

NEW CONCEPTS IN CUSTOMER AND TERRITORIAL RESTRICTIONS—THE SCHWINN AND SEALY DOCTRINES

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Recent Supreme Court decisions in United States v. Arnold, Schwinn & Company and United States v. Sealy, Incorporated have raised new questions concerning the legality of customer and territorial restrictions imposed on dealers, distributors, franchisees, and licensees by manufacturers. In this article the author analyzes these cases and concludes that attacks on customer and territorial restrictions will be more effective in the future and, to avoid government prosecution and treble damage actions by private litigants, businessmen and lawyers should be cautious in the use of such restraints.

WHEN lawyers or businessmen refer to "exclusive contracts," "exclusive territories," or "exclusive dealerships," what precisely is meant? The terms can mean either an agreement by a manufacturer with its distributor prohibiting the manufacturer from selling to any others within the distributor's "exclusive" territory, or an agreement by a manufacturer with its distributor that the distributor will not sell to purchasers located outside an "exclusive" territory. Agreements of the first type, if ancillary to the sale of goods for resale, have consistently been upheld as reasonable protection for the distributor's property rights in his resale business, since the manufacturer can neither undersell the distributor nor establish a competitor of the distributor.¹ Emphasized in this article are agreements in the second category, which allocate markets among competitors and which have sometimes been held to violate the Sherman Act. Some agreements refer to "closed territories," "areas of primary responsibility," or "zones of influence;" and de-

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¹ Such agreements reflect reasonable refusals to sell which are legal under the Sherman Act. See *Packard Motor Car Co. v. Webster Motor Car Co.*, 243 F.2d 418 (D.C. Cir. 1957); *Schwinn Motor Co. v. Hudson Sales Corp.*, 239 F.2d 176 (4th Cir. 1956); *United States v. White Motor Co.*, 194 F. Supp. 562 (N.D. Ohio 1961), *rev'd on other grounds*, 372 U.S. 253 (1963).

pending on the intent of the parties, they may also denote "exclusive territories."² The balance of the article considers both "horizontal" and "vertical,"³ foreign and domestic, "exclusive" territorial and customer restrictions, regardless of the designation given them, with particular emphasis on the recent United States Supreme Court decision in *United States v. Arnold, Schwinn & Company*,⁴ which delineated new guideposts in this area of the law. Some practical rules, based on *Arnold, Schwinn & Company* and other recent cases, appear at the conclusion.

THE SCHWINN CASE

In 1952, Schwinn, a family-owned business engaged in the manufacture and sale of bicycles, parts, and accessories, began a franchise marketing plan to increase retailers' promotion of Schwinn bicycles and insure quality service and sales. Under the "Schwinn Plan," Schwinn shipped directly to retail dealers who were invoiced and extended credit by Schwinn, and Schwinn then paid a commission to the distributor taking the orders. These dealers were franchised for designated locations; they could sell only to consumers and were not permitted to act as agents for unfranchised dealers or discount houses; their number in any area was limited; and they could purchase only through a Schwinn distributor. Sales were also made to dealers by means of agency or consignment arrangements with distributors. Finally, sales were made to distributors who could sell only in specific territories and to franchised Schwinn dealers. Distributors and dealers were never restricted from selling other brands of bicycles; and, except in so-called "fair trade" states, dealers were not restricted as to price. Schwinn was "firm and resolute," but it had not cancelled the franchises of retailers for sales

² In *United States v. Philco Corp.*, 1956 Trade Cas. 71,751 (E.D. Pa.), a consent decree permitted the use of "area of primary responsibility" to protect Philco's right to select its customers, but the decree did not allow Philco to interfere with the distributors' right to sell where and to whomever they chose. In *Boro Hall Corp. v. General Motors Corp.*, 124 F.2d 822 (2d Cir. 1942), cert. denied, 317 U.S. 695 (1943), General Motors was allowed to prohibit Chevrolet dealers from establishing sales outlets outside their "zones of influence."

³ "Horizontal" agreements among competing manufacturers, distributors, or dealers, see, e.g., *Seagram-Distillers Corp. v. Old Dearborn Distrib. Co.*, 363 Ill. 610, 2 N.E.2d 940 (1936) (price-fixing), should be distinguished from "vertical" agreements affecting only a manufacturer and its distributors or dealers, e.g., *Liquor Store, Inc. v. Continental Distilling Corp.*, 40 So. 2d 371 (Fla. 1949) (resale price maintenance).

⁴ 388 U.S. 365 (1967).

through discount houses or unfranchised retailers. Similarly, no distributors had been cut off for sales outside the restricted territory.

In 1966 about 75% of Schwinn's bicycle sales were made under the "Schwinn Plan" through its twenty-two distributors and 5,000 to 6,000 franchised retail dealers. When the "Schwinn Plan" was first instituted, Schwinn had 22.5% of the retail bicycle market in the United States. Ten years later its gross sales had increased but its percentage of the market decreased to 12.8%. Other competitors, such as Sears Roebuck & Co. and Montgomery Ward & Co., substantially increased their share of the market during this period.

The Government charged that Schwinn had entered a price-fixing conspiracy, allocated exclusive territories to distributors, and restricted sales to franchised dealers only.⁵ The district court, while rejecting the price-fixing charge, held the territorial limitation to be unlawful per se with respect to products sold by Schwinn to distributors, but upheld the customer limitation on distributors and the limitations on sales by Schwinn to franchised dealers under the "Schwinn Plan" where distributors functioned as agents or consignees.⁶ Only the latter holding was appealed to the Supreme Court.⁷

In its 5-to-2 majority opinion, the Court labelled this a "vertical," not a "horizontal" restriction,⁸ and found that Schwinn had unilaterally imposed restrictions which affected only intra-brand competition.⁹ The Court refused to allow the legality of the arrangement to turn on whether Schwinn's motives were for "nonpredatory, business profit" purposes.¹⁰ The "rule of reason" rationale enunciated in *White Motor Company v. United States*¹¹ was not applied since Schwinn "was not a newcomer, seeking to break into or stay in the bicycle business," nor was it "a 'failing company.'"¹² The Court stated that such restrictions "may be permissible in an

⁵ *Id.* at 367.

⁶ *United States v. Arnold, Schwinn & Co.*, 237 F. Supp. 323 (N.D. Ill. 1965).

⁷ 388 U.S. at 368.

⁸ *Id.* at 372.

⁹ *Id.* at 378. "Intra-brand" competition, involving similar items with the same brand name, should be distinguished from "inter-brand" competition, involving similar items of different manufacturers and with different brand names. See generally Preston, *Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards*, 30 LAW & CONTEMP. PROB. 506, 508 (1965).

¹⁰ 388 U.S. at 375.

¹¹ 372 U.S. 253 (1963).

¹² 388 U.S. at 374.

appropriate and impelling competitive setting" in the "unusual" as opposed to the "ordinary" sale and distribution of products.¹³

Relying on *White Motor Company*¹⁴ and *Dr. Miles Medical Company v. John D. Park & Sons*,¹⁵ the Court distinguished Schwinn's "vertical" restraints from "horizontal" restraints, such as those in *Klor's, Incorporated v. Broadway-Hale Stores, Incorporated*¹⁶ (combination of manufacturers) and *United States v. General Motors Corporation*¹⁷ (combination of distributors),¹⁸ and held that the district court decree should be revised on remand to enjoin not only territorial limitations on sales to distributors, but also sales to both distributors and dealers upon "any condition, agreement or understanding limiting [their] freedom as to where and to whom [they] will resell the products."¹⁹ The Court stated:

Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with which an article may be traded after the manufacturer has parted with dominion over it.²⁰

Once the manufacturer has parted with title and risk, he has parted with dominion over the product, and his effort thereafter to restrict territory or persons to whom the product may be transferred—whether by explicit agreement or by silent combination or understanding with his vendee—is a "per se" violation of § I of the Sherman Act.²¹

¹³ *Id.* at 379.

¹⁴ *White Motor Company* attempted to justify its restrictions on dealers' and distributors' territories and customers by the need to encourage "inter-brand," rather than "intra-brand," competition and the need to resist fierce competition from larger competitors. The Supreme Court agreed with the Government's position that such "vertical" restrictions could be per se violations of the Sherman Act, but the case was remanded for further study of the industry and competition therein to determine if these circumstances justified use of the "rule of reason." 372 U.S. at 263-64.

¹⁵ 220 U.S. 373 (1911). In this case *Dr. Miles Company* consigned unpatented proprietary drug products to 400 jobbers, who could sell only to designated retailers at certain prices. The retailers also were restricted by contract with *Dr. Miles Company* to sell only at "full retail" prices and not to sell to jobbers or wholesalers not approved by the company. The Supreme Court found these restrictions on retailers, after title had passed, to be unreasonable restraints of trade aimed at maintaining prices and preventing competition, but upheld the restrictions on jobber-consignees.

¹⁶ 359 U.S. 207 (1959).

¹⁷ 384 U.S. 127 (1966).

¹⁸ 388 U.S. at 373-78.

¹⁹ *Id.* at 378.

²⁰ *Id.* at 379.

²¹ *Id.* at 382.

As to Schwinn's sales to retailers by consignment or agency arrangements through distributors under the "Schwinn Plan," the Court, relying on *Simpson v. Union Oil Company*,²² held that the "rule of reason,"²³ not a "per se" rule, should be applied.²⁴ Similarly, the Court found that Schwinn's restrictions under the "Schwinn Plan," agency, or consignment were reasonable since:

1. Other bicycles, reasonably interchangeable as articles of competitive commerce, were available to distributors and dealers.
2. Schwinn's distributors and dealers actually handled other brands of bicycles.
3. There was no price-fixing involved.
4. The trial court found that competition had made necessary the challenged program, and the net effect of the program was to preserve rather than harm competition.²⁵

The dissent emphasized the district court's finding as to the ultimate effect of Schwinn's policies,²⁶ and preferred to apply the "rule of reason" to the customer and territorial restrictions in Schwinn's sales, consignment, agency, and "Schwinn Plan" distribution.²⁷

FOREIGN TERRITORIAL RESTRICTIONS

To understand the application of the *Schwinn* "per se" rule to foreign transactions,²⁸ one should know that both foreign and domestic commerce are included in the Sherman Act definition of "commerce,"²⁹ and that the courts of the United States have juris-

²² 377 U.S. 13 (1964). Union Oil used consignments of gasoline and leases for service stations throughout eight western states to control Simpson's and its other gasoline dealers' retail prices. The Supreme Court held that the consignment selling arrangement did not justify Union Oil's "coercive" practices to maintain retail prices in "a vast gasoline distribution system," and found these restraints unreasonable in violation of the Sherman Act. *Id.* at 21-22.

²³ This rule, which weighs the "equities" after the motives of the parties and the effect on the market have been determined, was read into the Sherman Act by the Supreme Court in *United States v. American Tobacco Co.*, 221 U.S. 106 (1911), and *Standard Oil Co. v. United States*, 221 U.S. 1 (1911).

²⁴ 388 U.S. at 380-81.

²⁵ *Id.* at 381-82.

²⁶ *See id.* at 384 (dissenting opinion).

²⁷ *See id.* at 385-86.

²⁸ In *United States v. National Lead Co.*, 332 U.S. 319 (1947), the Court firmly asserted that the "per se" doctrine would be applied equally to foreign and domestic "commerce."

²⁹ Section 1 of the Sherman Antitrust Act states: "Every contract, combination in

diction over all United States corporations, regardless of where their business is done, and over all foreign corporations located or owning property within the United States.³⁰

American businessmen have for years been apprehensive when territorial restrictions are used in foreign distributorship agreements, but there have been no United States cases in which such restrictions have been held illegal. One reason for this lack of judicial attention is that most foreign dealers or distributors are local in their selling area. However, with world trade increasing, foreign distributors frequently purchase products from United States manufacturers and resell these in competition with the manufacturer's domestic distributors. Similarly, many distributors in the United States are expanding sales to foreign countries. Territorial restrictions on such distributors would have a definite effect on the foreign "commerce" of the United States. Further, many foreign distributors have offices in the United States, thus subjecting them, as well as their United States supplier, to the terms of the Sherman Act and jurisdiction of the local courts. Unless there is present some "appropriate and impelling competitive setting,"³¹ the *Arnold, Schwinn & Company* case now makes restrictions on the territory or customers of foreign distributor-purchasers "per se" violations of the Sherman Act. The "rule of reason" is no longer applicable to such restrictions.

When licensing is involved and the litigants are not competitors, the courts have looked favorably on reasonable territorial restrictions. In *Foundry Services, Incorporated v. Beneflux Corporation*,³² a New York corporation obtained certain trade secrets pertaining to fluxes used in casting molten metal from an English corporation. Under the agreement the New York corporation was given an exclusive license to manufacture and sell these fluxes in the United States and Canada. The New York corporation sought to enjoin the English

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 (1964).

³⁰ United States courts have jurisdiction over foreign corporations with property or subsidiaries in the United States. For example, in *United States v. Swiss Bank Corp.*, 1940-43 Trade Cas. 683 (D.N.J. 1941), Chemical and Pharmaceutical Enterprises, Ltd., through its controlled Swiss subsidiary, was required to divest itself of stock in Schering Corporation of New Jersey.

³¹ 388 U.S. at 379.

³² 110 F. Supp. 857 (S.D.N.Y.), *rev'd on other grounds*, 206 F.2d 214 (2d Cir. 1953).

corporation from competing with it in the United States. The court found this restrictive territorial conduct ancillary to a valid primary purpose—to prohibit the licensor of a secret process from competing with its single licensee in the assigned area and to be free from the latter's interference elsewhere. The court distinguished the case at bar from *Timken Roller Bearing Company v. United States*³³ and other "horizontal" conspiracies among competitors to allocate world markets, which have consistently been held "per se" illegal.³⁴

It should be noted, however, that the *Arnold, Schwinn & Company* Court did not extend the "per se" rule to patent licensing.³⁵ The rights of patentees were established in several cases allowing patent owners to control the sales territory, price, and quality of manufacture of patented products.³⁶ The licensing of a trademark does not justify territorial restrictions on the licensees when price-fixing, allocation of world markets, or monopolization are also present; but the use of trademarks can be reasonably controlled to protect the licensor's trademark rights.³⁷

DOMESTIC TERRITORIAL RESTRICTIONS

Until about 1950 the Justice Department had not challenged a "vertical" restriction on customers or territories standing alone. However, during the late 1940's and following, several consent decrees were obtained in which the defendants agreed to cease "vertical" territorial restrictions.³⁸ Except for the more serious customer

³³ 341 U.S. 593 (1951). This case represents a classic "horizontal" conspiracy to allocate markets through exclusive territories. Timken, producer of 75% of the roller bearings sold in the United States, and its French and English subsidiaries, allocated territories among themselves, fixed prices, and cooperated to protect their markets from outside competition. The Court, rejecting Timken's claim that they were merely exercising their right to license the "Timken" trademark, found allocation of territories the central purpose of the agreements and held that the agreements were so prejudicial to the public interest that they were unreasonable and illegal "per se." *Id.* at 598-99.

³⁴ See, e.g., *United States v. E.I. duPont de Nemours & Co.*, 351 U.S. 377 (1956); *United States v. General Elec. Co.*, 80 F. Supp. 989 (S.D.N.Y. 1948); *United States v. General Dyestuff Corp.*, 57 F. Supp. 642 (S.D.N.Y. 1944).

³⁵ 388 U.S. at 379 n.6.

³⁶ See *United States v. New Wrinkle, Inc.*, 342 U.S. 371 (1952); *United States v. National Lead Co.*, 332 U.S. 319 (1947); *United States v. General Elec. Co.*, 272 U.S. 476 (1926).

³⁷ See cases cited note 34 *supra*.

³⁸ E.g., *United States v. J.P. Seeburg Corp.*, 1957 Trade Cas. 72,476 (N.D. Ill.); *United States v. Philco Corp.*, 1956 Trade Cas. 71,751 (E.D. Pa.); *United States v.*

or territorial restriction cases, which also involved group boycotts, price-fixing, or monopolization of other types as an integral part of the restrictions,³⁹ the courts and the Federal Trade Commission, until the *Arnold, Schwinn & Company* case, had found "vertical" customer or territorial restrictions to be legal.⁴⁰

After the Justice Department's insistence during the 1950's that "vertical" customer or territorial restrictions were per se illegal, lawyers and businessmen in 1961 welcomed the first test case, *United States v. White Motor Company*,⁴¹ in which the Government charged that the defendant, a manufacturer of trucks and parts, had acted unlawfully by entering into identical contracts with about 300 dealers and distributors. The arrangements provided for restrictions on customers and territories and allowed fixing of prices on sales to the Government, certain national accounts, and about 5% of distributor sales to dealers. The district court entered summary judgment, holding that the price-fixing and territorial and customer restrictions were all illegal "per se."⁴² On appeal of the customer and territorial restriction issues only, the Supreme Court held that

Austenal Laboratories, Inc., 1950-51 Trade Cas. 64,612 (S.D.N.Y. 1951); *United States v. Bendix Aviation Corp.*, 1948-49 Trade Cas. 62,903 (S.D.N.Y. 1948); *United States v. Libbey-Owens-Ford Glass Co.*, 1948-49 Trade Cas. 62,802 (N.D. Ohio 1948).

³⁹ In a landmark case, *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211 (1899), an agreement among competing corporations in the iron pipe industry to eliminate all competition among themselves when bidding for contracts in certain territories was found to be an unreasonable restraint of trade in violation of the Sherman Act. Similar restrictions involving group boycotts have been held illegal, e.g., *United States v. General Motors Corp.*, 384 U.S. 127 (1966); *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959); *Fashion Originators' Guild of America, Inc. v. FTC*, 312 U.S. 457 (1941), as well as horizontal price-fixing, *United States v. Sealy, Inc.*, 388 U.S. 350 (1967); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951); *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons*, 340 U.S. 211 (1951); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940), and vertical price-fixing, *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707 (1944); *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911).

⁴⁰ E.g., *Chicago Sugar Co. v. American Sugar Ref. Co.*, 176 F.2d 1 (7th Cir. 1949), cert. denied, 338 U.S. 948 (1950); *Fosburgh v. California & Hawaiian Sugar Ref. Co.*, 291 F. 29 (9th Cir. 1923); *Cole Motor Car Co. v. Hurst*, 228 F. 280 (5th Cir. 1915), cert. denied, 247 U.S. 511 (1918); *Phillips v. Iola Portland Cement Co.*, 125 F. 593 (8th Cir. 1903), cert. denied, 192 U.S. 606 (1904); *Reliable Volkswagen Sales & Serv. Co. v. World-Wide Auto. Corp.*, 182 F. Supp. 412 (D.N.J. 1960); *United States v. Newbury Mfg. Co.*, 36 F. Supp. 602 (D. Mass. 1941); *General Cigar Co.*, 16 F.T.C. 537 (1932); *Revlon Prods. Corp. v. Bernstein*, 204 Misc. 80, 119 N.Y.S.2d 60 (Sup. Ct. 1953), aff'd, 285 App. Div. 1139, 142 N.Y.S.2d 364 (1955); *Hickock Mfg. Co. v. Fairley Trading Corp.*, 117 N.Y.S.2d 874 (Sup. Ct. 1952).

⁴¹ 194 F. Supp. 562 (N.D. Ohio 1961).

⁴² *Id.* at 585-87.

summary judgment was improperly granted and that the legality of these arrangements should be determined at trial.⁴³

The Court distinguished *White Motor Company* from *United States v. Bausch & Lomb Optical Company*,⁴⁴ on the ground that the restrictions in the latter case were ancillary to price-fixing which was "an integral part of the whole distribution system,"⁴⁵ and from *Timken Roller Bearing Company v. United States*⁴⁶ since the arrangement there was "horizontal" among competitors rather than "vertical."⁴⁷ Holding that these "vertical" restrictions must be analyzed on a case-by-case basis to determine if the "rule of reason" applies, the Court remanded to the lower court.⁴⁸ Before the case was reheard, however, White Motor Company changed its distribution process to comply with the Government's position, and a consent decree was entered.⁴⁹ The three dissenting Justices, consistent with the *Arnold, Schwinn & Company* decision, found that the customer and territorial restrictions were illegal "per se."⁵⁰

After *White Motor Company*, customer and territorial restrictions were again considered in *United States v. Penn-Olin Chemical Company*,⁵¹ in which the district court found that an agreement between Pennsalt and Olin limiting Olin's sodium sales to certain pulp and paper mills in the Southeast was not an unreasonable restriction. The Justice Department did not appeal this holding.

In *Snap-On Tools Corporation v. FTC*,⁵² the Federal Trade Commission had held that Snap-On Tools had unlawfully allocated exclusive sales territories to dealers and had prevented them from selling to certain accounts. On appeal these restrictions were found to be reasonable on the grounds that they were necessary to maintain adequate sales representation and service. Further, no monopoly was present and the suppression of competition was not

⁴³ 372 U.S. 253 (1963).

⁴⁴ 321 U.S. 707 (1944).

⁴⁵ 372 U.S. at 260.

⁴⁶ 341 U.S. 593 (1951).

⁴⁷ 372 U.S. at 261.

⁴⁸ *Id.* at 261-63. The Court stated: "[W]e know too little of the actual impact of both that [territorial] restriction and the one respecting customers to reach a conclusion on the bare bones of the documentary evidence before us." *Id.* at 261.

⁴⁹ *United States v. White Motor Co.*, 1964 Trade Cas. 79,762 (N.D. Ohio).

⁵⁰ 372 U.S. at 275 (dissenting opinion).

⁵¹ 217 F. Supp. 110 (D. Del. 1963), *vacated on other grounds*, 378 U.S. 158 (1964).

⁵² 321 F.2d 825 (7th Cir. 1963).

significant.⁵³ The Sixth Circuit followed *Snap-On Tools* in finding under similar circumstances that restricted distributors' territories were reasonable in *Sandura Company v. FTC*.⁵⁴

In *General Motors Corporation*,⁵⁵ General Motors conspired with three trade associations, composed of all eighty-five Chevrolet dealers in the Los Angeles area, to force twelve of the dealers to discontinue Chevrolet sales through discount houses. After receiving complaints from its dealers facing increased sales and price competition, General Motors personnel talked with the twelve dealers and obtained promises that they would comply with the "location clauses" in their distributor contracts prohibiting dealers from establishing new "sales" locations without the automaker's approval. After these promises were obtained, the trade associations, in cooperation with General Motors, policed dealer sales to insure discontinuance of sales through discount houses. No conspiracy was found by the lower court since the parties had acted independently in "parallel" activity.⁵⁶ The Supreme Court, relying on *Klor's, Incorporated* and *United States v. Parke, Davis & Company*,⁵⁷ held that this was a classic "boycott" conspiracy to eliminate one class of competition, with price restraint inherent therein⁵⁸—a "per se" restraint of trade in violation of the Sherman Act. Distinguishing unilateral "vertical" restrictions cases, the Court relied on conspiracy, and found it unnecessary to determine either the validity of the "location clause" in the dealer contracts or whether General Motors could have unilaterally enforced this clause to prohibit sales through discount houses in the Los Angeles area.⁵⁹

In a recent case, *United States v. Sealy, Incorporated*,⁶⁰ Sealy, which was owned and controlled by thirty licensees of the "Sealy" trademark, agreed with these licensee-manufacturers not to license other manufacturers in each licensee's territory. The licensees in return agreed not to manufacture or sell Sealy products outside their designated areas. Products made under other trade names,

⁵³ *Id.* at 830-37.

⁵⁴ 339 F.2d 847 (6th Cir. 1964).

⁵⁵ 384 U.S. 127 (1966).

⁵⁶ *United States v. General Motors Corp.*, 234 F. Supp. 85, 87-89 (S.D. Cal. 1964).

⁵⁷ 362 U.S. 29 (1960).

⁵⁸ 384 U.S. at 140.

⁵⁹ *Id.* at 142-48.

⁶⁰ 388 U.S. 350 (1967).

however, could be sold anywhere. In addition, Sealy and its licensee-stockholders fixed and policed prices at which retailers sold Sealy products. The Government charged Sealy with violation of section 1 of the Sherman Act by conspiring with its licensees to fix prices at which retail dealers could sell bedding products bearing the "Sealy" trademark, and to allocate mutually exclusive territories among such licensees.⁶¹ Although the district court held that the conspiracy to fix minimum retail prices violated the Sherman Act,⁶² Sealy did not appeal this determination. However, it was also held that the Government failed to prove an unreasonable restraint of trade with respect to the conspiracy to allocate mutually exclusive territories among licensees.⁶³ This latter holding was appealed by the Government.

Finding that the territorial restrictions emanated from a "horizontal" conspiracy among Sealy and its licensees,⁶⁴ the Supreme Court refused to apply the "rule of reason" on the basis that the combination of price-fixing and territorial exclusiveness brought this case within the "per se" rationale of *Timken Roller Bearing Company*.⁶⁵ The dissent argued that the Sealy arrangement represented a "vertical" rather than "horizontal" restriction,⁶⁶ and that since "intra-brand" competition might be harmful to "inter-brand" competition, the restriction was within the "rule of reason."⁶⁷

CONCLUSIONS

The recent *Arnold, Schwinn & Company* decision presents a sharp turn in the law as applied to "vertical" customer or territorial restrictions, since it holds that under ordinary circumstances customer or territorial restrictions on a dealer or distributor are "per se" violations of the Sherman Act when the manufacturer sells to the dealer or distributor and does not retain title to the product and assumes no risk of loss. After this decision and *Sealy, Incorporated*, government attacks on customer and territorial restrictions imposed on dealers, distributors, franchisees, and licensees will be more effec-

⁶¹ *Id.* at 351.

⁶² *United States v. Sealy, Inc.*, 1964 Trade Cas. 80,070, at 80,107 (N.D. Ill.).

⁶³ *Id.* at 80,106-07.

⁶⁴ 388 U.S. at 354-56.

⁶⁵ *Id.* at 357-58.

⁶⁶ *Id.* at 358 (dissenting opinion).

⁶⁷ *Id.* at 359-60.

tive and extensive. The increased potentiality of government prosecution and treble damages from private litigation should lead to cautious use of such restrictions. Under *Arnold, Schwinn & Company*, manufacturers should consider using customer or territorial restrictions in selling through dealers or distributors in a truly "vertical" arrangement only if one of the following conditions exists: (1) the manufacturer owns the dealers or distributors; (2) the restrictions do not, and will not, affect the foreign or domestic "commerce" of the United States; (3) the manufacturer consigns products to dealers or distributors with title retained and risks assumed by the manufacturer; (4) the manufacturer retains title and assumes risks in an agency relationship with dealers or distributors; or (5) some unusual "competitive setting" exists, such as a "newcomer manufacturer seeking to break into or stay in business" or a "failing company" attempting to survive. If either the first or second condition exists, customer or territorial restrictions can undoubtedly be used; if the third or fourth condition is present, the "rule of reason" makes such restrictions legal when the manufacturer and its distribution system are not dominant, price-fixing or similar antitrust restraints are not also present, the restrictions are justified and made necessary by competition, and the net effect of the restrictions is to preserve and not to damage competition. Of course, if the fifth condition clearly exists, the "rule of reason" makes the restrictions legal. However, if none of these five conditions are present, restrictions on foreign or domestic dealers or distributors that control them as to customers, or that assign "exclusive territories," "areas of primary responsibility," or "zones of influence," if in fact restrictions on the purchaser's resale of the product, are "per se" illegal, and should be amended or avoided in the future.

The decision in *Sealy, Incorporated* confirms past Supreme Court decisions making "horizontal" agreements or conspiracies illegal "per se" if they involve price-fixing and restrictions on customers or territories. Although price-fixing and customer and territorial restrictions were present in *Sealy, Incorporated*, the Court's holding would undoubtedly have been the same if price-fixing had not been present, since all competition, price and otherwise, is eliminated by customer or territorial restrictions, and the precedent for "per se"

illegality for "horizontal" conspiracy among competitors is even stronger than for the "vertical" customer or territorial restrictions found to be illegal "per se" in *Arnold, Schwinn & Company*. Thus, excluding restrictions involving the reasonable exploitation of patents or trademarks, limitations involving unusual circumstances, such as the establishment of a joint venture by non-dominant or non-competitive companies, or restrictions that do not and will not affect the foreign or domestic "commerce" of the United States, all customer or territorial restrictions among competitors should be avoided.

Manufacturers can sometimes accomplish "exclusive territory" objectives by refusing to sell to more than one distributor or dealer in a geographical "trading area." Although the selected distributor or dealer cannot be restricted to a specific "trading area," frequently the product itself, after-sale service requirements, financial condition of the dealer or distributor, or other factors standing alone restrict the dealer's or distributor's selling territory. Under these circumstances manufacturers may be able to legally select their customers to take advantage of restrictions inherent in the customer's business.