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Comment

Vertical Territorial Restraints Before and After *Schwinn*: A Clash Between Manufacturers and the Law

From the perspective of a business firm, the antitrust laws act as unnatural restraints upon the normal operation of the American capitalistic system.[1] This is so because an essential feature of "capitalism" is its unplanned and decentralized method of production; a relatively unregulated price system should dictate automatically the answers to the fundamental business questions—what, how, and for whom to produce and distribute.[2]

Perhaps no other area of antitrust concern more vividly illustrates this clash between unfettered capitalism and the restraints of antitrust legislation via judicial interpretation than that of the manufacturer-dealer relationship.[3] The typical manufacturer, moti-

1. It is interesting to note that in the early stages of the development of America's capitalism, the government merely acted as a "protector," of the entire system and declined to involve itself in its internal operations. Early nineteenth century economists, basing their programs upon Adam Smith's treatises, proclaimed that the "proper role of government was only to protect and organize the institutions of capitalism." President Madison believed that America's infant ecomony needed protective tariffs to shield it from Europe's more sophisticated practices, and that, "protected by the institutions of capitalism, individuals would be driven by self-interest to organize and develop the productive capacity of the country" without the need of governmental controls to protect them. W. CARTER & M. LENDAHL, CORPORATE CONCENTRATION AND PUBLIC POLICY 4 (3d ed. 1959).

2. Ranlett & Curry, *Economic Principle: The 'Monopoly,' 'Oligopoly,' And 'Competition' Models*, in ANTITRUST AND THE U.S. SUPREME COURT 247 (M. Duggan ed. 1972).

3. In this context, the manufacturer-dealer relationship refers to the normal sales transaction whereby a manufacturer conveys title to goods to an independent dealer who thereafter transfers these goods to other suppliers in the vertical distributional chain or sells them directly to the consumers or users.

The term "franchising" has often been defined broadly enough to encompass such "dealer-sales" agreements, but that term is more properly employed to describe a continuing commercial relationship wherein a franchisee is authorized to sell specific goods and/or services and is dependent upon the franchisor for his supply of goods or for specialized services or marketing plans relating to their sale. Most often franchising involves the distribution of brand name or trademarked products or services over which the franchisor has a continuing interest in quality control and customer relations.

For further discussion on the definition of franchising as distinguished from a manufacturer-dealer relationship see Fromson, *The Distributor Agreement: Selected Legal* vated by economically sound business practices, may desire to regulate the retail distribution of goods he has already sold to wholesalers in order to optimize his own long-term profit margin.[4] The viability of such post-sale controls, absent any form of governmental regulation, would be tested in the market place by the economic "law" of supply and demand.[5] That is, if the manufacturer's controls increased the demand for his product in such a way as to swell his net profits then such controls would be continued. Conversely, if the reactive conduct of the consumers or competing firms caused the manufacturer to lose profits, the controls upon distribution would be abandoned. The antitrust laws,[6] however, add an artificial restraint to the free enterprise system, and consequently the distributive restrictions imposed upon wholesalers or retailers must not only satisfy the natural demands of the marketplace, but also must comply with the overriding policy of the antitrust legislation as interpreted by the courts.

This comment will deal specifically with the United States Supreme Court's treatment of post-sale territorial restraints[7] imposed

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Problems Part 1, 47 N.Y. ST. B.J. 23 (1975); Rockefeller, *Franchising and the Antitrust Laws*, 56 CHI. B. REC. 44-45 (1974).

4. For the instances in which manufacturers would wish to maintain such controls and the forms in which these controls appear see the discussion beginning at text accompanying note 88 *infra*.

5. Competitive pricing rations out the limited supply of goods to those who can afford to satisfy their desires. Inherent in the economic system are determinations as to whom goods will be allocated, *i.e.*, who can afford them. P. SAMUELSON, ECONOMICS—AN INTRODUCTORY ANALYSIS 60-61 (1961). Demand, in turn, signals changes in which goods are to be produced, how, at what cost, and in what quantity. Equilibrium, of course, is reached where demand and supply schedules for a particular good intersect. *Id.* at 64-67.

6. The specific enactment normally employed as a restraint upon distributive controls imposed by manufacturers is § 1 of the Sherman Antitrust Act, 15 U.S.C. § 1 (1973), which reads in pertinent part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal: . . .

7. The intricacies of territorial restraints will be discussed throughout this comment. Generally, a vertical territorial or geographic restraint is any limitation which a seller imposes on a buyer that limits the buyer's freedom to resell to persons wherever or from wherever the buyer desires.

Two other types of vertical restraints, customer restrictions and resale price maintenance, will only be analyzed as they relate to territorial restrictions. Customer restrictions limit the class of customers with whom retailers or wholesalers may deal, and generally are found in connection with other vertical restrictions. *See, e.g.*, White Motor Co. v. United States, 372 U.S. 253 (1963). Retail price maintenance, the imposition by the manufacturer of minimum resale prices on goods, was the first type of vertical restraint to be reviewed by the courts by the manufacturer upon his dealers and with the manner in which lower courts have agreed or disagreed with the Supreme Court over the extent to which the Sherman Act should limit a manufacturer's business decision to impose such restraints.

THE JUDICIAL EVOLUTION OF A PER SE RULE

In the first Supreme Court case to tackle any form of vertical restraint, *Dr. Miles Medical Co. v. John D. Park & Sons*,[8] the Court declared that the manufacturer's restrictions upon the resale price of its medicines sold to wholesalers and retailers was a per se violation[9] of § 1 of the Sherman Act.[10] Dr. Miles had argued that since a manufacturer may choose not to sell to particular buyers, a fortiori, he could impose conditions upon those with whom he selected to deal.[11] To rebut this argument, Justice Hughes simply referred to the normal invalidity of general restrictions upon alienation as authority for stating that "every sort of restriction" may not be imposed upon purchasers.[12] For the first time, the mystical ban on "restraints upon alienation" was accepted without comment in an analysis of manufacturer-imposed restrictions.

The main thrust of the opinion branded resale price maintenance a per se violation and precluded any consideration of Dr. Miles' contention that it had been damaged by price cutting. Although the Court was firm in maligning such agreements,[13] it had difficulty

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and is, therefore, important as a starting point for the analysis of such restraints in general. *See, e.g.*, United States v. Parke Davis & Co., 362 U.S. 29 (1960); Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

The above-mentioned *vertical* restraints should be distinguished from *horizontal* territorial, customer, and price restrictions which competing distributors impose upon each other. Such horizontal arrangements have a longer history of judicial scrutiny and condemnation and have traditionally been considered more abusive than vertical restraints. *See, e.g.*, United States v. Sealy, Inc., 388 U.S. 350 (1967); Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951); Addyston Pipe & Steel Co. v. United States, 175 U.S. 211 (1899).

8. 220 U.S. 373 (1911).

9. For an explanation of the per se rule/"rule of reason" dichotomy see note 22 *infra*.

10. Dr. Miles had instigated the action itself, seeking an injunction to stop a wholesale drug concern from inducing other drug companies to breach their resale price maintenance agreements with plaintiff. The Court rejected the manufacturer's contention that it operated a "consignment" method of distribution, and thus set the stage for the pronouncement of a rule governing resale price maintenance under normal sales conditions. 220 U.S. at 398-99.

11. *Id.* at 404.

12. *Id.*

13. Without further comment the Court stated, "that these agreements restrain trade is obvious." *Id.* at 400.

explaining exactly how the manufacturer would be restraining trade by its imposition of resale prices when "the advantage of established retail prices primarily concerns the dealers"[14] and not the manufacturers. Without actually accusing Dr. Miles of being a "pawn" of its distributors, the Court invalidated its resale price program because it considered a vertically imposed price restriction to be as pernicious as one initiated by the retailers themselves.[15] Thus, because the Court could not fathom the circumstances in which a manufacturer would wish to impose resale price restrictions for other than anticompetitive purposes, it held all such restraints to be per se illegal.[16]

In its first case to deal expressly with vertical territorial restriction, *White Motor Co. v. United States*,[17] the Supreme Court was less willing to impose a per se ban upon that form of manufacturer-imposed restraint without some evidence of the economic milieu in which it was created.[18] White had imposed upon distributors and dealers of its trucks both territorial and customer restrictions,[19] and

14. *Id.* at 407.

15. Horizontal price-fixing among competitors had long been a per se violation. *See, e.g.*, Swift & Co. v. United States, 196 U.S. 375 (1905); Addyston Pipe & Co. v. United States, 175 U.S. 211 (1899); United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898).

16. The Court somewhat cryptically darted over the discussion of how Dr. Miles could use resale price maintenance for its own anticompetitive advantage when it stated:

> *If there be an advantage to a manufacturer* in the maintenance of fixed retail prices, the question remains whether it is one which he is entitled to secure by agreements restricting the freedom of trade on the part of dealers who own what they sell.

220 U.S. at 407-08 (emphasis added).

17. 372 U.S. 253 (1963).

18. Earlier circuit court cases dealing with the area of vertical territorial restrictions had generally upheld such restraints. *See, e.g.*, Boro Hall Corp. v. General Motors Corp., 124 F.2d 822 (2d Cir. 1942), *cert. denied*, 317 U.S. 695 (1943); Phillips v. Iola Portland Cement Co., 125 F. 593 (8th Cir. 1903), *cert. denied*, 192 U.S. 606 (1904).

19. 372 U.S. at 255. Typical of the territorial clauses used is the following:

> Distributor is hereby granted the exclusive right, except as hereinafter provided, to sell during the life of this agreement, in the territory described below, White and Autocar trucks purchased from Company hereunder.
>
> . . . .
>
> Distributor agrees to develop the aforementioned territory to the satisfaction of Company, and not to sell any trucks purchased hereunder except in accordance with this agreement, and not to sell such trucks except to individuals, firms, or corporations having a place of business and/or purchasing headquarters in said territory.

Id. at 255-56.

Typical of the customer clause is the following:

> Distributor further agrees not to sell nor to authorize his dealers to sell such trucks to any Federal or State government or any department or political subdivision thereof,

the district court, adopting the view that such restrictions were per se illegal, granted a summary judgment for the government.[20] In reversing the district court and remanding the case for a trial on the merits, the Court expressed its hesitancy to declare vertical territorial restrictions illegal per se without an in-depth analysis of the circumstances surrounding their use.[21] Justice Douglas' much quoted opinion reflected a cautious approach to adding a new category to the list of per se antitrust violations:[22]

> Horizontal territorial limitations, like "group boycotts, or concerted refusals by traders to deal with other traders" . . . are naked restraints of trade with no purpose except stifling of competition. A vertical territorial limitation may or may not have that purpose or effect. We do not know enough of the economic and business stuff out of which these arrangements

> unless the right to do so is specifically granted by Company in writing.

Id. at 256.

20. United States v. White Motor Co., 194 F. Supp. 562 (N.D. Ohio 1961).

21. The Court stated:

> This is the first case involving a territorial restriction in a vertical arrangement; and we know too little of the actual impact of both that restriction and the one respecting customers to reach a conclusion on the bare bones of the documentary evidence before us.

372 U.S. at 261.

22. The general inquiry which a court makes concerning a violation of the antitrust laws has been labeled the "rule of reason," since from the inception of Sherman Act litigation, the Supreme Court had declared that only *unreasonable* restraints of trade will be barred. The rule demands an inquiry into

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

Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918) (emphasis added).

Some restraints, however, are labeled illegal per se since

> 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.

Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958). Examples of such per se illegal restrictions include tying an unpatented product to a patented article, International Salt Co. v. United States, 332 U.S. 392 (1947); horizontal divisions of markets among competitors, Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951); group boycotts, Fashion Originators' Guild v. FTC, 312 U.S. 457 (1941); vertical price-fixing, United States v. Parke Davis & Co., 362 U.S. 29 (1960); and horizontal price-fixing, Kiefer-Stewart Co. v. Seagram & Sons, 340 U.S. 211 (1951).

> emerge to be certain. They may be too dangerous to sanction or they may be allowable protections against aggressive competitors or the only practicable means a small company has for breaking into or staying in business . . . and within the "rule of reason." We need to know more than we do about the actual impact of these arrangements on competition to decide whether they have such a "pernicious effect on competition and lack . . . any redeeming virtue" . . . and therefore should be classified as *per se* violations of the Sherman Act.[23]

In reality, the *White* Court was authoring a neutral opinion; *i.e.*, it was merely delaying its decision whether to declare vertical territorial restrictions per se illegal until relevant data could be gathered on the effects of such conduct. However, the attitudes expressed to some degree by Justice Douglas, speaking for the Court, and more definitively by Justice Brennan, in his own concurring opinion, evidenced a propensity to endorse the "rule of reason" as the proper standard for judging the validity of vertical territorial restrictions. Justice Douglas analogized this area of manufacturer-imposed restraints to the merger field and commented that "in cases involving the question whether a particular merger will tend 'substantially to lessen competition' . . ., a trial rather than the use of the summary judgment is normally necessary."[24]

This comment, coupled with a passing reference to the "failing company" defense available to merging companies,[25] may have been an expression by the Court that such vertical restraints lack the pernicious quality that would render them per se illegal.

Justice Brennan was more direct with his doubts about a per se ban. He posited several economically rooted marketing factors for the trial court to consider in assessing White's own justifications for the restraints. White had defended its geographic limitations on the grounds that, as a company incapable of vertical integration, the use of restricted dealerships was the only feasible method of competing effectively with its large competitors.[26] Justice Brennan emphasized the distinctions he saw between vertical and horizontal

23. 372 U.S. at 263 *quoting* Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958) (citations omitted).

24. 372 U.S. at 264.

25. *Id.*

26. *Id.* at 256-57. White argued that to encourage its dealers to make vigorous sales efforts in a particular area, it was imperative that it be able to offer protection to such dealers from the competition of other distributors. *Id.*

territorial restraints and between territorial restraints and resale price maintenance—whereas horizontal divisions of markets and resale price maintenance may have a distinctly pernicious effect upon *inter*brand competition, the effect of manufacturer-imposed geographic restrictions is less clear.[27] If White's claims were valid, then the restraints upon *intra*brand distribution could be permissible attempts to promote more vigorous *inter*brand competition. Indeed, Justice Brennan reiterated several other situations in which territorial restrictions might be vital to a manufacturer's continued existence, and thus acceptable even under antitrust scrutiny.[28]

Justice Clark, in his dissent, was vehemently in favor of declaring all such vertical restraints a per se violation of the Sherman Act.[29] Following the rationale of *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,[30] he characterized vertically imposed territorial restraints as being no less anticompetitive than similar horizontal restrictions.[31] To the *Dr. Miles* Court and Justice Clark, the motive of the manufacturer for imposing restrictions was irrelevant; the only significant factor was the existence of a restraint that had the appearance of a traditional form of cartelization. Justice Clark was unwilling to concede that there existed any business justification for vertical restraints other than the elimination of competition.[32]

The *White* decision gave the lower federal courts freedom to study vertical territorial restraints and develop an appropriate method of analysis for future judicial scrutiny. The only two circuits to take up this post-*White* inquiry adopted the "rule of reason" approach suggested by Justice Brennan.[33]

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27. *Id.* at 268.

28. *Id.* at 269. Justice Brennan suggested that a new entrant into a market might not be able to induce distributors to deal with its product unless some territorial guarantees are offered. Similarly, a manufacturer, to whom extensive advertising, promotion and servicing are vital, might find that such territorial guarantees are the only way to insure that its wholesalers and/or retailers will carry on these activities adequately. *Id.*

29. *Id.* at 276. He stated:

> I believe that these "bare bones" really lay bare one of the most brazen violations of the Sherman Act that I have experienced in a quarter of a century.

Id.

30. 220 U.S. 373 (1911).

31. 322 U.S. at 279.

32. *Id.* at 281.

33. The two cases that dealt with vertical territorial restrictions after *White Motor* actually involved asserted violations of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (1970), dealing with unfair trade practices. The courts, however, have consistently

In *Snap-On Tools Corp. v. FTC*,[34] the Seventh Circuit adopted a "rule of reason" approach without the inquiry into the significance of such a rule that *White* had seemed to demand. The court rather summarily concluded that *White* had declared vertical territorial restrictions not to be per se violations of the Sherman Act.[35] Having thus decided to review the business justifications for Snap-On's restrictions upon its dealers, the court went on to hold such restraints reasonable as necessary competition-promoting tactics.

Snap-On was a large manufacturer of mechanics' tools and related equipment which were distributed by independent dealers.[36] The nature of the tool industry was such that significant point-of-sale services were necessary to effectively compete in the market.[37] Dealers traveled directly to their customers' shops and places of business and displayed their goods in mobile, walk-in trucks. This enabled the dealers to provide on-the-spot demonstrations and to develop continuing relationships with the mechanic-users.[38]

The circuit court found that Snap-On's territorial restrictions upon its dealers were necessary to the maintenance of these wholesale practices and that they were "not significantly anti-competitive."[39] A minimal curtailment of intrabrand competition would thus be tolerated to effectuate more vigorous interbrand competition.

In *Sandura Co. v. FTC*,[40] the Sixth Circuit similarly held that an examination of the particular facts surrounding Sandura's imposition of territorial restraints was a necessary prerequisite to determining their legality. Sandura was a small, hard-surface floor coverings manufacturer which was attempting to market a product that few distributors were eager to handle.[41] A previous campaign to sell

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analyzed such alleged violations identically with those attacked under the Sherman Act, and thus the holding of *White Motor* was controlling.

Most of the lower court cases dealing with vertical territorial restraints before *White Motor* had also adopted a "rule of reason" approach. *See, e.g.*, Chicago Sugar Co. v. American Sugar Ref. Co., 176 F.2d 1 (7th Cir. 1949), *cert. denied*, 338 U.S. 948 (1950); Fosburgh v. California & Hawaiian Sugar Ref. Co., 291 F. 29 (9th Cir. 1923).

34. 321 F.2d 825 (7th Cir. 1963).
35. *Id.* at 828.
36. *Id.* at 827.
37. *Id.* at 828.
38. *Id.* at 829.
39. *Id.* at 832.
40. 339 F.2d 847 (6th Cir. 1964).
41. *Id.* at 850-51.

this particular floor covering before all of the production defects were eliminated had left the company in a critically poor financial situation and had tarnished its reputation among the industry's wholesalers and retailers.[42] To enlist dealers to handle its product and to induce them to expend money on the necessary advertising and local services that it was unable to provide, Sandura promised these distributors exclusive territories within which to deal.[43] The circuit court found these facts sufficient to justify the imposition of "closed territories," placing great emphasis upon the fact that Sandura would most likely have been unable to compete in the floor covering industry without their implementation and continued use.[44] To reach this conclusion, the court developed a balancing test whereby the perniciousness of the least restrictive vertical restraint necessary to remain a viable competitor in the market was weighed against the adverse effect upon interbrand competition.[45]

Despite this foundation of judicial tolerance for vertically imposed territorial restrictions, the government continued to press for a declaration of their per se illegality. Barely four years after the *White Motor* decision, the Supreme Court accepted the Justice Department's appeal from a partially adverse decision in *United States v. Arnold, Schwinn & Co.*[46] The unusual procedural posture of this appeal and the equivocal language of the opinion combined to create a somewhat cryptic guide for the treatment of future "closed territory" cases.

Schwinn was a large manufacturer of bicycles which distributed its merchandise both by direct sales to distributors and retailers and by sales to retailers through consignment agreements with the dis-

42. *Id.*

43. *Id.*

44. *Id.* at 852-53.

45. *Id.* at 856. In this respect, the court was concerned with the severity of the vertical restraint employed. The Federal Trade Commission argued that Sandura could have achieved the same results by assigning "areas of primary responsibility" to its dealers rather than the more restrictive "closed territories." With the former type of restraint, distributors are assigned geographic areas for which they are to expend their best efforts, and the manufacturer may unlawfully refuse to deal with a distributor if he fails to adequately cover his assigned area. Dealers are not prohibited from selling wherever they wish, but the burden of the "primary area of responsibility" somewhat deters a distributor from overextending his sales base.

The *Sandura* court found that Sandura's distributors would not have been willing to provide the services and advertising necessary unless they had been given completely "exclusive territories."

46. 388 U.S. 365 (1967).

tributors.[47] In the "sales" arrangement, title and dominion passed directly to the retailer or distributor, but in the "consignment" or "agency" arrangement, title and risk of loss remained with the manufacturer until the bicycle was sold to the retail customer.[48] The manufacturer designated both the territories within which distributors could operate and the franchised retailers with whom they could deal.[49] Schwinn defended these restrictions by insisting that they were necessary for independent manufacturers to compete with larger, vertically integrated producers capable of more sophisticated marketing techniques.[50] Indeed, the government did not contend that interbrand competition was adversely affected, but insisted that the effect upon intrabrand competition alone constituted an unreasonable restraint of trade.[51]

The district court held that Schwinn's territorial restrictions on its wholesalers were per se violations of the Sherman Act when they affected outright sales to the distributors,[52] but were reasonable under the "rule of reason" when employed in conjunction with the agency or consignment arrangement.[53] The lower court also accepted Schwinn's implementation of customer limitations upon its wholesalers as a reasonable marketing technique.[54]

Schwinn did not appeal the decision of the district court, and consequently, the lower court's pro-government pronouncement concerning the per se illegality of vertical territorial restrictions in a "sale" situation was not actually within the Supreme Court's

47. *Id.* at 370.

48. United States v. Arnold, Schwinn & Co., 237 F. Supp. 323, 327-28 (N.D. Ill. 1965).

49. 388 U.S. at 371. The implementation of this regulated system of wholesale and retail distribution was brought about by Schwinn's declining market share. In 1951, Schwinn had the largest single share of the domestic bicycle market, 22.5% but, by 1961, this figure had declined to 12.8%. *Id.* at 368. In an effort to regain some of its lost sales, Schwinn began to streamline its marketing operations. It instituted the practice of selling only to franchised bicycle dealers, and in this manner, reduced the number of retail outlets by 2/3. Wholesalers were permitted to sell only to franchised dealers within their assigned territories and retailers were restricted from selling to other retailers. *Id.* at 370-71.

50. *Id.* at 374-75. Schwinn was still a family-owned company which sold its bicycles exclusively under its own label and primarily through private retail outlets. The vast majority of bicycles sold by other manufacturers were sold under private labels by giant chains and mass merchandisers, or by national concerns which operated their own stores and franchisers. *Id.* at 368-69. *See also* discussion accompanying note 47 *supra*.

51. *Id.* at 369-70.

52. 237 F. Supp. at 342-43.

53. *Id.* at 342.

54. *Id.* at 343.

scope of review. The United States had appealed the court's findings that Schwinn's limitation of sales to "franchised" dealers and its territorial restraints upon distributors used as agents were both valid restraints under the "rule of reason."

The Supreme Court substantially accepted the lower court's distinctions based upon a "sale" versus a "consignment" arrangement. It reversed the district court on the issue of customer restrictions; such restraints were to be judged on the same basis as territorial restrictions and were thus illegal limitations upon "wholesalers" who obtained title to the goods.[55] The Court, however, refused to accept the government's contention that territorial restrictions in a "consignment" arrangement were equally as pernicious as those accompanying a "sale," and upheld the lower court on this issue.[56]

Although the validity of territorial restrictions accompanying a "sale" was not directly at issue on appeal. Justice Fortas wove his opinion around the premise that such restraints were per se illegal:

> As the District Court held, where a manufacturer *sells* products to his distributor subject to territorial restrictions upon resale, a *per se* violation of the Sherman Act results. And, as we have held, the same principle applies to restrictions of outlets with which the distributors may deal and to restraints upon retailers to whom the goods are sold. Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it. *White Motor, supra*; *Dr. Miles, supra*. Such restraints are so obviously destructive of competition that their mere existence is enough. If the manufacturer parts with dominion over his product or transfers risk of loss to another, he may not reserve control over its destiny or the conditions of its resale.[57]

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55. 388 U.S. at 377-78.

> [T]he decree should be revised to enjoin any limitation upon the freedom of distributors to dispose of the Schwinn products, which they have bought from Schwinn, where and to whomever they choose. The principle is, of course, equally applicable to sales to retailers, and the decree should similarly enjoin the making of any sales to retailers upon any condition, agreement or understanding limiting the retailer's freedom as to where and to whom it will resell the products.

Id. at 378.

56. *Id.* at 380-82.

57. *Id.* at 379.

The language of *Schwinn* seemed clear: any restraint imposed by a manufacturer upon the resale of goods that he has sold to his distributors constitutes a per se violation of the Sherman Act. On the other hand, where such restraint accompanies an "agency" or "consignment" arrangement, its validity will be tested by the "rule of reason."[58]

THE LEGAL AND ECONOMIC BASES FOR THE *Schwinn* DECISION

Although the main objective of the *Schwinn* decision appeared to be the inclusion of "sale-related" vertical territorial and customer restraints within the list of per se violations of the Sherman Act, there were several counter-indicia that cast doubt upon the scope of that conclusion. First, there was a peculiarly vague phrase used by Justice Fortas within his discussion on the per se illegality of territorial and customer restrictions: "Under the Sherman Act, it is unreasonable *without more* for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it."[59] The words "without more" contradict the usual meaning attached to a per se ban, since they would imply that when certain additional factors were present, vertical restrictions would be justified even when dominion and control over the goods have been relinquished. Buttressing this view is the fact that the *Schwinn* Court never specifically stated that it was overruling the *White Motor*'s philosophy concerning the need to evaluate the specific facts of each case. Indeed, Justice Fortas' reference to that case seemed to indicate its continued viability:

> We first observe that the facts of this case do not come within the specific illustrations which the Court in *White Motor* articulated as possible factors relevant to a showing that the challenged vertical restraint is sheltered by the rule of reason because it is not anticompetitive. Schwinn was not a newcomer,

58. *Id.* at 380.

> Where the manufacturer retains title, dominion, and risk with respect to the product and the position and function of the dealer in question are, in fact, indistinguishable from those of an agent or salesman of the manufacturer; it is only if the impact of the confinement is "unreasonably" restrictive of competition that a violation of § 1 results from such confinement, unencumbered by culpable price fixing.

Id.

59. *Id.* at 379 (emphasis added). This statement is set forth more fully in content at quoted text accompanying note 57 *supra*.

seeking to break into or stay in the bicycle business. It was not a "failing company."[60]

Therefore, at least the two specific defenses of a "newcomer" or "failing company" would seem to be available to future litigants; and the "without more" language may imply that other defenses are also available. As this comment will more fully discuss later, various lower courts have used this language to counter a per se rule.[61]

Secondly, the Court specifically stated that it was "remitted to an appraisal of the market impact of these practices"[62] because the government had not contended for a per se rule; but such an analysis of the practical effect of a particular litigant's market procedures would directly conflict with Justice Fortas' later remarks that seemingly precluded any inquiry into the reasonableness of the restraints.[63] It could be reasoned that the Court was only willing to look at the record to pass upon the legality of the "consignment" arrangements, but the general language employed seems to negate such an inference.

It is also interesting to note what significance the Supreme Court justices themselves have given to the *Schwinn* decision. In *United States v. Sealy*,[64] decided the same day as *Schwinn*, the Court struck down as a per se violation a territorial allocation system imposed by a licensor of the Sealy mattress trademark upon its licensees. Using *White Motor* as controlling authority, the Court reiterated the different antitrust treatment afforded horizontal versus vertical territorial restraints,[65] and then proceeded painstakingly to characterize the Sealy licensing arrangement as horizontal in nature so as to fall within the per se rule.[66] If the impact of *Schwinn* was to make all vertical territorial restrictions per se illegal when dominion and control are relinquished, then such a careful analysis

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60. *Id.* at 374.
61. *See* text accompanying notes 107-14 *infra*.
62. 388 U.S. at 373.
63. *See* quote in text at note 57 *supra*.
64. 388 U.S. 350 (1967).
65. *Id.* at 352.

> Because this Court has distinguished between horizontal and vertical territorial limitations for purposes of the impact of the Sherman Act, it is first necessary to determine whether the territorial arrangements here are to be treated as the creature of the licensor, Sealy, or as the product of a horizontal arrangement among the licensees. White Motor Co. v. United States, 372 U.S. 253 (1963).

Id.

66. *Id.* at 352-53.

of the licensor's marketing structure would not have been needed; either a horizontal or vertical arrangement would have invoked the per se rule. Similarly, in *United States v. Topco*,[67] a case decided almost five years after *Sealy* and *Schwinn*, the Court again emphasized the horizontal nature of a trademark licensing scheme employed by independent grocery chains to apply a per se rule of invalidity.[68] What is even more startling about this decision is that *United States v. Arnold, Schwinn & Co.*[69] was cited to support the proposition that *horizontal* territorial limitations are per se violations of the Sherman Act.[70] No mention of vertical territorial restraints was made in the *Topco* opinion or in any subsequent Supreme Court opinion discussing per se classifications.

Although the previously discussed factors can hardly be ignored in an analysis of the *Schwinn* decision, the overall impact of the opinion seems clearly to be the establishment of some sort of per se rule of invalidity for certain territorial restrictions. The restrictions employed by the Schwinn Company were typical of territorial restraints used by countless other manufacturers, so that it would be difficult to limit the scope of *Schwinn* to a particularly pernicious type of restraint. The mere fact that the Supreme Court found identical restrictions reasonable in a "consignment" arrangement but invalid in a "sales" situation can only indicate the creation of a "new" standard of review for territorial restrictions where title to goods has passed to a third party.

Accepting the fact that *Schwinn* does, at the very least, establish a "modified" per se rule, it is somewhat difficult to understand why the Court chose to do so. From a precedential standpoint the *Schwinn* decision stands on shaky ground; a well-established body of case law had developed and approved the "rule of reason" approach to territorial restrictions both before the Supreme Court's

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67. 405 U.S. 596 (1972).
68. *Id.* at 608-09.
69. 388 U.S. 365 (1967).
70. 405 U.S. at 608. Chief Justice Burger, in his dissent, criticized the majority opinion for citing *Schwinn* for this proposition, noting that the *Schwinn* Court had specifically stated that it was dealing with *vertical*, not *horizontal* restraints. *Id.* at 617-18.

The Chief Justice also stated unequivocally that *Schwinn* was decided under a "rule of reason," not under a per se rule, citing the language quoted in text at note 60 *supra* to support his view. *Id.*

decision in *White Motor*[71] and after.[72] The *Schwinn* opinion is conspicuously void of any reference to these lower court cases, and that omission is all the more significant since two circuit courts had recently rejected a per se rule.[73] No matter what the Court may have envisioned the import of *Schwinn* to be, some mention of the established case law would have been desirable as a guide to understanding the Court's changed outlook. Both the Sixth and Seventh Circuits had authored well-reasoned opinions in support of territorial restrictions under the particular facts presented to their courts, and the failure of the Supreme Court to consider those cases in its opinion adds even more support to the theory that *Schwinn* did not establish an absolute per se rule of invalidity for "sales" situations.

What the Court did rely upon for its decision was the "ancient rule against restraints on alienation."[74] This vague doctrine, although somewhat rooted in Anglo-Saxon property law, was not a familiar tenet in the American law of personalty.[75] Justice Fortas cited several cases to support the application of the rule within the realm of antitrust analysis, but of these, only *Dr. Miles Medical* had made reference to it[76]—a fleeting reference devoid of any antitrust support. The remaining cases all dealt with concerted efforts by manufacturers and distributors to employ sales restrictions in an effort to eliminate competitors[77] or to fix resale prices.[78] They could hardly support the proposition that the rule against restraints upon alienation prohibits the manufacturer from unilaterally imposing restrictions upon the resale of its goods when neither an effect upon

71. *See, e.g.*, Chicago Sugar Co. v. American Sugar Ref. Co. 176 F.2d 1 (7th Cir. 1949), *cert. denied*, 338 U.S. 948 (1950); Fosburgh v. California & Hawaiian Sugar Ref. Co., 291 F. 29 (9th Cir. 1923); Cole Motor Car Co. v. Hurst, 228 F. 280 (5th Cir. 1915), *cert. denied*, 247 U.S. 511 (1918); Phillips v. Iola Portland Cement Co., 125 F. 593 (8th Cir. 1903), *cert. denied*, 192 U.S. 606 (1904).

72. *See* Sandura Co. v. FTC, 339 F.2d 847 (6th Cir. 1964); Snap-On Tools Corp. v. FTC, 321 F.2d 825 (7th Cir. 1963).

73. *See* note 72 *supra*.

74. 388 U.S. at 380.

75. *See* 388 U.S. at 391-92 (Stewart, J., dissenting).

76. 220 U.S. at 404-05.

77. United States v. General Motors Corp., 384 U.S. 127 (1966) (automobile manufacturer and distributors conspired to eliminate unfranchised "discount" retailers); Klor's Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959) (group boycott by manufacturers and distributors of electrical appliances not to sell to one competing retailer); Fashion Originators' Guild v. FTC, 312 U.S. 457 (1941) (garment and textile manufacturers conspired to eliminate competitors who "pirated" their original designs by refusing to sell to retailers and other manufacturers who dealt with such competitors).

78. United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944) (distributor of optical lenses carefully regulated the method of distribution and the resale price from its wholesalers to retailers).

its own competitors nor a conspiracy of its own distributors is involved.

Another basic flaw in the *Schwinn* opinion is the absence of a definitive statement concerning the purpose of the antitrust laws.[79] The confusion accompanying that decision stems somewhat from the divergence of views concerning the proper interpretation of the antitrust legislation. Whereas some judges have clearly stated that the lessening of any form of intrabrand competition by vertical restraints is a prohibited restraint of trade no matter what the effect on interbrand competition,[80] others consider the ultimate effect upon the latter to be the major concern.[81] From the standpoints of judicial consistency and consumer benefit, it would appear that a strict per se ban against the lessening of any form of competition via territorial restraints is uncalled for. At a very early date, the Supreme Court recognized the fact that only *unreasonable* restraints of trade are prohibited by the antitrust laws.[82] Since almost every agreement between business entities has as its purpose the lessening of competition to some degree, it would certainly be devastating to the business community to say that the elimination of any form of competition whatsoever is unreasonable.[83] The Court has traditionally recognized certain instances where the ancillary lessening of one form of competition has been tolerated as a necessary and justifiable consequence of a business practice which increases economic efficiency in the marketplace, but does not harm the consumer by increasing monopoly profits.[84] Mergers, for example, have consistently been analyzed with this concept in mind, since to state

79. The basic ideas developed within the following discussion were suggested primarily by Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282 (1975) [hereinafter cited as Posner] and Bork, *The Rule of Reason and the Per Se Concept*, 75 YALE L. J. 375 (1965) [hereinafter cited as Bork].

80. *See, e.g.*, White Motor Co. v. United States, 372 U.S. 253, 278-81 (1963) (Clark, J., dissenting); *cf.* United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967) (Fortas, J., opinion of the Court).

81. *See, e.g.*, White Motor Co. v. United States, 372 U.S. 253, 268-69 (1963) (Brennan, J., concurring); Sandura Co. v. FTC, 339 F.2d 847, 854-55 (6th Cir. 1964); Snap-On Tools Corp. v. FTC, 321 F.2d 825, 831-32 (7th Cir. 1963); *cf.* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 382-94 (1967) (Stewart & Harlan, J.J., dissenting).

82. Northern Pac. Ry. v. United States, 356 U.S. 1, 5-6 (1958); *see* discussion at note 22 *supra*.

83. *See* Northern Sec. Co. v. United States, 193 U.S. 197, 404-05 (1904) (Holmes, J., dissenting).

84. *See* Addyston Pipe & Steel Co. v. United States, 175 U.S. 211 (1899).

that the lessening of any form of competition is per se illegal would be to declare that every merger is prohibited. Vertical territorial restraints, like mergers, should be judged on the basis of their overall effect upon the competitive market.

The antitrust laws have generally been considered to have as their main purpose the perpetuation of as nearly perfect competition[85] as possible within any one particular area of commerce.[86] In terms of manufacturer-imposed restraints, therefore, the antitrust analysis should focus upon the extent to which such restrictions actually enable a manufacturer to artificially increase his profit margin at the expense of the consumer by cutting his output and increasing prices.[87] A consideration of the interbrand versus intrabrand effect becomes much less important than a full understanding of the motives for manufacturers to impose such restraints upon their distributors and the likely result of these restraints in any particular distributive situation.

Many economists and commentators have suggested that there are only two basic reasons why a manufacturer would implement vertical restraints in the form of resale price maintenance, territorial allocations, or customer allocations upon his distributors: either he is the pawn of a distributor's cartel or he wishes to increase his own distributive efficiency.[88] The former situation would create a defi-

85. "Perfect competition" is actually a model of economic analysis that has not been obtained in any real market or industry. It requires that there be a sufficient number of buyers and sellers with no barriers to entry of the market so that each individual seller takes the market price as established by "supply and demand," *i.e.*, he can sell as much or as little as he wants at the market price without affecting such price.

No industry or line of commerce is perfectly competitive; there are always some barriers to entry of the market. Oligopolies (markets in which there are only a small number of sellers) and monopolies (markets in which there is only one seller) exist when there are more extreme barriers to entry in the form of legal restraints such as patents or franchises, natural deterrents such as the need for excessive capital investments, or predatory practices such as boycotts, tie-ins, etc.

86. *See* Markovits, *Some Preliminary Notes on the American Antitrust Laws' Economic Tests of Legality*, 27 STAN. L. REV. 841, 850-51 (1975). Although Professor Markovits does not agree that this economic test is completely adequate, he does recognize that it has been used most frequently. *Id.*

87. *See* Bork, *supra* note 79; Posner, *Exclusionary Practices and the Antitrust Laws*, 41 U. CHI. L. REV. 506 (1974).

88. *See* Bork, *supra* note 79, at 403; Posner, *supra* note 79, at 283. There is also the possibility that the manufacturer is involved in a manufacturers' cartel and is employing a form of vertical restraint such as resale price maintenance as a means of "policing" the cartel. If the manufacturers are artificially setting higher prices and reducing their output in an effort to reap monopoly profits, they must be certain that no member is underselling the other

nite antitrust violation since the only purpose of a cartel is the reduction of output and the collection of monopoly profits.[89] If such a cartel is not the motive, economic "common sense" dictates that the manufacturer is not attempting to restrict output. Any restrictions upon distributors in the form of resale price maintenance or "exclusive territories" that had the effect of reducing output would lower the manufacturer's own profits while increasing those of his distributors. Since no rational manufacturer would attempt to lower his own profits intentionally, his only motive for implementing vertical restraints upon his distributors would be to enhance the efficiency of his distributive efforts.

Although there are numerous ways that a division of markets may enhance a manufacturer's efficiency,[90] one of the most important in terms of antitrust analysis seems to be the "optimization of local sales efforts." In many instances a manufacturer may feel that his product will not be properly marketed unless the distributor maintains a well-stocked inventory, an elaborate showroom, a uniquely trained sales force that provides personalized services to its customers, etc. If the distributors were left free to respond only to the demands of the retail customers, then undoubtedly many of them would develop the point-of-sale services that the manufacturer de-

cartel participants. It is extremely difficult to detect such "cheating" since a lower retail price may be a function either of a retailer's efficient operation, lower profit margin, etc., or a reduced price from the manufacturer. If all of the cartel manufacturers employ resale price maintenance, then an individual manufacturer is discouraged from lowering the price at which he sells to his distributors since any advantage from such lowered prices can only accrue to the wholesalers or retailers.

The instances in which a manufacturers' cartel would employ such resale price maintenance are few and should be easily detected. Bork, *supra* note 79, at 411-15. The use of "closed territories" or "exclusive outlets" could not solve the "policing" problem of a cartel and, therefore, implementation of one of these types of restraint would not suggest such illegal conduct. Bork, *supra* note 79, at 411.

89. A cartel is an arrangement in which producers or distributors of a product agree to limit output in an effort to increase monopoly profits. For distributors to effectively create such a cartel, they would have to include all or most of the manufacturers within the relative product market, otherwise buyers could substitute one brand for another and undermine the cartel's price-maximizing effect. Posner, *supra* note 79, at 283.

90. Professor Bork suggests the following in addition to "optimizing local sales efforts":

1. Encouraging exchanges of information;

2. Minimizing the costs of providing post-sales services and minimizing the risks of customer dissatisfaction;

3. Preventing overlapping use of a service whose cost is shared;

4. Preventing duplication of costs and customer irritation due to overlapping distributive effort. Bork, *supra* note 79, at 430.

sired in an effort to win customers from other wholesalers. But a few distributors at least would decide not to provide these services themselves, preferring rather to take a "free ride" on the services provided by other distributors. By way of example, if hand tool distributor *A* maintained a fleet of well-stocked "walk-in" trucks in which he traveled to local tool shops and gave personalized demonstrations to prospective customers, then hand tool distributor *B* could open a cut-rate mail order operation and supply the tools to the shops at lower prices after *A*'s demonstration had influenced them to buy. Under these circumstances, it would not be long before distributor *A* would abandon his expensive sales operation and begin to compete with *B* as equally as possible. At that point, the manufacturer would be unable to receive the best local marketing techniques for his product, and larger vertically integrated manufacturers who controlled their entire distributive operations would have a distinct advantage.[91]

One way for a manufacturer to avoid this problem is to grant exclusive territories in exchange for a distributor's promise to provide the point-of-sale services desired.[92] The manufacturer employing these restraints is indeed limiting intrabrand competition at the wholesale and/or retail level but, under this prevailing economic theory, unless he is the pawn of a reseller's cartel, he is doing so in an effort to create a more efficient marketing operation and increase interbrand competition. The elimination of competition at the wholesale or resale level can never increase the manufacturer's market share since he is only controlling the distributive efforts that correspond to his established rate of production. His market control is fixed in the same way as a manufacturer who is vertically integrated, and thus the elimination of distributors cannot increase the manufacturer's power to restrict output.[93]

91. This example is essentially the situation presented in Snap-On Tools Corp. v. FTC, 321 F.2d 825 (7th Cir. 1963).

92. The "free ride" problem may also be eliminated by a scheme of manufacturer-imposed resale price maintenance. If manufacturer *B* in the example were unable to sell at a price lower than *X* dollars, he would then be forced to provide the same point-of-sale services that other distributors could supply at that price, for if he provided fewer services, the customers would buy from other distributors who offered more for the same price of *X* dollars. Since resale price maintenance is employed by manufacturers for similar motives as territorial restrictions, it would seem that the same criteria should govern both types of restrictions. Bork, *supra* note 79; Posner, *supra* note 79. *But see* United States v. White Motor Co., 372 U.S. at 268 (Brennan, J., concurring).

93. Bork, *supra* note 79, at 402.

Taking these economic factors into consideration, a per se rule of illegality for vertical territorial restrictions seems both harmful and unnecessary. Increased efficiency of the distribution process is a valid motive for imposing vertical restrictions, and where this can be accomplished without harm to the consumer, it should be acceptable as a reasonable restraint of trade. The mere likelihood that some vertical territorial restrictions may be employed to disguise dealer cartels does not seem a valid justification for prohibiting all such restraints; the courts should not find it so difficult to recognize and strike down the latter.[94]

THE JUDICIAL EROSION OF A PER SE RULE

Although the economic and legal bases for *Schwinn*'s holding may have been questionable, the message of that case was clearly the condemnation of vertical territorial restrictions in a "sales" situation without regard to the reasonableness of the restraint. Nonetheless, the number of cases in which this new rule has been unequivocally responsible for the condemnation of vertical territorial restraints is few.[95] The lower federal and state courts, in the best

94. *Id.* at 405-11.

At this point it should be noted that the preceding economic analysis and conclusions are not unanimously accepted by economists. This author has read various articles attempting to explain the economic bases for manufacturer-imposed vertical restraints, and has presented the views of Professors Bork and Posner as the most persuasive to him.

Professor Comanor, the most prominent opponent of Professor Bork, feels that vertical territorial restraints should be held per se illegal since they allow for a misallocation of resources in the marketplace. According to his theory, the point-of-sale services demanded by the manufacturer may not necessarily coincide with the wants of the consumer. Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath*, 81 HARV. L. REV. 1419 (1968). *Contra*, Bork, *supra* note 79, at 421-22. *See also* Zimmerman, *Distribution Restrictions After Sealy And Schwinn*, 12 ANTITRUST BULL. 1181 (1967).

95. *See* United States v. Revlon, Inc., 1975 Trade Cas. ¶ 60,202 (S.D.N.Y. 1975); GTE Sylvania Inc. v. Continental T.V., Inc., 1974 Trade Cas. ¶ 75,072 (9th Cir. 1974), *petition for rehearing en banc granted and opinions withdrawn*, 1974 Trade Cas. ¶ 75,435 (9th Cir. 1974); Eastex Aviation, Inc. v. Sperry & Hutchinson Co., 367 F. Supp. 868 (E.D. Tex. 1973); Cook v. Ralston Purina Co., 366 F. Supp. 999 (M.D. Ga. 1973); Dobbins v. Kawasaki Motors Corp., 362 F. Supp. 54 (D. Ore. 1973); United States v. Glaxo Group Ltd., 302 F. Supp. 1 (D.D.C. 1969), *rev'd on other grounds*, 410 U.S. 52 (1973).

Schwinn has also been relied upon to condemn vertical territorial restraints in cases in which the legality of such restrictions was not the primary basis of the cause of action. *See, e.g.*, Hensley Equip. Co. v. Esco Corp., 383 F.2d 252 (5th Cir. 1967) (illegal vertical territorial restraint constituted patent misuse); Clairol Inc. v. Cosmetics Plus, 325 A.2d 505 (N.J. Super. Ct. 1974) (cosmetic manufacturer brought suit to enjoin distributor from injuring its good will by distributing professional merchandise to general public).

tradition of judicial creativity, quickly began to distinguish *Schwinn*'s mandate and to develop a number of exceptions and mandatory prerequisites to the application of the rule.

At least three circuits,[96] and possibly four,[97] have adopted what has come to be known as the "firm and resolute" enforcement requirement. Grasping at the statement in *Schwinn* that the manufacturer had affirmatively enforced its territorial restrictions with threats of termination,[98] these courts have made such enforcement of compliance a necessary element of a cause of action against manufacturers employing territorial restraints. The mere existence of a restrictive clause in a franchise agreement has been held not to constitute a per se violation. In the first case to adopt such a view, *Janel Sales Corp. v. Lanvin Parfums, Inc.*,[99] the Second Circuit held that a clause specifically restricting sales of cosmetics to consumers[100] was not a per se violation since the evidence was at best conflicting as to how insistent Lanvin was in enforcing compliance.[101] Other courts, following this reasoning, refused to declare naked contractual clauses per se illegal,[102] and at least one court has construed

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Other courts have cited *Schwinn* for the proposition that challenged vertical restraints were per se illegal when price fixing was also involved. Such reliance was unnecessary since vertical restraints imposed in conjunction with a plan of resale price maintenance had long been considered per se illegal under the rule of United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944).

96. Good Inv. Promotions, Inc. v. Corning Glass Works, 493 F.2d 891 (6th Cir. 1974); Colorado Pump & Supply Co. v. Febco, Inc., 472 F.2d 637 (10th Cir.), *cert. denied*, 411 U.S. 987 (1973); Janel Sales Corp. v. Lanvin Parfums, Inc., 396 F.2d 398 (2d Cir.), *cert. denied*, 393 U.S. 938 (1968).

97. Reed Bros., Inc. v. Monsanto Co., 1975 Trade Cas. ¶ 60,329 (8th Cir. 1975) (court stated that manufacturer had "firmly and resolutely" enforced its territorial restrictions).

98. The *Schwinn* Court stated:

> In any event, it is clear and entirely consistent with the District Court's findings that Schwinn has been "firm and resolute" in insisting upon observance of territorial and customer limitations by its bicycle distributors and upon confining sales by franchised retailers to consumers, and that Schwinn's "firmness" in these respects was grounded upon the communicated danger of termination.

388 U.S. at 372.

99. 396 F.2d 398 (2d Cir.), *cert. denied*, 393 U.S. 938 (1968).

100. The clause provided:

> (6) "Retailer" will not, where statute or law permits such restriction, sell any of the "Commodities" except to consumers for use.

396 F.2d at 400.

101. *Id.* at 406-07.

102. *See* Good Inv. Promotions, Inc. v. Corning Glass Works, 493 F.2d 891 (6th Cir. 1974); Bougeois v. A.B. Dick Co., 386 F. Supp. 1094 (W.D. La. 1974); Knutson v. Daily Review, Inc., 383 F. Supp. 1346 (N.D. Cal. 1974); Todhunter-Mitchell & Co. v. Anheuser-Busch, Inc.,

such an "unenforced" provision to be no more than a permissible "area of primary responsibility clause."[103]

Although these courts may be laudable in their attempts to circumvent a decision they seemingly view as economically unsound, there is no firm legal basis for demanding a showing of actual enforcement of an agreement as a prerequisite to the establishment of an antitrust violation. The *Schwinn* Court did mention the fact that "firm and resolute" coercion was involved in that case, but proof of enforcement has never been an essential element of a cause of action under section 1 of the Sherman Act.[104] The offensive agreement or combination standing alone is enough to constitute a violation[105] and the term "combination" has been loosely defined to include a "unilateral act committed by a first party in dealing with a second party wherein the latter concurs in the former's act and related policies with knowledge of their intended effect."[106] Deference to the actual Supreme Court mandate in *Schwinn* would dictate per se illegality for vertical territorial restrictions whether or not they were resolutely enforced, and the side-stepping of these courts must therefore be viewed as an indication of judicial displeasure with the rule.

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375 F. Supp. 610 (E.D. Pa. 1974); A. P. Hopkins Corp. v. Studebaker Corp., 355 F. Supp. 816 (E.D. Mich. 1972), *aff'd*, 496 F.2d 969 (6th Cir. 1974); *cf.* Bowen v. New York News, Inc., 1975 Trade Cas. ¶ 60,415 (2d Cir. 1975) ("firm and resolute" enforcement evidence not needed because of existence of conspiracy between newspaper and franchise dealers); Fairfield County Beverage Distribs., Inc. v. Narragansett Brewing Co., 378 F. Supp. 376 (D. Conn. 1974) (court found manufacturer had enforced territorial restrictions, but held that state liquor law sanctioning restraints immunized them from antitrust scrutiny); Ansul Co. v. Uniroyal Inc., 306 F. Supp. 541 (S.D.N.Y. 1969), *aff'd in pertinent part*, 448 F.2d 872 (2d Cir. 1971), *cert. denied*, 404 U.S. 1018 (1972) (court held restrictions to be firmly and resolutely enforced). *But see* Hobart Bros. Co. v. Malcolm T. Gilliland, Inc., 471 F.2d 894 (5th Cir. 1973).

103. Colorado Pump & Supply Co. v. Febco, Inc., 472 F.2d 637 (10th Cir. 1973). In this case, a written agreement between the manufacturer and distributor established an exclusive distributorship within a specified geographic area. The court, noting that no contract provision or conduct on the part of the manufacturer had actually forbidden the distributor from selling wherever he pleased, construed the contract language to be no more than a description of a primary marketing territory and as such not a per se violation. 472 F.2d at 639. For a definition of an "area of primary responsibility" clause see note 122 *infra*.

104. 15 U.S.C. § 1 (1970).

105. United States v. McKesson & Robbins, Inc., 351 U.S. 305 (1956); United States v. Trenton Potteries Co., 273 U.S. 392, 402 (1927).

106. Sunny Hill Farms Dairy Co. v. Kraftco Corp., 381 F. Supp. 845 (E.D. Mo. 1974), *paraphrasing the holding of* Albrecht v. Herald Co., 390 U.S. 145 (1968). *See also* United States v. Parke Davis & Co., 362 U.S. 29 (1960).

Another group of cases has used the "without more" language[107] of the *Schwinn* opinion to limit the per se rule's applicability to the narrowest of situations. In *Tripoli Co. v. Wella Corp.*,[108] the Third Circuit stated that *Schwinn* merely holds illegal per se those restraints employed solely as a means of competing more effectively in the market, and does not apply to situations where there are other reasonable motives for such restraints. In that case, the assertion by Wella that its customer restrictions were employed as legitimate safety precautions was enough to bring the "rule of reason" into play.[109] The court then concluded that it was reasonable for Wella to limit the resale of certain of its products to the professional beauty trade as a means of protecting the non-professional consumer from misuse of these dangerous products and to protect itself from potential product liability.[110] One court, following the *Tripoli* rationale, held that a manufacturer may enjoin its distributors from selling "professional" hair products to non-professional customers where such sales may expose the manufacturer to tort liability and adversely affect its reputation and good will,[111] and a state court of appeals had directed its trial courts to apply the "rule of reason" to analyze vertical restraints imposed by a fast food chicken franchisor for the purpose of quality control.[112]

Other courts facing similar factual circumstances have declined to read any "consumer safety" or "protection from tort liability or loss of good will" exceptions into the *Schwinn* holding. In *United States v. Glaxo Group Ltd.*,[113] the district court held that the use of

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107. *See* text accompanying notes 59-60 *supra*.

108. 425 F.2d 932 (3rd Cir. 1970).

109. *Id.* at 936.

110. *Id.* at 937-38. The court noted that the hair conditioners packaged for professional use are made with a different formula than those for home use; are meant to be applied differently; and come packaged with instructions printed on the carton rather than on the individual packages. *Id.* at 937. *See* Carter-Wallace, Inc. v. United States, 449 F.2d 1374 (Ct. Cl. 1971) (court applied "rule of reason" to test vertical restraints on resale of drug meprobamate); *cf.* United States v. Safety First Products Corp., 1972 Trade Cas. ¶ 74,223 (S.D.N.Y. 1972) (consent order allowing restrictions of sales of dangerous fire protection equipment to "qualified persons"); United States v. Fisons Ltd., 1972 Trade Cas. ¶ 73,794 (N.D. Ill. 1972) (consent order in which manufacturer agreed to discontinue restraints upon resale of drugs).

111. Clairol, Inc. v. Asaro, 1975 Trade Cas. ¶ 60,350 (E.D. Mich. 1975). *See also* Clairol Inc. v. Cosmetics Plus, 325 A.2d 505 (N.J. Superior Ct. 1974) (court rejected *Tripoli* exception yet, nonetheless, enjoined distributors from reselling to non-professionals hair products that required special skills to administer).

112. La Fortune v. Ebie, 26 Cal. App. 3d 72, 102 Cal. Rptr. 588 (Ct. App. 1972).

113. 302 F. Supp. 1 (D.D.C. 1969), *rev'd on other grounds*, 410 U.S. 52 (1973).

resale restrictions to "insure proper medical standards" for the production of antibiotic drugs was a per se violation regardless of the legitimate safety and health motives.[114]

In a somewhat analogous area, several courts have wrestled with the plausibility of an exception to *Schwinn* based upon the uniqueness of the product. In *Adolph Coors Co. v. FTC*,[115] a beer manufacturer insisted that its unique brewing process made it imperative to control the speed and method of distribution of its beer and that such quality control could only be achieved by restricting the wholesale dealers.[116] The Tenth Circuit conceded that in its judgment the "per se rule should yield to situations where a unique product requires territorial restrictions to remain in business,"[117] but felt compelled to follow what it considered *Schwinn*'s inflexible ban of such vertical restraints.[118] The Fifth Circuit,[119] reviewing the same brewer's justifications for resale restrictions, was less willing to discard altogether the possibility of a "quality control" exception. However, the court felt that, even assuming the validity of such a rule, in this instance vertical territorial restraints had not been proven to be essential to the continued integrity of the product, and thus constituted unreasonable restraints of trade.[120] In addition, the court found that the geographic controls were ancillary to a scheme of resale price maintenance, and therefore illegal per se without

114. *Id.* at 9; *cf.* United States v. Fisons Ltd., 1972 Trade Cas. ¶ 73,794 (N.D. Ill. 1972) (consent decree in which manufacturer agreed to discontinue restrictions on resale of drugs).

115. 497 F.2d 1178 (10th Cir. 1974), *cert. denied*, 95 S. Ct. 775 (1975).

116. *Id.* at 1187. The beer is made by a type of brewing process that requires quick refrigerated marketing to assure its quality. The brewer restricted the territories within which its distributors could sell and thereby kept strict control over proper refrigerated storage and elimination of stale beer. *Id.* at 1182.

117. *Id.* at 1187.

118. It was actually not necessary for the court to base its analysis upon *Schwinn*, since there was evidence of price fixing. Vertical territorial restraints ancillary to a scheme of resale price maintenance had long been held per se illegal under the rule of United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944). *See* Adolph Coors Co. v. A & S Wholesalers, Inc., 1975 Trade Cas. ¶ 60,187 (D. Col. 1975).

119. Copper Liquor, Inc. v. Adolph Coors Co., 506 F.2d 934 (5th Cir. 1975), *rehearing en banc denied*, 509 F.2d 758 (5th Cir. 1975).

120. *Id.* at 944-45. The court was extremely wary of developing such a "quality control" exception for unique products since it anticipated that most every manufacturer would consider its product "unique" in some way. It also stated that such an exception could only be tolerated in extreme cases where the manufacturer could not remain in business employing less restrictive marketing practices. *Id.* at 947; *cf.* Todhunter-Mitchell & Co. v. Anheuser-Busch, Inc., 375 F. Supp. 610 (E.D. Pa. 1974) (brewer alleged that restrictions were necessary for quality control but court found evidence did not support such claim).

regard to the exact import of *Schwinn*.[121]

In light of the judicial eagerness to carve out the above noted exceptions in areas that seem particularly close to the factual situation in *Schwinn*, *i.e.*, where a restraint upon the alienation of the sale of a good actually occurs, it is not surprising that most courts have refused to stretch the rule to eliminate less restrictive measures. Thus, "area of primary responsibility" clauses[122] have been upheld,[123] at least where they are not merely disguising an enforced restraint upon alienation.[124] Similar judicial acceptance has generally been given to "exclusive territories"[125] and "location"[126] and

121. *Id.* at 947-48; *see* note 118 *supra*.

Some beer and liquor manufacturers may find help in the twenty-first amendment to the United States Constitution, since a state law encouraging brewers to set up and enforce geographical areas of distribution for its dealers was held to pre-empt the federal antitrust laws. Fairfield County Beverage Distribs. Inc. v. Narragansett Brewing Co., 378 F. Supp. 376 (D. Conn. 1974). The Constitution will not provide a defense, however, unless a state legislatively sanctions such restrictions for the distribution of beer or alcohol. Adolph Coors Co. v. A & S Wholesalers, Inc., 1975 Trade Cas. ¶ 60,187 (D. Col. 1975).

122. An "area of primary responsibility" clause is a contractual arrangement whereby the manufacturer, rather than confining the dealer's sales to a specific geographic area, merely makes the dealer responsible for a "best effort" within defined boundaries and may thereafter discontinue the dealership if the "area of primary responsibility" is not covered adequately. In a practical sense, this device discourages to some degree sales outside of the dealer's assigned territory since the dealer must concentrate his efforts on meeting his territorial quotas. Most courts, however, in an obvious attempt to reach a more realistic view of manufacturers' marketing needs, have sanctioned these restraints since the dealer is technically not confined to any specific area. Such devices were given specific recognition by Justice Brennan in his concurring opinion in White Motor Co. v. United States, 372 U.S. 253, 271-72 (1963).

123. *See, e.g.*, United States v. Topco Associates, 319 F. Supp. 1037 (N.D. Ill. 1973), *aff'd per curiam*, 414 U.S. 801 (1973); Plastic Pkg'g Materials, Inc. v. Dow Chem. Co., 327 F. Supp. 213 (E.D. Pa. 1971) (contract provisions setting out a "primary responsibility area" not illegal even though there was some evidence of the manufacturer "advising" the distributor to stay within bounds).

124. *See* Hobart Bros. Co. v. Malcolm T. Gilliland, Inc., 471 F.2d 894 (5th Cir. 1973) ("primary responsibility" clause per se illegal since silent understanding expanded it into a territorial restriction).

125. *See, e.g.*, Trixler Brokerage Co. v. Ralston Purina Co., 1974 Trade Cas. ¶ 75,357 (9th Cir. 1974); Bushie v. Stenocord Corp., 460 F.2d 116 (9th Cir. 1972); Elder-Beerman Stores Corp. v. Federated Dept. Stores, Inc., 459 F.2d 138 (6th Cir. 1972); Western Wholesale Liquor Co. v. Gibson Wine Co., 372 F. Supp. 802 (D.S.D. 1974); Beckman v. Walter Kidde & Co., 316 F. Supp. 1321 (E.D.N.Y. 1970), *aff'd per curiam*, 451 F.2d 593 (2d Cir. 1971), *cert. denied*, 408 U.S. 922 (1972).

The grant of an "exclusive territory" is the promise by a manufacturer not to employ another dealer or sell to anyone else located within a specific geographic area.

126. *See, e.g.*, Salco Corp. v. General Motors Corp., 1975 Trade Cas. ¶ 60,322 (10th Cir. 1975); Kaiser v. General Motors Corp., 1975 Trade Cas. ¶ 60,354 (E.D. Pa. 1975).

"pass-over" clauses.[127] Such restrictions, though not as effective as absolute territorial restraints, are alternate methods by which manufacturers can somewhat control the point of sale operations of their distributors and consequently increase their own efficiency. Courts have been equally as reluctant to apply the rule where the passage of title to goods is not directly involved, as in the licensing of trademarks, copyrights and patents[128] and the franchising of services.[129]

The cases that have declined to read *Schwinn* as establishing an across-the-board per se rule have not stood unopposed.[130] Several courts have implied that lesser restraints upon intrabrand competition than those that appeared in *Schwinn* are still unreasonable per se. Although the opinion in *GTE Sylvania Inc. v. Continental T.V., Inc.*[131] has been subsequently withdrawn pending a rehearing before

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A location clause limits a dealer in that the manufacturer may discontinue dealing with him if goods are sold from other than approved sales outlets. Such a provision was explicitly approved by the trial court in *Schwinn* after remand from the Supreme Court. United States v. Arnold, Schwinn & Co. 291 F. Supp. 567 (N.D. Ill. 1968).

In GTE Sylvania Inc. v. Continental T.V., Inc., 1974 Trade Cas. ¶ 75,072 (9th Cir. 1974), *petition for rehearing en banc granted and opinions withdrawn*, 1974 Trade Cas. ¶ 75,435 (9th Cir. 1974), a three judge panel headed by former Supreme Court Justice Clark declared a television manufacturer's system of selling to only authorized locations of franchised dealers to be a per se violation of section 1 of the Sherman Act, 15 U.S.C. § 1 (1970). No case prior to this decision had expanded the *Schwinn* rule to encompass less restrictive controls than those actually present in *Schwinn* itself, and in light of the judicial tolerance afforded "area of primary responsibility" clauses, "pass over" clauses, and "exclusive territories," the opinion was somewhat of a maverick. On December 19, 1974, the Ninth Circuit granted the defendant's motion for rehearing en banc and, in a somewhat unprecedented move, withdrew the panel's opinion. For a well reasoned criticism of the short-sighted views of the short-lived opinion see 88 HARV. L. REV. 636 (1975).

127. *See, e.g.*, Superior Bedding Co. v. Serta Associates, Inc., 355 F. Supp. 1143 (N.D. Ill. 1972). *See also* White Motor Co. v. United States, 372 U.S. 253, 270-71 (1963) (Brennan, J., concurring). *See generally* Timberg, *Territorial Restrictions on Franchisors*, 19 ANTITRUST BULL. 205, 207-08 (1974).

A "pass-over" clause requires a dealer to turn over part of the profit it makes on a sale outside of its "area of primary responsibility" to the dealer responsible for the sales promotion and servicing efforts in that territory. The use of such a provision is a direct attempt to deal with the problem of "free riding." *See* text accompanying notes 90-92 *supra*.

128. *See, e.g.*, Williams & Co. v. Williams & Co.-East, 377 F. Supp. 418 (C.D. Cal. 1974); Jack Winter, Inc. v. Koratron Co., 375 F. Supp. 1 (N.D. Cal. 1974); Selegson v. Plum Tree, Inc., 361 F. Supp. 748 (E.D. Pa. 1973).

129. *See, e.g.*, Anderson v. American Auto. Ass'n, 454 F.2d 1240 (9th Cir. 1972); *cf.* National Dairy Prods. Corp. v. Milk Drivers Local 680, 308 F. Supp. 982 (S.D.N.Y. 1970). *See also* Polytechnic Data Corp. v. Xerox Corp., 362 F. Supp. 1 (N.D. Ill. 1973).

130. *See* cases cited at note 95 *supra*.

131. 1974 Trade Cas. ¶ 75,072 (9th Cir. 1974), *petition for rehearing en banc granted and opinions withdrawn*, 1974 Trade Cas. ¶ 75,435 (9th Cir. 1974).

the Ninth Circuit en banc, the reasoning in that case somewhat typifies the views of less enlightened enforcers of the antitrust laws. Sylvania, a television manufacturer with a declining share of the market, instituted a new marketing program wherein it limited the number of dealers to which it would sell in any one area and prohibited sales from other than approved retail outlets in an effort to encourage its dealers to vigorously promote its brand.[132] Continental T.V., which owned eight franchised outlets in San Francisco, began to sell Sylvania televisions from its new unapproved Sacramento store. Sylvania, presumably feeling that it did not need additional outlets in Sacramento, put pressure upon Continental to discontinue sales from that location and finally cancelled all of Continental's franchised stores.[133] The trial judge[134] found that such efforts to restrict sales to certain retail outlets were per se illegal,[135] and the Ninth Circuit affirmed. The circuit court's opinion was somewhat confusing because it stated that a manufacturer may still choose dealers on the basis of their location, and may give a dealer an exclusive franchise and promise not to franchise others in that area,[136] but may not take steps to enforce these decisions without conflicting with *Schwinn*'s mandate.[137]

Another recent case, *Reed Bros., Inc. v. Monsanto Co.*,[138] has also confused the *Schwinn* doctrine, and again Justice Clark,[139] the champion of unfettered intrabrand competition, has authored the opinion. In this case, Monsanto, a manufacturer of herbicides, contracted to sell to dealers who agreed to exert their best efforts within designated "areas of primary responsibility."[140] Reed Bros. was one such Monsanto dealer who was "responsible" for a seven county area in Iowa.[141] In 1968, Monsanto dropped Reed as a distributor for the reason that it had not adequately represented the manufacturer

132. 1974 Trade Cas. ¶ 75,072, at 96,793.
133. *Id.*
134. The trial judge was none other than retired Justice Clark sitting by designation.
135. John P. Maguire & Co. v. Continental T.V., Inc., Civil No. 44251 TCC (N.D. Cal., Feb. 16, 1971), *aff'd sub nom.* GTE Sylvania Inc. v. Continental T.V., 1974 Trade Cas. ¶ 75,072 (9th Cir.), *petition for rehearing en banc granted and opinions withdrawn*, 1974 Trade Cas. ¶ 75,435 (9th Cir. 1974).
136. 1974 Trade Cas. ¶ 75,072, at 96,794.
137. *Id.* at 96,795.
138. 1975 Trade Cas. ¶ 60,329 (8th Cir. 1975).
139. Again, retired Justice Clark was sitting by designation.
140. 1975 Trade Cas. ¶ 60,329, at 66,352.
141. *Id.*

within its assigned territory.[142] Thereafter, Reed began to operate as a "discounter" of Monsanto's products, buying from other distributors at a high-volume discount and selling to retailers or other wholesalers over the telephone.[143] In 1969, Monsanto instituted a new shipping policy which provided that dealers could accept orders for prepaid delivery only for destinations within their areas of responsibility and that orders for pick-up of herbicides would be accepted only at Monsanto warehouses within the ordering distributor's assigned territory.[144] In addition, Monsanto instigated a rebate program whereby distributors were given a per unit rebate for all herbicides sold directly to retail dealers, allegedly for the purpose of compensating those distributors who employed extra salesmen to vigorously penetrate the dealer market.[145] The natural effect of these policies was to make it economically burdensome for a distributor to sell to anyone outside of his area of responsibility because of the increased shipping costs and also to make it more expensive for anyone except a retail dealer to buy from a distributor. Consequently, Reed's wholesaling business declined considerably,[146] and it brought suit against Monsanto for violations of § 1 of the Sherman Act.[147]

The court concluded that Monsanto's decision to drop Reed as one of its distributors was justified by Reed's neglect of its area of primary responsibility, but held that its post-termination activities constituted *Schwinn* violations.[148] It is difficult to understand what the *Reed* court was actually prohibiting by its decision since there was evidence that Monsanto not only affected the distributors by its shipping and rebate programs, but also coerced them into actual compliance with the territorial restrictions by threats of termination.[149] The court did not restrict its condemnation to such patent enforcement of territorial restrictions, however, but implied that Monsanto's conduct which raised the cost of herbicides to Reed also fell within the purview of *Schwinn* since it effectively eliminated Reed from competing as a wholesaler.[150]

142. *Id.*
143. *Id.*
144. *Id.* at 66,353.
145. *Id.*
146. *Id.* at 66,354.
147. 15 U.S.C. § 1 (1970).
148. 1975 Trade Cas. ¶ 60,329, at 66,356.
149. *Id.* at 66,357-59.
150. *Id.* at 66,359.

Looking at the *Sylvania* and *Reed* cases in contrast to the more enlightened post-*Schwinn* case law, it is clear that *Schwinn* has done little to aid the judiciary in understanding and enforcing the antitrust laws. Confusion still abounds. The Supreme Court may have decided in *Schwinn* that the elimination of all intrabrand competition is to be considered illegal per se because it outweighs any benefits from increased interbrand competition,[151] or it may have merely decided that the complete restraint upon alienation is too extreme a restriction to achieve desired marketing controls when less restrictive methods are possible. Whatever premise the Supreme Court relied upon, it is clear that cases such as *Sylvania* and *Reed* go beyond the dictates of *Schwinn* to ban any restraints that adversely affect intrabrand competition.

In *Sylvania*, the location clauses imposed by the manufacturer definitely decreased intrabrand competition to some degree because a retailer's sale potential is limited by the geographic draw of his approved sales outlet, *i.e.*, a retailer could only effectively compete within an area reasonably proximate to his franchised store. Competition still exists on the retail level, however, since the placement of outlets does not prohibit any dealer from selling to any customer who wishes to travel to his store. In addition, it is unlikely that a manufacturer could promote such vigorous sales efforts by its distributors without being able to enforce its promises to lessen intrabrand competition by limiting the number of dealer outlets. In *Reed*, Monsanto's policy of giving rebates to distributors who sold directly to retailers made it more costly for a wholesaler to stay in business, but the effect was certainly not the elimination of all intrabrand competition.[152]

Both of these cases seem to imply that it is per se illegal to restrict any form of intrabrand competition other than by unilateral decisions not to sell to a particular dealer. *Schwinn* may have declared that the complete elimination of all intrabrand competition is an unreasonable restraint of trade, no matter what the effect on inter-

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151. *See* Zimmerman, *Distribution Restrictions After Sealy And Schwinn*, 12 ANTITRUST BULL. 1181, 1184 (1967).

152. It should be noted here that the court would have been justified to find that Monsanto had violated *Schwinn* by actual enforcement of its territorial restrictions or that Monsanto's restraints were unreasonable because they had been instituted merely to eliminate Reed as a wholesaler. The findings of the court went beyond these two conclusions, however, and implied that the ancillary elimination of a wholesaler as a result of a manufacturer's business policies renders such conduct illegal without any inquiry into its reasonableness.

brand competition, but it never purported to declare where the balance might be struck between increased interbrand competition and a mere lessening of intrabrand competition. For this reason, *Schwinn* is not authority for declaring the latter situation per se illegal, and in light of the questionable basis for abandoning the "rule of reason" even where intrabrand competition is completely eliminated, the courts should refrain from meddling into the business decisions of manufacturers where there is no further reason to do so.

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