

# NOTES

## THE PER SE RULE AS APPLIED TO VERTICAL TERRITORIAL RESTRAINTS: AN IMPROPER STANDARD

In *United States v. Arnold, Schwinn & Co.*<sup>1</sup> the United States Supreme Court advanced the “ancient rule against restraints on alienation”<sup>2</sup> as the basis for its holding that vertical territorial restraints<sup>3</sup> con-

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### THE FOLLOWING CITATION WILL BE USED IN THIS NOTE:

Bork, *The Rule of Reason and Per Se Concept: Price Fixing and Market Division*, 75 YALE L.J. 375 (1966) [hereinafter cited as Bork].

1. 388 U.S. 365 (1967). See notes 19-31 *infra* and accompanying text for a discussion of this case.

2. *Id.* at 380. See generally 2 COKE, INSTITUTES OF THE LAWS OF ENGLAND § 360 (16th ed. 1809).

3. A market arrangement is vertical when there exists an agreement, express or implied, between parties on different rungs of the trade ladder regulating the ultimate distribution of a product to the consumer. Vertical arrangements are to be distinguished from horizontal arrangements which are formed between competitors on the same trade level. See generally Bork 375; Note, *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967)—*Vertical Customer and Territorial Restrictions and the Sherman Act*, 63 Nw. U.L. REV. 262 (1968).

Territorial restraints involve geographic limitations upon distributors and/or retailers. For example, in *Schwinn*, distributors could sell bicycles only to retailers located within the perimeter of the distributor's designated territory. 388 U.S. at 371.

Customer restraints do not involve geographic limitations but do specify to whom a product may or may not be sold. Vertical customer restraints also appeared in the *Schwinn* distribution scheme since the franchised dealers were authorized only to sell to consumers and not to unfranchised retailers. *Id.* See generally Note, *Restricted Channels of Distribution Under the Sherman Act*, 75 HARV. L. REV. 795 (1962).

A third form of market arrangement is price fixing. Because of its obviously harmful anti-competitive nature, all instances of price fixing, vertical or horizontal, direct or indirect, have been uniformly held to constitute per se violations of the Sherman Act. See note 4 *infra* for a discussion of the per se rule. The United States Supreme Court emphasized that a finding of price fixing mandates application of the per se rule in *United States v. McKesson & Robbins, Inc.*, 351 U.S. 305 (1956): “[P]rice fixing is contrary to the policy of competition underlying the Sherman Act . . . [and] its illegality does not depend on a showing of its unreasonableness, since it is conclusively presumed to be unreasonable. It makes no difference whether the motives of the participants are good or evil . . . or whether the effect of the agreement is to raise or decrease prices.” *Id.* at 309-10.

See also *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911) (price fixing in a vertical arrangement); *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211 (1951); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940) (price fixing in a horizontal arrangement).

stitute per se violations<sup>4</sup> of section one of the Sherman Act.<sup>5</sup> During the eight years since *Schwinn* was decided, lower courts have differed in their interpretations of its holding. Some have embraced the case's

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4. Trade practices are subjected to judicial scrutiny under either the per se rule or the "rule of reason." The development of the per se rule was a logical response to the adoption of section 1 of the Sherman Act, which reads in part: "Every contract, combination in the form of trust or otherwise . . . in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. . . ." 15 U.S.C. § 1 (1970). The Supreme Court initially applied a literal interpretation of the statute, and from 1890 to 1911 any activity found to constitute a restraint was condemned as illegal per se. See, e.g., *Northern Sec. Co. v. United States*, 193 U.S. 197 (1904); *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897).

The establishment of per se rules under the Sherman Act is a function of whether a court has had sufficient experience with a particular trade practice to justify a conclusion that the questioned practice almost invariably lacks any redeeming quality. Other factors contributing to the decision to adopt a per se rule include the business community's desire for certainty in planning its day-to-day transactions and a desire by Congress, law enforcement agencies, and the courts to avoid the inevitable delays resulting from prolonged and complex antitrust litigation. See E. KINTNER, *AN ANTITRUST PRIMER* 21-22 (1964); J. VAN CISE, *UNDERSTANDING THE ANTITRUST LAWS* 117 (1970 ed.).

Although the literal interpretation of the statute was abandoned in *Standard Oil Co. v. United States*, 221 U.S. 1 (1911), per se illegality still remains a potent rule which is applied to several trade practices other than price fixing arrangements discussed in note 3 *supra*. See, e.g., *United States v. Sealy, Inc.*, 388 U.S. 350 (1967) (horizontal restraints); *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959) (group boycotts); *United States v. General Dynamics Corp.*, 258 F. Supp. 36 (S.D.N.Y. 1966) (reciprocal dealing). See note 31 *infra* and accompanying text for a discussion of how some courts have distorted the concept of per se illegality.

The "rule of reason" involves judicial inquiry into the intent and effect of questioned trade restraints before a restraint's legality is determined. See generally A. NEALE, *THE ANTITRUST LAWS OF THE UNITED STATES OF AMERICA* 20-21 (2d ed. 1970). First suggested by Chief Justice White in *Standard Oil Co. v. United States*, 221 U.S. 1, 63-64 (1911), the rule was more fully developed by Justice Brandeis in *Board of Trade v. United States*, 246 U.S. 231 (1918). Brandeis recognized that every trade agreement restrains to some extent and concluded that the question of legality should therefore turn on whether a restraint merely regulates competition or actually suppresses or destroys it. *Id.* at 238.

Brandeis perceived the proper test of alleged Sherman Act violations to be one of balancing all relevant factors surrounding the trade restraint. His checklist of factors to be considered included peculiarities of the business involved, conditions before and after imposition of the restraint, reasons for the adoption of a particular practice, and the purpose sought to be attained. *Id.* Once these factors are considered, he reasoned, a court will be able to properly interpret the overall effect of the restraint and predict the consequences of its continuation. *Id.*

Having established the ground rules for his reasonableness test, Brandeis proceeded to evaluate the restraint before him by assimilating these relevant factors into a three-pronged test of nature, scope, and effect. *Id.* at 239-40. This test, with its ad hoc examination of all relevant factors surrounding a questioned restraint, is the essence of the "rule of reason," and courts today essentially follow the Brandeis format when using the rule.

5. 15 U.S.C. § 1 (1970).

broadest implications, finding the mere existence of a territorial restraint sufficient to render a contract of sale per se illegal.<sup>6</sup> Other courts have understood *Schwinn* to require the "resolute enforcement" of a restraint before illegality attaches.<sup>7</sup> Still others, confining *Schwinn* to its facts, have held that vertical territorial restraints can actually be justified in certain situations.<sup>8</sup>

The Supreme Court has not attempted to clarify *Schwinn* since the opinion was issued in 1967.<sup>9</sup> This Note takes the position that a reevaluation is in order. After tracing the case law leading up to *Schwinn*, and pointing out the confusion which has ensued since, the Note will analyze three recent court of appeals cases which demonstrate the need to replace *Schwinn's* indiscriminate per se rule with the more flexible "rule of reason" standard. The analysis will suggest that the *Schwinn* rule is unsuitable, first, because its broad "passage of title" test is particularly susceptible to misapplication, and second, because the rule discourages the implementation of effective methods of promoting competition, thereby frustrating the policies underlying federal antitrust legislation.

#### VERTICAL TERRITORIAL RESTRAINTS BEFORE AND AFTER *Schwinn*

The first Supreme Court case involving territorial restrictions in a vertical arrangement was *White Motor Co. v. United States*,<sup>10</sup> in which the Court considered whether to extend the well-established per se rule prohibiting *horizontal* territorial restraints<sup>11</sup> to agreements be-

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6. See notes 32-35 *infra* and accompanying text.

7. See notes 36-38 *infra* and accompanying text.

8. See notes 39-49 *infra* and accompanying text.

9. The Court may have been presented with an opportunity to reevaluate *Schwinn* in *United States v. Topco Associates, Inc.*, 405 U.S. 596 (1972). In *Topco*, an association of small supermarket chains organized in an effort to obtain merchandise under private labels in order to compete effectively with larger chains. Members agreed not to sell *Topco* merchandise outside the territory in which they were licensed to operate, and there were similar self-imposed restrictions upon sales at the wholesale level.

The Supreme Court held that the territorial restrictions were illegal per se, but this holding was premised on a finding that the restrictions, while possessing some vertical characteristics, were essentially horizontal in nature. *Id.* at 608.

See Note, *Territorial Restrictions and the Per Se Rules—A Reevaluation of the Schwinn and Sealy Doctrines*, 70 MICH. L. REV. 616 (1972), which argued that *Topco* provided an opportunity for the Court to adopt a unified doctrine whereby all territorial restraints would be evaluated under the "rule of reason."

10. 372 U.S. 253 (1963).

11. See note 3 *supra*. The per se rule was first applied to horizontal arrangements in *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211 (1899), and since then all forms of horizontal restraint have consistently fallen within the per se rule because they are "naked restraints of trade with no purpose except stifling of competition." *White*

tween a manufacturer and its authorized dealers.<sup>12</sup> The Court, in neutral terms, declined to apply a per se rule because it could not gauge the competitive impact of a vertical restraint on the basis of the evidence before it.<sup>13</sup>

Within a year after *White Motor* was decided, two courts of appeals had occasion to consider the neutral language appearing in that opinion.<sup>14</sup> In *Snap-On Tools Corp. v. FTC*,<sup>15</sup> the Seventh Circuit, in the process of evaluating a contract of sale under which a manufacturer limited the territory in which dealers could resell its products, interpreted *White Motor* as explicitly rejecting a per se rule against vertical arrangements.<sup>16</sup> The Sixth Circuit reached a similar conclusion in *Sandura Co. v. FTC*.<sup>17</sup> In both cases the challenged territorial restraints were eventually sustained upon application of the "rule of reason" test.<sup>18</sup>

This "rule of reason" test for vertical territorial restraints lasted only four years before it was supplanted by a rule of per se illegality in *United States v. Arnold, Schwinn & Co.*<sup>19</sup> Schwinn had been the leading domestic bicycle producer in 1951, accounting for twenty-two percent of all sales. Ten years later its market share had fallen to less

*Motor Co. v. United States*, 372 U.S. 253, 263 (1963). See *United States v. Topco Associates, Inc.*, 405 U.S. 596 (1972) (horizontal restraint held per se illegal where no price fixing involved so long as price exceeds wholesale cost); *United States v. Sealy, Inc.*, 388 U.S. 350 (1967); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951) (horizontal arrangements among competitors to divide territory); *Interphoto Corp. v. Minolta Corp.*, 417 F.2d 621 (2d Cir. 1969) (horizontal restraints part of an unlawful price fixing scheme).

12. *White Motor Company* was a manufacturer of trucks. The company entered into agreements with its distributors whereby the distributor was granted the exclusive right to sell *White* trucks within a described territory. The distributor in turn agreed not to sell to individuals or businesses outside the territory. 372 U.S. at 255-56.

13. *Id.* at 263.

14. Both cases involved alleged violations of section 5 of the Federal Trade Commission Act. The statute reads in part: "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful." 15 U.S.C. § 45(a)(1) (1970). The Federal Trade Commission has discretion under section 5, 15 U.S.C. § 45(b) (1970), to declare a trade practice unfair if it does violence to the Sherman Act, and its jurisdiction also encompasses activity which may be deemed "unfair" because it is unethical or causes injury to consumers or competitors. However, this broad jurisdictional base is somewhat offset by the Commission's remedial powers, which generally operate only prospectively and do not assess damages. See generally P. AREEDA, *ANTITRUST ANALYSIS* 62-67 (2d ed. 1974).

15. 321 F.2d 825 (7th Cir. 1963).

16. *Id.* at 831. See note 18 *infra*.

17. 339 F.2d 847 (6th Cir. 1964).

18. *Id.* at 858; 321 F.2d at 831-33.

19. 388 U.S. 365 (1967).

than thirteen percent, while one of its competitors had come to command twenty-three percent of the market.<sup>20</sup> In an attempt to bolster its sagging market position, Schwinn set up a distribution scheme using some twenty-two wholesalers through which its bicycles were distributed to franchised retailers. In some cases the goods were sold outright, and in others a consignment plan was employed. Under both arrangements the wholesalers were required to refrain from selling outside specific territories assigned by Schwinn, as well as from selling to retailers that Schwinn had not franchised.<sup>21</sup>

The *Schwinn* Court began its discussion of the legality of Schwinn's practices by acknowledging that the company was not guilty of price fixing.<sup>22</sup> The Court also observed, however, that Schwinn had not simply been exercising its recognized right to decide to which dealers it would sell bicycles.<sup>23</sup> Thus, Schwinn's distribution scheme fell somewhere between trade practices which are illegal per se and those which constitute permissible vertical restraints.<sup>24</sup>

Having thereby established the parameters of its analysis, the Court proceeded to distinguish territorial and customer restrictions<sup>25</sup> which remain in effect after a manufacturer has sold its product from those imposed upon a product transferred on consignment. This distinction was drawn in light of the "ancient rule against restraints on alienation."<sup>26</sup> It resulted in the adoption of a strict "passage of title" test under which post-sale restrictions are declared illegal per se,<sup>27</sup>

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20. *Id.* at 368-69.

21. *Id.* at 371.

22. *Id.* at 373. See notes 3-4 *supra*.

23. See *United States v. Colgate & Co.*, 250 U.S. 300 (1919), which held that a unilateral refusal to deal with wholesalers and retailers who do not follow suggested resale prices is permissible under the Sherman Act. Earlier cases read *Colgate* as requiring that some type of illicit contract between manufacturer and dealer must exist before the termination of a business would be declared illegal. See, e.g., *Frey & Son, Inc. v. Cudahy Packing Co.*, 256 U.S. 208 (1921); *United States v. Schrader's Son, Inc.*, 252 U.S. 85 (1920). This reading was modified by *FTC v. Beech-Nut Packing Co.*, 257 U.S. 441 (1922), and *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960). *Parke, Davis* indicated that only manufacturer actions amounting to a mere announcement of policy and simple refusal to deal would be protected under *Colgate*. If a manufacturer's actions go beyond these boundaries, and other methods are used to enforce adherence to resale prices, a Sherman Act violation will result. *Id.* at 44. See Comment, *The Colgate Doctrine: Its Past and Present*, 12 HOUSTON L. REV. 409, 415-17 (1975); Comment, *Franchising + Antitrust = Confusion: The Unfortunate Formula*, 9 SANTA CLARA LAWYER 266, 279 (1969).

24. 388 U.S. at 375-76.

25. See note 3 *supra* where customer and territorial restrictions are distinguished.

26. 388 U.S. at 380.

27. *Id.* at 379. The *Schwinn* Court suggested that "proper application of section 1 of the Sherman Act to this problem requires differentiation between the situation where

while restrictions in the absence of a sale are to be examined according to the "rule of reason."<sup>28</sup> While holding that vertical territorial restraints are per se illegal once title has passed, the *Schwinn* Court appeared to hedge somewhat by recognizing that circumstances could arise which would be "relevant to a showing that the challenged restraint is sheltered by the rule of reason because it is not anticompetitive."<sup>29</sup> Thus, the Court apparently felt that post-sale restrictions might sometimes be justified, and for this reason, it cannot be said that the Court adopted the same per se standard for vertical territorial restrictions that is applicable to price fixing.<sup>30</sup> Rather, *Schwinn* seems to have established what may be termed a "qualified" per se standard.<sup>31</sup>

Lower courts have disagreed over the extent of *Schwinn's* prohibitions. One district court, in *United States v. Glaxo Group, Ltd.*,<sup>32</sup> struck down customer restrictions requiring manufacturer approval prior to the resale of certain drug products. While acknowledging that the manufacturer imposed the resale restrictions for the "laudable" purpose of ensuring "uniform standards of health and safety" in drug preparation, and while admitting that the *Schwinn* rule was "unpredictable," the court nevertheless read *Schwinn* to require the imposition of per se illegality.<sup>33</sup> In *Interphoto Corp. v. Minolta Corp.*,<sup>34</sup> the

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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. To permit the manufacturer to control the product's destiny after sale "would sanction franchising and confinement of distribution as the ordinary instead of the unusual method which may be permissible in an appropriate and impelling competitive setting, since most merchandise is distributed by means of purchase and sale." *Id.* at 379.

Justice Stewart, joined by Justice Harlan, dissented from that part of the opinion which held post-sale restrictions to be illegal per se. He argued that the ancient doctrine that a manufacturer has no legitimate interest in what becomes of his products after sale "no longer holds true in a day of sophisticated marketing policies, mass advertising, and vertically integrated manufacturer-distributors. Restrictions like those involved in a franchising program should accordingly be able to claim justification under the ancillary restraints doctrine." *Id.* at 392 (footnote omitted).

28. *Id.* at 381-82.

29. *Id.* at 374. The Court mentioned the danger of corporate failure and the efforts of a newcomer who seeks to break into a specific market as situations which might constitute extenuating circumstances. *Id.* See note 88 *infra* for a discussion of the "failing firm" exception in the context of the *Sylvania* case.

30. See note 3 *supra*.

31. The Supreme Court has similarly hedged in its application of a per se rule to another trade restraint, the "tying" arrangement. Compare *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958) and *International Salt Co. v. United States*, 332 U.S. 392 (1947) with *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594 (1953). See also *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961).

32. 302 F. Supp. 1 (D.D.C. 1969).

33. *Id.* at 9.

34. 295 F. Supp. 711 (S.D.N.Y.), *aff'd per curiam*, 417 F.2d 621 (2d Cir. 1969).

Second Circuit also indicated that territorial restrictions are per se illegal under *Schwinn*, even though this determination was not necessary to the court's holding.<sup>35</sup> Finally, *Schwinn* was strictly followed in a New Jersey case involving the celebrated Glenn Turner pyramid enterprises. The court in *Kugler v. Koscot Interplanetary, Inc.*<sup>36</sup> struck down a multilevel distribution scheme under which distributors were limited to a single source of supply and all methods of distribution were prohibited except by home delivery and at beauty shows. Relying on federal law,<sup>37</sup> *Kugler* declared the scheme illegal per se in light of *Schwinn*.<sup>38</sup>

The first case to hold that not all post-sale restraints are invalid under *Schwinn* was *Tripoli Co. v. Wella Corp.*,<sup>39</sup> where the Third Circuit focused on the following language in *Schwinn*:

Under the Sherman Act, it is unreasonable *without more* for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it.<sup>40</sup>

The court interpreted this passage as sanctioning those vertical restrictions for which the manufacturer could supply a rational explanation.<sup>41</sup>

In *Tripoli*, a manufacturer terminated sales to a wholesale distributor who had begun selling to retailers hair care products specifically

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35. 295 F. Supp. at 720 n.4.

36. 120 N.J. Super. 216, 293 A.2d 682 (1972).

37. *Kugler* was decided under a state antitrust law which instructed that it be applied in a manner consistent with the prevailing judicial constructions of analogous federal statutes. *Id.* at 238, 293 A.2d at 694.

38. Borrowing terminology from the *Schwinn* opinion, the court applied a per se rule because of Koscot's firm and resolute policies which were "grounded upon the communicated danger of termination." *Id.* at 246, 293 A.2d at 699. Some courts have read *Schwinn* as sanctioning vertical restrictions where a resolute enforcement policy and a communicated danger of termination are absent; to this extent, these requirements may be seen as a qualification of *Schwinn's* sweeping per se rule. See *Colorado Pump & Supply Co. v. Febco, Inc.*, 472 F.2d 637 (10th Cir.), cert. denied, 411 U.S. 987 (1973); *Janel Sales Corp. v. Lanvin Parfums, Inc.*, 396 F.2d 398 (2d Cir.), cert. denied, 393 U.S. 938 (1968); Comment, *Vertical Territorial and Customer Restrictions Under the Sherman Act: Decisions Since United States v. Arnold, Schwinn & Co.*, 22 J. PUB. L. 483, 489-90 (1973); cf. *United States v. Eaton Yale & Towne, Inc.*, 1972 Trade Cas. ¶ 73,899 (D. Conn. 1972).

39. 425 F.2d 932 (3d Cir.), cert. denied, 400 U.S. 831 (1970).

40. *Id.* at 936, citing *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 379 (1967).

41. This interpretation of *Schwinn's* "without more" terminology received recent support in *Good Investment Promotions, Inc. v. Corning Glass Works*, 493 F.2d 891 (6th Cir. 1974). But see *Kugler v. Koscot Interplanetary, Inc.*, 120 N.J. Super. 215, 245-46, 293 A.2d 682, 698 (1972) (*Tripoli's* reading of "without more" criticized as "narrow").

earmarked for professional use only. Because of the potential dangers to health which general consumer use presented,<sup>42</sup> the Third Circuit concluded that protecting the public from injury and insulating the manufacturer from potential product liability together offset any reduction of competition which might have resulted from the sales restrictions.<sup>43</sup>

The "dangerous product" exception established by *Tripoli* was expanded to accommodate product peculiarities in *LaFortune v. Ebie*.<sup>44</sup> In that case a fast-food franchisee had delivered chicken to homes outside his assigned territory. Taking the position that *Schwinn* had not proscribed all territorial restrictions, a California appellate court reversed a trial court determination of per se illegality, holding that the restraint in question was susceptible to ratification under the "rule of reason" standard.<sup>45</sup> The court remanded the case for a new trial and provided a checklist of factors to be considered by the lower court in deciding whether the restraint was justified: "For example, speed of delivery, quality of product, and condition of product at time of delivery may be factors which under the rule of reason could justify restraints of trade that would be unreasonable in the marketing of a standardized manufactured appliance."<sup>46</sup>

Also upheld as a proper exception to *Schwinn* have been "area of primary responsibility" clauses, under which a franchisee is required to concentrate his efforts in a designated territory but is allowed to sell outside that territory.<sup>47</sup> These clauses are unattractive for at least two

42. Some of the bottles and individual instruction sheets designated for professional use did not meet the labeling requirements of the Federal Food, Drug & Cosmetic Act. The danger created by these factors was compounded by the fact that the items designated for professional use were not identical to those sold for consumer use. 425 F.2d at 937 (3d Cir. 1970).

43. A "dangerous product" exception to *Schwinn* was recognized by a district court in *United States v. Safety First Products Corp.*, 1972 Trade Cas. ¶ 74,223 (S.D.N.Y. 1972), where a manufacturer prohibited the resale of fire extinguishing equipment to those not trained in the installation and servicing of the equipment.

44. 26 Cal. App. 3d 72, 102 Cal. Rptr. 588 (1972).

45. *Id.* at 75, 102 Cal. Rptr. at 590.

46. *Id.* at 75-76, 102 Cal. Rptr. at 590. *But cf.* *Clairol, Inc. v. Cosmetics Plus*, No. C-241-72 (Sup. Ct. N.J., July 26, 1974) (*Schwinn's* broad policy that manufacturers may not restrict the transfer of their product after sale may not be frustrated by manufacturer's motive to protect its goodwill established through years of advertising and service).

*LaFortune's* restriction of *Schwinn*, which may be termed the "unique product" exception, was unsuccessfully pursued by Adolph Coors Company in cases discussed later in this Note. See notes 50-75 *infra* and accompanying text.

47. *Colorado Pump & Supply Co. v. Febco, Inc.*, 472 F.2d 637 (10th Cir.), *cert. denied*, 411 U.S. 987 (1973); *Superior Bedding Co. v. Serta Associates, Inc.*, 353 F. Supp. 1143 (N.D. Ill. 1972); *Plastic Packaging Materials, Inc. v. Dow Chemical Co.*,



reasons, however. First, they tend to frustrate the minimization of post-sale service costs which only a rigid market division, through elimination of resale competition, can accomplish.<sup>48</sup> Second, a manufacturer who utilizes such a clause runs the risk of having it declared a mere facade designed to shield an illegal territorial restraint, with the result that the manufacturer's elaborate arrangement will fall victim to the per se rule.<sup>49</sup>

#### THE Coors CASES: A TEMPTATION RESISTED

The Adolph Coors Company brews, distributes and sells beer under the trade name of "Coors." From a single brewery in Colorado, the company distributes its beer to just eleven states. Distributors are assigned a specific territory in which they may market the beer, and its standard distribution contract enables Coors to terminate the contract for any breach of the territorial restrictions which it imposes.<sup>50</sup>

In *Adolph Coors Co. v. FTC*,<sup>51</sup> the Court of Appeals for the Tenth

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327 F. Supp. 213 (E.D. Pa. 1971). *Contra*, *Hobart Bros. v. Malcolm T. Gilliland, Inc.*, 471 F.2d 894 (5th Cir.), *cert. denied*, 412 U.S. 923 (1973). See note 49 *infra*.

One commentator has argued that *Schwinn* never did proscribe the use of this device. See Zimmerman, *Distribution Restrictions After Scaly and Schwinn*, 12 ANTI-TRUST BULL. 1181 (1968).

48. See Bork 467.

49. This was the rationale behind the holding in *Hobart Bros. v. Malcolm T. Gilliland, Inc.*, 471 F.2d 894 (5th Cir. 1973), where a "primary responsibility" clause was found per se illegal because it was the result of "a silent understanding to restrain trade in violation of § 1 of the Sherman Act . . ." *Id.* at 900.

50. Coors, the nation's fourth largest brewer of beer, has adopted business practices unique to the beer industry in that its three larger competitors have established "branch breweries" throughout the United States. The company maintains its single brewery in Golden, Colorado, because Coors beer is made only with nearby Rocky Mountain spring water, which is generally free of organic materials. Use of this water allows the beer to be made by a non-pasteurized, aseptic process which accounts for the beer's light taste and high price.

Because the aseptic process is used, Coors beer is very fragile, and the company claims that if the beer is not kept continuously refrigerated or is maintained over ninety days, it spoils. The company's brewing process and distribution procedures are discussed in detail in *Copper Liquor, Inc. v. Adolph Coors Co.*, 506 F.2d 934, 936-37 (5th Cir. 1975), and *Adolph Coors Co. v. FTC*, 497 F.2d 1178, 1182 (10th Cir. 1974), *cert. denied*, 43 U.S.L.W. 3388 (U.S. Jan. 14, 1975).

The credibility of Coors' claim that the need for continuous refrigeration justifies imposition of territorial restraints was recently challenged when a federal district judge dismissed Coors' complaint against a beer distributor who was purchasing Coors beer in Colorado and shipping it to North Carolina for sale to retail outlets. The court stated that despite the transfer of the beer to North Carolina in an unrefrigerated truck, Coors' reputation had not been damaged because not all of its authorized distributors' delivery trucks are refrigerated, and not all retail outlets served by the distributors have proper refrigeration facilities. *Wall Street J.*, Feb. 28, 1975, at 12, col. 2.

51. 497 F.2d 1178 (10th Cir. 1974).

Circuit upheld an FTC finding that Coors was in violation of section five of the Federal Trade Commission Act.<sup>52</sup> The court first ruled that there was substantial evidence to support the Commission's finding of per se illegality because of Coors' price-fixing and price-maintenance programs.<sup>53</sup> This initial holding made any further analysis of the Coors distribution scheme unnecessary,<sup>54</sup> yet the court went on to examine Coors' claim that its territorial restrictions were reasonable and legal.<sup>55</sup> Considering itself compelled in light of *Schwinn* to strike down the restrictions as illegal per se,<sup>56</sup> the court nevertheless urged that the *Schwinn* rule be modified: "Perhaps the Supreme Court may see the wisdom of grafting an exception to the per se rule when a product is

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52. 15 U.S.C. § 45 (1970). See note 14 *supra*.

In an Initial Decision, the Administrative Law Judge found that Coors had not violated the Act and recommended dismissal of all charges. On appeal, the Federal Trade Commission substituted its findings for those of the Administrative Law Judge and ordered Coors to cease and desist from, *inter alia*, entering into price fixing agreements, threatening termination of distributorships upon a refusal to sell at recommended prices or a violation of territorial restrictions, and entering into or enforcing agreements to restrict territories in which a distributor may sell. *Adolph Coors Co. v. FTC*, 497 F.2d at 1181 n.2 (10th Cir. 1974).

53. 497 F.2d at 1184. Among the charges leading to the finding of illegal price maintenance programs were refusals to sell to retailers unless they adhered to Coors' suggested prices and failure to deliver beer to retailers who cut prices. *Id.* at 1185. One retailer who testified that his distributor had cut off deliveries after the retailer had offered special weekend prices subsequently brought a private action against Coors in *Copper Liquor, Inc. v. Adolph Coors Co.*, 506 F.2d 934 (5th Cir. 1975). See notes 58-70 *infra* and accompanying text for a discussion of this case.

54. As indicated in note 3 *supra*, the courts have consistently held that any finding of price fixing necessitates a finding of per se illegality.

55. Coors argued that freshness and proper handling under refrigeration depended upon the use of territorial restrictions. The substance of these arguments was detailed more fully in the *Copper Liquor* case, where Coors argued that distributors, who must make large capital expenditures to meet the refrigeration standards necessary for warehouses and trucks, would have difficulty in obtaining necessary credit and shy away from making such expenditures absent an assurance that another Coors distributor within a territory would not compete with them. Furthermore, Coors feared that the presence of intrabrand competition would tend to erode the company's market penetration, whereas increased market penetration was essential to Coors' growth because their centralized brewing facilities tended to make impractical any expansion of the geographical area serviced. Coors also cited the difficulties in monitoring proper treatment of the beer, assuring proper maintenance of draught facilities, and supervising compliance with state alcoholic beverage statutes as justifications for its territorial restrictions. 506 F.2d at 937-39.

56. The Tenth Circuit read *Schwinn* as a "clear and unequivocal" adoption of a "passage of title" test. Accordingly, it held that since Coors had parted with title and risk to its beer upon sale to distributors, any effort thereafter to restrict territories or persons to whom the beer could be transferred was a per se violation of section 1 of the Sherman Act or section 5 of the Federal Trade Commission Act. 497 F.2d at 1186-87.

*unique* and where the manufacturer can justify its territorial restraints under the rule of reason."<sup>57</sup>

In *Copper Liquor, Inc. v. Adolph Coors Co.*,<sup>58</sup> a retail liquor store owner charged that Coors had conspired with its distributors, in violation of section one of the Sherman Act,<sup>59</sup> to fix the resale price of its beer, and that it had directed its distributors to cut off the store owner's supply when he sold the beer below a suggested price.<sup>60</sup> The store owner also charged that Coors had conspired with its distributors to create and enforce exclusive territories within which a distributor was permitted to conduct business, thereby preventing the owner from obtaining more beer from other distributors once his original supply was cut off. The Court of Appeals for the Fifth Circuit held that there was sufficient evidence of price fixing in the record to show a Sherman

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57. *Id.* at 1187 (emphasis added). The court prefaced its plea with a reference to *LaFortune v. Ebie*, 26 Cal. App. 3d 72, 102 Cal. Rptr. 588 (1972), which supported the theory of excepting "unique products" from the per se rule (see notes 44-46 *supra* and accompanying text), but tied to the *LaFortune* exception an additional requirement that the restrictions be necessary to remain in business. 497 F.2d at 1187. When couched in these terms, the exception to the per se rule described by the *Coors* court resembled the "failing firm" exception *Schwinn* itself appeared to recognize. See note 29 *supra*.

The probable explanation for Coors' failure to avail itself of the "failing firm" exception suggested in these cases is that this defense is usually limited to situations where a company is in danger of bankruptcy. See, e.g., *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969). Coors, the fourth largest beer brewer in the United States, was in no danger of collapse. Nevertheless, Coors argued in its petition for certiorari to the United States Supreme Court that "[d]estruction of the Coors vertically-assigned exclusive marketing territories will . . . threaten the very market penetration which is required for Coors to survive in the industry . . . ." 681 ANTITRUST & TRADE REG. REP. at A-15 (Sept. 24, 1974), quoting *Adolph Coors Co. v. FTC*, No. 74-128, Petition for Certiorari, Aug. 16, 1974 (emphasis added). The wording of this petition suggests that Coors may have recognized the propriety of the "failing firm defense" in situations other than imminent corporate collapse. See note 88 *infra* where this interpretation of the "failing firm defense" is discussed more fully.

The Tenth Circuit may have precluded a Supreme Court reconsideration of *Schwinn*—as it had requested—by agreeing with the Commission's finding of price fixing. Apparently realizing the futility of an appeal based solely on the argument that a "rule of reason" should be adopted where price fixing is present, Coors' petition for certiorari attacked the Tenth Circuit's evaluation of the price fixing evidence. Coors claimed that the court had considered only that evidence supporting the FTC's decision and argued that such an interpretation of the standards for judicial review of administrative proceedings was violative of due process. 681 ANTITRUST & TRADE REG. REP. at A-16 (Sept. 24, 1974).

58. 506 F.2d 934 (5th Cir. 1975).

59. 15 U.S.C. § 1 (1970).

60. The plaintiff retailer in *Copper Liquor* had previously testified about Coors' alleged price fixing in *Adolph Coors Co. v. FTC*. See 497 F.2d at 1185; 506 F.2d at 936. See note 53 *supra*.

Act violation.<sup>61</sup>

Recognizing the reasonableness of Coors' territorial restrictions in light of its unique brewing process,<sup>62</sup> the Fifth Circuit, like the Tenth Circuit,<sup>63</sup> was tempted to graft an exception to *Schwinn*.<sup>64</sup> Indeed, the Fifth Circuit professed agreement with *Tripoli Co. v. Wella Corp.*<sup>65</sup> which had urged that *Schwinn* should not apply where products require close supervision.<sup>66</sup> But the court refused to apply the *Tripoli* exception because the Coors restrictions, while yielding a secondary benefit by maintaining quality control,<sup>67</sup> functioned primarily as devices for controlling prices.<sup>68</sup> Thus, the taint of price fixing<sup>69</sup> foreclosed ratification of Coors' distribution practices under the "rule of reason."<sup>70</sup>

Although the presence of price fixing in the Coors distribution scheme compelled a finding of per se illegality, the *Coors* cases unmistakably encourage a change in the sweeping per se rule announced in *Schwinn*. The Tenth Circuit urged the Supreme Court to modify the *Schwinn* rule for cases involving a unique product,<sup>71</sup> and the Fifth Circuit suggested that, in addition to the "failing firm" and "newcomer"

61. 506 F.2d at 946. The case was remanded to the United States District Court for the Western District of Texas to determine the extent of injury and damages, if any, which were sustained by the plaintiff. *Id.* at 955.

62. See note 50 *supra*.

63. See text accompanying notes 56-57 *supra*.

64. *Id.* at 944.

65. 425 F.2d 932 (3d Cir.), *cert. denied*, 400 U.S. 831 (1970).

66. See notes 39-43 *supra* and accompanying text.

67. Quality control considerations were advanced to justify enforcement of territorial restrictions in *Todhunter-Mitchell & Co. v. Anheuser-Busch, Inc.*, 375 F. Supp. 610, 622-23, *modified*, 383 F. Supp. 586 (E.D. Pa. 1974). However, the court in *Todhunter* found this argument unconvincing because examination of the evidence offered at trial revealed that the defendant's concern over quality control was insignificant.

68. 506 F.2d at 944.

69. See note 60 *supra* and accompanying text.

70. The court went on to state in dicta that even if price fixing were absent from the facts of the case, the record would not support a conclusion that the territorial restrictions were essential to the survival of the firm: "It may be that the process by which Coors beer is brewed necessitates refrigerated marketing and rotation of stock, and that vertical territorial restraints are helpful in supervising the proper application of these techniques . . . . But there is not enough in the present record to demonstrate that these ends could not be met by less restrictive means than those presently employed." *Id.* at 944-45 (footnote omitted).

While the validity of the assertion that a trade restriction is always improper if a less restrictive alternative is available might be questioned, the fact remains that such an analysis simply represents an application of the "rule of reason." Use of the "rule of reason" does not guarantee that a trade practice will be upheld; rather, its value lies in the prevention of a premature judgment rendering illegal per se a practice which may be justified when all alternatives are weighed. See note 4 *supra*.

71. *Adolph Coors Co. v. FTC*, 497 F.2d 1178, 1187 (10th Cir. 1974).

situations recognized by the *Schwinn* Court itself,<sup>72</sup> other exceptions to the rule may be appropriate.<sup>73</sup> By taking pains to urge some modification of *Schwinn* after having established the clear illegality of Coors' distribution practices, the two *Coors* courts appeared to support the arguments originally advanced in *Tripoli*<sup>74</sup> and *LaFortune*<sup>75</sup> favoring the adoption of the "rule of reason" for evaluating vertical territorial restraints.

*Sylvania*: THE DANGERS OF CONTINUED  
ADHERENCE TO *Schwinn*

A recent case from the Ninth Circuit, *GTE Sylvania, Inc. v. Continental T.V., Inc.*,<sup>76</sup> illustrates how continued attempts to adhere to *Schwinn* can result in a misapplication of its per se rule. The case also affords a further opportunity to analyze the potentially adverse effects that applying a per se rule to vertical territorial restraints will have on competition. In 1962, Sylvania adopted a new franchising policy designed to strengthen its declining position in the television market.<sup>77</sup> Under this "elbow room policy," the number of retail franchises in a given geographic area was limited in order to reduce competition among authorized franchisees; however, franchised retailers were permitted to sell televisions to customers who lived outside the assigned areas.<sup>78</sup>

In the fall of 1965, Continental, a retail chain operating Sylvania franchises at eight locations in northern California,<sup>79</sup> opened an unauthorized store in Sacramento. Continental stocked its new Sacramento store by transferring Sylvania sets from one of its franchised locations. After a month of unsuccessful efforts to halt this practice, Sylvania cancelled Continental's franchise.<sup>80</sup> Continental then brought an action

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72. See note 29 *supra* and accompanying text.

73. *Copper Liquor, Inc. v. Adolph Coors Co.*, 506 F.2d 934, 945 (5th Cir. 1975).

74. See notes 39-43 *supra* and accompanying text.

75. See notes 44-46 *supra* and accompanying text.

76. 1974-1 Trade Cas. ¶ 75,072, at 96,792 (9th Cir.), *petition for rehearing en banc granted*, Civil No. 71-1705 (Dec. 12, 1974).

77. Sylvania's share of the television market was approximately two percent in 1962. Within two years after adoption of this new "elbow room policy," its market share rose to five percent. 1974-1 Trade Cas. at 96,793.

78. *Id.* This "exclusive location" agreement, while involving no specific geographical boundaries, is nevertheless a form of vertical territorial division since the built-in impracticalities of doing business at a distance restrict the area in which the majority of a franchisee's business is conducted. See Bork 466.

79. 1974-1 Trade Cas. at 96,796 (dissenting opinion).

80. *Id.* at 96,793.

charging that Sylvania had violated section one of the Sherman Act<sup>81</sup> by enforcing the location clause of the franchise contract. It prevailed at the trial level, winning an award for treble damages.<sup>82</sup>

The Ninth Circuit sustained the award, confirming that the source of Sylvania's liability was its series of attempts to enforce the location restrictions.<sup>83</sup> These "attempts to enforce" were classified as per se illegal under *Schwinn's* "passage of title" test because they were made after Sylvania had sold its televisions to Continental.<sup>84</sup>

Even assuming the continued vitality of *Schwinn's* broad per se rule, *Sylvania* did not present an appropriate occasion for its application. The Ninth Circuit failed to recognize the distinction between the transfer of a franchised product within a single company and an ordinary dealer-customer sale. This distinction is important, for although a manufacturer is relatively uninterested in who ultimately purchases his product, he usually does have a strong interest in who sells it.<sup>85</sup> When Continental shipped Sylvania television sets to an unauthorized store in Sacramento, the effect of the transfers was to establish a new Sylvania outlet;<sup>86</sup> and the court, by sanctioning these transfers, gave Continental the power to determine the location and number of authorized Sylvania dealerships. This right clearly belonged to Sylvania alone.<sup>87</sup> Thus, as a result of improperly applying *Schwinn's* "passage

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81. 15 U.S.C. § 1 (1970).

82. 1974-1 Trade Cas. at 96,797 n.7 (dissenting opinion).

83. *Id.* at 96,795.

84. *Id.*

85. For example, a manufacturer obviously prefers to have his product sold by dealers possessing service expertise and promotional abilities. See notes 114-115 *infra* and accompanying text.

86. The court acknowledged that Sylvania could have used legal means to prevent Continental from holding itself out as a franchised dealer at unauthorized locations, *id.* at 96,794, but conceded that its holding in the case did not spell out what those legal means were, *id.* at 96,795. Yet by embracing the "passage of title" doctrine of *Schwinn*, the court appeared to adopt an inconsistent position, since *Schwinn* prevents any enforcement of restrictions after title has passed.

87. The unquestioned right of a manufacturer to determine who his franchisees will be, and where they will be located, was recognized by the Supreme Court in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 376 (1967). The *Sylvania* court itself recognized this right, 1974-1 Trade Cas. at 96,794, but found the source of liability to be Sylvania's "procuring an agreement" of location restriction and its subsequent attempts to enforce that agreement, *id.* at 96,795.

There seems to be no support for the argument that an exclusive location agreement is itself illegal. In *United States v. General Motors Corp.*, 384 U.S. 127 (1966), the Supreme Court expressly declined to declare a location clause illegal, *id.* at 139-40, and in *Boro Hall Corp. v. General Motors Corp.*, 124 F.2d 822, 823 (2d Cir. 1942), *cert. denied*, 317 U.S. 695 (1943), the Second Circuit held that a contract clause restricting used car dealer locations was not an unreasonable trade restraint.

of title" test, the Ninth Circuit created an unworkable rule whereby a franchisor is given the exclusive right to determine the location of its franchised outlets, but is prevented from taking steps to enforce this right.<sup>88</sup>

In addition to illustrating that *Schwinn* is susceptible to misapplica-

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Since the location clause itself was insufficient to justify a finding of illegality, Sylvania's attempts to enforce the agreement must have been the source of its liability. As indicated in note 23 *supra*, the *Colgate* doctrine is limited by *Parke, Davis* and *Beech-Nut* to a simple refusal to deal and does not exempt enforcement activities beyond this point. However, this reading of *Colgate* may well be inapposite with respect to the facts in *Sylvania*, since *Parke, Davis* and *Beech-Nut* involved the enforcement of suggested retail prices, a considerably more suspect trade restraint than an exclusive location clause. See note 3 *supra*.

In a further attempt to justify its application of *Schwinn* to the facts in *Sylvania*, the majority suggested that if Continental had formed a wholly owned subsidiary to operate the unauthorized store to which it then sold Sylvania sets, it would have been much more difficult to draw the franchise distinction urged by Sylvania. 1974-1 Trade Cas. at 96,795 n.2. The transparency of this argument is revealed when one considers its treatment from an accounting perspective. When selling a product to its wholly owned subsidiary, the parent records the transaction as intercompany income, while the subsidiary records an intercompany expense. At the fiscal year-end, consolidation of the two companies' financial statements results in a wash of the intercompany transaction, eliminating it from the consolidated income statement. For an illustration of how intercompany expenses are treated in a consolidated income statement, see H. FINNEY & R. OLD-BERG, *LAWYER'S GUIDE TO ACCOUNTING* 269-73 (1955).

88. See 49 N.Y.U.L. REV. 957, 968 (1974). The Ninth Circuit may have also erred in its application of *Schwinn* by refusing to accept Sylvania's argument that its territorial restraints should be tested by the "rule of reason" because it was a "failing firm." The company argued that at the time its "elbow room policy" was instituted, termination of its television manufacturing division would have been unavoidable unless its market share were increased. While *Schwinn* recognized that the danger of market failure is a possible justification for invoking the "rule of reason," 388 U.S. at 374, the *Sylvania* majority rejected Sylvania's argument because the company's market share had increased substantially by the time Continental's franchise had been terminated, and Sylvania had made no claim that it was about to abandon the television market in 1965. 1974-1 Trade Cas. at 96,796.

In his dissent, Judge Ely argued that the majority's interpretation of the "failing firm" defense was unworkable in the context of an ongoing method of distribution because a company would need to remain in a failing market position as long as a vertical restraint was in effect in order to qualify for the defense. *Id.* at 96,802. He offered a different reading of the defense, suggesting that a company would need to establish initially that it was in danger of market failure, after which it could justify continuing a restraint by showing that market failure would still occur without it. *Id.* Such a test appears to be somewhat impractical in light of the need for continuing judicial supervision as long as a particular remedial measure is used. Nevertheless, Judge Ely's test appears preferable to that of the Sylvania majority since, under the majority's reading, companies desiring to strengthen their weak market position can implement only those ineffectual policies which keep their market position at the same level which originally signaled the need for a change.

For an excellent discussion of the judicial development of the "failing firm" defense, see Blum, *The Failing Company Doctrine*, 16 B.C. IND. & COM. L. REV. 75 (1974).

tion, *Sylvania* also demonstrates that applying an indiscriminate per se rule to vertical territorial restraints is improper because such a rule 1) does not recognize possible policy justifications for restraining intra-brand competition, 2) limits a manufacturer to unattractive marketing alternatives, and 3) unreasonably frustrates the adoption of valid franchising arrangements.

Sylvania's objective in adopting its "elbow room policy" was to enhance its market position<sup>89</sup> and, by making its product more competitive, to promote interbrand competition. By limiting franchise density, a procedure resulting in the reduction of intrabrand competition,<sup>90</sup> the company hoped to provide its retailers with the incentive to carry and to promote the Sylvania brand. However, intrabrand competition was reduced only to the extent that franchisees were restricted to selling at locations selected by Sylvania.<sup>91</sup> The propriety of these restrictions, when imposed as a means of promoting interbrand competition, has been the subject of spirited debate.<sup>92</sup> Those commentators advocating the use of vertical territorial restraints argue that any reduction of intrabrand competition is offset by the increased operational efficiency which each dealer achieves as a result of being forced to develop his territory fully.<sup>93</sup> Greater efficiency in turn assures higher profit margins, which arguably serve to create dealer goodwill.<sup>94</sup> Furthermore,

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89. See note 77 *supra*.

90. See generally 53 TEXAS L. REV. 127, 131-32 (1974).

91. 1974-1 Trade Cas. at 96,794. That this restriction was unimportant in light of Sylvania's ultimate purpose was stressed by Judge Ely in his dissent:

In ignoring Sylvania's ultimate purpose, to remain in the market as a competitor, and looking solely to its immediate purpose, to limit intrabrand competition, the majority misses the forest while viewing the trees. The free market policy of the antitrust laws is not served by fashioning rules which foster intrabrand competition to the point of extinguishing interbrand competition. In a market dominated by a single company, RCA, it is relevant that Sylvania possessed only a minor fraction of the market, that dealers possessed no veto power against additional dealers entry into the area, that dealers could and did carry competing brands, and that the limitation of location on Sylvania dealers had no effect on prices, volume of products available, quality, or consumer choice. *Id.* at 96,800 n.18.

92. Compare Bork 430-52, with Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath*, 81 HARV. L. REV. 1419, 1422-33 (1968). See Day, *Exclusive Territorial Arrangements Under the Antitrust Laws—A Reappraisal*, 40 N.C.L. REV. 223 (1962); Jones, *Control of Distributors' Activities*, 1964 A.B.A. ANTITRUST SECTION 68; Jordan, *Exclusive and Restricted Sales Areas Under the Antitrust Laws*, 9 U.C.L.A. L. REV. 111 (1962); Preston, *Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards*, 30 LAW & CONTEMP. PROB. 506 (1965); Stewart, *Antitrust Considerations Involved in Product Distribution*, 19 BUS. LAWYER 967 (1964); Note, *Restricted Channels of Distribution Under the Sherman Act*, 75 HARV. L. REV. 795 (1962).

93. See Bork 438-39. See also P. AREEDA, *supra* note 14, at 539-40.

94. See P. AREEDA, *supra* note 14, at 539.



the assurance of a specific market insulated from competition by other dealers selling the same brand may provide the necessary incentive for a potential dealer to carry an untried product, or to make initial capital expenditures which might otherwise be considered too speculative.<sup>95</sup> Commentators opposing vertical territorial restraints note that a per se rule has been applied to horizontal arrangements<sup>96</sup> providing similar efficiencies and risk reductions.<sup>97</sup> It has also been urged that vertical restrictions allow distributors to engage in unjustified product differentiation which, by reducing product interchangeability and interbrand price competition, allows a manufacturer to increase prices and restrict output, all at the consumer's expense.<sup>98</sup> Regardless of the relative merits of these arguments, the very existence of the debate suggests that vertical territorial restraints are too diverse and complex to be governed by a broad and indiscriminate per se rule.<sup>99</sup>

*Sandura Co. v. FTC*,<sup>100</sup> decided three years before *Schwinn*, provides a model for analyzing the effect of a vertical territorial restraint on intrabrand competition under the "rule of reason." In *Sandura*, a manufacturer of hard-floor covering granted closed territories to its distributors, who also handled much of Sandura's advertising program. The Sixth Circuit recognized that product differentiation,<sup>101</sup> a "hallmark" of the floor-covering industry, increases the importance of intrabrand competition and that consequently, where product differentiation is extensive, there must be strong reasons for restricting intrabrand competition.<sup>102</sup> The court then proceeded to assess the importance of successful advertising in an industry characterized by highly differentiated products. Finding that the advertising services provided by its distributors were essential to Sandura's ability to continue as a competitive force in an industry dominated by larger firms, the court upheld the closed territories.<sup>103</sup>

In addition to proscribing potentially effective methods of promoting interbrand competition, continued adherence to *Schwinn* may encourage some manufacturers to acquire outright ownership of distri-

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95. See generally 88 HARV. L. REV. 636, 640-41 (1975). This argument was advanced by Adolph Coors Company in the *Copper Liquor* case. See note 55 *supra*.

96. See, e.g., *United States v. Topco Associates, Inc.*, 405 U.S. 596 (1972).

97. See Comanor, *supra* note 92, at 1429.

98. *Id.* at 1422-27.

99. See Note, *supra* note 9, at 636-37.

100. 339 F.2d 847 (6th Cir. 1964). See notes 17-18 *supra* and accompanying text.

101. See text accompanying note 98 *supra*.

102. *Id.* at 857.

103. *Id.*

bution mechanisms by way of vertical integration.<sup>104</sup> The integration of manufacturing and distribution functions would obviate the enforcement problems which franchising agreements entail, but the cost of vertical integration is so high<sup>105</sup> that, as a practical matter, it is an alternative available only to larger companies with substantial available capital. Moreover, by enlarging their already extensive operations, companies which resort to vertical integration would arguably be acting in a manner inconsistent with the policies underlying the federal anti-trust statutes.<sup>106</sup>

Other marketing alternatives available to a franchising manufacturer include the utilization of a consignment plan,<sup>107</sup> and the complete severance of all controls over a product after it has been sold to a distributor. Exclusive reliance upon a consignment plan would be unattractive to most manufacturers due to the administrative burdens which it imposes and the added expense required in maintaining larger inventories.<sup>108</sup> Like vertical integration, consignment plans appear to represent a viable alternative only for companies with readily available capital.<sup>109</sup> Finally, completely severing all controls over a manufac-

104. See Pollack, *Alternative Distribution Methods After Schwinn*, 63 NW. U.L. REV. 595, 608-10 (1968); Comment, *Franchising*, *supra* note 23, at 281.

Schwinn itself developed and implemented a plan of vertical integration after losing the Continental lawsuit. See Keck, *Alternative Distribution Techniques—Franchising, Consignment, Agency, and Licensing*, 13 ANTITRUST BULL. 177, 188-90 (1968).

105. See Comment, *Franchising*, *supra* note 23, at 281.

106. See section 2 of the Sherman Act: "Every person who shall monopolize, or attempt to monopolize, . . . any part of the trade or commerce among the several States . . . shall be deemed guilty of a misdemeanor . . ." 15 U.S.C. § 2 (1970). See also section 7 of the Clayton Act: "No corporation engaged in commerce shall acquire . . . stock or other share capital . . . or assets of another corporation engaged also in commerce, where . . . the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18 (1970).

These antitrust statutes would apply only where vertical integration is achieved through merger, as opposed to internal growth where a company discontinues the use of independent middlemen and fills these positions with its own employees. But where merger is involved, *Schwinn's* tacit encouragement of vertical integration, coupled with its explicit rejection of vertical territorial restraints imposed after title has passed, conflicts directly with the Supreme Court's declaration in *United States v. Philadelphia Nat'l Bank* that "integration by merger is more suspect than integration by contract . . ." 374 U.S. 321, 366 (1963). See Pollack, *supra* note 104, at 608-09.

107. See text accompanying notes 25-28 *supra*.

108. See Comment, *Franchising*, *supra* note 23, at 282-83.

109. See notes 105-106 *supra* and accompanying text.

In addition to the obvious business disadvantages of a consignment plan, the possibility exists that the cooperation necessary between franchisor and franchisee when agency practices are employed may be held improper by a further narrowing of *Colgate*, *Beech-Nut*, and *Parke, Davis*. See Kittelle, *Territorial and Customer Restrictions Through Consignment or Agency—Schwinn or Sin?*, 12 ANTITRUST BULL. 1007, 1025-27 (1967). See note 23 *supra*.

tured product would seem antithetical to a franchise system, since manufacturers who choose such a system necessarily have a strong interest in how their products are distributed.<sup>110</sup>

Faced with an absolute proscription of all vertical territorial restraints, large and small manufacturers alike will continue to be frustrated in their attempts to establish a workable franchise system. While a financially healthy company may be able to avail itself of those marketing alternatives which require substantial expenditures,<sup>111</sup> the burden of *Schwinn* will fall heavily on the small manufacturer—a party whose continued competitive vitality the antitrust laws are designed to preserve.<sup>112</sup> The small manufacturer, unable to generate the capital necessary to vertically integrate the distribution process into his operation, must either abandon all post-sale controls over his product or risk a lawsuit by adopting some form of vertical restraint. The *Sylvania* case graphically illustrates the dangers of unrestricted distribution. By applying a “passage of title” test to exclusive location clauses, the Ninth Circuit may have curtailed *Sylvania*’s ability to attract potential franchisees with promises of limited intrabrand competition,<sup>113</sup> and may have opened the door to product sales by retailers who are deficient in service expertise<sup>114</sup> and promotional acumen.<sup>115</sup>

#### CONCLUSION

*Schwinn*’s indiscriminate per se rule is inadequate and unjust in light of this country’s ever-changing patterns of production, distribution, and consumption. By miscalculating “the economic and business stuff out of which [vertical territorial restrictions] emerge,”<sup>116</sup> the *Schwinn* Court inhibited the implementation of distribution schemes which promote competition, and encouraged forms of vertical integration which seem inconsistent with federal antitrust policy.<sup>117</sup>

The *Coors* courts recognized the need to modify *Schwinn*’s inflex-

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110. See notes 113-115 *infra* and accompanying text.

111. See notes 105 & 109 *supra* and accompanying text.

112. See *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 386-87 (1967) (Stewart, J., concurring in part and dissenting in part).

113. See note 95 *supra* and accompanying text.

114. The need for adequate post-sale service is increased in proportion to product complexity, and the intricate transistors and circuits of a television set place it high on the complexity scale. See Bork 446-49.

115. The importance of promotional abilities at the dealer/distributor level was demonstrated in *Sandura Co. v. FTC*, 339 F.2d 847 (1964). See notes 100-103 *supra* and accompanying text.

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

117. See note 106 *supra* and accompanying text.

ible per se rule, and *Sylvania*, in addition to demonstrating how easily the "passage of title" test can be misapplied, illustrated how strict adherence to *Schwinn* can unfairly confine a manufacturer to unattractive distribution methods. Antitrust policy and the exigencies of today's complex marketplace would be better served by evaluating vertical territorial restraints under the "rule of reason" standard.