NOTES

ANTITRUST LAW—VERTICAL RESTRAINTS—LEGALITY OF NON-PRICE VERTICAL RESTRAINTS DETERMINED UNDER RULE OF REASON—*Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

In 1962, GTE Sylvania Inc. (Sylvania) was engaged in the manufacture and sale of television sets.[1] Due to its rather limited share of the television market,[2] Sylvania attempted to increase its sales through the adoption of a "selective distribution policy."[3] This process utilized a franchise system[4] through which it was hoped selected authorized dealers would be induced to efficiently promote and sell

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[1] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980,982 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

[2] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 982 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). Following World War II, television sales were dominated by RCA. RCA controlled 60 to 70% of a market comprised of 130 other manufacturers including Sylvania. Although Sylvania's share of this market had never been significant, the company became concerned when, by 1962, its market share had diminished to a mere one to two percent. 537 F.2d at 982 & n.2.

[3] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 982–83 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). Sylvania, along with its competitors, had previously employed a "saturation distribution" process. 537 F.2d at 982–83. Under this method, an unlimited number of Sylvania's products were channeled through independent and manufacturer-owned distributorships and made available to any dealer desiring to market the product at any given location. The goal of the procedure "was to generate as much volume as possible." *Id.* at 982. The selective distribution program which replaced the saturation process was more discriminating in that wholesale and factory distributorships were supplanted by a "'straight line distribution'" procedure through which Sylvania sold its products directly to franchised dealers. *Id.* at 983. For a discussion of selective and saturation distribution, see Note, *Restricted Channels of Distribution under the Sherman Act*, 75 HARV. L. REV. 795, 795–96 (1962).

[4] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 983 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). Sylvania employed a franchising arrangement whereby the manufacturer selected particular wholesalers or retailers to market its product in return for their cooperation in managing their businesses according to standards set by the manufacturer. *See* 537 F.2d at 983. *See also* Comment, *Vertical Territorial and Customer Restrictions in the Franchising Industry*, 10 COLUM. J. L. & SOC. PROB. 497, 498 (1974).

In designing the franchise policy, Sylvania had made special attempts to comply with antitrust standards: dealers were not given exclusive territories, nor could they override any decision by Sylvania to franchise other dealers in a given area; dealers were free to sell to any customers, 537 F.2d at 983, and were not prohibited from selling the products of Sylvania's competitors. 433 U.S. at 38 n.3 (1977). For a general discussion of franchising relationships, *see* Kintner, *Distribution Restrictions in Franchise Agreements—As Viewed By A Member Of The Private Bar*, 12 ANTITRUST BULL. 1211 (1967); Pollock, *Antitrust Problems in Franchising*, 15 N.Y.L.F. 106 (1969); Pollock, *Franchising, Customer Restrictions, and Building a Better Mousetrap*, 10 ANTITRUST BULL. 381 (1965).

Sylvania products.[5] Fundamental to the new franchise scheme was a location restriction[6] under which participating dealers were effectively prohibited from moving Sylvania merchandise from one location to another for subsequent marketing unless Sylvania had previously sanctioned the transfer.[7]

Continental T.V., Inc. (Continental)[8] was granted franchises at various locations within the state of California by Sylvania in May, 1964.[9] Subsequent to the franchise agreement, a financing arrangement, known as the " 'Maguire plan,' " was initiated among Sylvania, Continental, and John P. Maguire & Co., Inc., a financing company.[10] This arrangement provided that Sylvania would be liable to Maguire should Continental repudiate its obligations.[11]

In March, 1965, Sylvania was advised of Continental's desire to expand its operations into the Sacramento market.[12] Continental, however, did not advise Sylvania of the selected location, a site in close proximity to an existing Sylvania franchise outlet.[13] In early

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[5] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 983 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

[6] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 983 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). The location restriction stipulated that authorized Sylvania dealers could sell Sylvania products only at locations designated and approved by Sylvania. 537 F.2d at 983.

[7] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 983 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

[8] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). Continental is an assemblage of several corporations commonly owned, which has operated as a retailer of radios and televisions since 1960. 537 F.2d at 984.

[9] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). Continental opened its first franchise in 1960 in San Jose, California. 537 F.2d at 984. By 1965, Continental had increased the number of franchises to eight, including retail outlets in the areas of San Francisco, Santa Clara, San Mateo and Alameda. *Id.*

[10] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). Under the "'Maguire plan,'" John P. Maguire & Co., Inc., a national finance corporation, secured payment for the Sylvania inventory obtained by Continental. Continental would reimburse Maguire either at the time the product was sold or six months after the date of delivery to Continental, if Continental still had the merchandise in its inventory. 537 F.2d at 984. Continental had never employed any financing arrangements for its inventory before dealing with Sylvania. Transactions with customers who preferred installment payments were managed by a nearby San Jose bank. *Id.*

[11] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). As a corollary to this obligation, Sylvania retained some degree of control over the level of credit available to Continental. 537 F.2d 984.

[12] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). The Sacramento area had proved to be very profitable for Sylvania. By 1965 it had provided Sylvania with a market share of over 15%. 433 U.S. at 39 n.6. At the same time, the sales volume of Continental affiliates was over $1,000,000, making Continental one of Sylvania's most successful retailers. 537 F.2d at 984 n.5.

[13] *See* GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). This proposed new dealership was to be located approximately one mile from Handy Andy, a previously franchised Sylvania dealer. 537 F.2d at 984.

September, 1965, Continental filed a franchise application for the new dealership.[14] Despite Sylvania's refusal to grant authorization to the dealership,[15] Continental transferred Sylvania goods to the Sacramento outlet.[16] Sale of these Sylvania products in the new retail store commenced on September 7, 1965.[17]

The deteriorating relationship between Sylvania and Continental had been previously strained in June, 1965 when Young Brothers, a dealer franchised by Sylvania, was granted a location near a Continental outlet in San Francisco.[18] Although Continental vigorously protested Sylvania's authorization of another dealership so near its own, Sylvania was not dissuaded.[19] As a result of Sylvania's refusal to reconsider the Young Brothers franchise grant, Continental cancelled a substantial order which it had previously placed with Sylvania.[20] Concurrent with this cancellation, Continental entered into a half-million dollar contract with Philco, a competitor of Sylvania, and placed Sylvania on notice that in the future it would decrease its orders for Sylvania televisions.[21]

Professing anxiety over Continental's unstable financial condition,[22] Sylvania decreased Continental's operational credit limit to

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[14] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). Acknowledging Sylvania's policy requiring its advance approval before the opening of any new franchise, Continental notified Sylvania of its plans to open the Sacramento retail outlet. 537 F.2d at 984.

[15] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984–85 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

[16] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). In refusing the franchise, Sylvania contended that the area already had an ample number of dealerships. 537 F.2d at 984–85.

[17] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 985 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

[18] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). The Young Brothers outlet was located approximately one mile from a Continental franchise. 537 F.2d at 984.

[19] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). Continental believed such close proximity between its own outlet and another Sylvania dealer infringed upon the objectives of selective distribution and was "violat[ive] [of] the spacing concept underlying the 'elbow room policy.'" 537 F.2d at 984; *see* notes 5–6 *supra* and accompanying text.

[20] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

[21] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

[22] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 985 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). Apparently, Sylvania's credit department had been provided with an uncomplimentary Dun & Bradstreet profile concerning the principal shareholder of Continental who also occupied a position as chief operating officer. 537 F.2d at 985. According to the statement, this shareholder possessed "a military conviction . . . for misappropriation of government

$50,000.[23] Continental responded by refusing to compensate Maguire for debts outstanding on Sylvania merchandise.[24] These actions eventually resulted in a dissolution of the franchise relationship between Continental and Sylvania.[25]

Upon Continental's refusal to tender the amounts outstanding under the financing agreement, Maguire filed a complaint against Continental to obtain a judgment for payments due.[26] In response to Maguire's suit, Continental instituted antitrust and tort cross-claims against Maguire and Sylvania.[27] Continental requested damages from both Maguire and Sylvania, and injunctive relief against the latter to prevent enforcement of the limitation on resale of Sylvania merchandise from any location not authorized by that corporation.[28]

The district court absolved Maguire of any antitrust infractions,[29] but found that Sylvania's imposition of the location clause constituted a per se violation of section one of the Sherman Act.[30] Relying upon the standards enunciated by the Supreme Court in *United States v.*

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funds and issuing worthless checks." *Id.* Sylvania was also distressed about Continental's delinquency in meeting payments to Maguire. *Id.* In addition, Continental had substantial financial responsibilities to Philco, a competing television manufacturer, which included a loan and a contract for Philco merchandise. *Id.*

23 GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 985 (9th Cir. 1976), *aff'd,* 433 U.S. 36 (1977). Continental's previous credit limit had been $300,000. 537 F.2d at 985.

24 GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 985 (9th Cir. 1976), *aff'd,* 433 U.S. 36 (1977). Over the three week period during which Continental withheld payment, a $62,000 unsecured debt was accumulated. 537 F.2d at 985.

25 GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 985 (9th Cir. 1976), *aff'd,* 433 U.S. 36 (1977).

26 GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 985 (9th Cir. 1976), *aff'd,* 433 U.S. 36 (1977). Pursuant to the filed complaint, Continental's bank accounts were attached by Maguire. 537 F.2d at 985. Repossession efforts were also made for any Sylvania goods still held by Continental. *Id.* Continental's stores and central warehouse located in San Jose were then shut down and the bank Continental had dealt with "terminated Continental's consumer financing program and called for the payment of a commercial loan." *Id.*

27 GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 985 (9th Cir. 1976), *aff'd,* 433 U.S. 36 (1977). The tort claim which, under California law, alleged that Continental suffered injury to its business and property, was resolved by the jury in favor of Maguire and Sylvania. 537 F.2d at 985–86.

28 GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 985 (9th Cir. 1976), *aff'd,* 433 U.S. 36 (1977); *see* notes 6–7 *supra* and accompanying text.

29 GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984 (9th Cir. 1976), *aff'd,* 433 U.S. 36 (1977). The jury found Maguire "had not engaged [with Sylvania] in a combination, contract or conspiracy" resulting in an illegal restraint of trade under antitrust law. 537 F.2d at 985–86.

30 GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 985–86 (9th Cir. 1976), *aff'd,* 433 U.S. 36 (1977).

Section one of the Sherman Act provides in pertinent part that: "[e]very 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." 15 U.S.C. § 1 (1976).

Arnold, Schwinn & Co.,[31] the district court found that distribution restrictions placed on goods where title, dominion and risk of loss had already passed were illegal as a matter of law.[32] Damages were assessed by the jury at $591,505.[33] Pursuant to section fifteen of the Clayton Act,[34] the court trebled the jury assessment and entered a judgment against Sylvania amounting to $1,774,515.[35]

The Ninth Circuit reversed the decision of the district court,[36] viewing that decision to be based upon a misinterpretation of *Schwinn*.[37] In so holding, the court felt *Schwinn* was clearly distinguishable from the case in *Sylvania*.[38] The court determined a "rule

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[31] 388 U.S. 365, 379 (1967). For a discussion of the *Schwinn* case, see notes 85–104 *infra* and accompanying text.

[32] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 987 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). The district court granted Continental "a limited injunction" which prohibited Sylvania from implementing its location restriction. 537 F.2d at 987.

[33] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 985–86 & n.6 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

[34] 15 U.S.C. § 15 (1976). This section provides that "[a]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws . . . shall recover threefold the damages by him sustained. . . ." *Id.*

[35] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 986 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

[36] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 1004 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). The case was first heard by a three judge panel which affirmed the district court's analysis using the *Schwinn* rationale. 1974-1 Trade Cas. ¶ 75,072 (9th Cir. May 9, 1974). However, the opinion was withdrawn and the arguments were reheard en banc. 1974-1 Trade Cas. ¶ 75,072 (9th Cir. May 9, 1974), *petition for rehearing en banc granted*, No. 71-1705 (9th Cir. Dec. 12, 1974). For a discussion of the original Ninth Circuit opinion, see Comment, Schwinn *Recycled—Enforced Restrictions On Location of Franchise Retail Outlets Held a Per Se Violation of Section 1 of the Sherman Act*, 49 N.Y.U. L. REV. 957 (1974); Note, *Antitrust Law—Enforcement of Dealer-Location Clauses Declared Per Se Illegal*, 53 N.C. L. REV. 775 (1975); Note, *Antitrust—Vertical Restraints—*Schwinn *"Per Se" Doctrine Extended to Location Clauses*, 53 TEX. L. REV. 127 (1974).

[37] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 988 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). In the opinion of the court, the district court's application of *Schwinn* was "inconsistent with the existing law permitting exclusive dealership and . . . would seriously undermine, rather than implement, the major purpose of the Sherman Act." 537 F.2d at 988.

[38] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 988–91 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). The court found *Sylvania* could be distinguished from *Schwinn* in that the territorial restrictions in *Schwinn* were applicable to the location of vendees, rather than vendors, as was the case in *Sylvania*. 537 F.2d at 989–90. While intrabrand competition had been "wholly destroyed" in *Schwinn*, the court determined that in *Sylvania* intrabrand competition had been "preserv[ed]." *Id.* at 990. In addition, the court considered the fact that the market share which Sylvania was to increase was considerably smaller at the outset of the implementation of the distribution restrictions than was the market share Schwinn held when it instituted its marketing program. *Id.* at 991. Finally, emphasizing the fact that location clauses may enhance rather than destroy competition, the court did not find a "net anticompetitive effect" from the enforcement of Sylvania's location restriction. *Id.* at 1000. The court also feared that a finding of per se illegality of location clauses would undermine franchising relationships to the detriment of small independent businessmen. *Id.* at 999.

of reason" standard should be employed in assessing the legality of the location clause.[39] The United States Supreme Court granted Continental's petition for certiorari,[40] and in *Continental T.V., Inc. v. GTE Sylvania Inc.*,[41] the Court held the rule of reason is the proper standard to use in determining whether a vertical restraint is a lawful marketing practice.[42] Emphasizing the economic impact of distribution restrictions, the Court rejected the facial evaluation used in *Schwinn* in favor of the rule of reason standard utilizing factors indicative of the effect which the restraint has on competition.[43] Through the application of such a standard the Court overruled the per se rule presented in *Schwinn* and its application to restraints on distribution.[44]

The Sherman Act of 1890 (Act)[45] was the product of public sentiment decrying the power and profits of giant business organizations.[46] The Act was designed to foster economic competition and effectively minimize anti-competitive practices by prohibiting any "contract, combination . . . or conspiracy . . . in restraint of

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[39] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 1000–14 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977). Used in antitrust analysis to determine the legality of certain business practices, the rule of reason evaluates factors denotative of the effect which the restraint has on competition. *See* Standard Oil Co. v. United States, 221 U.S. 1, 64–65 (1911). For a general discussion of the rule of reason and the *Standard Oil* Case, see notes 48–49, 59–68 *infra* and accompanying text.

[40] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980 (9th Cir. 1976), *cert. granted*, 429 U.S. 893 (1976), *aff'd*, 433 U.S. 36 (1977).

[41] 433 U.S. 36 (1977).

[42] *Id.* at 57–59.

[43] *Id.* at 58–59. For a more detailed discussion of the economic impact test and other factors, see notes 121–35 *infra* and accompanying text.

[44] 433 U.S. at 58–59.

[45] Sherman Act, ch. 647, 26 Stat. 209 (1890).

[46] *See* E. HUNT, PROPERTY AND PROPHETS 103–06 (2d ed. 1972).

Rapid industrialization following the Civil War resulted in the ascendance of mammoth business organizations. This growth and consequential desire for absolute monopolization of each business sector led to "industrial warfare" to the detriment of the consumer, who ultimately bore the higher costs of products and services. *See id.* at 103–04.

Organizations such as the National Grange and the National Farmer's Alliance effectively protested the political and economic influence exerted by these industries. Of special concern was the railroad industry, which affected farmers' transportation costs and, ultimately, profits. *See* A. NEALE, THE ANTITRUST LAWS OF THE UNITED STATES OF AMERICA 12 (2d ed. 1970). The Interstate Commerce Act of 1887, proscribing rate discrimination to any railroad, represented a major effort to curtail the excesses of big business. *Id.* In 1888; an election year, the major political parties reacted against the monopolistic propensities of industry, culminating in the passage of the Sherman Act two years later. *Id.; see* E. HUNT, *supra* at 105. For an indepth historical study of the Sherman Act, see H. THORELLI, THE FEDERAL ANTITRUST POLICY 164–225 (1955).

trade."[47] Literally construed, the Act would hold every "restraint of trade" to be illegal.[48] Traditionally, however, the statute has been interpreted as invalidating only unreasonable restraints.[49] In this regard, the Court has found certain business practices to be unreasonable as a matter of law, thus meriting a per se ruling as to their illegality.[50] Dealing primarily with threshold level questions of fact,

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[47] Sherman Act, 15 U.S.C. § 1 (1977); *see* A. AUSTIN, ANTITRUST: LAW, ECONOMICS, POLICY, § 3.2 (1976); C. KAYSEN & D. TURNER, ANTITRUST POLICY 17–20 (1965).

It is interesting to note that although passage of the Sherman Act seemed to indicate strong support for its immediate utilization, early enforcement efforts were minimal. A. NEALE, *supra* note 36, at 16. It was thirteen years before additional funds were granted to the Justice Department for "enforcement" purposes. *Id.* Government authorities also acted in a dilatory manner in bringing suit against any transgressors of the Act. *Id.* Moreover, of the first seven cases brought by the Government, six ended in acquittal. *Id.*

[48] The term "restraint of trade" has origins dating back to common law. *See* H. THORELLI, *supra* note 46, at 17. Because of the broad scope and complexity of antitrust regulation, a precise definition of what constitutes a restraint of trade is virtually impossible. A. NEALE, *supra* note 46, at 18–20. Recognizing these limitations, however, A.D. Neale contends that the term might be broadly defined as "action by private businessmen to prevent some form of competition from operating in the market." *Id.* at 19 n.1. At the time of the adoption of the Sherman Act, the phrase was one which was familiar to attorneys and lawmakers and thought to be commonly understood within the legal community. *Id.* at 13–15. Recognizing that the Act, on its face, expressly prohibited all restraints, the Court in United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897), found a literal interpretation of section one of the Sherman Act to be appropriate, irrespective of the common law practice of invalidating only unreasonable restraints of trade. *Id.* at 327–28; *accord*, United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898). *See generally* L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST §§ 64–65, at 167–72 (1977).

[49] *See, e.g.*, Northern Pac. Ry. v. United States, 356 U.S. 1 (1958); Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918); Standard Oil Co. v. United States, 221 U.S. 1 (1911).

The adherence by the courts to a strict standard of interpretation of the Sherman Act was not, however, universally accepted. Indeed, one year after the decision in *Trans-Missouri Freight*, Judge Taft of the Sixth Circuit enunciated the view that only unreasonable restraints of trade were illegal under the statute. United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898); *see* E. KINTNER, AN ANTITRUST PRIMER 17 (2d ed. 1973); A. NEALE, *supra* note 46, at 13–16; L. SULLIVAN, *supra* note 48, at 167–71. In Standard Oil Co. v. United States, 221 U.S. 1 (1911), the Supreme Court adopted the "rule of reason" standard which specifically uses reasonableness as the criterion to decide the legality of a restraint of trade. *Id.* at 64–66; *see* E. KINTNER, *supra* at 21–22. Standard Oil and thirty-six other corporations had been charged with combining in restraint of trade (a section one violation of the Sherman Act) and monopolizing (a section two violation). *Standard Oil Co.*, 221 U.S. at 31–32; *see* L. SULLIVAN, *supra* note 48, at 172–73. The Court, however, acknowledged that prior cases, such as *Trans-Missouri* and *Joint Traffic*, which had not recognized a rule of reason approach were still viable, as they involved restraints which merited a finding of illegality regardless of their reasonableness. 221 U.S. at 64–68.

[50] Standard Oil Co. v. United States, 221 U.S. 1, 65 (1911); *see, e.g.*, International Salt Co. v. United States, 332 U.S. 392 (1947) (tying arrangements found to be per se illegal); Fashion Originators' Guild of America, Inc. v. F.T.C., 312 U.S. 457 (1941) (group boycotts of industry combinations constitute unfair method of competition; United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940) (price-fixing held per se illegal); Addyston Pipe & Steel Co. v. United States, 175 U.S. 211 (1889) (division of markets agreement determined to be direct restraint of interstate commerce). *See generally* A. NEALE, *supra* note 46, at 27–29; C. KAYSEN & D. TURNER, *supra* note 47, at 142–44; E. KINTNER, *supra* note 49, at 20–21.

the per se approach does not require any investigation into the economic aspects of the practice.[51]

Utilizing the per se rule, the Court, in *Northern Pacific Railway Co. v. United States*[52] examined a "tying arrangement"[53] through which Northern Pacific provided that any sale or lease of its land would be contingent upon an agreement that the parties use Northern Pacific railroad lines to ship any of their products.[54] In evaluating the legality of this arrangement, the Court enunciated the standard that a restraint would be deemed illegal per se if found to have a "pernicious effect on competition and lack[ing] . . . any redeeming virtue."[55] In pronouncing this standard, the Court declared that a per se ruling would eliminate the burdensome need for an investigation into the historical and economic circumstances of the particular case, which "so often . . . [proved] fruitless when undertaken."[56] Applying this criterion, the Court found that the effect of the arrangement was so deleterious as to warrant a per se ruling.[57] Fundamental to this ruling was the Court's desire to establish a framework of review which would ensure predictability in future judicial evaluations of possible violations arising under the Sherman Act.[58]

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[51] A. NEALE, *supra* note 46, at 27. Where a per se unreasonable restraint is involved, a judicial proceeding may concern itself only with questions of fact as to whether the restraint actually occurred. *Id.* In defense to allegations of a per se violation, a business will not be permitted to "challenge the presumption in favour of competition." *Id.* Assertions that the contested action worked no public harm or, in fact, actually facilitated competition will be excluded by the court. *Id.* at 27–28. *See also* ABA ANTITRUST SECTION, MONOGRAPH NO. 2, VERTICAL RESTRICTIONS LIMITING INTRABRAND COMPETITION 31 (1977) [hereinafter cited as ABA ANTITRUST SECTION, MONOGRAPH NO. 2].

[52] 356 U.S. 1 (1958).

[53] *Id.* at 5. A tying arrangement is a device employed by a seller in which the purchase or lease of one particular product is conditioned upon the sale or lease of another product, or the prohibition on buying such other product from a competitor. *Id.* at 5–6; *see* E. KINTNER, *supra* note 49, at 47. Generally, a seller will utilize such an arrangement to obtain a greater market share for a product with a lesser consumer preference. E. KINTNER, *supra* note 49, at 47. For a general discussion of tying arrangements, *see id.* at 47–59.

[54] 356 U.S. at 3. Northern Pacific's agreement also provided that, if a competing railroad offered better services or lower rates, the parties to these agreements could utilize those services or rates. *Id. See also* L. SULLIVAN, *supra* note 48, at § 157, 454–56.

[55] 356 U.S. at 5.

[56] *Id.* For further discussion of the per se rule, see Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 YALE L. J. 373, 378–87 (1966).

[57] 356 U.S. at 7–8. Emphasizing Northern Pacific's maintenance of "substantial economic power," together with the involvement of "a 'not insubstantial' amount of interstate commerce," the Court held that the nature of the tying agreement mandated a per se finding of illegality. *Id.* at 7.

[58] *See id.* at 5. For a discussion of the need for certainty as to businessmen and the legal community, see Stedman, *A New Look at Antitrust: The Report of the Attorney General's Committee*, 4 J. PUB. L. 223, 260–62 (1955).

In contrast to the facial evaluation employed in cases involving per se violations, other business practices have necessitated a more discriminating analysis of their effects on competition.[59] Recognition of this necessity resulted in the adoption by the Court of a rule of reason standard under which a wide range of factors relative to a restraint's character and market effects would be considered in determining the legality of a particular arrangement.[60]

The rule of reason and its proper application was examined by the Supreme Court in *Chicago Board of Trade v. United States*.[61] In an effort to stabilize trading hours, the Chicago Board of Trade adopted a "'Call' rule" which prohibited after-hours trading on the exchange at any price other than the final bid at the close of the session.[62] In reply to the Government's challenge of the legality of the rule, Justice Brandeis acknowledged that all business agreements impinge to some extent upon competition.[63] In this regard, Justice Brandeis declared that the determination as to whether a particular business arrangement would constitute an illegal restraint was dependent upon its overall effect on competition.[64] In evaluating the legality of the exchange's trading restriction, the Court outlined certain factors which should be considered in determining the extent to which competition has been inhibited.[65] Among the considerations emphasized by the Court were the effects of the restraint on the industry, the characteristics of the restraint, and an analysis of the particular industry involved.[66] Although the Court recognized it would

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[59] *See* Standard Oil Co. v. United States, 221 U.S. 1, 66 (1911). *See also* Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961) (legality of requirements contract viewed under rule of reason).

[60] *See* Standard Oil Co. v. United States, 221 U.S. 1 (1911); A. NEALE, *supra* note 46, at 20–27.

[61] 246 U.S. 231, 238–39 (1918).

[62] *Id.* at 237. Prior to the institution of the "'Call' rule," bids were in a state of constant change during the entire day. This not only inhibited "the convenience of members," but allowed a certain group of warehousemen in Chicago to perpetuate a monopoly in grain dealings. *Id.*

[63] *Id.* at 238. For further discussion of the *Chicago Board of Trade* decision, see generally A. NEALE, *supra* note 46, at 21–22; L. SULLIVAN, *supra* note 48, at 175–79.

[64] 246 U.S. at 238–39; *see* L. SULLIVAN, *supra* note 48, at 176–78. *See generally* A. NEALE, *supra* note 46, at 21–23.

[65] 246 U.S. at 238.

[66] *Id.* For examples of various factors which courts have reviewed, see, *e.g.*, The Times-Picayune Pub. Co. v. United States, 345 U.S. 594, 614–15 (1953) (effect of restraint); United States v. Columbia Steel Co., 334 U.S. 495, 527–28, *rehearing denied*, 334 U.S. 862 (1948) (market share); Sugar Inst. v. United States, 297 U.S. 553, 600–02 (1936) (effect of restraint in specific industry); United States v. Insurance Bd., 188 F. Supp. 949, 955 (N.D. Ohio 1960) (degree of restraint); United States v. Twentieth Century-Fox Film Corp., 137 F. Supp. 78, 84 (S.D. Cal. 1956) (reason for adopting restraint).

be appropriate to review those factors evincing the intention of the parties, Justice Brandeis indicated that intent alone would not be determinative of the legality of the restraint.[67] Such considerations of intent would aid the Court in only evaluating the reasonableness of the overall arrangement.[68]

Restraints have been found to be illegal because of their detrimental effect on competition under both per se and rule of reason approaches.[69] There are several arrangements which affect competition in differing ways. Business restraints within a particular market have been categorized as vertical or horizontal depending upon whether they are contained within a single organizational structure or extend laterally into other competing business associations.[70] A horizontal restraint involves an agreement between competitors at the same level of production or distribution, such as an arrangement between manufacturers.[71] Business arrangements among companies at different stages of production or distribution are classified as vertical, as illustrated by an agreement between a manufacturer and distributor.[72] The Supreme Court has traditionally viewed horizontal restraints as unreasonable per se since such restrictions reduce competition in the participating industry.[73] Although vertical restraints

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[67] 246 U.S. at 238–39.

[68] *Id.*; *see, e.g.*, Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 702–03 (1967), *rehearing denied*, 387 U.S. 949, *on remand*, 396 F.2d 161 (10th Cir. 1968); United States v. Columbia Steel Co., 334 U.S. 495, 524–25, *rehearing denied*, 334 U.S. 862 (1948); Standard Oil Co. v. United States, 221 U.S. 1, 58–59 (1911); Philadelphia Record Co. v. Manufacturing Photo-Engravers Ass'n, 155 F.2d 799, 803 (3d Cir. 1946).

[69] *See generally*, Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961) (requirements contract upheld under rule of reason); International Salt Co. v. United States, 332 U.S. 392 (1947) (tying arrangement found per se illegal); Fashion Originators' Guild of America, Inc. v. F.T.C., 312 U.S. 457 (1941) (group boycotts found per se illegal); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940) (price-fixing found per se illegal); Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918) (trade restriction upheld under rule of reason).

[70] *See* White Motor Co. v. United States, 372 U.S. 253 (1963) (manufacturer imposed vertical restriction upon distributors and dealers); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940) (group of major oil companies effectuated a horizontal price-fixing agreement). For a general discussion of vertical and horizontal restraints, see ABA ANTITRUST SECTION, MONOGRAPH NO. 2, *supra* note 51, at 1–6, 43–47; Bork, *supra* note 56, at 391–429.

[71] P. AREEDA, ANTITRUST ANALYSIS 260 (2d ed. 1974); E. KINTNER, *supra* note 49, at 42–43. For examples of per se illegal horizontal arrangements, see United States v. Topco Assocs., 405 U.S. 596 (1972) (division of market by competitors held per se unlawful); Fashion Originators' Guild of America, Inc. v. F.T.C., 312 U.S. 457 (1941) (boycott conducted by competitors found per se illegal); United States v. Socony-Vacuum Oil Co., 310 U.S. 140 (1940) (price-fixing among competitors found per se illegal).

[72] *See* White Motor Co. v. United States, 372 U.S. 253 (1963); P. AREEDA, *supra* note 71, at 498–99; E. KINTNER, *supra* note 49, at 43–46, L. SULLIVAN, *supra* note 48, § 130, at 376–77.

[73] *See, e.g.*, Fashion Originators' Guild of America, Inc. v. F.T.C., 312 U.S. 457 (1941) (group boycotts by manufacturers found per se illegal); United States v. Socony-Vacuum Oil

restrict competition to a certain extent, their beneficial effects may outweigh this limitation.[74] While a vertical restraint will curtail, if not eliminate, intrabrand competition—competition between distributors of the same manufacturer's product— it may concurrently increase interbrand competition—competition between manufacturers of the same type of product.[75] Therefore, when confronted with a vertical arrangement, the courts have often applied the rule of reason analysis since the arrangements are often not as facially detrimental as their horizontal counterparts.[76]

The legitimacy of vertical customer and territorial restrictions was first addressed by the Supreme Court in *White Motor Co. v. United States.*[77] The White Motor Co., a truck manufacturing firm,

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Co., 310 U.S. 150 (1940) (price-fixing found per se illegal); United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899) (division of markets found per se illegal). *See also* E. KINTNER, *supra* note 49, at 42–43; A. NEALE, *supra* note 46, at 63–64.

[74] *See* ABA ANTITRUST SECTION, MONOGRAPH NO. 2, *supra* note 51, at 1–6. *See also* Preston, *Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards*, 30 LAW & CONTEMP. PROB. 506, 511–12 (1965). *But see* Comanor, *Vertical Territorial and Customer Restrictions:* White Motor *and its Aftermath*, 81 HARV. L. REV. 1419 (1968). For a discussion of the detrimental effects of vertical restraints, see notes 125–28 *infra* and accompanying text.

[75] *See* ABA ANTITRUST SECTION, MONOGRAPH NO. 2, *supra* note 51, at 1–6 (1977). *See also*, Bork, *supra* note 46, at 472–73; Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282, 283–85 (1975); Preston, *supra* note 74, at 511.

[76] *See, e.g.*, Sandura Co. v. F.T.C., 339 F.2d 847 (6th Cir. 1964); Snap-On Tools Corp. v. F.T.C., 321 F.2d 825 (7th Cir. 1963); Boro Hall Corp. v. General Motors Corp., 124 F.2d 822 (2d Cir. 1942), *cert. denied*, 317 U.S. 695 (1943).

[77] 372 U.S. 253, 261 (1963). Generally, a vertical customer restraint is a manufacturer-imposed restriction which limits the class of customers, such as the government, distributors, retailers or consumers, to whom a distributor or retailer may sell. A vertical territorial restraint, also imposed by the manufacturer, restricts geographically the area in which a distributor or retailer may sell the product. *See* Averill, Sealy, Schwinn *and* Sherman One: *An Analysis and Prognosis*, 15 N.Y.L.F. 39, 41 n.10 (1969); Comment, *Restricted Distribution After* "Schwinn," 9 B.C. INDUS. & COM. L. REV. 1032, 1042–46 (1967); Note, *supra* note 3, 75 HARV. L. REV. at 795–97. More specifically, territorial restraints are not limited to restrictions such as closed territorial clauses in which sales outside defined geographic boundaries are strictly prohibited. *See* Averill, *supra* at 51 n.10; Note, *Territorial and Customer Restrictions: A Trend Toward a Broader Rule of Reason?*, 40 GEO. WASH. L. REV. 123, 124–25 (1971). Also included are less restrictive arrangements such as profit pass-over clauses, primary areas of responsibility and location clauses. A profit pass-over clause compels a dealer who sells outside his assigned territory to return to the dealer in whose territory he made the sale either all or a portion of his profit. *See* Bennett, *Vertical Territorial Restraints: Do's and Don'ts for the Manufacturer with Independent Distributors*, 32 BUS. LAW. 1771, 1778–79 (1977); Comment, *supra* at 1042–43; Note, *supra* note 3, 75 HARV. L. REV. at 814–17. Primary areas of responsibility are arrangements through which a dealer is encouraged to use his best efforts to sell the manufacturer's product by use of a quota system or threat of franchise termination. *See* Bennett, *supra* at 1779–80; Comment, *supra* at 1042–46. Location clauses are arrangements through which manufacturers confine retail sellers of their goods to particular designated outlets. *See* Bennett, *supra* at 1780–82; Louis, *Vertical Distributional Restraints Under* Schwinn *and* Sylvania: *An*

had a sales distribution program under which agreements restricting sales territories and customer solicitation were made with wholesale and retail dealers.[78] The territorial restraint prohibited dealers from marketing White Motor trucks outside their assigned region.[79] The customer restraint precluded dealers from selling any White Motor merchandise to federal or state governments without specific approval from the company.[80] Since the district court had utilized a summary judgment proceeding in determining that the restraints were per se violations,[81] the Supreme Court found the record was insufficient to determine the inherent unreasonableness of the restraints.[82] In remanding the case for a full hearing relative to the character of the restraints, the court declared that without an inquiry into the intent of White Motor and the effect of the restrictions, a court would be unable to determine whether a per se rule or rule of reason approach was appropriate for customer and territorial restraints.[83] The Court found, however, that a per se approach would have been necessary if the customer and territorial restraints had been an integral part of a

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Argument for the Continuing Use of a Partial Per Se Approach, 75 MICH. L. REV. 275, 287–95 (1976); Comment, *Location Clauses:* Schwinn *Versus* Schwinn's *Progeny*, 29 BAYLOR L. REV. 119, 119 (1977).

[78] White Motor Co. v. United States, 372 U.S. 253, 255–58 (1963). These restrictive agreements were included within form contracts, which were executed either directly between the manufacturer and the dealer or indirectly between the wholesaler and the dealer. United States v. White Motor Co., 194 F. Supp. 562, 565–66 (N.D. Ohio 1961), *rev'd*, 372 U.S. 253 (1963).

[79] 372 U.S. at 255–56. The sanction maintained by White Motor for breach of the territorial restraint apparently was a profit pass-over provision and not a franchise termination. *Id.* at 270–71 & n.10 (Brennan, J., concurring).

[80] *Id.* at 256–57. For a detailed discussion of the utilization of vertical customer restrictions, see Note, *supra* note 3, 75 HARV. L. REV. at 817–23.

[81] 194 F. Supp. at 586–87, *rev'd*, 372 U.S. 253.

[82] 372 U.S. at 264. Justice Douglas, writing for the majority, noted that a summary judgment proceeding was an appropriate forum in antitrust law in which to determine the presence of particular restraints that had been ascertained to be per se illegal because "a trial to show their nature, extent, and degree [was] no longer necessary." *Id.* at 259–60. The district court had determined that a per se approach for vertical territorial and customer restraints was warranted and, therefore, entered a summary judgment. *See* 194 F. Supp. 562, 587–88 (N.D. Ohio 1961). In holding that this restraint would be categorized as a per se violation, the court relied upon the analysis set forth in *Northern Pacific* emphasizing the deleterious effect of such restrictions on competition. *Id.* at 587; *see Northern Pacific*, 356 U.S. at 5 (1957). For further discussion of the lower court proceedings, see Note, *supra* note 3, 75 HARV. L. REV. at 797–801.

[83] 372 U.S. at 261–63. Justice Clark dissented, along with Chief Justice Warren and Justice Black, because he believed the record had been substantial enough at that point to decide the case even though a summary judgment proceeding had been utilized. *See id.* at 280–82 (Clark, Black, JJ., & Warren, C.J., dissenting). The dissenters had found the White Motor distribution program to be "one of the most brazen violations of the Sherman Act . . . experienced in a quarter of a century," *id.* at 276, and without "justification," *id.* at 281, thereby meriting a per se declaration of illegality. *See id.* at 279, 281.

price-fixing scheme imposed by White Motor on those who distributed its products.[84]

The *White Motor* case was remanded but final adjudication came in the form of a consent decree, not a trial. *See* United States v. White Motor Co., 5 Trade Reg. Rep. (1964 Trade Cas.) ¶ 71,195 (N.D. Ohio, Sept. 8, 1964). The decree not only prohibited *White Motor* from continuing the distribution program, but also mandated cancellation of any contracts between distributors and White Motors which were inconsistent with the decree. *Id.* For further general discussion of the *White Motor* case, see L. SULLIVAN, *supra* note 48, § 143, at 402–03; Bennett, *supra* note 77, at 1772; Comment, *supra* note 77, 9 B.C. INDUS. & COM. L. REV. at 1034–36; Note, *supra* note 77, 40 GEO. WASH. L. REV. at 127–28; Note, *Territorial Restrictions and Per Se Rules—A Reevaluation of the* Schwinn *and* Sealy *Doctrines*, 70 MICH. L. REV. 616, 618–20 (1972).

Prior to *White Motor*, the Second Circuit had sustained the validity of at least one type of territorial restraint, location clauses. Boro Hall Corp. v. General Motors Corp., 124 F.2d 822, 823–24 (2d Cir. 1942), *cert. denied*, 317 U.S. 695 (1943). In that case, the location clause under review was agreed upon by General Motors, an automobile manufacturer, and the Boro Hall Corp., an automobile dealership. 124 F.2d at 823. Boro Hall wished to open a used car outlet outside its agreed upon "'Zone of Influence.'" *Id.* General Motors, however, would not agree to any location which it believed would be prejudicial to its other dealers. *Id.* Boro Hall claimed this arrangement was a restraint of trade and instituted a treble damage suit under the Sherman Act. *Id.* The court found the location clause was a reasonable business practice especially in light of the fact that General Motors had retained the right to terminate the contract with the dealer on thirty days' notice. *Id.*

White Motor was followed by the decision of the Seventh Circuit in Snap-On Tools Corp. v. F.T.C., 321 F.2d 825 (7th Cir. 1963), wherein the court applied the rule of reason to vertical territorial restraints. *Snap-On Tools* involved territorial restrictions in which franchise dealers were given specific distribution routes, deemed essential to effective merchandising in the tool industry, to sell Snap-On products. *Id.* at 829, 832. Sales were not restricted to certain customers provided that the sale was made in the dealer's assigned territory. *Id.* at 829. Accordingly, salesmen were encouraged to solicit thoroughly along their assigned route. *Id.* The court found the arrangements were reasonable due to the nature of the tool industry and the fact that interbrand competition would be enhanced. *Id.* at 833, 837. For a further discussion of the *Snap-On* decision, see Note, *supra* note 77, 40 GEO. WASH. L. REV. at 128–29; Note, *supra*, 70 MICH. L. REV. at 620–22.

Following the *Snap-On Tools* decision, the Sixth Circuit in Sandura Co. v. F.T.C., 339 F.2d 847 (6th Cir. 1964), applied the rule of reason to a territorial restraint which involved agreement between Sandura and its distributors. *Id.* at 849–51. These agreements provided that the distributors could only sell Sandura merchandise to retail dealers within their assigned geographic area. *Id.* From the record, the court determined that the territorial restrictions were reasonable since there was no indication that intrabrand competition was significantly impaired. *Id.* Rather, the court concluded that overall interbrand competition was enhanced by the viable competition in the product market now provided by Sandura. *Id.* at 858–59. An important consideration by the court was the financial condition of Sandura. *Id.* at 850–51. Although the court had not accepted Sandura's claim to be a "failing company," it had considered the fact that Sandura had been near insolvency prior to the institution of one closed territory system due to a product failure. *Id.* at 855–56. For further discussion of the *Sandura* decision, see Bennett, *supra* note 77, at 1773; Preston, *supra* note 74, at 525–26; Note, *supra* note 77, 40 GEO. WASH. L. REV. at 128–29; Note, *supra*, 70 MICH. L. REV. at 620–22.

[84] 372 U.S. at 261–64. Vertical price-fixing, in which the manufacturer determines the actual price, a minimum price or a maximum price at which a distributor or retailer will sell the manufacturer's product, has been determined by the Supreme Court to be per se unreasonable. United States v. Parke Davis & Co., 362 U.S. 29, 43–47 (1960); Dr. Miles Medical Co. v. John

Following *White Motor*, the Court again considered the legality of vertical territorial and customer restraints in *United States v. Arnold, Schwinn & Co.*[85] and determined that even in the absence of price-fixing, such restraints warranted per se treatment under certain circumstances.[86] Schwinn, a major bicycle manufacturing firm, adopted a franchise system and implemented a varied distribution program.[87] Distributors either bought bicycles from Schwinn for resale to dealers, or made agency or consignment arrangements with retailers who received the merchandise directly from Schwinn.[88] Alternatively, retailers could adopt the "Schwinn Plan" whereby they received merchandise directly from Schwinn, who was responsible for retailer invoices, credit arrangements and payments of commissions to the distributor who solicited the order.[89] All of these distribution options entailed customer restrictions which prohibited any retailer from selling or reselling Schwinn products to a non-franchised retailer or distributor.[90] In addition, territorial restrictions confined distributors' sales activities to assigned areas.[91]

D. Park & Sons, Co., 220 U.S. 373, 404–09 (1911); *see* 372 U.S. at 260. In United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944), the Court expanded the per se doctrine to encompass those vertical restraints which were integral to a price-fixing arrangement. *Id.* at 719–21, 724. However, because of the insufficient record in *White Motor*, the Court was unable to conclude whether the *Bausch & Lomb* doctrine would be applicable in order to find the restraints per se illegal. 372 U.S. at 260–61, 264. For a more detailed discussion of vertical price-fixing, see L. SULLIVAN, *supra* note 48, at §§ 131–41, 377–99; A. NEALE, *supra* note 46, at 272–99. *See also* Posner, *supra* note 75, at 286–99 (1975); Bork, *supra* note 56, at 397–465.

[85] 388 U.S. at 379–80.

[86] *Id.* at 375–79.

[87] *Id.* at 370–71. In 1951, Schwinn possessed 22.5% of the bicycle market, which was "the largest single share of the United States bicycle market." *Id.* at 368. However, by 1961 Schwinn's market share had decreased to 12.8%, a level surpassed by its competitors. *Id.* at 368–69.

[88] *Id.* at 369–70.

[89] *Id.* The "Schwinn Plan" appeared to be the most popular method of distribution. *See id.* at 370 n.3. At the time of the trial, approximately seventy-five percent of Schwinn's sales were under the plan. *Id.* One probable reason for this popularity was the fact that by taking over many of the traditional distributor duties, such as invoicing and arranging credit, the plan enabled distributors to increase sales volume without overextending their financial capacity. United States v. Arnold, Schwinn & Co., 237 F. Supp. 323, 327 (N.D. Ill. 1965), *rev'd and remanded*, 388 U.S. 365 (1967).

[90] 388 U.S. at 370–71. Schwinn, a "family-owned business," marketed most of its merchandise in "bicycle specialty shops," which also provided repair services for the merchandise. *Id.* at 368–69. Through customer restrictions, Schwinn hoped to preclude sales to nonfranchised dealers, including discounters. *See id.* at 370–71. Schwinn's sanctioning policy for breach of the customer restriction included "'cancellation'" of the violator's franchise. *Id.* at 371–72. For a discussion of the vertical customer restrictions, see note 77 *supra* and accompanying text.

[91] 388 U.S. at 370–71. Schwinn not only restricted "[t]he number of franchised dealers in any [particular] area" but, also "designated [the] location[s]" from which a dealer could market Schwinn products. *Id.* For a discussion of vertical territorial restrictions, see note 77 *supra* and accompanying text.

In attempting to determine the legality of these restraints, the Court examined the effects of Schwinn's plan on competition.[92] Initially, the Court noted the absence of any price-fixing in Schwinn's scheme.[93] Furthermore, the Court found that Schwinn was neither a "failing company" nor a "new entrant" into the bicycle market, inferring that these may be important considerations under the per se rule.[94] The Court then proceeded to distinguish the forms of business arrangements arising under the Schwinn distribution program in terms of sale and nonsale transactions.[95] The outright sale transactions encumbered by the customer and territorial restraints were found to violate the rule against restraints on alienation.[96] This common law rule prohibited any restrictions on the resale of products once the seller had relinquished title and dominion.[97] Since Schwinn had failed to retain title and dominion over the merchandise in the sale transactions, the Court found Schwinn was precluded from restricting further disposition of its products by the purchaser.[98] The

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[92] 388 U.S. at 372–82.

[93] *Id.* at 373. For a discussion of the ramifications of those restrictions which are ancillary to price-fixing, see note 84 *supra* and accompanying text.

[94] 388 U.S. at 374. Although the Court has not specifically held that "failing companies" or "new entrants" are exceptions to the per se rule, the Court has suggested that these two situations may constitute viable exceptions. *See id.*; White Motor Co. v. United States, 372 U.S. 253, 263 (1963) (Court noted vertical territorial restrictions "may be . . . the only practicable means a small company has for breaking into or staying in business."). For a discussion of failing company and new entrant defenses, see generally, Bennett, *supra* note 77, at 1776–77; Note, *Newcomer Defenses: Reasonable Use of Tie-Ins, Franchises, Territorials, and Exclusives*, 18 STAN. L. REV. 457 (1966); ABA ANTITRUST SECTION, MONOGRAPH NO. 2, *supra* note 51, at 16.

[95] 388 U.S. at 377–80. The Court differentiated between sales in which "the manufacturer parts with title, dominion or risk with respect to the article, and where he completely retains ownership and risk of loss." *Id.* at 378–79. This distinction was initially proposed by the district court below, which stated that sales where title, dominion and risk had passed necessitated a per se rule with respect to territorial restraints on the resale of goods. *See* United States v. Arnold, Schwinn & Co., 237 F. Supp. 323, 342 (N.D. Ill. 1965), *rev'd and remanded*, 388 U.S. 365 (1967).

[96] 388 U.S. at 380.

[97] *Id.* The rule against restraints on alienation is a property law concept having its origin in the English common law. 2 COKE, INSTITUTES OF THE LAWS OF ENGLAND § 360 (Day ed. 1812). Initially, it was believed the rule would prohibit unfair resale restrictions by merchants on their products. *Id.* This rule was interpreted by the English courts, however, to prohibit only those restraints which were unreasonable in light of their effect on competition. *See* Mitchel v. Reynolds, 1 P. Wms. 181, 24 Eng. Rep. 347 (1711). *See also* 388 U.S. at 391–92 (Stewart, J., dissenting). The ancient rule against restraints on alienation had also been applied by the Supreme Court in Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911), in which the Court invalidated an agreement between a medicine manufacturer and its distributors and retailers to fix retail prices of the manufacturer's products. *Id.* at 404–05.

[98] 388 U.S. at 379–80. In making this ruling, the majority was apparently motivated by a desire to maintain the freedom of businessmen to sell their products as they desired. *See id.* at 376–79. Justice Stewart, however, concurring in part and dissenting in part, disagreed that the rule against restraints on alienation was the proper basis for the majority's holding. *Id.* at 391–

Court noted, however, that ownership remained with Schwinn under the Schwinn Plan, agency and consignment arrangements and therefore certain limitations on the economic freedom of retailers and distributors to dispose of the goods were not deemed violative of the alienation rule.[99] Based on this distinction, the Court held that the sale transactions under the Schwinn distribution program would be viewed as per se illegal, while the legality of the nonsale transactions would be decided under the rule of reason approach.[100]

In pronouncing the sale transactions to be per se illegal, the Court reasoned it would be "obviously destructive of competition"[101] to permit vertical restrictions on sale transactions where the manufacturer passed complete title to the distributor or retailer. In the opinion of the Court, restraints on resale should be limited to certain

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93. Suggesting that the "antiquity" of the doctrine was not enough to compel its utilization, Justice Stewart added that the doctrine "is not nearly so rigid as the Court implies." *Id.* at 391. Consequently, Justice Stewart determined that the common law doctrine "is irrelevant to . . . the effect of antitrust laws upon vertical distributional restraints in the American economy today." *Id.* at 392. Indeed, several commentators have agreed with Justice Stewart and consequently the Court's reliance upon the doctrine has received much criticism. *See, e.g.*, Handler, *The Twentieth Annual Antitrust Review*, 53 VA. L. REV. 1667, 1684–86 (1967); Pollack, *Alternative Distribution Methods After* Schwinn, 63 NW. U. L. REV. 595, 601 (1968); Robinson, *Recent Antitrust Developments: 1974*, 75 COLUM. L. REV. 243, 280 (1975). *But see* Louis, *supra* note 77, at 276 n.6, 277–79. For further discussion of the *Schwinn* Court's usage of the restraints against alienation doctrine, see Posner, *supra* note 75, at 295–96; Comment, *supra* note 77, B.C. INDUS. & COM. L. REV. at 1036–39.

[99] 388 U.S. at 380–81. Prior to *Schwinn*, the Court had used the agency-consignment arrangement as a basis of distinction. *See* Dr. Miles Medical Co. v. John D. Park & Sons, Co., 220 U.S. 373, 400–04 (1911). However, in Simpson v. Union Oil Co., 377 U.S.13 (1964), the Court, again faced with a consignment arrangement, held that such a device could not be used to circumvent the federal antitrust law. *Id.* at 17–18. Justice Stewart, dissenting in *Schwinn*, feared that clever draftsmen would manipulate business arrangements to comply with the *Schwinn* ruling in form but not in substance. *See* 388 U.S. at 393–94 (Stewart, J., concurring in part, dissenting in part). *See generally* Averill, *supra* note 77, at 68; Pollack, *supra* note 98, at 606–08; Comment, *supra* note 77, B.C. INDUS. & COM. L. REV. at 1033–36, 1050–57; Comment, *Vertical Territorial Restraints and the Per Se Concept*, 18 BUFFALO L. REV. 153, 160–63 (1969).

[100] 388 U.S. at 379–80. The sale-nonsale distinction made by the Court has met with sound criticism by a number of authorities. *See, e.g.*, Handler, *supra* note 98, at 1683–89; Pollack, *supra* note 98, at 599–601, 606–08; Robinson, *supra* note 98, at 270–75. Professor Handler summed up much of the criticism against the distinction by commenting that "[f]orm is exalted over substance to a degree unparalleled in the history of antitrust." Handler, *supra* note 98, at 1684.

[101] 388 U.S. at 379. The effect of vertical restraints on competition has been the subject of much debate. Most commentators, however, have accepted the proposition that although intrabrand competition may be decreased by vertical restraints, overall competition may be enhanced by a concurrent increase in interbrand competition. *See, e.g.*, Bork, *supra* note 56, at 430–52; Preston, *supra* note 74, at 508, 511–12; Zimmerman, *Distribution Restrictions After* Sealy *and* Schwinn, 12 ANTITRUST BULL. 1181, 1184–87 (1967). *But see* Comanor, *supra* note 74, at 1422–36.

exceptional circumstances, rather than encouraged.[102] The Court, however, cautioned that a total prohibition of vertical restraints through adoption of an inclusive per se rule was also not warranted, since such a bar would inhibit the ability of small businesses to compete with larger entities.[103] An additional concern was that a per se rule might foster vertical integration, a situation where the manufacturer takes over some or all aspects of distribution or retailing, thereby diminishing competition.[104]

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[102] 388 U.S. at 379–80. The Court was particularly concerned with the possibility that "franchising and confinement of distribution" arrangements would be accepted as the norm rather than the exception. *Id.* at 379.

[103] *Id.* at 379–80. Although the Court did not want to establish an "inflexib[le]" rule applicable to vertical restraints, the reasoning suggested by the Court that such a ruling would disadvantage small businessmen has been criticized by at least one commentator. *See id.* at 379; Handler, *supra* note 98, at 1687 n.96. Professor Handler has suggested that the agency, consignment, and Schwinn Plan arrangements, permissible under the *Schwinn* decision, could not be economically utilized by small businessmen. *Id.* Acknowledging that consignment arrangements necessitate a large inventory, Handler noted that "[t]he financing of such an operation will often be beyond the means of the smaller company." *Id.* Additionally, Handler stated that agency and "Schwinn plan" programs would be "unworkable" since warehouses for local distribution would be needed. *Id.*

[104] 388 U.S. at 379–80. Subsequent to the Court's decision, Schwinn announced a plan to vertically integrate the distribution aspects of the business by utilizing "company-owned sales subsidiaries." R. Keck, *The* Schwinn *Case*, 23 BUS. LAW. 669, 685–87 (1968). This was precisely the type of arrangement which the Court had hoped to avoid. *See* 388 U.S. at 380.

Lower courts have interpreted the *Schwinn* decision in a variety of ways, allowing distribution restrictions to be viewed under the rule of reason, regardless of the type of transaction, where the circumstances of the case permitted such an interpretation. *See* Comment, *supra* note 4 at 505–11. For example, the Third Circuit accepted a "dangerous product" exception to the *Schwinn* rule in Tripoli Co. v. Wella Corp., 425 F.2d 932, 936–38 (3d Cir.), *cert. denied*, 400 U.S. 831 (1970). *See also* Carter-Wallace, Inc. v. United States, 449 F.2d 1374, 1380 (Ct. Cl. 1971). However, a "unique product" exception was denied by the Tenth Circuit in Adolph Coors Co. v. F.T.C., 497 F.2d 1178, 1187 (10th Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975). Another interpretation of *Schwinn* deemed " 'firm and resolute' " enforcement was necessary for per se treatment. *See* Colorado Pump & Supply Co. v. Febco, Inc., 472 F.2d 637, 639 (10th Cir.), *cert. denied*, 411 U.S. 987 (1973); Janel Sales Corp. v. Lanvin Parfums, Inc., 396 F.2d 398, 406–07 (2d Cir.), *cert. denied*, 393 U.S. 938 (1968). *But see* Response of Carolina, Inc. v. Leasco Response, Inc., 537 F.2d 1307 (5th Cir. 1976). The "without more" language of *Schwinn* has also received various interpretations as to whether the Court was indicating that additional factors constituting "more" would take the restraint out of the per se category. *See* Good Inv. Promotions, Inc. v. Corning Glass Works, 493 F.2d 891, 893 (6th Cir. 1974); Tripoli Co. v. Wella Corp., 425 F.2d 932, 936 (3d Cir.), *cert. denied*, 400 U.S. 831 (1970); Clairol Inc. v. Cosmetics Plus, 130 N.J. Super. 81, 91–101, 325 A.2d 505, 510–15 (Ch. Div. 1974). *See also* Albrecht v. Herald Co., 390 U.S. 145, 153 (1968) (Supreme Court's use of the phrase "without more" in dealing with resale price maintenance not given much significance); Note, *supra* note 73, 70 MICH. L. REV. at 626–27; ABA ANTITRUST SECTION, MONOGRAPH NO. 2, *supra* note 51, at 11–12. Primary areas of responsibility have also been upheld by court decisions and consent decrees as being beyond the reach of *Schwinn*. *See, e.g.*, Kaiser v. General Motors Corp., 530 F.2d 964 (3d Cir. 1976), *aff'd*, 396 F. Supp. 33 (E.D. Pa. 1975); Colorado Pump & Supply Co. v. Febco, Inc., 472 F.2d 637 (10th Cir.), *cert. denied*, 411 U.S. 987 (1973); Superior

In *Continental T.V., Inc. v. GTE Sylvania Inc.*,[105] the Supreme Court reconsidered the per se rule adopted in *Schwinn* for certain

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Bedding Co. v. Serta Assocs., Inc., 353 F. Supp. 1143 (N.D. Ill. 1972); United States v. Arnold, Schwinn & Co., 291 F. Supp. 564 (N.D. Ill. 1968). *But see* Reed Bros. v. Monsanto Co., 525 F.2d 486, 499–500 (8th Cir. 1975), *cert. denied*, 423 U.S. 1055 (1976); Hobart Bros. Co. v. Malcolm T. Gilliland, Inc., 471 F.2d 894, 900 (5th Cir.), *cert. denied*, 412 U.S. 923 (1973). Profit pass-over clauses have also gained approval of the courts since *Schwinn*. *See, e.g.*, United States v. Topco Assoc., Inc., 319 F. Supp. 1031 (N.D. Ill. 1970), *aff'd without opinion*, 414 U.S. 801 (1973); Superior Bedding Co. v. Serta Assocs., Inc., 353 F. Supp. 1143 (N.D. Ill. 1972).

[105] 433 U.S. 36 (1977).

Prior to *Schwinn* and *Sylvania*, the Supreme Court was faced with a location clause in United States v. General Motors Corp., 384 U.S. 127 (1966), in which General Motors elicited promises from automobile dealers not to sell their product to discounters. *Id.* at 136. The Court specifically deferred the question of the legality of the location clause since concerted, rather than unilateral, action had been taken by the manufacturer and dealers to enforce the location restriction. In the opinion of the Court, the concerted action constituted a conspiracy to foreclose market access to a particular group of sellers in violation of the Sherman Act. *Id.* at 139–40, 145. The majority relied upon United States v. Parke, Davis & Co., 362 U.S. 29 (1960), which had precluded manufacturers from refusing to sell to retailers who had deviated from the suggested minimum resale prices when concerted action was involved. *Id.* at 45–46; *see* 384 U.S. 143–44.

Concurring in the *General Motors* decision, Justice Harlan pronounced that a manufacturer should be permitted to refuse to sell to the dealers who failed to adhere to the suggested prices only if unilateral action was utilized. Similarly, a location clause may be enforced unilaterally. *Id.* at 148–49 (Harlan, J., concurring). In making these pronouncements, Justice Harlan relied upon the 1919 decision of United States v. Colgate & Co., 250 U.S. 300 (1919). 384 U.S. at 148–49 (Harlan, J., concurring). Under the "Colgate Doctrine," a manufacturer may unilaterally "announce in advance the circumstances under which he will refuse to sell." 250 U.S. at 307. Justice Harlan's view that the unilateral employment of a location clause may be reasonable was subsequently re-enforced by the *Schwinn* case itself which had been remanded by the Supreme Court for an entry of decree in accordance with the opinion. *See* United States v. Arnold, Schwinn & Co., 291 F. Supp. 564, 566 (N.D. Ill. 1968). *See also* United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967). Notwithstanding the Supreme Court opinion, the district court recognized the ability of Schwinn to maintain location clauses in their franchise agreements. 291 F. Supp. at 566.

More recently, the Third and Tenth circuits have upheld location clauses. Kaiser v. General Motors Corp., 530 F.2d 964 (3d Cir. 1976), *aff'g* 396 F. Supp. 33 (E.D. Pa. 1975); Salco Corp. v. General Motors Corp., 517 F.2d 567 (10th Cir. 1975). *See also* Sheldon Pontiac v. Pontiac Motors Div., Gen. Motors Corp., 418 F. Supp. 1024 (D.N.J. 1976). *Kaiser* involved an automobile dealership in which the dealer, for business reasons, no longer wished to remain at the location at which he had been franchised by General Motors. 396 F. Supp. at 35. Kaiser requested permission to relocate his dealership because the opening of a new highway decreased sales at his location. *Id.* Refusing, General Motors contended the area requested was already adequately serviced. *Id.* Kaiser then sued General Motors to have the location clause declared invalid. *Id.* at 36. The court, however, in holding for General Motors, recognized the right of the manufacturer to designate a specific location for retail marketing. *Id.* at 42. Similarly, the Salco Corporation and General Motors disagreed on a new location for a dealership which resulted in a voluntary termination by Salco of the relationship. 517 F.2d at 570–71. Finding the location clause significantly important to General Motors' franchise scheme and, ultimately, the company's business interests, the court noted the restriction helped ensure the "adequate coverage of a market" and, consequently, the "economic viability of its dealerships." *Id.* at 573.

vertical customer and territorial restraints.[106] Sylvania's franchise system involved a location restriction.[107] This restriction was a vertical restraint which prohibited franchised products from being sold from any location other than the specific location agreed upon by Sylvania and the franchised retailer, in this case, Continental.[108] This location restriction was equated by the Court with the customer restriction considered in *Schwinn*.[109] In effect, both the location and customer restrictions could deny the dealer the freedom to sell his merchandise in any manner he wished.[110] Moreover, Schwinn's customer restriction and Sylvania's location restriction were both applicable after title to the goods had passed from the manufacturer to the distributor or retailer.[111] The Court noted that it was immaterial that one restriction was directed at customers while the other concerned territory and therefore concluded that, since the "intent and competitive impact" of the restrictions were alike, they should be evaluated according to the same standards.[112] Accordingly, the Court found the per se rule in *Schwinn* would be applicable to a

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[106] 433 U.S. at 51–57.

The Ninth Circuit had not reconsidered *Schwinn* because the court felt *Schwinn* was distinguishable from *Sylvania* on a number of significant points. 537 F.2d at 988–92. First, the court relied upon the fact that the Sylvania restriction was on the "vendor" rather than the "vendee." *Id.* at 990. Additionally, the court found the restrictions resulted in different effects on competition. *Id.* Finally, the court determined that the market shares involved in both *Schwinn* and *Sylvania* were too dissimilar to rely upon the *Schwinn* analysis as controlling. *See id.* at 991.

[107] 433 U.S. at 42–59.

[108] *Id.* at 46. For a discussion of the legality of location restrictions prior to *Sylvania*, see note 105 *supra*. *See also* Comment, *supra* note 36; Comment, *supra* note 77; Note, *Antitrust Law—Enforcement of Dealer-Location Clauses Declared Per Se Illegal*, 53 N.C. L. REV. 775 (1975); Note, *Antitrust—Vertical Restraints—*Schwinn *"Per Se" Doctrine Extended to Location Clauses*, 53 TEX. L. REV. 127 (1974).

[109] 433 U.S. at 46. The *Schwinn* Court had also considered both territorial restrictions and customer restrictions as subject to the same analysis. *See* 388 U.S. at 378–79, 382.

[110] 433 U.S. at 46. The majority rejected any distinctions proffered by either the Ninth Circuit or Justice White's concurrence since the distinctions relied upon were not found to be relevant to the *Schwinn* Court's analysis of vertical restraints. *Id.* at 46–47 n.12. First, the *Sylvania* Court pointed out that the *Schwinn* Court had not differentiated the standards for a per se or rule of reason analysis on the basis of the impact of the restriction on intrabrand competition. *See id.* Additionally, in *Sylvania* the Court suggested that contrary to the reasoning of both the Ninth Circuit and Justice White, Schwinn's products, as in *Sylvania*, were the equivalent of other manufacturers in the market, thereby ruling out any difference between the two cases based on consumer preference for a particular manufacturer's product. *See id. See also* 433 U.S. at 63; United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967); GTE Sylvania Inc. v. Continental T.V. Inc., 537 F.2d 980, 991 (9th Cir. 1976). *But see* United States v. Arnold, Schwinn & Co., 237 F. Supp. 323, 335 (N.D. Ill. 1965).

[111] 433 U.S. at 45–46.

[112] *Id.* at 46.

determination of the legality of the location restriction in the Sylvania franchise arrangement.[113]

In light of this, the Court determined that a re-evaluation of the *Schwinn* holding was necessary.[114] The distinction made in *Schwinn* between sale and nonsale transactions was found to be an inadequate basis for deciding whether a per se rule or rule of reason should apply.[115] The Court indicated that this distinction neither served the purpose of the Sherman Act, that of safeguarding competition, nor did it take into consideration relevant economic factors.[116] In the opinion of the Court, economic aspects such as market impact and effect on competition should be appraised when evaluating the legality of vertical territorial and customer restraints.[117]

The Court recognized that in *Schwinn* an attempt had been made to accommodate the dual market effect of the restraint, possible increased interbrand competition and probable decreased intrabrand competition, by mandating a per se approach for sales transactions.[118] In spite of this, however, the distinction made between sale and nonsale transactions was ineffective primarily because it failed to demonstrate any economic impact.[119] Therefore, the Court refused to employ the per se standard adopted in *Schwinn* for vertical territo-

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[113] *Id.* at 47–48, 51–54.

[114] *Id.* at 47. The Court acknowledged *Schwinn* had been "an abrupt and largely unexplained departure from *White Motor* . . . where only four years earlier the Court had refused to endorse a per se rule for vertical restrictions." *Id.* (citation omitted). In light of the apparent absence of a rational explanation for the *Schwinn* analysis and the consequent confusion of the law in this area, the Court felt compelled to re-define the parameters of legality as to vertical restraints by re-evaluating *Schwinn* under the traditional guidelines of *Northern Pacific* which the Court had used to determine the propriety of a per se rule. *See id.* at 47–51.

[115] *Id.* at 57. The sale-nonsale distinction was, in part, premised upon the rule against restraints on alienation. 388 U.S. at 380. Citing numerous commentaries critical of the use of the rule "as both a misreading of legal history and a perversion of antitrust analysis," the Court in *Sylvania* rejected *Schwinn's* reliance on the rule as faulty since "'the state of the common law 400 or even 100 years ago is irrelevant to the issue before use: the effect of the antitrust laws upon vertical distributional restraints in the American economy today.'" 433 U.S. at 53 n.21 (quoting 388 U.S. at 392 (Stewart, J., dissenting)). For a discussion of the sale-nonsale transaction analysis in *Schwinn*, see notes 95–101 *supra* and accompanying text.

[116] *See* 433 U.S. at 49–57. The Court determined that the *Schwinn* Court excluded nonsale transactions from the per se rule not because of a fear of detriment to intrabrand competition or hope of increased interbrand competition, but rather because the *Schwinn* Court had not wanted to prohibit all distributional restraints and believed a total per se rule could be harmful since it would be "too 'inflexibl[e].'" *Id.* at 54 (citation omitted).

[117] *Id.* at 54–59.

[118] *Id.* at 52–54. The *Sylvania* Court suggested that in *Schwinn*, the Court had failed to present any "analytical support" upon which to reasonably base a different standard for vertical restraints which depended on the sale or nonsale form of the transaction. *Id.* at 54.

[119] *Id.* at 53–54.

rial and customer restrictions and instead chose to return to the standards set out in *Northern Pacific* to determine the propriety of a per se rule for vertical customer and territorial restraints.[120]

Focusing on the actual economic impact of the restriction, the *Northern Pacific* Court had identified two criteria for assessing the need for a per se rule.[121] These factors were the "pernicious effect" of the restraint on competition and the "redeeming value," is any, that accrued from the restriction.[122] The Court, applying these factors in *Sylvania*, found that there was no demonstration that vertical restraints had an inherent deleterious effect on competition.[123] The Court also noted that vertical restraints ordinarily have a "redeeming" aspect, since they foster interbrand competition.[124]

The Court analyzed the independent, yet dual effects on the market which generally result from the use of vertical restraints—that of decreasing intrabrand competition while increasing interbrand competition.[125] Intrabrand competition decreases because vertical restrictions provide a means by which the manufacturer may limit the number of available dealers from whom a consumer may purchase a specific manufacturer's product.[126] However, the Court noted that this decrease in intrabrand competition is not always absolute, since consumers may have the option of traveling to other dealerships or may substitute comparable products of other manufacturers.[127] In addition, the Court found that manufacturers generally will retain some level of intrabrand competition to encourage a higher volume of sales, resulting in greater profit.[128]

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[120] *Id.* at 54–59.

[121] Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1957).

[122] *Id.*

Since the *Schwinn* Court had not utilized the *Northern Pacific* rationale for adopting per se rules, the *Sylvania* Court determined that it was necessary to re-evaluate *Schwinn* under the standards for per se rules imposed by *Northern Pacific*. 433 U.S. at 51. For a discussion of the *Northern Pacific* decision, see notes 52–58 *supra* and accompanying text.

[123] 433 U.S. at 50–58.

[124] *Id.* at 54–56. Maintaining that vertical restraints may permit "certain efficiencies in . . . distribution," the Court stated that "'redeeming virtues' are implicit in every decision sustaining vertical restrictions under the rule of reason." *Id.* at 54; *see* Preston, *supra* note 74, at 511. For further discussion of the "redeeming" economic aspects of vertical restraints see notes 129–35 *infra* and accompanying text.

[125] 433 U.S. at 51–52 & n.19.

[126] *Id.* at 54. In regard to vertical restrictions, the *Sylvania* Court was particularly concerned with the location clause which the Court described as an effective limitation on the number of dealers which could realistically serve a particular area of consumers. *Id.*

[127] *Id.*

[128] *See id.* at 56 & n.24. *See generally* Bork, *supra* note 56, at 403.

While intrabrand competition may be decreased, vertical restraints increase competition at the manufacturers' level, since such restrictions allow for a higher level of "marketing efficiency."[129] By giving dealers a designated area in which to develop their business without the pressures of intrabrand competition, the manufacturer is able to attract competent and aggressive retailers for his product while the dealer is further encouraged by higher profit margins.[130] The "free rider" situation, which occurs when a dealer's promotional service activities benefit nearby dealers who are thereby able to escape these costs, is also avoided.[131] The manufacturer may therefore benefit from increased promotional activities and improved service and repair facilities provided by its dealers.[132] Consumers may also benefit by receiving greater information about the product while having access to more reliable service and repair facilities when needed.[133] Moreover, the manufacturer may be in a better position to protect himself against consumer product liability and warranty litigation since he has retained some control over disposition of the product.[134] The net result is that interbrand competition is stimulated by manufacturer and dealer activities which are fostered under the imposition of certain vertical restraints.[135]

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[129] 433 U.S. at 54–55 & n.23. Several commentators have also theorized that vertical restraints may result in increased interbrand competition. *See, e.g.*, Bork, *supra* note 56, at 429–52; Posner, *supra* note 75, at 283–85; Preston, *supra* note 74, at 507–12. *See generally* ABA ANTITRUST SECTION, MONOGRAPH NO. 2, *supra* note 51, at 38–40; Zimmerman, *supra* note 101, at 1185. *But see* Comanor, *supra* note 74, at 1427–38.

[130] *See* 433 U.S. at 55; Preston, *supra* note 74, at 511.

[131] *See* 433 U.S. at 55. Referring to the "free rider" problem as a "market[ing] imperfection," the Court found that competition alone would not necessarily increase the amount of promotional and service activities offered by dealers, even though the dealers would all benefit to a greater extent if such services were offered uniformly rather than not at all. *Id.* For a general discussion of the "free rider" situation, see Bork, *supra* note 56, at 430–38; Posner, *supra* note 75, at 284–85.

[132] 433 U.S. at 55. *See, e.g.*, Bork, *supra* note 56, at 435–36; Posner, *supra* note 75, at 283–85.

[133] *See* 43 U.S. at 55; Bork, *supra* note 56, at 435–39.

[134] 433 U.S. at 55 n.23. For a listing of the applicable federal statutes, *see id.* The "safety responsibilities" of the manufacturer and possible subsequent liability were concerns of the Third Circuit in Tripoli Co. v. Wella Corp., 425 F.2d 932 (3d Cir.), *cert. denied*, 400 U.S. 831 (1970), wherein the court sustained the validity of a customer restriction where the product could cause dangerous reactions to customers resulting in a products liability suit. 425 F.2d at 938–39.

[135] *See* 433 U.S. at 54–56.

In light of the potential net competitive benefit obtainable from vertical restraints, the Court determined that the rule of reason would be the proper analysis under which to determine the legality of a vertical restraint. *Id.* at 57–59. The Court, however, declared that should a particular vertical restraint acquire a "'pernicious effect on competition' or . . . [a] 'lack [of]

Justice White, in a concurring opinion, determined that *Schwinn* need not have been overruled since *Sylvania* could have been distinguished.[136] Basing his conclusion, in part, on the fact that the type of restraint involved in *Sylvania* differed significantly in both "intent and competitive impact" from the restraints considered in *Schwinn*,[137] Justice White stated that any potential harm to intrabrand competition resulting from a location restriction is neither as certain nor as great as that caused by a customer restriction.[138] First, the prevention of sales to unfranchised dealers, including discounters, effectuated by a customer restriction was found by Justice White to stifle intrabrand price competition.[139] Furthermore, unlike a customer restriction, Justice White recognized that a location restriction does not significantly limit the retailers' "freedom" of disposal of goods, signaling a "significant difference" to the impact on competition.[140]

Justice White also perceived a lesser limitation on interbrand competition resulting from a location restriction.[141] Sylvania had only a small share of a market dominated by other television manufacturers, while Schwinn enjoyed a greater percentage of the market as well as a national reputation.[142] Justice White felt the *Schwinn* per

. . . any redeeming virtue,'" the application of a per se analysis to that particular restraint might be justified. *Id.* at 58–59 (quoting *Northern Pacific*, 356 U.S. at 5).

[136] 433 U.S. at 59.

[137] *Id.* at 60.

[138] *Id.* at 60–62.

[139] *Id.* at 60–62. Concerned with the decrease in intrabrand price competition when discounters are foreclosed from purchasing goods from franchised dealers, Justice White recognized a potential increase in intrabrand price competition under a location restriction. In the opinion of Justice White, an already franchised dealer could profit from lowering prices and selling in large quantities to discounters, thereby increasing its own sales volume. *See id.* at 60.

[140] *Id.* at 61–62. Citing recent cases and commentators which have tried to define the breadth of the *Schwinn* rule, Justice White stated that the *Schwinn* decision did not modify the validity of location restrictions since the *Schwinn* per se analysis was inapplicable to such restrictions. *Id.* at 59, 62–63; *see* note 105 *supra*. *See also* Kaiser v. General Motors Corp., 530 F.2d 964 (3d Cir. 1976); Salco Corp. v. General Motors Corp., 517 F.2d 567 (10th Cir. 1975); United States v. Arnold, Schwinn & Co., 291 F. Supp. 564 (N.D. Ill. 1968); McLaren, *Territorial and Customer Restrictions, Consignments, Suggested Retail Prices and Refusals to Deal*, 37 ANTITRUST L. J. 137, 144–45 (1968); Pollack, *supra* note 98, at 603; Robinson, *supra* note 98, at 278.

[141] 433 U.S. at 63–66.

[142] *Id.* at 63–65. Speaking in terms of "product differentiation and market share," Justice White found the "market power" held by Schwinn (22.5%) and Sylvania (1% to 2%) in their generic markets was vastly different. *Id.* at 63–64. Part of Schwinn's market power was a result of consumer preference for Schwinn products—a preference which Sylvania products did not enjoy. *Id.* Justice White stated that this preference, which protected Schwinn from interbrand competition, also could have provided discounters with an opportunity to profit had it not been for Schwinn's customer restrictions. *Id.* at 63–64.

se rule may be inapplicable to a manufacturer similar to Sylvania, holding a "'precarious' position" in the industry.[143] In this situation many substitute products are available to the consumer.[144] Furthermore, when a manufacturer either desires "to enter a new market" or holds a relatively small market share, vertical restraints were found by Justice White to be valuable in strengthening interbrand competition.[145] Justice White noted prior decisions in which "minimal market power" had represented an important factor considered by the Court in its determination to apply a rule of reason standard rather than a per se rule.[146] Therefore, Justice White concluded that the Court should not abandon a per se rule where strong market power is present, but rather should apply a rule of reason standard in situations where a manufacturer has only a small share of the market.[147]

The sale-nonsale distinction in *Schwinn* was found by Justice White to be a reasonable basis for determining when a per se rule should be applied.[148] Justice White noted that in making this distinction the Court was primarily concerned with allowing businessmen freedom to dispose of their goods as they desired, rather than with the intrabrand-interbrand effects on competition.[149] This distinction was still valid since precedent had shown the Court to be interested in any limitation on the ability of businessmen to function freely in the market.[150] Therefore, Justice White suggested that the

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[143] *Id.* at 64–65.

[144] *Id.* The availability of substitute products and consumer preference for those products reflects the market power of the manufacturer. ABA ANTITRUST SECTION, MONOGRAPH NO. 2, *supra* note 51, at 62–63. This concept, known as product differentiation, is a factor demonstrating the ability of the manufacturer to effectively compete in the market. *Id.* "Simply stated, product differentiation is the degree to which developed consumer loyalty to a particular product will enable sellers to charge a premium price for that product above that charged for substitute products without losing substantial sales volume." *Id.* at 62 n.250; *see* note 142 *supra*.

[145] *Id.* at 64–66.

[146] *Id.* at 65–66. As indicated by Justice White, market power has traditionally been a factor used by the Court in antitrust cases to limit the reach of per se rules. *Id.*; *See, e.g.*, United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 366 (1963) (legality of mergers are dependent upon market shares); Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 6–7 (1958) (per se rule applicable to tie-in arrangements only where there is "sufficient economic power"); United States v. Jerrold Elecs. Corp., 187 F. Supp. 545, 559–61 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961) ("infant industries" are not within the per se rule). *See generally* Note *supra* note 94.

[147] 433 U.S. at 66.

[148] *Id.* at 66–69.

[149] *Id.* at 66–67.

[150] *Id.* at 67–68; *see, e.g.*, United States v. Arnold, Schwinn & Co., 388 U.S. 365, 379–80 (1966); Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211, 213 (1951); United States v. General Elec. Co., 272 U.S. 476, 487–89 (1926); United States v. Colgate & Co., 250

majority should not have so easily dispensed with this concern, even if "relevant economic impact" provided a stronger principled basis upon which to determine the legality of vertical restraints.[151]

Finally, Justice White determined that the test of "relevant economic impact" impliedly questioned the firmly established per se rule for vertical price restraints.[152] He noted that the reasons advanced for the majority's emphasis on economic analysis in determining the validity of vertical nonprice restraints were equally applicable to vertical price restraints.[153] Moreover, Justice White suggested that reliance solely on an economic analysis would provide justification for resale price maintenance in situations involving a new entrant into a market, a "free rider" problem or a desire to increase dealer promotional and service activities.[154]

Justice White concluded that a more narrow holding based on the facts presented would be more appropriate than an outright overruling of *Schwinn.*[155] The rule of reason should govern location restrictions where the manufacturer maintains only a small share of the market if the "competitive impact" of the restraint is minimal.[156] Further, the Court need not dispense with the sale-nonsale distinction in order to decide that a rule of reason for location clauses is necessary.[157]

In *Sylvania,* the Court determined that the legality of vertical nonprice restraints would be ascertained under the rule of reason.[158]

U.S. 300, 307 (1919); Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373, 410–11 (1911); *See also* ABA ANTITRUST SECTION, MONOGRAPH NO. 2, *supra* note 51, at 82–83, 87–91, 96–97; Blake & Jones, *Toward a Three-Dimensional Antitrust Policy*, 65 COLUM. L. REV. 422, 427–36 (1965).

[151] 433 U.S. at 68–69.

[152] *Id.* at 69–70.

[153] *Id.*

[154] *See id.* at 70.

[155] *Id.* at 71. Justice White believed a moderate stance was appropriate in light of the legitimate distinctions between *Sylvania* and *Schwinn* proffered by the Ninth Circuit. Referring to the majority's quick "dispos[al]" of the Ninth Circuit decision below, Justice White stated that

> [t]o reach out to overrule one of this Court's recent interpretations of the Sherman Act, after such a cursory examination of the necessity for doing so, is surely an affront to the principle that considerations of *stare decisis* are to be given particularly strong weight in the area of statutory construction.

Id. at 60 (citations omitted).

[156] *Id.*

[157] *Id.* Justices Brennan and Marshall dissented, indicating only that the per se rule adopted in *Schwinn* should not be abandoned. *Id.*

[158] *Id.* at 59. The Court clearly stated that the application of the per se rule to vertical price restraints was not re-examined in the *Sylvania* decision. *Id.* at 51 n.18. The Court would only note that, despite some commentators' analysis that the reasons for imposing vertical nonprice restraints may be the same as for imposing price restraints, "significant differences . . . could

To reach this conclusion, the Court overruled *Schwinn*[159] despite indications by Justice White that a viable basis upon which to distinguish the cases existed.[160] The *Sylvania* Court found the *Schwinn* analysis and per se rule unworkable due to its inability to accommodate both the potential positive and negative effects of vertical restraints.[161] Beneficial business practices were consequently prohibited by some courts.[162] Additionally, in prescribing the per se rule for vertical restraints, the Court in *Schwinn* failed to utilize important economic factors such as market power variations and the differing effects on interbrand competition.[163] The *Sylvania* majority, however, found no insurmountable distinctions between the two cases which could have prevented a re-analysis of the *Schwinn* per se rule.[164] Consequently, in *Sylvania*, the per se rule of *Schwinn* was abandoned in favor of the rule of reason approach which provides for

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easily justify different treatment." *Id.* For a discussion of vertical price restraints, see notes 169–70 *infra* and accompanying text.

[159] *Id.* at 58.

[160] *Id.* at 59–64. For a discussion of the distinctions between *Schwinn* and *Sylvania* according to Justice White, see notes 136–38 *supra* and accompanying text.

[161] *Id.* at 52–57. The *Schwinn* per se rule, based upon the sale-nonsale distinction made by the Court, allowed distribution restrictions on nonsale transactions alone. 388 U.S. at 379. Manufacturers dealing in sales transactions, however, were unable to gain the advantages that distribution restrictions brought such as increased investment, promotion of goods and the provision of service and repair facilities resulting in a concentration on interbrand competition by the retailer. *See* 433 U.S. at 56; Note, *supra* note 77, at 144. The *Sylvania* Court recognized this problem, stating that "[c]apital requirements and administrative expenses may prevent smaller firms from using the exception for nonsale transactions." *Id.*; *see* Note, *supra* note 77, at 143–44.

[162] In its broadest sense, the *Schwinn* per se rule proscribed distribution restrictions where a sale agreement, rather than agency or consignment arrangement was in force. *See* 388 U.S. at 379. Consequently, vertical restraints such as customer restrictions and exclusive distributorships have been invalidated under the *Schwinn* holding. *See, e.g.*, United States v. Glaxo Group, Ltd., 302 F. Supp. 1, 8–10 (D.D.C. 1969) (customer restrictions invalidated despite consumer health and safety justifications); Sherman v. Weber Dental Mfg. Co., 285 F. Supp. 114, 116 (E.D. Pa. 1968) (territorial restraint found illegal under *Schwinn* since straight sales arrangement employed). The *Schwinn* per se rule has also been construed very narrowly by lower federal courts. For a discussion of exceptions to the per se rule, see note 104 *supra*. *See also* ABA ANTITRUST SECTION, MONOGRAPH NO. 2, *supra* note 51, at 12–25; Note, *supra* note 77, at 131–34.

[163] 433 U.S. at 52–54. Professor Posner has suggested that, in part, the *Schwinn* per se rule based on sale-nonsale distinctions reflected economic beliefs of that time. Posner, *The Rule of Reason and the Economic Approach*, 45 U. CHI. L. REV. 1, 3 (1977). Specifically, it was thought by some economists that a distribution restriction such as in *Schwinn* would "reinforce an image of superior quality that would reduce the substitutability of other . . . brands and thus increase . . . monopoly power in [that] . . . market." *Id.* Additionally, it was not a widely accepted belief that advertising led to valuable increased product information which therefore downplayed the value of vertical restraints as incentives to promotional activities. *Id.* at 4–5.

[164] 433 U.S. at 46–47; *see* notes 109–13 *supra* and accompanying text.

the legality of those vertical restraints which are ultimately beneficial to competition.[165]

Economic impact was found by the *Sylvania* Court to be the most prudent test to use in determining the legality of vertical restraints.[166] Accordingly, the Court recognized that any possible future per se rule devised for a specific vertical restraint must be premised upon the restriction's "demonstrable economic effect."[167] This test encompasses a balancing of the potential benefits of the restraint to interbrand competition with the injury to intrabrand competition to determine whether overall competition, interbrand, has been enhanced to a sufficient extent by the particular restraint.[168] Although the Court specifically declared that this analysis leaves unaffected the long established per se rule for vertical price restraints,[169] the economic impact analysis of *Sylvania* leaves open the possibility of future legitimization of such restraints.[170]

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[165] 433 U.S. at 58–59.

[166] *Id.* at 57–59. Endorsing economics as a means to determine competitive effects, the *Sylvania* Court stated that "[c]ompetitive economies have social and political as well as economic advantages, but an antitrust policy divorced from market considerations would lack any objective benchmarks." *Id.* at 53 n.21 (citation omitted). Professor Posner believes that the decision hails "the new importance of economics" in antitrust analysis since the Court has acknowledged the lack of an economic basis for the *Schwinn* decision and had adopted a rule which is based on economic analysis. *See* Posner, *supra* note 163, at 12–13.

[167] 433 U.S. at 58–59. In this way the Court can decide on a one-by-one basis whether the particular restraint falls within the per se standards of *Northern Pacific*. For a discussion of these standards, see notes 52–58 *supra* and accompanying text.

[168] *See* 433 U.S. at 54–57. Professor Posner suggests that in the future the Court may redefine the standards for the legality of restraints in areas such as tie-ins and maximum resale pricing. Posner, *supra* note 163, at 10–12. Posner based his comments upon the language in *Sylvania* which points to the primacy of interbrand competition. *Id.*; *see* 433 U.S. at 52 n.19, 54–57. The free-rider concept was suggested by Posner to be another reason as to why the Court may reconsider per se rules in other areas. Posner, *supra* note 163, at 10–11. Free-riding undercuts the incentive for retailers to provide essential services to consumers such as repairs. *Id.* The free-rider concept, easily seen in the context of distribution restrictions, also may affect tie-ins since franchisers may utilize tie-ins to "assur[e] quality control and product and service uniformity." *Id.* at 11–12.

[169] 433 U.S. at 51 n.18.

[170] *See id.* at 54–59. Although the law has traditionally separated vertical price and nonprice restraints because they involve different policy considerations, *see id.* at 51 n.18, the *Sylvania* Court's reliance on a "purely economic approach" implicitly challenges the rationale for the per se rule for vertical price restraints. 433 U.S. at 69–70 (White, J., concurring). *See* Posner, *supra* note 163, at 7–10. The economic and policy considerations regarding nonprice restraints are very similar to those of vertical price restraints. *See* 433 U.S. at 69 (White, J., concurring). Posner, *supra* note 84, at 286–99; Bork, *supra* note 56, at 396–464. Vertical price-fixing, like other vertical restraints, results in economic efficiency which promotes increased product output. *See* 433 U.S. at 70 (White, J., concurring). A byproduct of this process is greater consumer protection since advertising and service repair facilities increase. *See id.* Although the Court's economic analysis appears viable for both vertical nonprice as well as price restraints, however,

The *Sylvania* decision provides a workable standard for both the courts and the business community to determine the legality of vertical distribution arrangements. The rule of reason standard will clearly allow restraints, such as location clauses, to be implemented as long as interbrand competition is fostered thereby that standard, in conjunction with the economic impact analysis should provide a viable framework of review for determining the per se status of future restraints based upon competition—the goal of the Sherman Act.

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it has stipulated that the analysis is only applicable to the evaluation of nonprice restraints. *See id.* at 51 n.18. Consequently, the Court has provided a doctrine that may lead lower courts to apply an economic impact analysis on the basis of fact differentiations from *Sylvania* and special circumstances, such as failing company and newcomer situations, to determine the validity of a vertical price restraint.