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Federal Antitrust Law-Sherman Act-Resale Restrictions in Agreements Between Manufacturer and Distributors

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FEDERAL ANTITRUST LAW—SHERMAN ACT—RESALE RESTRICTIONS IN AGREEMENTS BETWEEN MANUFACTURER AND DISTRIBUTORS—Defendant, a manufacturer of heavy trucks, entered into agreements with its wholesale distributors and retail dealers whereby the distributors and dealers agreed to resell defendant's trucks at prices fixed by defendant. They also agreed to restrict their sales to customers located within the territories designated by defendant and to allow defendant to deal directly with all government accounts. The Justice Department, charging violation of sections 1 and 3 of the Sherman Act,[1] brought a civil suit[2] to enjoin defendant from continuing or renewing any of the aforementioned arrangements. On plaintiff's motion for summary judgment, *held*, motion granted. Vertical agreements involving resale price maintenance and the allocation of territories and customers are unreasonable per se violations of the Sherman Act. *United States v. White Motor Co.*, 194 F. Supp. 562 (N.D. Ohio 1961), *jurisdiction noted*, 82 Sup. Ct. 946 (1962).

Since the court had no direct precedents on which to determine the legality of territorial security agreements,[3] it adopted the rationale em-

1 26 Stat. 209 (1890), as amended, 15 U.S.C. §§ 1, 3 (1958).

2 Under § 4 of the Sherman Act, 26 Stat. 209 (1890), as amended, 15 U.S.C. § 4 (1958).

3 Territorial security agreements have been under attack by the Justice Department and the Federal Trade Commission; and a number of consent decrees have prohibited them. *E.g.*, United States v. Rudolph Wurlitzer Co., 1958 Trade Cas. 74,006 (W.D. N.Y. 1958). But the legality of these agreements has not until now been put to a court test.

ployed to prohibit resale price maintenance agreements. In *Dr. Miles Medical Co. v. Park & Sons*,[4] the Supreme Court recognized that a system of vertical resale price maintenance agreements between a manufacturer and each of his distributors eliminated competition among distributors in much the same way as if the distributors themselves had entered into a horizontal agreement to charge identical prices. Since any such horizontal agreement among distributors would be a clear violation of the Sherman Act,[5] the vertical agreements achieving substantially the same results were held to be illegal per se. In the principal case the system of vertical territorial security agreements between defendant and his distributors had the same effect as a horizontal agreement among various distributors to divide markets and eliminate competition among themselves. Since distributors may not allocate among themselves exclusive territories within which they would otherwise compete,[6] the court reasoned on the basis of *Dr. Miles* that the series of vertical agreements used by defendant to reach the same result were illegal per se.[7]

Although this line of analysis may be convenient as an enforcement tool,[8] it is unfortunate that the court felt it necessary to hold territorial security agreements illegal per se rather than merely illegal under the facts of the case. By dismissing the subject agreements so summarily, the court precluded the possibility of finding in any later case that the legitimate objectives of territorial security agreements may outweigh the concomitant restrictions on competition. Examples of important lawful purposes of territorial security agreements might be the orderly nation-wide marketing of goods and the prevention of transshipments[9] which tend to injure the manufacturer's good will and expose local distributors to destructive price competition. Admittedly, territorial security agreements restrict inter-terri-

4 220 U.S. 373 (1911).

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

6 United States v. National Lead Co., 332 U.S. 319 (1947).

7 The holding is technically limited to situations where the territorial security agreements are accompanied by resale price maintenance agreements and customer limitations; but the analysis used by the court would seem to apply to territorial security agreements even in the absence of these other factors.

8 The Federal Trade Commission has cited the principal case in two recent cases holding that territorial security agreements and resale price maintenance agreements create a combination or conspiracy in violation of § 5 of the Federal Trade Commission Act, 38 Stat. 717 (1914), as amended, 15 U.S.C. § 45 (1958). Snap-On Tools Corp., No. 7116, FTC, Nov. 1, 1961; Sandura Co., No. 7042, FTC, Sept. 15, 1961 (initial decision of hearing examiner).

9 Transshipping (bootlegging) refers to a transaction in which a distributor sells at a sacrifice price to a dealer in another area. The dealer is thereby able to undercut all other dealers in his own area. This kind of discount operation can be very detrimental to the profits of dealers who normally operate at a low margin of profit and therefore cannot match the discount price. Transshipping also affects the good will and brand name of the manufacturer because it leads the public to believe that the product is overpriced at the prevailing retail prices.

tory competition among distributors of the same manufacturer. But in the case of small manufacturers attempting to compete with larger, well-established manufacturers, these restrictions might enable the small manufacturer to attain the legitimate objectives stated above and to compete more effectively. If this would be the result, then industry-wide competition would actually be effectively increased and not diminished. Since restrictions on competition among distributors may strengthen competition among manufacturers, arguably a court should first ask what kind of competition the Sherman Act was designed to protect.[10] If the court had merely held White's agreements illegal under the facts rather than illegal per se, it might have been possible in later cases for defendant to show that under certain circumstances the net result of territorial security agreements is entirely consistent with the policies underlying the Sherman Act's provisions.

Had the court wanted to uphold the legality of White's territorial security agreements, it might have applied the doctrine of ancillary restraint.[11] This approach has been used to support the validity of exclusive dealer agreements in which the manufacturer promises not to appoint any other dealers within a given area.[12] By stressing the main lawful purposes to be achieved by territorial security agreements, the court could have held that the agreements were reasonable restraints ancillary to the sale of White's trucks. But now that the court has refused to apply the doctrine of ancillary restraint, manufacturers must look to other means by which to give its dealers some measure of security against problems incident to transshipments.

A possible solution has been suggested by a number of consent decrees recognizing the right of an individual manufacturer to choose its own distributors and to designate geographical areas in which its respective distributors shall be primarily responsible for promoting the manufacturer's product.[13] While a distributor is not contractually restricted to this area,

10 *Cf.* Packard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418 (D.C. Cir.), *cert denied*, 355 U.S. 822 (1957). "To penalize the small manufacturer for competing in this way not only fails to promote the policy of the antitrust laws but defeats it." *Id.* at 421.

11 *Cf.* United States v. Columbia Pictures Corp., 189 F. Supp. 153 (S.D.N.Y. 1960). "Where challenged conduct is subservient or ancillary to a transaction which is itself legitimate, the decision is not determined by a *per se* rule. The doctrine of ancillary restraint is to be applied. It 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 market place; (3) is not imposed by a party or parties with monopoly power." *Id.* at 178.

12 See, *e.g.*, Packard Motor Car Co. v. Webster Car Co., 243 F.2d 418 (D.C. Cir.) *cert. denied*, 355 U.S. 822 (1957); Schwing Motor Co. v. Hudson Sales Corp., 138 F. Supp. 899 (D. Md.), *aff'd per curiam*, 239 F.2d 176 (4th Cir. 1956), *cert. denied*, 355 U.S. 823 (1957).

13 *E.g.*, United States v. American Type Founders Co., 1958 Trade Cas. 74,203 (D.N.J. 1958); United States v. Rudolph Wurlitzer Co., 1958 Trade Cas. 74,006 (W.D.N.Y. 1958);

any concentration on customers outside this area and any transshipments may justify the manufacturer in finding that the distributor has failed to devote his best efforts to his own territory, and such a finding might allow the manufacturer to refuse to deal any further with the particular distributor. As long as there is no conduct on the part of the manufacturer or distributor implying any *agreement*[14] to restrict the latter's activities to the area of primary responsibility, the manufacturer's unilateral refusal to deal should be protected under the *Colgate* case[15] doctrine which recognizes the right of the private manufacturer to choose the parties with whom he wishes to deal and to announce in advance the circumstances under which he will refuse to deal.

Furthermore, the manufacturer may delegate to its distributors the performance of certain minimum marketing functions, such as the maintenance of a minimum inventory of the manufacturer's product, thorough promotion of the manufacturer's product within the distributor's area of primary responsibility, and by the maintenance of a staff and facilities to perform effectively all marketing functions for which the distributor is responsible. Once the manufacturer has delegated these minimum marketing functions, he may refuse to deal with any distributor failing to meet the minimum standards. To the extent that performance of these minimum functions may tend to combat transshippers, the manufacturer can protect the legitimate interests of its local dealers along with its own good will. Whether these arrangements can actually eliminate transshipments remains to be seen; but in view of the holding in the principal case, they appear to

United States v. J. P. Seeburg Corp., 1957 Trade Cas. 72,476 (N.D. Ill. 1957); United States v. Philco Corp., 1956 Trade Cas. 71,751 (E.D. Pa. 1956).

14 To reduce the risk that distributor cooperation might evidence an agreement or conspiracy to allocate territories, the manufacturer should take the following basic precautions: (1) He should omit any reference to territorial restrictions as a condition of the continuance of the franchise. Any suggestion that distributors restrict their activities to a designated area should be contained in a clearly unilateral declaration of the manufacturer's general policy, but the distributor should be free to decide whether or not to acquiesce therein. In the Matter of Columbus Coated Fabrics Corp., 55 F.T.C. 1500 (1959). (2) He should refrain from soliciting any assurances from nonconforming distributors that they will adhere to the policy in the future, since such assurances may imply an agreement between the manufacturer and the distributor. United States v. Parke, Davis & Co., 362 U.S. 29, 46 (1960). (3) He should allow only his own employees and agents to investigate distributor activities, since any assistance by a distributor in determining whether any distributor is violating the manufacturer's policy is evidence of an implied agreement. United States v. Bausch & Lomb Co., 321 U.S. 707, 723 (1944); FTC v. Beech-Nut Co., 257 U.S. 441, 455-56 (1922).

15 United States v. Colgate & Co., 250 U.S. 300 (1919). "In the absence of any purpose to create or maintain a monopoly, the act does not restrict the long-recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell." *Id.* at 307.

indicate the boundaries of permissible restrictions on the territorial scope of distributors' activities.

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