Douglas emphasized the anticompetitive effects of the exhibitors' circuit-wide bargaining practices, which he indicated necessarily results from the utilization of economic leverage:

A man with a monopoly of theatres in any one town commands the entrance for all films into that area. If he uses that strategic position to acquire exclusive privileges in a city where he has competitors, he is employing his monopoly power as a trade weapon against his competitors. . . . *Though he makes no threat to withhold the business of his closed or monopoly towns unless the distributors give him the exclusive film rights in the towns where he has competitors, the effect is likely to be the same where the two are joined.* When the buying power of the entire circuit is used to negotiate films for his competitive as well as his closed towns, he is using monopoly power to expand his empire. And even if we assume that a specific intent to accomplish that result is absent, he is chargeable in legal contemplation with that purpose since the end result is the necessary and direct consequence of what he did.¹¹⁷

This treatment of "buying leverage" in *Griffith* invites comparison with the movie block-booking cases.¹¹⁸ While the latter were examples of selling leverage of a forward-vertical nature, *Griffith's* restrictive effects were of a backward-vertical nature. As already noted, each may involve the use of economic power in one market as a lever to foreclose competition in another; *i.e.*, each is a form of "tying" in the broader sense. The significant difference between the block-booking cases and *Griffith* is found in Justice Douglas' indication in the latter that a tying "agreement," express or implied, is not necessary to violate Sherman Act section 2. Furthermore, as in the Commission's quasi-tying theory, he would not require evidence of threats or other overtly coercive tactics to find a violation because bargaining from a position of power "to foreclose competition, to

¹¹⁵ *Id.*

¹¹⁶ *Id.* at 107.

¹¹⁷ *Id.* at 107-08 (citation omitted) (emphasis added).

¹¹⁸ *United States v. Paramount Pictures, Inc.*, 334 U.S. 131 (1948).

gain a competitive advantage, or to destroy a competitor, is unlawful."¹¹⁹

A more recent example of the use of the leverage theory under Sherman Act section 2 is found in the pending complaint in *United States v. General Tire & Rubber Co.*¹²⁰ In addition to a count charging an intra-corporate conspiracy in violation of Sherman Act section 1, the complaint charges a violation of section 2 by coercive and persuasive reciprocal buying efforts in an attempt to monopolize "substantial amounts" of interstate commerce. Pursuant to and in effectuation of the alleged attempt to monopolize, the defendants are alleged to have engaged in the following practices:

- (a) established and maintained a Trade Relations Department and trade relations program;
- (b) took measures to insure that suppliers and potential suppliers were aware of the defendants' Trade Relations Department and its activities;
- (c) directed their respective purchasing personnel to report their purchases to General Tire's Trade Relations Department and to observe requests and suggestions from said Department concerning purchasing from particular suppliers and potential suppliers;
- . . .
- (e) refused to buy from those suppliers who refuse to purchase from the respective defendants.¹²¹

The effects of such practices allegedly were that actual and potential suppliers have been foreclosed from selling "substantial quantities" of materials and services to defendants, and that competitors of defendants have been foreclosed from selling "substantial quantities" of competing products and services to those having reciprocal arrangements with defendants.

In addition to the fact that the *General Tire* complaint attacks unilateral attempts at reciprocity of both the coercive and persuasive variety, it is especially noteworthy in two other quasi-tying respects. First, the thrust of the complaint is not directed at the use of monopoly power or dominance in any defined relevant market, but at the use of "buying power" derived from the fact that defendants purchase "substantial quantities" of specified goods and services.

¹¹⁹ *Id.* at 107.

¹²⁰ Civil No. 67155 (N.D. Ohio, filed March 2, 1967). The full complaint is reported in 36 A.B.A. ANTITRUST L.J. 134 (1967), and in 295 ANTITRUST & TRADE REG. REP. § X-1 (March 7, 1967).

¹²¹ *United States v. General Tire & Rubber Co.*, 36 A.B.A. ANTITRUST L.J. 134, 139 (1967).

Second, the adverse effect is stated in terms of competition foreclosed in substantial quantities of such goods and services. In other words, the quantitative substantiality test is invoked to show *both* sufficient economic power, or leverage, in the tying interest (purchases) and an adverse effect on a "not insubstantial" amount of commerce in the tied interest (sales). And all of this without the need to establish an agreement or combination, or detriment to the other party. The gravamen of the section 2 count is (1) the communicated policy, (2) implemented through the unilateral control of quantitatively substantial purchases, (3) resulting in a quantitatively substantial foreclosure of competition with third parties. If successful, this would be not only a substantial inroad on the *Colgate* doctrine but also a significant step beyond the quantitative substantiality test of *International Salt* and toward virtually per se treatment of reciprocal dealing policies.

V. PER SE RULES VERSUS THE RULE OF REASON

A. *The Problem*

The value of certainty and simplicity in enforcement provided by per se rules is immediately apparent. Less apparent is the proper classification and labeling of the types of conduct to be included in the per se category, and the identification of particular conduct as fitting within one of those classes. Is it sufficient to say, as the Court has, that the per se category is made up of "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"?¹²² What constitutes the requisite "pernicious" competitive effect? How is that distinguished from the resulting "precise harm"? What qualifies as a "redeeming virtue" as opposed to a "business excuse"? Are the effect and justification factors to be given equal weight? Is there to be *any* inquiry in per se cases, short of an "elaborate inquiry" into the competitive harm? How elaborate is "elaborate"?

Questions such as these suggest that the classification of any particular type of conduct as per se unreasonable is going to require, in the first instance, an inquiry into the nature, purposes and actual or probable effects of the conduct. In other words the per se "rule" is merely a special application of the Rule of Reason: Where it is

¹²² *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

once determined that identifiable types of conduct always result in unreasonable restraints of trade, they are properly classified as per se unreasonable. Initially, this requires knowledge of "enough of the economic and business stuff out of which these arrangements emerge to be certain."¹²³

Carrying this analysis further, the specified conduct, though not in itself per se illegal, may be unreasonable under certain limited conditions, in which case only those conditions need be established to prove a violation. The quantitative substantiality and comparative substantiality tests are examples of this "simplified" approach. The fewer the conditions precedent the less extensive the inquiry necessary to prove a violation; *i.e.*, the burden of proof may be viewed as a continuum ranging from per se unreasonable, through proof of minimum conditions, to an extended economic inquiry—all being within the general principle of the Rule of Reason. The problem then is the predetermination of the nature and quality of proof necessary to test the various identifiable categories of conduct, bearing in mind the pitfalls of misclassifications and mislabeling.

Where the purpose or effect of a particular type of conduct is solely to restrain trade, an extended Rule of Reason inquiry is manifestly inappropriate. But where the restraint is ancillary to a lawful main purpose, it is necessary to balance the relative harm against the benefit, or "redeeming virtue," to determine the net effect, or "reasonableness," of the conduct. This process requires a determination of (1) the legitimate interest to be served by the practice, (2) whether the restraint is reasonably ancillary to, and no broader than necessary to accomplish, that lawful main purpose, and (3) whether competition is not "unduly" restrained. This procedure, in turn, requires a consideration of the purpose, power and effect of the conduct in question.¹²⁴

¹²³ *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963).

¹²⁴ In *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 281 (6th Cir. 1898), Judge Taft (later Chief Justice) recognized the doctrine of ancillary restraints in his classic review of the common law authorities prior to the Sherman Act. The Supreme Court subsequently adopted the reasoning of Judge Taft in applying the Rule of Reason to ancillary restraints of trade. *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 498 (1940); *Standard Oil Co. v. United States*, 221 U.S. 1, 51 (1911). For the historical development of the Rule of Reason, see Bork, *Ancillary Restraints and the Sherman Act*, 15 A.B.A. ANTITRUST SECTION 211 (1959). Cf. Turner, *The Validity of Tying Arrangements Under the Antitrust Laws*, 72 HARV. L. REV. 50 (1958). Where less restrictive alternatives are available, Professor Turner would rule the ancillary restraint not reasonably necessary to accomplish the lawful purpose, and therefore per se unreasonable. *Id.* at 59. This extension of the "reasonably-ancillary" test has been

B. *Power and Effect*

This review discloses a rather startling paradox regarding the power and effect yardsticks in restrictive dealing practices: (1) Tying (and quasi-tying) arrangements are likely to be *less* restrictive on competition than exclusive dealing arrangements, but (2) tying is treated as more nearly per se illegal than exclusive dealing.

The increasingly refined quantitative substantiality test, as applied to tying and quasi-tying (including reciprocity), has reached the point of virtually per se illegality. We have seen the Supreme Court move from a requirement of monopoly power or dominance in the tying interest to the inference of the requisite power from the "uniqueness or consumer appeal" of the tying interest. Under the latter test, Justice Black's "simple example" in *Northern Pacific*¹²⁵ of a lawful attempt by one of a dozen food stores to tie the sale of sugar to the sale of flour is not so simple after all. If the seller's tying product, flour, is an exclusive or private brand with special consumer appeal, or is made by a patented process, or is otherwise unique, the requisite power may be inferred. Indeed, under the economic leverage test advanced by the Commission in the TBA cases, the flour need not have any unique attributes or special appeal. Under this quasi-tying test the requisite power may be inferred from the market structure, or from the bargaining position of the seller vis-a-vis the buyers. For example, if the customers were also "franchised" resellers, employees, debtors, creditors, or dependent on the seller for recipro-

criticized on the ground that "it strips the rule of reason of any genuine content," inasmuch as "there will almost always be a less restrictive alternative, and indeed, further alternatives to each alternative *ad infinitum*." Handler, *Some Misadventures in Antitrust Policymaking—Nineteenth Annual Review*, 76 YALE L.J. 92, 123-24 (1966). Whatever the logic of the proposal, or its alleged fallacy, the courts have not yet shown any inclination totally to discard the Rule of Reason as the pervasive antitrust test. Professor Turner would go further, however, where the legitimate interest could not be served by a less restrictive alternative, and ask "whether the contribution made by the restrictive practice is likely to be outweighed by the harm, over the range of situations in which it may be used." Turner, *supra* at 59. He would lump the justified and unjustified ancillary restraints together on the ground that "A per se rule is clearly justified . . . if the contributions to legitimate interests, though sacrificed by a per se rule, are comparatively small." *Id.* Aside from the arbitrariness of this approach, an obvious difficulty is the quantitative balancing of unlike desiderata. At a minimum it requires a policy determination that the certainty and simplicity of the per se test warrants sacrificing some other legitimate interests. Here again, this balancing of interests requires a consideration of the purpose, power and effect of the conduct in question.

¹²⁵ *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 6-7 (1958). See text accompanying note 16 *supra*.

cal business, the fear of endangering the relationship or the hope of currying favor may be sufficient as a psychological carrot-stick weapon to secure the buyer's acquiescence in the proffered tie-in. Furthermore, under the Commission's quasi-tying theory, this may result from the relationship alone, without any threats, promises, overt coercion, agreement or understanding. The only question would be whether the commerce affected, or likely to be affected, is "not insubstantial."

The lower limits of quantitative substantiality remain undetermined.¹²⁶ The Supreme Court has yet to uphold a tying arrangement on the ground that the amount of commerce affected was insignificant. In any event, the problem may have been effectively mooted under the Court's *Brown Shoe* rationale that, under FTC Act section 5, the Commission need not even meet the incipiency test of Clayton Act section 3.¹²⁷ As already noted, if similar reasoning were adopted in an attempt-to-monopolize case under Sherman Act section 2, the relegation of tying and quasi-tying to the per se category would be complete, whether in an action by the Commission, the Department of Justice, or a private plaintiff.

At least on its face, the *Standard Stations*¹²⁸ comparative substantiality test for exclusive dealing or requirements contracts appears to approach more closely a qualitative appraisal of the actual or probable effects. Furthermore, in judging exclusive dealing arrangements the Court has not limited its inquiry to a simple determination of the percentage market share affected.¹²⁹

This more qualitative approach to exclusive dealing has been emphasized by the Court in measuring the competitive effects of vertical mergers under Clayton Act section 7. In *Brown Shoe Co. v. United States*¹³⁰ the Court noted, in measuring the effect of a vertical acquisition, that the share of the market foreclosed was "an important consideration," but that where "the foreclosure is neither of monopoly nor *de minimis* proportions, the percentage of the market foreclosed by the vertical arrangement cannot itself be decisive."¹³¹ In cases between these obvious extremes, "it becomes necessary to undertake an examination of various economic and historical factors" to

¹²⁶ Cf. note 26 *supra*.

¹²⁷ *FTC v. Brown Shoe Co.*, 384 U.S. 316 (1966).

¹²⁸ *Standard Oil Co. v. United States*, 337 U.S. 293 (1949).

¹²⁹ *Id.* at 309.

¹³⁰ 370 U.S. 294 (1962).

¹³¹ *Id.* at 329.

test the probable competitive effects of the merger.¹³² These "economic and historical factors" involve an examination of the particular restraint in its competitive setting, including the industry structure, its development and whether there is a trend in that industry toward concentration¹³³—such factors, in other words, as were considered in *Standard Stations* in testing requirements contracts. The Court's merger test is particularly relevant in light of the fact that it recognized the virtually identical language and tests of illegality under sections 3 and 7 of the Clayton Act. And, in emphasizing the interdependence of the relative market foreclosure and the economic purpose of the vertical arrangement, the Court restated the proposition that

if a particular vertical arrangement, considered under § 3, appears to be a limited term exclusive-dealing contract, the market foreclosure must generally be significantly greater than if the arrangement is a tying contract before the arrangement will be held to have violated the Act.¹³⁴

The question remains: Why should tying receive harsher treatment than exclusive dealing? It certainly is not because a "pernicious effect" is more likely to result from tying than from exclusive dealing—at least not if perniciousness is measured by the degree of the probable foreclosure of competition. By definition a requirements contract or exclusive-dealing arrangement requires the buyer to refrain absolutely from dealing in competing products. On the other hand, tying may or may not involve such total exclusivity. If the particular tie-in required the purchase of all requirements in the tied product it would amount to the same thing as a requirements contract, with the already noted distinction that the "leverage," or condition, is found in the power possessed in a different rather than the same product. But tying does not necessarily, if even often, go that far. Full-line forcing, block-booking, and package-licensing do not have that absolutely exclusive effect in the tied products unless the quantity required to get the "package" equals the buyer's total requirements. Theoretically, every supplier to Macy's or Gimbels' could require each store to stock its full line of goods without in any way foreclosing competition or raising entry barriers. Assuming the department stores have the space and the capital to handle all lines fully, not only would competition not be foreclosed but the increased

¹³² *Id.*

¹³³ *Id.* at 332.

¹³⁴ *Id.* at 329-30

availability of consumer products should actually result in increased competition.

The one instance in which tying typically takes on the appearance of a full requirements obligation is where the tied products are used as inputs into tying machinery. But again a closer examination reveals that, depending on the circumstances, something less than total exclusivity or qualitatively substantial foreclosure may result. Even where the tying machine constitutes a monopoly, conditioning its lease on the exclusive use of the lessor's input supplies will not necessarily have a substantial effect on competition in the tied product, either comparatively or qualitatively. Of course, if the only use for the tied product is as an input to the monopoly machine, the effect would be to totally foreclose competition in the tied product. But, if the tied product has other uses—*i.e.*, if the line of commerce is more broadly defined—the relative foreclosure of competition would be less than complete, and possibly “insignificant” in qualitative, if not quantitative, terms. An annual sale of 500,000 dollars in salt, or anything else, has little competitive significance without knowing the market's *total* annual sales, to say nothing of the “economical and historical factors” of the competitive setting.

In the input tying case, if comparable machines are readily available at terms competitive with the tying machine, and if the lessee can conveniently utilize the substitute machines, competition in the tied product may be affected no more than in the full-line forcing example. The lessee is free to use the tying lessor's machine exclusively, not at all, or together with as many other competing machines as he desires. Yet, the watered-down “uniqueness” test for judging “power” in the tying product may make the contract illegal with a bare showing that the amount of tied product affected was not quantitatively insubstantial.

Although the subsequent trend toward today's per se attitude in tying cases makes its precedent value more than a little dubious, the Court's 1923 decision in *FTC v. Sinclair Ref. Co.*¹³⁵ provides an excellent example of the importance of the particular factual setting in judging the effects of tying. The Commission had instituted separate proceedings under the FTC and Clayton Acts against some thirty refiners and wholesalers of gasoline, condemning and ordering them to cease the practice of selling, leasing or loaning gasoline storage tanks and pumps to retail dealers at nominal prices upon the condition that the equipment be used only with gasoline supplied by

¹³⁵ 261 U.S. 463 (1923).

the lessor. After noting that the contract in *Sinclair* did not limit the lessee's right to deal in competing goods, leaving him "free to follow his own judgment," the Court went on to distinguish the circumstances of this arrangement from tie-ins which had been declared to be unlawful:

Many competitors seek to sell excellent brands of gasoline and no one of them is essential to the retail business. The lessee is free to buy wherever he chooses; he may freely accept and use as many pumps as he wishes and may discontinue any or all of them. He may carry on business as his judgment dictates and his means permit, save only that he cannot use the lessor's equipment for dispensing another's brand. By investing a comparatively small sum, he can buy an outfit and use it without hindrance. He can have respondent's gasoline, with the pump or without the pump, and many competitors seek to supply his needs.¹³⁶

The Court concluded that the record disclosed no "purpose or power to acquire unlawful monopoly" and no probability of an unduly anticompetitive effect. "Upon the contrary, it appears to have promoted the public convenience by inducing many small dealers to enter the business and put gasoline on sale at the crossroads."¹³⁷

With all that has transpired during the forty-five years since *Sinclair*, it is understandable that it is generally mentioned today, if at all, for its limited historical interest. However, this neglect or relegation to the annals of ancient legal history is ill deserved. It is pregnant with the underlying economic, social, and political and antitrust implications of tying, and many of the most significant distinctions relevant to the effects of such practices are implicit in the Court's qualitative approach. Among these is the recognition that tying may affect competition (1) at either the buyer or seller level, or both; and (2) in either the tying or tied product market, or both.

The primary focus of concern in tying has been the possible foreclosure of existing and potential competitors from the tied product market. This may result in one or both of two ways: (1) from the leverage or economic power in the tying product; or (2) from the combined power, or "conglomerate" leverage, in the "package" of both the tying and tied products. The former involves the traditional extension-of-monopoly theory as refined by the *Loew's* doctrine, whereby the seller may have an advantage over competitors in the tied product who have a less desirable tying product, or none at all.

¹³⁶ *Id.* at 474.

¹³⁷ *Id.* at 475.

Furthermore, even where the seller has no competitive advantage over other diversified sellers—*i.e.*, where the latter have an equally acceptable tying product (as in *Sinclair*)—competition with non-diversified competitors in the tied product may be affected. This is the “collective foreclosure” effect emphasized in *Standard Stations*. Assuming that the package tie-in is more attractive to the buyer than separate acquisitions of the tying and tied products from different sources, the single-line supplier of the tied product may be forced to expand into the tying market to overcome the competitive advantage of his diversified competitors. This in turn would further a trend toward diversification, or “conglomerate bigness,” such as that condemned in the merger cases.¹³⁸ Thus, *Sinclair* is important for its recognition that no adverse competitive effects are likely to result from tying where there is no resulting competitive advantage, and where competition flourishes in the sale of both the tying and tied products by both diversified and single-line competitors.

A significant problem implicit in *Sinclair*, though not discussed, is the use of tying as an indirect method of price cutting.¹³⁹ The tying equipment was leased to dealers on a nonprofit or a below-cost basis, while the gasoline was sold at competitive prices. This had the effect of indirectly lowering the price of gasoline tied to the equipment lease. Thus, if Sinclair gained any advantage over competing gasoline suppliers it was because of the indirect price reduction of gasoline, rather than an inherent power or leverage in the tying equipment. At most, this type of arrangement would amount to a gasoline requirements contract, but not tying in the usual sense. And where, as the Court found in *Sinclair*, the dealer is not bound to deal exclusively in the seller's gasoline, and may practicably purchase and resell competing brands as well, or switch at will, the requirements label would also be inappropriate. Under these conditions, the effect would be the introduction of some indirect price competition into the sale of gasoline—a result seemingly consistent with antitrust policy. This competition may be met by other gasoline marketers in kind, either by similar equipment offers to dealers or by direct cuts

¹³⁸ *E.g.*, *FTC v. Proctor & Gamble Co.*, 386 U.S. 568 (1967); *United States v. Continental Can Co.*, 378 U.S. 441 (1964); see Day, *Conglomerate Mergers and “The Curse of Bigness,”* 42 N.C.L. REV. 511 (1964).

¹³⁹ See Turner, *supra* note 124, at 65. Combination sales, “bonus” offers, “free” gifts, premiums and the like have become a common method of sales promotion. The prime point of concern has been whether a particular practice is false or misleading in violation of section 5 of the FTC Act. See G. ALEXANDER, *HONESTY AND COMPETITION* 138-52 (1967).

in gasoline prices, thereby enabling the dealers to acquire the equipment on their own with the resultant savings in the lower cost of gasoline. In other words, in a *Sinclair* situation the competing suppliers of the tied product may have to meet competition by cutting their prices, either directly or indirectly, but need not diversify if they are unable or unwilling to do so.

The difficulty in this analysis of promotional tying—the “free gift” forthcoming only on the purchase of another (tied) product—is its disregard for the possible effect on competition with the non-diversified suppliers of the tying product, and the secondary, long-run effect it may have on non-diversified sellers of the tied product. For example, consider the independent suppliers of gasoline storage and handling equipment in *Sinclair*. Again, the effect on competition will vary according to the circumstances. Suppose that all of the major oil companies diversify into the production of the equipment themselves (or “sponsor” equipment made by another, as in the *TBA* cases). Even though competition between them is unaffected, and the dealers benefit from the non-price competition, the independent equipment suppliers may be forced to either diversify into gasoline to meet the competition or go out of the equipment business. In turn, this would eliminate the independent source of equipment, forcing the non-diversified oil companies to either diversify to meet the competition of those already diversified or go out of business. In either event, the trend to economic concentration, or “conglomerate bigness,” would be furthered.

On the other hand, suppose that the equipment subject to the promotional tying was purchased from the equipment manufacturers for redistribution by the oil companies. Rather than selling directly to the dealers, the equipment suppliers would merely be competing for sales to the oil companies with minimal, if any, likely effect on competition in the sale of equipment.¹⁴⁰ Indeed, the ability to sell in larger quantities to the oil companies may give rise to cost savings which, if passed on, might further benefit the dealers and, ultimately, the public. Finally, the continuation of the independent equipment suppliers would enable non-diversified oil companies to meet the non-price competition of its competitors either (1) with similar promotional tying or (2) with direct price cuts, permitting dealers to acquire their own equipment from the independent suppliers.

Another factor relevant to the determination of the probable

¹⁴⁰ This distinction was recognized in *Susser v. Carvel Corp.*, 332 F.2d 505, 519 (2d Cir. 1964).

competitive effect of tying is the object of the restriction—whether it is the ultimate consumer or a middleman purchasing for resale. In *Sinclair*, where the restriction was on the dealers, the Court noted that competing suppliers were not limited in their choice of outlets to the ultimate consumer. Neither was the consuming public restricted in its choice of brands, as exemplified in the Court's finding that the effect of the arrangements had been to encourage competition between independent dealers "at the crossroads."¹⁴¹ In the middleman tie-ins, the controlling question would be whether adequate alternative outlets are readily available at equal cost and convenience, so that competition for sales to the ultimate consumer by actual and potential competitors is not impaired. On the other hand, there is no way around tying restrictions on the consumer—if consumers are tied up, the availability of alternative outlets is immaterial.¹⁴²

At the buyer level the usual concern with tying is said to be its coercive effect in limiting the customer's freedom of choice in suppliers. However, the fact that the buyer willingly agrees to the restriction, whether because he is indifferent, unaffected, or even benefited, is not controlling. For example, a competitive-terms clause permitting the purchase of a competitor's tied product where it was available under more favorable terms would not excuse the tie-in from the virtual *per se* treatment,¹⁴³ on the theory that, all other things being equal, the tying seller still has a competitive advantage at the same price. Similarly, mutual patronage, under the *General Dynamics*¹⁴⁴ view, would be unlawful even though both parties to the reciprocal restrictions favor the arrangement. In other words, the foreclosure of competitors is the real consideration, and the restriction on the buyer's freedom of choice is only secondary, or make-weight. In requirements contracts, however, *Tampa Electric* would consider whether the restrictive dealing arrangement benefited the buyer as well as the seller, at least where a substantial *share* of the

¹⁴¹ 261 U.S. at 475.

¹⁴² See *International Business Mach. Corp. v. United States*, 298 U.S. 131, 135 (1936). Noting that tying IBM tabulating cards to the lease of IBM tabulating machines "precludes the use of the cards of any competitor," the Court distinguished *Sinclair* on the ground that "as the only use made of the gasoline was to sell it, and as there was no restraint upon the purchase and sale of competing gasoline, there was no violation of the Clayton Act." Cf. *Turner*, *supra* note 124, at 72-73.

¹⁴³ *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1 (1958); *International Salt Co. v. United States*, 332 U.S. 392 (1947).

¹⁴⁴ *United States v. General Dynamics Corp.*, 258 F. Supp. 36 (S.D.N.Y. 1966).

market is not foreclosed and there is no trend to concentration. The latter view, placing greater emphasis on the *purpose*, or "redeeming virtue," of requirements contracts benefiting the buyer, illustrates the interdependence of the power, purpose and effects elements in restrictive dealing practices generally.

C. Purpose—Redeeming Virtue or Business Excuse

As already noted, under the Rule of Reason a lawful main purpose must be established to justify an ancillary restraint, but such lawful purpose will not save an "unreasonable" restraint of trade, even where ancillary to the accomplishment of that purpose.¹⁴⁵ In other words, "purpose" is a negative element—it may support a finding of illegality but, by itself, will not support a finding of legality. For example, the requirements contract in *Tampa Electric* was found to be for the lawful purpose of insuring to the public utility a sufficient supply of coal. But this purpose alone would not be enough to justify the restraint. As noted in the Court's *Brown Shoe* merger decision (citing *Tampa Electric*), a requirements contract "may escape censure" if, in addition to this lawful purpose, "only a small share of the market is involved . . . and if there is no trend toward concentration in the industry."¹⁴⁶

The consequences of this interdependence of purpose and effect have already been demonstrated. It has been seen that promotional tying may have the redeeming virtue of introducing indirect price competition but, depending upon the circumstances, it may also have anticompetitive effects which would serve to reduce it to an unjusti-

¹⁴⁵ See note 124 *supra*. A concise restatement of this theory of ancillary restraints is found in *United States v. Columbia Pictures Corp.*, 189 F. Supp. 153, 178 (S.D.N.Y. 1960):

The doctrine of ancillary restraint . . . permits, as reasonable, a restraint which (1) is reasonably necessary to the legitimate primary purpose of the arrangement, and of no broader scope than reasonably necessary; (2) does not unreasonably affect competition in the marketplace; and (3) is not imposed by a party or parties with monopoly power.

¹⁴⁶ *Brown Shoe Co. v. United States*, 370 U.S. 294, 330-31. A recent illustration of the Court's emphasis of the interdependence of purpose and effect is found in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 375 (1967):

Our inquiry is whether, assuming nonpredatory motives and business purposes and the incentive of profit and volume considerations, the effect upon competition in the marketplace is substantially adverse. The promotion of self-interest alone does not invoke the rule of reason to immunize otherwise illegal conduct. It is only if the conduct is not unlawful in its impact in the marketplace or if the self-interest coincides with the statutory concern with the preservation and promotion of competition that protection is achieved.

fiable business excuse. The genesis of the tying cases—*i.e.*, tying input supplies to patented machines—still has its tenacious defenders who assert that the practice may be justified on the ground that it provides a legitimate means of economic price discrimination. According to the more or less abstract theories advanced in its support, it would permit the tying seller to maximize his profits while more fairly charging for the intensity of use (or need) of the tying machine according to the amount of tied input supplies utilized in the process.¹⁴⁷ But the argument that this use of tying as a “metering” device may benefit the buyer (particularly the small user) as well as the seller ignores the fact that competing sellers would thereby be foreclosed from the tied product market, contrary to judicial policy.¹⁴⁸

A common defense to a charge of unlawful tying is that it is essential to protect goodwill in the tying interest. Where the two products are complementary, the use of an inferior tied product may result in customer dissatisfaction with the combination, with some or all of the fault being attributed to the tying product. The usual judicial response has been that normally there are less restrictive alternatives available to accomplish this purpose, such as requiring that complementary products, from whatever source, meet reasonably necessary standards or specifications, or warning that the use of inferior complementary products may produce unsatisfactory results.¹⁴⁹ Here again the need or justification for using the tying restriction and the effectiveness of the less restrictive alternative will depend upon the circumstances—in particular, whether the tying restriction operates directly upon the ultimate consumer or upon a middleman selling to the ultimate consumer.

Where a manufacturer sells through a middleman there is in-

¹⁴⁷ See, e.g., Director & Levi, *Law and the Future: Trade Regulation*, 51 NW. U.L. REV. 281, 290 (1956); Bowman, *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19 (1957); Burstein, *A Theory of Full-Line Forcing*, 55 NW. U.L. REV. 62 (1960); Ferguson, *Tying Arrangements and Reciprocity: An Economic Analysis*, 30 LAW & CONTEMP. PROB. 552 (1965); Baldwin & MacFarland, *Some Observations on “Per Se” and Tying Arrangements*, 6 ANTITRUST BULL. 433 (1961); Baldwin & McFarland, *Tying Arrangements in Law and Economics*, 8 ANTITRUST BULL. 743 (1963); E. SINGER, *ANTITRUST ECONOMICS* 177-86, 189-95 (1968).

¹⁴⁸ See Turner, *supra* note 124, at 63 n.42; Adams, *The Legality of Compulsory Package Licensing of Patents*, 12 ANTITRUST BULL. 773, 790-91 (1967). Again, the difficulty with applying the judicial extension-of-monopoly theory to this situation is that the amount of commerce foreclosed in the tied product may be minuscule. See Burstein, *supra* note 148, at 63-64.

¹⁴⁹ See, e.g., *International Salt Co. v. United States*, 332 U.S. 392, 397 (1947); *International Business Mach. Corp. v. United States*, 298 U.S. 131, 139-40 (1936).

creased likelihood that the ultimate consumer will not receive sufficient warning that the complementary goods must meet certain specifications in order to function properly. The transference of blame to the manufacturer's product, and the resultant loss of goodwill, is especially likely where the complementary products are supplied by the same dealer. In that case, even if the manufacturer's written warning is communicated to the ultimate purchaser, he may disregard it on the assurance of a dealer who is more interested in a sale than in the protection of the manufacturer's goodwill, or he may mistakenly assume that the complementary products supplied by the dealer meet the manufacturer's specifications. This problem was recognized in *Pick Mfg. Co. v. General Motors Corp.*,¹⁵⁰ where the Seventh Circuit upheld a requirement that Chevrolet dealers "not sell, offer for sale, or use in the repair of Chevrolet motor vehicles and chassis, second-hand or used parts or any part or parts not manufactured by or authorized by the Chevrolet Motor Company. . . ."¹⁵¹ Each new Chevrolet carried a limited-time warranty against defects in materials and workmanship which was inapplicable where the car was repaired or altered in a way that, in the manufacturer's judgment, affected its reliability. In upholding the goodwill defense to a Clayton Act section 3 charge, the court stated:

In the minds of the owners, the cars are identified and associated with the manufacturer. If defective or inefficient repairs or replacements should be made, and the cars, as a result, should operate unsatisfactorily, the owners' recollections will naturally and inevitably revert to the specific name and manufacturer thereof. Defective parts, preventing efficient operation of cars, bring dissatisfaction with the automobiles themselves. The natural result is blame of the manufacturer and consequent loss of sales.¹⁵²

Even where a manufacturer sells directly to the ultimate consumer, tying may be necessary if the manufacturer is unable to convince the purchaser how important it is that complementary products meet his specifications. This problem arose in *Dehydrating Process Co. v. A. O. Smith Corp.*,¹⁵³ where the First Circuit upheld defendant's refusal to sell its patented silo unloading device unless the purchaser also used his patented glass-lined silo. Defendant had previously sold the unloader separately to thirty-six customers. Of

¹⁵⁰ 80 F.2d 641 (7th Cir. 1935), *aff'd per curiam*, 299 U.S. 3 (1936).

¹⁵¹ *Id.* at 642.

¹⁵² *Id.* at 643.

¹⁵³ 292 F.2d 653 (1st Cir. 1961).

these thirty-six customers, eighteen complained that it did not work properly where not used with defendant's silo, and six unloaders were returned.¹⁵⁴ In the face of this actual loss of goodwill and of defendant's inability to convince customers of the need to install the unloaders in silos meeting its specifications, the tying restrictions were held to be sufficiently reasonable, in the absence of rebuttal evidence, to uphold a directed verdict for defendant.

A similar goodwill problem was involved in *United States v. Jerrold Electronics Corp.*¹⁵⁵ The court there recognized that defendants were initially "confronted with a rather unique situation" in the development and sale of television equipment for community TV antenna systems.¹⁵⁶ The court emphasized the fact that defendant was engaged in the "launching of a new business with an uncertain future," and that during the development period the nature of the complicated equipment required responsible installation and servicing of sensitive equipment, all of which justified Jerrold in selling the components only as a single system and requiring the purchaser to secure servicing exclusively from it.¹⁵⁷

Several difficulties attend the attempt to justify tying on the ground that it is essential to protect goodwill in a new product, an infant industry, or generally because no other source of supply is available for complementary products meeting necessary specifications or standards. One problem arises where conditions change and alternative sources of supply meeting the necessary standards become available. In that event, it may be expected that the tie would no longer be justified, and would thereafter be illegal. For example, at some unspecified point before the trial in *Jerrold Electronics* the industry was said to have matured sufficiently to no longer warrant the tying practices; they were therefore declared to have become unlawful.¹⁵⁸ Another difficulty is that the very existence of the tie might discourage potential suppliers from attempting to enter the industry or to develop a product meeting the necessary specifications. These considerations, together with the difficulties of determining whether any other supplier can, or possibly could, meet the necessary specifications, suggest that it may be safer for the seller to frame the restrictions in terms of specifications or standards rather

¹⁵⁴ *Id.* at 656.

¹⁵⁵ 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961).

¹⁵⁶ *Id.* at 556.

¹⁵⁷ *Id.* at 556-57.

¹⁵⁸ *Id.* at 558. The court held that defendant had the burden of establishing at what point in time the restrictive dealing policy "was no longer justified." *Id.*

than tying. Where policing presents an unreasonable burden, the seller should be permitted to retain the right to determine which of the alternative sources meet the reasonably necessary specifications—provided, of course, that this determination is made objectively and in good faith.

One final situation in which tying may be the only means available for the protection of goodwill is where it is not practicable to prescribe specifications to insure that complementary products function properly with the tying product. Indeed, according to the Court's dictum in *Standard Stations*, "the only situation . . . in which the protection of goodwill may necessitate the use of tying clauses is where specifications for a substitute would be so detailed that they could not practicably be supplied."¹⁵⁹ A recent application of this rationale is found in the *Carvel* litigation. The Second Circuit, by a split decision in *Susser v. Carvel Corp.*,¹⁶⁰ upheld a requirement that a franchised soft ice cream dealer purchase his ice cream mix, cones and other supplies from the trademark franchisor or from a source approved by him. Noting that controls are necessary to assure the goodwill of the licensed trademark,¹⁶¹ the majority concluded that it is difficult to control "something so insusceptible of precise verbalization as the desired texture and taste of an ice cream cone or sundae."¹⁶² This reasoning was subsequently endorsed by the Commission in its section 5 proceedings challenging the Carvel franchise restrictions.¹⁶³ According to the Commission, "[Q]uality might be achievable by specifications whereas uniformity in all probability could not be."¹⁶⁴

Although the Second Circuit and the Commission agreed on the "practicability" test, their views differed regarding the nature of the Carvel franchise arrangements. When read together, these decisions suggest that some significant trademark problems may arise where a trademark owner attempts to exercise control over the *use* of his trademark on goods emanating from a *licensee* or *franchisee*, as distinguished from restrictive dealing limitations on a *purchaser* of his trademarked products. While the usual goodwill arguments

¹⁵⁹ *Standard Oil Co. v. United States*, 337 U.S. 293, 306 (1949).

¹⁶⁰ 332 F.2d 505 (2d Cir. 1964), *cert. dismissed as improvidently granted*, 381 U.S. 125 (1965).

¹⁶¹ *Id.* at 519.

¹⁶² *Id.* at 520.

¹⁶³ *Carvel Corp.*, [1965-1967 Transfer Binder] TRADE REG. REP. ¶ 17,298 (FTC 1965).

¹⁶⁴ *Id.* at p. 22,428.

already discussed would apply whenever complementary goods are tied to the sale of trademarked products, the law has been somewhat confused by the interaction of trademark and antitrust principles where a trademark is *licensed* for use on goods originating with the licensee.

A threshold question raised by these decisions is whether licensing the use of a trademark conceptually can constitute a tying product. The three-judge court held that it could, while the Commission took the position that it could not. According to Judge Friendly, joined by Judge Medina, the Carvel trademark was the "true tying item."¹⁶⁵ Judge Lumbard agreed that the commissary supplies were "separate products"¹⁶⁶ tied to the "lease or license of the trademark itself" but added that he felt this leverage was "buttressed by . . . [an] . . . array of patents and subsidiary trademarks."¹⁶⁷ The Commission disagreed. Commissioner Jones for the Commission stated that "the trademark license conceptually cannot constitute a 'tying' product and, even if it could, it could never be regarded as a separable 'product' apart from the mix and commissary items to which it is attached within the meaning of the typical tie-in arrangement."¹⁶⁸

A basic issue thus confronted in *Carvel* is the nature and function of trademarks. Under the orthodox view, trademarks indicate the source (even though anonymous) of the product or service to which they relate. Theoretically, the trademark owner's self-interest will motivate him to provide a product or service which has a uniformly high quality in order to encourage repeat sales and establish consumer preference over the long run. By contrast, an infringer's interest may be strictly short run—to misappropriate the trademark's goodwill by taking a "free ride" for so long as it lasts. It is against this *risk* of injury through deception that the trademark owner and the public is protected, without requiring the additional burden of proving in each case actual diversion of trade, injury to the trademark owner's reputation, or economic detriment to the deceived purchaser.

This "source" doctrine raises the question whether trademark licensing would be deceptive, and therefore prohibited, whenever the trademark is used with goods or services emanating from one

¹⁶⁵ 332 F.2d at 519.

¹⁶⁶ *Id.* at 514.

¹⁶⁷ *Id.* at 513.

¹⁶⁸ [1965-1967 Transfer Binder] TRADE REG. REP. at p. 22,425.

or more sources (*e.g.*, licensees) other than the trademark owner. This conclusion finds support in the common law principle that the right to use a trademark "cannot be transferred in gross."¹⁶⁹ According to this view, as expressed in the Restatement, Torts:

A right to the use of a trade-mark or trade name can be transferred along with a subject matter with which the trade-mark or trade name is associated, if that subject matter is itself transferable.¹⁷⁰

A similar approach is taken in section 10 of the Lanham Act, permitting the *assignment* of a trademark "with the goodwill of the business in which the mark is used, or with that part of the goodwill of the business connected with the use of and symbolized by the mark. . . ."¹⁷¹ Further support for the "source" doctrine is found in the Act's definition of "abandonment," which provides that a trademark is deemed to be abandoned "when any course of conduct of the registrant, including acts of omission as well as commission, causes the mark to *lose its significance as an indication of origin*."¹⁷²

It could be argued that, under a strict application of the source theory, trademark law *requires* that the licensor exact an exclusive-dealing restriction on the ingredients used in the manufacture or further processing of products bearing his trademark. At a minimum, licensing might be permitted under this view only where the trademark licensor "so actively participated in the preparation of the final product through the supply of an essential ingredient or service that consumer attribution of the origin to the licensor was reasonably accurate."¹⁷³ Furthermore, this trademark principle would not conflict with antitrust proscriptions of tying and exclusive dealing because, as noted by the Commission in *Carvel*, conceptually the trademark license is inseparable from the "product" to which it relates—*i.e.*, soft ice cream.¹⁷⁴ However, the Commission's decision in *Carvel* did not rest on the "source" doctrine. Instead, the franchise restrictions were upheld on the more recent "control" theory of trademark licensing.

This major challenge to the orthodox "source" theory is founded

¹⁶⁹ 3 RESTATEMENT, TORTS § 755 (1938).

¹⁷⁰ *Id.* § 756.

¹⁷¹ Trade-Mark Act of 1946, 15 U.S.C. § 1060 (1964).

¹⁷² 15 U.S.C. § 1127 (1964) (emphasis added).

¹⁷³ Comment, *Quality Control and the Antitrust Laws in Trademark Licensing*, 72 YALE L.J. 1171, 1177 (1963).

¹⁷⁴ *Carvel Corp.*, [1965-1967 Transfer Binder] TRADE REG. REP. ¶ 17,298 at 22,425 (FTC 1965).

in the belief that the consumer views trademarks as symbols of *quality* rather than of origin. It is argued that the trademark owner should be permitted to license others to use his trademark on their goods or services, provided the licensor retains control over their quality, just as he may sell under his own trademark products supplied by others to his specifications. This quality control theory underlies that interpretation of the Lanham Act which finds authority in section 5 for licensing federally registered trademarks for use on products or services emanating from the licensees. That section, governing the use of a registered trademark by "related companies," provides:

Where a registered mark or a mark sought to be registered is or may be used legitimately by related companies, such use shall inure to the benefit of the registrant or applicant for registration, and such use shall not affect the validity of such mark or of its registration, provided such mark is not used in such manner as to deceive the public.¹⁷⁵

A "related company" is defined in the Act as one which "legitimately controls or is controlled . . . in respect to the *nature* and *quality* of the goods or services in connection with which the mark is used."¹⁷⁶ From this it is concluded that trademark licensing is permissible under the Lanham Act, provided the licensor and licensees meet the definition of "related companies," *i.e.*, that the licensor retains the requisite *control* over the nature and quality of the licensee's goods and services.

In principle, the Commission in *Carvel* combined the "control" theory with the "source" doctrine in concluding that

since no property right inheres in a trademark apart from the product or service to which it relates [source doctrine], and since trademarks may be licensed but only on condition that the trademark owner retains control over the licensee's use of the trademark [control doctrine], it is conceptually impossible, in our opinion, to view a license to use a trademark as separate and distinct from the sale of the trademarked product or its ingredient.¹⁷⁷

In application, however, the Commission followed the control doctrine in reversing the hearing examiner's conclusion "that the restrictions imposed on Carvel's licensees were not reasonably related

¹⁷⁵ Trade-Mark Act of 1946, 15 U.S.C. § 1055 (1964).

¹⁷⁶ 15 U.S.C. § 1127 (1964) (emphasis added).

¹⁷⁷ *Carvel Corp.*, [1965-1967 Transfer Binder] TRADE REG. REP. ¶ 17,298 at 22,426 (FTC 1965).

to Carvel's right—and obligation—to control the quality of its trademark product and the identity and image of its trade name."¹⁷⁸

As the *Carvel* litigation demonstrates, the control theory presents a trademark situation closely akin to the antitrust goodwill defense. Under their theory "tying" may be permitted (or required) to maintain uniformity and quality (goodwill) "where specifications for a substitute would be so detailed that they could not practicably be supplied."¹⁷⁹ This similitude is underscored in the Commission's finding that the "same problems of uniformity of quality and ease of administration" were not present with respect to such standardized items as toppings, nuts and cones.¹⁸⁰ As to these, however, the record evidence did not disclose the amount of commerce involved and it was concluded that the foreclosure from including such items in the franchise restrictions was "in all likelihood *de minimis* in view of Carvel's share of the purchasing market for these items, which is probably less than one-tenth of one percent, that an order prohibiting such a restriction is unwarranted."¹⁸¹

Perhaps the most interesting problem touched upon in the *Carvel* litigation concerned the antitrust consequences of licensing the use of a mark as a trade name. The court and the Commission agreed that prohibiting the sale of non-Carvel products by the specially designed outlets displaying the Carvel name was reasonably ancillary to the protection of goodwill and the trademark "image." Both tribunals relied on the control theory to support their conclusions. According to the Commission, such products "would be attributed to that [Carvel] name, and any defects in quality, over which Carvel would have no control, would detract from its name and goodwill."¹⁸² Expanding on the same theme, the Second Circuit stated:

The requirement that only Carvel products be sold at Carvel outlets derives from the desirability that the public identify each Carvel outlet as one of a chain which offers identical products at a uniform standard of quality. The antitrust laws certainly do not require that the licensor of a trademark permit his licensees to associate with that trademark other products unrelated to those customarily sold under the mark. It is in the public interest that products sold under one particular trademark be subject to the control of the trademark owner. Carvel was not

¹⁷⁸ *Id.* at p. 22,427.

¹⁷⁹ *Standard Oil Co. v. United States*, 337 U.S. 293, 306 (1949).

¹⁸⁰ [1965-1967 Transfer Binder] TRADE REG. REP. at p. 22,428.

¹⁸¹ *Id.*

¹⁸² *Id.* at p. 22,431.

required to accede to the requests of one or another of the dealers that they be permitted to sell Christmas trees or hamburgers, for example, which would have thrust upon Carvel the obligation to acquaint itself with the production and sale of these items so as to establish *reasonable quality controls*.¹⁸³

The logical extension of this justification for trademark/trade name franchising brings us full cycle to where we began. Whether considered a "right" or an "obligation," the control necessary to prevent confusion of origin and to insure uniformity and quality—the preservation of goodwill and trademark image—may be said to require the franchisee to limit his dealings to those trademarked products of his licensor, under whose trade name he conducts his business. This legitimate purpose remains the same whether the franchise is one for Standard Oil products, Brown shoes, Atlantic sponsored TBA, or Carvel soft ice cream. The question remains: when and under what circumstances will this purpose be considered to be merely an unacceptable "business excuse" for unlawful tying, quasi-tying, or exclusive dealing; and when and under what circumstances will it be considered to be a "redeeming virtue," or legitimate "franchising"?

Each of these examples of tying defenses leads to the conclusion that, unless it can be affirmatively demonstrated both that restrictive dealing is *essential* to the promotion or sale of a commodity or service and that the ancillary restraint has the net effect of *enhancing* competition, the restriction will be unlawful if the proscribed degree of foreclosure results. In each of the illustrations in which the defense was successful, the restriction was shown to be *essential* for the preservation of goodwill and, therefore, of the very existence of the business—if the restriction were prohibited, the business would likely suffer irreparable harm, and consequently would be an ineffective competitor if able to survive at all.

This "survival" limitation on tying defenses is consistent with the Court's assertion in the *Brown Shoe* merger decision that "unless the tying device is employed by a small company in an attempt to break into a market, the use of a tying device can rarely be harmonized with the strictures of the antitrust laws,"¹⁸⁴ and with the Court's recognition that integration may be justified where essential to a small company for it to compete with larger competitors dominating the market, or to save a failing company from going under.¹⁸⁵

¹⁸³ *Sussex v. Carvel Corp.*, 332 F.2d 505, 517 (2d Cir. 1964) (citations omitted) (emphasis added).

¹⁸⁴ *Brown Shoe Co. v. United States*, 370 U.S. 294, 330 (1962) (citation omitted).

¹⁸⁵ *Id.* at 331.

Beyond these limited "survival" defenses, the cases hold out little hope of successfully justifying an otherwise unlawful restrictive dealing practice.

The survival defenses are themselves, at the same time, delusive and illusive. In the first place, proof that tying is necessary for survival may be difficult or impossible. The problems of the "failing company" defense in merger cases have been well aired.¹⁸⁶ When is a company failing? When it is on the verge of bankruptcy? When it is losing money? When its market share is declining? Assuming the proper criteria for "failing" are determined and met, there still remains the question: Is restrictive dealing necessary to save it? This involves the problem of the availability of more reasonable alternatives. For example, what if a business loan would enable the company to get back on its competitive feet? Or what if new management, or other less restrictive promotional activities such as increased advertising, would save it? Similar problems attend the "against giants" and "new entry" defenses. Finally, as already noted, if the survival defense is established there remains the problem of how long the restrictive-dealing arrangement may be continued. Once established, the justification may evaporate when the company ceases to be failing, the competitive disadvantage of a small company in a market of giants is overcome, or the new entry, new product, or new industry becomes established. The point in time when the defense ceases to exist may present a problem of proof at least as evasive as the initial establishment of the "survival" defense.¹⁸⁷

VI. CONCLUSION

This meandering review of restrictive dealing practices ends about where it began. The legal status of exclusive dealing, tying and quasi-tying (including reciprocity) remains in doubt. The applicable standards of legality have been blurred by judicial preoccupation with labels, blind adherence to unanalyzed precedent (and dicta), and a general reluctance to recognize distinctions, as well as similarities, in the nature, purposes and effects of various restrictive dealing practices in the context of the particular competitive setting.

¹⁸⁶ See, e.g., discussion and references in *Dean Foods Co.*, [1965-1967 Transfer Binder] TRADE REG. REP. ¶ 17,765 at 23,106-15 (FTC 1966); cf. *id.* at 23,122-24 (dissenting opinion). See also *Hearings on S. 1312 [the "Failing Newspaper" bill] Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 90th Cong., 1st Sess. (1968).

¹⁸⁷ See *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545, 558 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961).

The difficulty in evolving informative guidelines for general application has been complicated by the inherent cumbersomeness of the common-law, case-by-case development of antitrust principles. As recognized by Judge Wyzanski in *United States v. United Shoe Mach. Corp.*, in antitrust law, "it is delusive to treat opinions written by different judges at different times as pieces of a jig-saw puzzle which can be, by effort, fitted correctly into a single pattern."¹⁸⁸ However, as Judge Wyzanski further noted, trends in judicial thinking may be discerned from a line of decisions.

The key to understanding, if not harmonizing, the decisions on restrictive dealing practices lies in identifying the basic antitrust policy of the Supreme Court. The Court's trend toward per se treatment of restrictive dealing practices may be recognized as merely symptomatic of a more fundamental shift in antitrust goals from the preservation of "effective" or "workable" competition, with its emphasis on market performance and proscriptions of "undue" restraints, to the protection of small-business competitors, with its emphasis on the preservation of a decentralized, fragmented, market structure and the curbing of incipient trends to economic concentration, oligopoly, or "bigness." Thus, even where a requirements contract is for the lawful purpose of insuring the customer a sufficient supply or of providing the seller with a predictable market for his output, it "may escape censure if only a small share of the market is involved . . . and if there is no trend toward concentration in the industry."¹⁸⁹ Similarly, the only defenses recognized for tying are those necessary for survival or for the enhancement of competition by small or relatively impotent competitors—such as where it is essential to establish a new product or industry, to salvage a failing company, or to enable small competitors to compete against giants in the industry.

This policy shift to an "anti-bigness" theme runs like a litany through the Court's recent decisions relating to vertical restraints, including mergers, territorial restrictions and price discrimination as well as restrictive dealing practices. The liturgy has been the equation of competition to numbers—a reversion to the classical model of "pure" or "perfect" competition based on the theory that "competition is likely to be greatest when there are many sellers, none of which has any significant market share."¹⁹⁰ Corollary to this

188 110 F. Supp. 295, 342 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954).

189 *Brown Shoe Co. v. United States*, 370 U.S. 294, 330-31 (1962).

190 *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363 (1963).

small-business thesis is the disdain for any arrangement which would give anyone a competitive advantage, or would infringe on the small-businessman's autonomy.

Paradoxically, the Court's aspirations of maintaining a fragmented, small-business, industry structure may result in a double standard which is anti-bigness on its face, but anti-small-business in operation. Tying and exclusive dealing contracts may be virtually per se illegal for substantial companies, while apparently open to the survival justification for disproportionately small, unestablished, or failing companies. Although this double standard simplifies the test for restrictive dealing arrangements by "big" companies, it leaves open the question of when a company is sufficiently small or failing to justify such arrangements. Neither the quantitative substantiality test nor the comparative substantiality test provides much encouragement that the defense will be liberally applied. The sparse decisions in this area lend even less hope that the promise of the defense is much more than an illusion. In operation, the limited defense may excuse restrictive dealing arrangements only in rare cases under exceptional conditions, and only so long as the exceptional conditions continue to exist. The remainder, including arrangements involving only relatively "small" companies, stand in the shadow of the Court's "almost" per se illegal test.

It is in the area of alternatives available to "large" businesses, as opposed to "small" businesses, that the anti-smallness effect becomes most obvious. The more restrictive nature of the alternatives available to the large marketers was the basis for Justice Douglas' dissent in *Standard Stations*, wherein he saw the majority's opinion as promising to "wipe out large segments of independent filling-station operators."¹⁹¹ He felt that the requirements contract method of doing business at least permitted the independent retailers to remain alive as "small business units," and that its elimination would promote further concentration in the major oil companies:

The formula suggested by the Court is either the use of the "agency" device, which in practical effect means control of filling stations by the oil companies, or the outright acquisition of them by subsidiary corporations or otherwise. Under the approved judicial doctrine either of those devices means increasing the monopoly of the oil companies over the retail field.¹⁹²

Justice Douglas concluded that "the requirements contract which

¹⁹¹ *Standard Oil Co. v. United States*, 337 U.S. 293, 319 (1949) (dissenting opinion).

¹⁹² *Id.* at 320 (citations omitted).

is displaced is relatively innocuous as compared with the virulent growth of monopoly power which the Court encourages."¹⁹³

The Court's subsequent shift in merger policy under amended Clayton Act section 7, and its retreat from the earlier per se legal treatment of agency/consignment arrangements, has alleviated to some degree Justice Douglas' fears of encouraging the "curse of bigness." However, vertical mergers have not been held to be illegal per se, and agency/consignment arrangements are still tested by the Rule of Reason.¹⁹⁴ Furthermore, a restrictive dealing policy may be implemented by unilateral action, either by customer selection on the basis of a pre-announced policy or through internal expansion vertically into a different level of the distribution chain. Absent monopolization, or an attempt to monopolize, each of these latter methods of vertical integration may be employed with apparent anti-trust impunity.

Taken together, the current antitrust treatment of restrictive dealing practices condemns as more nearly per se illegal those arrangements which are most accessible to smaller businesses, while permitting those methods of achieving the same goals which are functionally available only to larger competitors. Vertical integration through internal expansion may be beyond the reach of smaller companies with limited financial, technical and management resources. Similarly, the agency/consignment device minimally requires the capital necessary to maintain the inventory to which title is retained. To be an effective enforcement method, a unilateral refusal to deal requires sufficient preference for the tying product, *i.e.*, sufficient "power," to induce acquiescence in the policy by independent purchasers. Thus, vertical integration by contract remains the only feasible method of restrictive dealing by smaller companies with limited resources and insufficient power or leverage.

This discrepancy in treatment of those restrictive dealing practices available to "big" as opposed to "small" businesses could be alleviated by reconciling the antitrust standards applicable to each. One solution would be to condemn the "big" business methods of achieving restrictive dealing objectives through unilateral refusals to deal, agency/consignment arrangements, and internal vertical expansion on the same basis as integration by contract. To completely eliminate their competitive advantage, existing "big" integrated companies would have to be broken up to meet the Populist ideal of

¹⁹³ *Id.* at 321.

¹⁹⁴ *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 380-82 (1967).

an egalitarian market structure. Obviously, a more practical and politically more likely solution would be to discard the virtually per se illegal treatment afforded vertical integration by contract in favor of the more flexible qualitative principles of the Rule of Reason ancillary restraint doctrine. However, the latter approach raises the perennial dilemma of the loss of certainty and ease of enforcement which is corollary to the empirical application of such an amorphous "rule."

An area of law as imperspicuous as this is manifestly inappropriate for an aimless case-by-case approach, as amply demonstrated by the pendulation, often out of phase, of the Commission and the courts between a Rule-of-Reason approach and per se illegal treatment,¹⁹⁵ with the current emphasis tending to the latter. Satisfaction of the divergent desiderata of certainty and flexibility requires the establishment of meaningful guidelines for judging restrictive dealing arrangements under a Rule-of-Reason test.

A major difficulty with this approach is in determining the proper method of its accomplishment. The trend in the opposite direction indicates that it is unlikely to happen in the Supreme Court, absent a drastic change in judicial policy. A complete solution may require a major legislative overhaul of the antitrust laws and enforcement procedures.¹⁹⁶ Again, however desirable this may be, its accomplishment appears to be unlikely in the foreseeable

¹⁹⁵ See, e.g., Bok, *The Tampa Electric Case and the Problem of Exclusive Arrangements Under the Clayton Act*, 1961 SUP. CR. REV. 267.

¹⁹⁶ The antitrust approach of the European Common Market provides a ready model for comparison. The EEC Commission has granted a group exemption to "exclusive distributorship" agreements on the grounds that

such arrangements allow the entrepreneur to concentrate his sales operations, overcome linguistic and legal difficulties, and help to intensify a steady flow of goods combined with a more rational distribution. They also offer small- and medium-sized enterprises an opportunity to compete in markets otherwise beyond their reach. Such exclusive distributorships as a rule also confer on consumers an equitable share in the resulting benefit, improving supply possibilities and implying advantages from more efficient distribution. COMMON MKT. REP. ¶ 9162, at 8351 (1967).

The group exemption may be withdrawn

if there is reason to believe that the products covered by the agreement are not competing with similar products in the area covered by the agreement, that access to the sector of activity of the exclusive dealer is barred to other dealers, or if the exclusive dealer exploits the group exemption to prevent without good reasons groups of purchasers from obtaining supplies or to sell the goods covered by the agreement at prices higher than warranted. *Id.*

future. Consequently, the most likely solution would seem to be through the enforcement agencies.

The merger area provides a ready model for the "guideline" approach by the enforcement agencies. The Antitrust Division of the Department of Justice recently published its long awaited merger guidelines,¹⁹⁷ and the Commission has promulgated separate guidelines for vertical mergers of cement manufacturing companies and their customers in the ready-mixed concrete business,¹⁹⁸ for vertical mergers of food distribution and sales companies,¹⁹⁹ and for product-extension mergers in the grocery manufacturing industry.²⁰⁰ The appropriateness of utilizing a more qualitative test for restrictive dealing arrangements through a similar guideline approach is self-evident. As the Supreme Court itself has noted, "integration by merger is more suspect than integration by contract, because of the greater permanence of the former."²⁰¹

In addition to the usual problems inherent in the dual anti-trust enforcement by the Department of Justice and the Commission,²⁰² strong arguments may be made for leaving regulation of restrictive dealing arrangements solely to the Commission. The Commission's peculiar expertise and mode of operation, with its unique investigatory powers, rule-making authority, advisory opinion program, and exclusively equitable powers, make it particularly well equipped for the guideline approach. Furthermore, the Commission's individualized industry approach in its merger guidelines has the dual merit of (1) outlining its enforcement policies in a narrower industry context, with a resultant increase in certainty, and (2) permitting more flexibility in applying the qualitative standard and adapting its guidelines to the particular conditions in each industry. As noted by Justice Brandeis in his celebrated dissent in *FTC v. Gratz*, "Methods of competition which would be unfair in one industry, under certain circumstances, might, when adopted in another industry, or even in the same industry under different circumstances,

197 TRADE REG. REP. ¶ 4430 (1968).

198 *Id.* ¶ 4510.

199 *Id.* ¶ 4520.

200 *Id.* ¶ 4530.

201 *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 366 (1963).

202 Indeed, if uniform enforcement is the goal, some method of harmonizing private antitrust actions also must be established to ensure its achievement. See Day, *Private Actions Under Section 7 of the Clayton Act*, 29 A.B.A. ANTITRUST SECTION 155 (1965).

be entirely unobjectionable."²⁰³ Finally, precedent for abdicating jurisdiction over restrictive-dealing arrangements to the Commission is found in the Department of Justice's virtually hands-off policy in Robinson-Patman Act enforcement.

Although this approach may be criticized as smacking of government "regulation," it may be the only practical alternative to achieving, with any degree of success, the elusive twin goals of certainty and reasonableness. That the Commission has the ability to utilize the Rule of Reason is demonstrated in such cases as *Carvel* and *Motion Picture Advertising*. Whether it would choose to adhere to that policy in the future is, of course, problematical. There is always the danger, as in bedding down with a well-intentioned horse, that if it should decide to roll over the consequences could be disastrous. But the current judicial trend to virtually per se illegal treatment of restrictive dealing arrangements warrants the risk of a trial.

²⁰³ 253 U.S. 421, 436 (1920).