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EXCLUSIVE TERRITORIAL ARRANGEMENTS UNDER THE ANTITRUST LAWS—A REAPPRAISAL

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The federal antitrust laws, their application and interpretation by the courts and the Federal Trade Commission, often present to the uninitiated an abstruse image of utter confusion. The fault for this happenstance all too often lies not with the unsophisticated observer, but with the courts, the Commission and the lawyers who advise them by their legal writings, arguments and briefs. An example of the confusion which can be created by unclear and imprecise thinking is found under the heading of "exclusive territorial arrangements." In reviewing the decisions in this area it indeed appears that, as in the related problem of exclusive dealing under the Clayton Act, the courts and the Commission are too often "using prior cases as a drunkard uses a lamppost, for support rather than illumination."[1] While a thorough reappraisal is long overdue, space here permits only a broad-brush sketch of the law relating to exclusive territorial arrangements as it now stands, with the writer's own suggestions for guideposts to harmonize the interests of business and the public within the framework of our national antitrust policies.[2]

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[1] Bok, *The Tampa Electric Case and the Problem of Exclusive Arrangements Under the Clayton Act*, 1961 SUPREME COURT REVIEW 267, 290. Exclusive dealing arrangements having the effect of restricting the buyer to dealing in the seller's goods to the exclusion of competitor's goods are beyond the scope of this article. Such practices are specifically governed by the Clayton Act, § 3, 38 Stat. 731 (1914), 15 U.S.C. § 14 (1958), which provides: "It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for the sale of goods, wares, merchandise, machinery, supplies or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, tend to create a monopoly in any line of commerce." This section does not apply to territorial restrictions.

[2] A review of prior writings discloses that virtually every writer on the

Initially, some fundamental marketing concepts should be kept in mind for an appreciation of the law as applied to differing factual situations. In our complex economy the distribution functions are traditionally performed by independent wholesalers or retailers, or both. By thus leaving the distribution of his product to independent specialists the manufacturer is free to concentrate his capital and energies on the manufacturing processes. His sales activities are normally limited to promoting his initial sale to the first link in his chosen chain of distribution, with perhaps some national advertising and local co-operative and missionary work. One of the main disadvantages of this method of distribution is that the manufacturer loses control of the distribution of his product once he has sold it;

subject of exclusive territorial arrangements believes that such distribution arrangements are valid if they do not constitute an attempt to monopolize or do not unreasonably lessen competition. See, *e.g.*, HALE & HALE, MARKET POWER: SIZE AND SHAPE UNDER THE SHERMAN ACT 39-41 (1958); HANDLER, ANTITRUST IN PERSPECTIVE (1957); REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 27 (1955); Breckenridge, *Some Phases of the Texas Antitrust Law*, 4 TEXAS L. REV. 129, 140-42 (1926); Chafee, *Equitable Servitudes on Chattels*, 41 HARV. L. REV. 945, 995-96 (1928); Hale, *Control Over Distribution: Monopoly Aspects of Restraints Upon Distributors and Producers*, 14 MISS. L.J. 170, 181-84 (1942); Handler, *Recent Developments in Antitrust Law*, 59 COLUM. L. REV. 843, 866-70 (1959); Handler, *Annual Review of Antitrust Developments*, 10 RECORD OF N.Y.C.B.A. 378-79 (1956); Kramer, *How to Comply with the Clayton Act: The Problems of Small Business*, in NEW YORK STATE BAR ASS'N, 1959 ANTITRUST LAW SYMPOSIUM 125, 132-34 (1959); Lewis, *Orderly Marketing and the Small Businessman*, 16 A.B.A. ANTITRUST SECTION 73, 77-80 (1960); Robinson, *Restraints on Trade and the Orderly Marketing of Goods*, 45 CORNELL L.Q. 254, 268 (1960); Seymour, *Some Aspects of Express Contracts and the Sherman Act*, in NEW YORK STATE BAR ASS'N, 1958 ANTITRUST LAW SYMPOSIUM 11-16; Thompson, *A Policy Against Undue Limitations on Competitive Conditions*, 1955 A.B.A. ANTITRUST SECTION 34, 39-40; Note, *The Exclusive Agency System: A Problem in Illegality*, 27 COLUM. L. REV. 838, 845 (1927); Note, *Restricted Channels of Distributions Under the Sherman Act*, 75 HARV. L. REV. 795 (1962); Comment, *The Anti-Trust Laws and the Automobile Industry*, 34 ILL. L. REV. 956, 959-60 (1940); Comment, *Government Regulation of Automobile Dealer Franchises*, 3 WAYNE L. REV. 206, 215-16 (1957). *Cf.* Baker, *Exclusive Territorial Dealerships, Resale Price Control and Related Problems*, 39 CHICAGO BAR RECORD 343, 346-53 (1958); Rifkind, *Division of Territories*, in HOW TO COMPLY WITH THE ANTITRUST LAWS 127 (Van Cise & Dunn 1954); Note, *The Resurgence of the Exclusive Territorial Distributorship as an Antitrust Problem*, 40 MINN. L. REV. 853 (1956); Address by Rufus E. Wilson, The Federal Bar Association and The Foundation of the Federal Bar Associaiton Briefing Conference on Antitrust Laws and Trade Regulations, January 5, 1962. See also *Hearings on H.R. 528, H.R. 2688, and H.R. 6544 Before the Subcommittee on Automobile Marketing Legislation of the House Committee on Interstate and Foreign Commerce*, 84th Cong., 1st Sess. 95-105 (1955).

his only guarantee of effective distribution of his product being his initial choice of distributors.

Assuming a manufacturer has sufficient resources, he may choose to sell his product to the ultimate consumer without any help from others than his own employees or agents. In such case, he would have to assume all risks and costs of performing the functions of distribution, including shipment to and interim storage at various points of sale throughout his marketing area. He would have to provide for all necessary retail outlets with adequate facilities and personnel for promotion, display and, perhaps, servicing and repairing products sold. In addition to any national advertising he might undertake he would have to bear the burden of promoting the product locally.

This expansion by a manufacturer forward toward the ultimate consumer is commonly referred to as "vertical integration," or more precisely, "forward integration." In addition to internal expansion forward, the manufacturer might expand by the merger route, through the acquisition of the stock or assets of one or more distributors or retailers.[3] Whatever manner of forward integration or combination thereof is employed, this method has the advantage for the manufacturer of retaining control of the distribution of his product, thereby insuring that it receives adequate promotion and market coverage.

It may be that the manufacturer does not have sufficient financial or technical resources to integrate forward by internal growth or by merger—or, perhaps, having such resources he may decide that it would be more beneficial to utilize independent distributors and retailers. In an effort to obtain the economy, efficiency and flexibility of independent distributors, and at the same time to assure that all competitive effort is directed toward competing products (inter-brand competition), and not turned within toward its own product (intra-brand competition), the manufacturer may adopt one or a combination of several contractual arrangements with his inde-

[3] Mergers are governed by the special provisions of the Clayton Act, § 7, 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1958), reading, in part: "No corporation engaging in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly."

pendent distributors.[4] One such method might be to prevent intra-brand price competition through the use of resale price maintenance covenants.[5] One serious limitation to this plan is that it still leaves all non-price weapons (viz., services, terms of sale, etc.), freely available for *intra-brand* competition. In addition, by restricting any *method* of competition—price or non-price—the manufacturer hamstrings his distributors in their *inter-brand* competition and deprives them of needed flexibility to compete successfully with rival brands. Thus, such contractual restrictions might well prove self-defeating in his efforts vis-à-vis competing brands.

Better tools for concentration on inter-brand competition are found in exclusive territorial arrangements, *i.e.*, exclusive selling, closed territories and geographical customer allocation. By "exclusive selling," the manufacturer assigns an exclusive territory to his distributor, and does not sell to anyone else within the distributor's designated territory. The distributor in turn treats his assigned territory as his "primary zone of influence" and attempts to develop it to its fullest potential. This arrangement gives the manufacturer some assurance that the distributor will devote his energies to promoting his product within his "zone" and, by a series of such strategically located exclusive dealers, he can gain needed market coverage. This arrangement does not prevent the distributor from selling outside his territory, but proper location of distributors to conform to natural marketing areas alleviates intra-brand "border clashes" through the natural barrier of proximity. By reducing

[4] See Kessler & Stern, *Competition, Contract and Vertical Integration*, 69 YALE L.J. 2-21 (1959).

[5] Vertical resale price maintenance was early held to violate the Sherman Act, Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911), and the Federal Trade Commission Act, FTC v. Beech-Nut Packing Co., 257 U.S. 441 (1922). Such practices may be legal if resulting from the manufacturer's unilateral refusal to deal with those who cut prices, provided no co-operation or coercion of intermediate distributors or dealers is involved. United States v. Colgate & Co., 250 U.S. 300 (1919). *Cf.* FTC v. Beech-Nut Packing Co., *supra;* George W. Warner & Co. v. Black & Decker Mfg. Co., 277 F.2d 787 (2d Cir. 1960). See also United States v. Parke, Davis & Co., 353 U.S. 29 (1960); United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944); Oppenheim, *The Parke Davis Decision: Colgate's Permissible Suggested Resale Price Policy is Neither Dead Nor Sterile*, 17 A.B.A. ANTITRUST SECTION 215 (1960); Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655, 703-04 (1962). Resale price maintenance may be exempt from the antitrust laws where pursuant to valid state Fair Trade laws under the federal enabling acts. 50 Stat. 693 (1937), 15 U.S.C. § 1 (1958); 66 Stat. 632 (1952), 15 U.S.C. § 45 (1958).

intra-brand competition, the distributor is more willing to invest in promoting the seller's product, free from fear of intra-brand cannibalism.

In order to further reduce the problem of intra-brand competition, the manufacturer might inaugurate "closed territories." Under this plan, the distributor is prohibited from promoting or selling in another's "closed" territory. This arrangement eliminates all intra-brand competition *within* the designated closed territories, but leaves the possibility of intra-brand competition *between* closed territories. Thus, a buyer from one territory still might enter and make a purchase in a different territory, or even arrange a purchase in a different territory by correspondence, with delivery f.o.b. distributor.

This latter loop-hole may be closed by still a third arrangement—"geographical customer allocation." Under this plan, each distributor is prohibited from selling to anyone who does not reside or have a place of business within his territory. Thus, if a purchaser should attempt to buy outside of the zone in which he resides or maintains a place of business, the distributor would have to decline the sale. Variations on this plan, to retain customer good-will and make up for inadvertent oversights, include providing for reimbursing the offended distributor for the loss of profit from the improper sale, in addition to any expected expense which may be incurred by him, such as servicing or honoring warranties.

Customer allocation can, of course, be used to allocate to specific distributors named customers or categories of customers classified by criteria other than geographical. Thus, accounts may be classified according to the purposes to which they place the product, the type of servicing required, or the peculiar methods of sale necessary. The manufacturer may also wish to reserve certain accounts to himself—which in a sense is what happens when customers are geographically allocated inasmuch as he is the only one who can make sales to distributors in all territories.

Each of these three arrangements could be undertaken separately or in combination. For example, where geographical customer allocation is used alone, presumably a dealer could promote and sell outside his territory so long as the buyer in fact resided or had his place of business within the seller's assigned territory. Conversely, though the promotion and sale are made in a dealer's territory, if it should turn out that the buyer is from a different territory, then the seller must decline to make the sale or perhaps reimburse the dealer in whose territory the buyer in fact resides. In practice the three arrangements would normally be used concurrently so that each of the former would be included as elements of the more restrictive provisions of the latter, as progressive steps in eliminating intra-brand competition.

Each of these territorial arrangements may result from an agreement or understanding between the parties, or by the seller's recognized right of customer selection and unilateral refusal to deal.[6] Under the latter method, the seller may simply carry out a policy of exclusive selling by unilaterally refusing to deal with more than the designated dealer in a particular territory. Similarly, the seller may enforce closed territories or geographical customer allocations by unilaterally refusing to deal with those who do not voluntarily acquiesce in his pre-announced policy. As a consequence of the differing means for accomplishing the various exclusive marketing arrangements, the courts have followed two lines of reasoning in determining the legality of the arrangements.

Where the policy is executed and enforced through the manufacturer's unilateral refusal to deal, and no question is raised of a contract, combination or conspiracy, monopolization or an attempt to monopolize thereby, the practice is beyond antitrust proscriptions.[7] Nor does the fact that the seller chooses to adopt such a policy at the instance of the buyer alter the legality of such a unilateral determination on the part of the seller.[8] It is where the restriction is accomplished by agreement—tacit or express—that serious antitrust questions may arise. It is to this latter area that the remainder of this article is addressed.

With these basic concepts in mind, an attempt shall be made to reappraise the past and present status of each of the three types of exclusive territorial arrangements, *i.e.*, exclusive selling, closed

[6] See authorities cited note 5 *supra*. See also FTC v. Raymond Bros.-Clark Co., 263 U.S. 565 (1924). *Cf.* Klor's, Inc. v. Broadway-Hale Stores, 359 U.S. 207 (1959); Lorain Journal Co. v. United States, 342 U.S. 143 (1951); Fashion Originators' Guild of America v. FTC, 312 U.S. 457 (1941).

[7] See authorities cited notes 5 and 6 *supra*.

[8] "Such decisions are not made in a vacuum." Schwing Motor Co. v. Hudson Sales Corp., 138 F. Supp. 899, 906 (D. Md.), *aff'd per curiam*, 239 F.2d 176 (4th Cir. 1956), *cert. denied*, 355 U.S. 823 (1957). In fact, "it is likely to be the dealer who asks for it." Packard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418, 421 (D.C. Cir.), *cert. denied*, 355 U.S. 822 (1957).

territories and geographical customer allocation, under the Sherman Act[9] and section 5 of the Federal Trade Commission Act.[10]

EXCLUSIVE SELLING

Almost two centuries before the enactment of the Sherman Act the common law developed, as an exception to the general rule that contracts in restraint of the right to engage in business or trade are void, the doctrine that certain ancillary restrictions are legal where reasonable under the circumstances to promote a lawful main pur-

[9] 26 Stat. 209 (1890), 15 U.S.C. §§ 1-7 (1958). The substantive provisions, §§ 1 and 2, of this act provide: Section 1. "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. . . . Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court."

Section 2. "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court."

[10] 38 Stat. 717 (1914), as amended, 52 Stat. 111 (1938), 15 U.S.C. § 45(a)(1) (1958), reading in part: "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful." The Supreme Court has noted that the Federal Trade Commission Act is all-inclusive and that "minimally that section [§ 5 of the FTC Act] registers violations of the Clayton and Sherman Acts." Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 609 (1953). Just how far beyond this "minimal" coverage the FTC Act goes is not yet clear. The outer limits indeed may extend far if the Commission is given its head as the Supreme Court indicated that it would in FTC v. Motion Picture Advertising Co., 344 U.S. 392 (1953), where it stated that the FTC Act was "designed to supplement and bolster the Sherman Act and the Clayton Act . . . to stop in their incipiency acts and practices which, when full blown, would violate those acts . . . as well as to condemn as 'unfair methods of competition' existing violations of them." Such an incipient incipiency doctrine portends unlimited expansion of FTC proscriptions of ominous scope, especially in view of Parkinson's Law under which "administrative decisions tend to feed upon themselves for their enlargement, and that, under the guise of the interstitial interpretation of the act which creates it, the administrative agency by its decisions tends to expand the authority originally given to it." Butler, *Federal Trade Commission Jurisdiction Under the Incipiency Doctrine,* LECTURES ON FEDERAL ANTITRUST LAWS 154, 173 (University of Michigan Law School Summer Institute 1953). See also Oppenheim, *Harmonization of Section 5 of the Federal Trade Commission Act with the Sherman and Clayton Acts,* 17 A.B.A. ANTITRUST SECTION 231 (1960).

pose.[11] In *United States v. Addyston Pipe & Steel Co.*,[12] Judge Taft (later Chief Justice) recognized this doctrine of ancillary restraints in his classic review of the common law authorities prior to the Sherman Act. The Supreme Court subsequently adopted the reasoning of Judge Taft in applying the Rule of Reason to ancillary restraints of trade.[13]

The protectable interest of the buyer in exclusive selling agreements was recognized by the Supreme Court in *United States v. Bausch & Lomb Optical Co.*[14] Although the Court there struck down an elaborate distribution scheme designed to fix resale prices, it let stand a separate arrangement giving the distribtuor, Soft-Lite, the exclusive right to sell pink-tinted lenses manufactured by defendant. In the district court, Judge Rifkind, in holding that this exclusive selling agreement did not violate section 1 of the Sherman Act, stated:[15]

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[11] In the celebrated case of Mitchel v. Reynold, 1 P. Wms. 181, 24 Eng. Rep. 347 (K.B. 1711), the court upheld an agreement not to practice a trade ancillary to the sale of a business on the ground that the restraint imposed was reasonable to protect the interests of the purchaser in seeing that the value of his purchase was not diminished by continued competition of his seller. Typical of the types of ancillary restraints upheld by the common law as reasonably necessary to protect a lawful main purpose include, in addition to such agreements of the seller of a business not to compete with the business sold, the agreement of a participant in a joint venture not to compete with that venture, and covenants not to compete with a former employer. See Blake, *Preventing Competition by a Former Employee,* 15 A.B.A. ANTITRUST SECTION 235 (1959); Bork, *Ancillary Restraints and the Sherman Act, id.* at 211.

[12] 85 Fed. 271, 281 (6th Cir. 1898), *aff'd,* 175 U.S. 211 (1899).

[13] Apex Hosiery Co. v. Leader, 310 U.S. 469, 498 (1940); Standard Oil Co. of New Jersey v. United States, 221 U.S. 1, 51 (1911). For the historical development of the Rule of Reason, see Bork, *supra* note 11. A concise restatement of the theory of ancillary restraints is found in United States v. Columbia Pictures Corp., 189 F. Supp. 153, 178 (S.D.N.Y. 1960): "The doctrine of ancillary restraint . . . permits, as reasonable, a restraint which (1) is reasonably necessary to the legitimate primary purpose of the arrangement, and of no broader scope than reasonably necessary; (2) does not unreasonably affect competition in the marketplace; and (3) is not imposed by a party or parties with monopoly power."

[14] 45 F. Supp. 387 (S.D.N.Y. 1942), *aff'd as modified,* 321 U.S. 707 (1944).

[15] *Id.* at 398-99. See also Bascom Launder Corp. v. Telecoin Corp., 204 F.2d 331, 335 (2d Cir. 1953), *cert. denied,* 345 U.S. 994 (1953): "[T]he Sherman Act was not violated, because the manufacturer had no monopoly of the product, and the 'restraint of trade' was (a) ancillary to a reasonable main purpose—a source of supply to the distributor—and (b) fairly protective of that distributor's interests but not so large as to interfere with the interests of the public."

> [T]he main purpose of the contract is to provide a source of supply for Soft-Lite. The restraining covenant is for the protection of the purchaser who is spending large sums to develop his good will and enlarge the public patronage of a relatively new article of commerce. The arrangement, though not a partnership in legal form, is functionally a joint enterprise in which one will produce and the other market the commodity.

The district court also noted that not only were there other competing lenses in the market, but that competition had actually increased by competitors' emulation of the success of Soft-Lite in its promotion of defendant's product.[16] Since *Bausch & Lomb,* courts have generally assumed such exclusive selling agreements to be legal, absent monopolization or an attempt to monopolize.[17]

The legality of exclusive selling arrangements was recently reviewed at length in two private antitrust treble damage actions brought by automobile dealers on the ground that they had been disfranchised as a result of allegedly illegal exclusive selling agreements.

Schwing Motor Co. v. Hudson Sales Corp.[18] involved treble damage actions under sections 1 and 2 of the Sherman Act by two franchised dealers for Hudson cars in Baltimore who alleged that their dealerships had been terminated in favor of granting an exclusive franchise to another dealer in the Baltimore area. Chief Judge Thomsen recognized that every manufacturer has a "natural and complete monopoly" of his own brand and that such an exclusive selling agreement would of necessity involve a "limited monopoly"

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[16] 45 F. Supp. at 399.

[17] For example, in United States v. Imperial Chem. Indus., 100 F. Supp. 504, 544-45 (S.D.N.Y. 1951), *enforcement decreed,* 105 F. Supp. 215 (S.D.N.Y. 1952), an international cartel case, the court termed exclusive distributing agreements not employed in furtherance of a conspiracy to be an "ordinary" business practice, entirely lawful absent a showing of illegal purpose. For a review of earlier federal and state cases, see note 2 *supra.* See also RESTATEMENT, CONTRACTS § 516(e) (1932): "A bargain to deal exclusively with another" is one instance of a reasonable restraint of trade unless "part of a plan to effect a monopoly." Texas provides an outstanding exception to the general acceptance of exclusive selling as an "ordinary" business practice, and prohibits all territorial restrictions under the state antitrust act. See Climatic Air Distrib. of South Texas v. Climatic Air Sales, Inc., 1961 Trade Cas. ¶ 69,991 (Sup. Ct. Tex.).

[18] 138 F. Supp. 899 (D. Md.), *aff'd per curiam,* 239 F.2d 176 (4th Cir. 1956), *cert. denied,* 355 U.S. 823 (1957).

in the exclusive distributor to sell the manufacturer's product within the defined territory.[19] Nevertheless, the court dismissed the complaint for failure to state a cause of action, pointing out that such an arrangement is not invalid where it is not used as a means of violating the antitrust laws, and where neither the manufacturer nor the exclusive distributor was shown to have "dominated" the market in automobiles either in the Baltimore area or elsewhere.[20] Judge Thomsen properly emphasized the distinction between a "real" monopoly in the relevant line of commerce and the "natural" monopoly which each manufacturer has in the product which he manufactures under his own brand. The latter may, of course, merge into the former where the manufacturer "dominates" the market, but absent this market domination, Judge Thomsen would permit the manufacturer to grant a dealer an "actual" monopoly in his brand or make in a defined territory. Any control over the price of the manufacturer's product in such an instance must be limited by the necessity to compete with rival brands. Where there is active inter-brand competition the Rule of Reason dictates that such exclusive agency agreements should be upheld, and the court so held.

Packard Motor Co. v. Webster Motor Car Co.[21] presented a factual situation similar to *Schwing;* it was also a treble damage action brought by a disfranchised automobile dealer against a manufacturer for alleged violation of sections 1 and 2 of the Sherman Act. Prior to the decision in *Schwing,* the district court entered judgment for the plaintiff after a trial. Chief Judge Edgerton, writing for the Court of Appeals for the District of Columbia, adopted the reasoning in *Schwing* in reversing the lower court's judgment. As in *Schwing,* the court of appeals applied the "reasonable interchangeability" test of the *Cellophane* case, *United States v. E. I. du Pont de Nemours & Co.,*[22] finding that Packard automobiles were reasonably interchangeable by consumers with other makes and concluding that the relevant line of commerce must therefore be "automobiles," and not merely "Packards."[23] The court found no evidence of any attempt of conspiracy to monopolize the market so defined, and concluded:[24]

[19] *Id.* at 902-03.
[20] *Ibid.*
[21] 135 F. Supp. 4 (D.D.C. 1955), *rev'd,* 243 F.2d 418 (D.C. Cir.), *cert. denied,* 355 U.S. 822 (1957).
[22] 351 U.S. 377 (1956).
[23] 243 F.2d at 420.
[24] *Id.* at 420-21.

> When an exclusive dealership "is not part and parcel of a scheme to monopolize and effective competition exists at both the seller and buyer levels, the arrangement has invariably been upheld as a reasonable restraint of trade. In short, the rule was virtually one of *per se* legality. . . . The fact that any other dealers in the same product of the same manufacturer are eliminated does not make an exclusive dealership illegal; it is the essential nature of the arrangement.

The courts in both *Schwing* and *Packard* found no monopolization or attempt to monopolize, noted that there was effective competition at both the buyer and seller levels, and contrasted the vertical agreements involved in exclusive selling with restrictive horizontal agreements between competitors. Neither court was impressed with the plaintiffs' emphases on the fact that the manufacturer in each case had agreed to establish the exclusive selling arrangement at the instance of the favored dealer.[25] Thus, once the exclusive selling arrangement is found to be free of illegal purpose or effect, it should make no difference whether it is instituted and enforced by mere unilateral refusal to deal on the part of the manufacturer, or by agreement at the instance of the buyer or seller.[25a]

More recently, in *Reliable Volkswagen S. & S. Co. v. World-Wide-Auto Corp.*,[26] a dealer alleged nine causes of action against the foreign manufacturer, its exclusive importer, a distributor, two dealers, and two individuals (officers and directors of the distributor). The complaint charged, *inter alia,* a violation of sections 1 and 2 of the Sherman Act by an alleged conspiracy of defendants to create a monopoly in the retail sale of Volkswagen products for the distributor and its two retail dealers in Connecticut, New Jersey and New York, pursuant to which defendants allegedly "eliminated" retail Volkswagen dealers therein, specifically plaintiff dealer, by exclusive selling arrangements.

On consideration of a motion to dismiss this count, the court noted that, whereas in *Schwing* and *Packard,* the relevant market

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[25] Note 8 *supra.*

[25a] Justice Harlan, dissenting in Poller v. Columbia Broadcasting System, 30 U.S.L. WEEK 4146, 4152 (U.S. Feb. 19, 1962), referred to the right of a manufacturer to transfer an "exclusive distributorship" from one dealer to another and concluded that this right "is preserved under the antitrust laws not only because of its unilateral decision, but because it does not amount to an unreasonable restraint of trade in any meaningful sense of the term. . . ."

[26] 182 F. Supp. 412 (D.N.J. 1960).

was determined to be "automobiles," the relevant market in *Reliable* was not certain.[27] In addition the court adverted that the virtually *per se* legality of the manufacturer-dealer arrangement in *Schwing* and *Packard* was limited to a competitive market free of monopoly.[28] Unlike *Schwing* and *Packard* the complaint in *Reliable* charged a conspiracy to create a "retail" monopoly in Volkswagen products for the tri-state area in the distributor and dealer defendants. The complaint also charged that the individual defendants were officers and directors of the distributor and two dealer defendants, and that the distributor acted for and carried out the orders and policies of the foreign manufacturer and its exclusive importer. In view of these allegations the court concluded that the legality of the exclusive selling arrangement "must await evidence of its reasonableness."[29]

In *United States v. Volkswagen of America, Inc.*,[30] decided by Judge Forman on the same day as *Reliable*, the government charged the defendant manufacturer, its exclusive importer and its fourteen distributors with a combination and conspiracy in violation of section 3 of the Clayton Act and section 1 of the Sherman Act. In considering the defendants' motion to dismiss allegations of exclusive territorial agreements the court declined to consider the merit of the defendants' contention that such arrangements were "legal *per se*," and agreed with the government's argument that regardless of their legality when considered alone, they would be illegal if they are a part of and promote an illegal price fixing scheme, as charged there.[31] *Schwing* and *Packard* were distinguished as not involving allegations of price-fixing, "a practice long since denominated illegal *per se*."[32] The court therefore denied the motion to dismiss, stating that in the instant case questions for the jury were presented as to whether the exclusive selling arrangements were designed to promote price maintenance, and if so, their utility in that regard.

The Federal Trade Commission has followed the courts in

[27] *Id.* at 419.

[28] *Id.* at 420.

[29] *Id.* at 421.

[30] 182 F. Supp. 405 (D.N.J. 1960).

[31] *Id.* at 411. The court quoted from Swift & Co. v. United States, 196 U.S. 375, 396 (1905), wherein Justice Holmes held, "The constituent elements, as we have stated them, are enough to give the scheme a body and, for all that we can say, to accomplish it. Moreover, whatever we may think of them separately when we take them up as distinct charges, they are alleged sufficiently as elements of the scheme. It is suggested that the several acts charged are lawful. . . . But they are bound together as the parts of a single plan. The plan may make the parts unlawful."

[32] 182 F. Supp. at 411.

upholding exclusive selling arrangements. In *Columbus Coated Fabrics*,[33] respondent was charged with violating section 5 of the FTC Act by (1) resale price fixing; (2) establishing and maintaining exclusive sales territories for distributors; and (3) boycotting certain dealers. While the hearing examiner treated the second charge as involving closed territories, the Commission found them in practice to involve only exclusive selling, noting that the distributors and dealers were free to sell wherever and to whomever they pleased.[34] The Commission affirmed the initial decision, dismissing the first two charges and issuing a cease and desist order as to the third. The hearing examiner had found that the respondent's product, "Wall-Tex" brand washable wall covering, was in substantial competition with other similar products at the distributor level and also with other dealers in the product at the retail level. Thus, assuming an express understanding between respondent and its distributors, the examiner[35] and the Commission[36] followed the reasoning of *Schwing* and *Packard* in noting that there was no evidence of monopolization and that there was effective competition at the buyer and seller levels.

Closed Territories

In contradistinction to the "virtual *per se* legal" status of exclusive selling arrangements, closed territories and customer allocation arrangements have come in for much closer scrutiny by the Department of Justice, the courts and the Commission. As already noted, the purpose of an exclusive selling arrangement, whereby the seller agrees to sell exclusively to a particular distributor in a designated area, may be defeated if other distributors should invade the exclusive distributor's assigned territory. In order to prevent this, and to insure the success of the exclusive arrangement in eliminating intra-brand competition, the distributor's right to sell beyond his exclusive territory must likewise be restricted. This paper makes a distinction in kind between "closed territories" by which the distributor is merely prevented from entering into another's territory to promote and make sales, and "geographical customer allocation" whereby the distributor is prevented from selling to anyone not residing or maintaining a place of business within his assigned territory. While the extent of the restraint obviously differs in each

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[33] 55 F.T.C. 1500 (1959).
[34] *Id.* at 1521.
[35] *Id.* at 1504.
[36] *Id.* at 1521-22.

of these two arrangements, the courts and the Commission have not as yet recognized the distinction, generally treating them together within the category of "closed territories."[37] The term "customer allocation" has been limited to classification on a basis other than geographical. Inasmuch as under the Rule of Reason the extent of the ancillary restraint imposed must be reasonable to promote the lawful main purpose of the arrangement, the difference in the effect of these two arrangements might well control the outcome of a particular case. For this reason, regardless of the name given by the courts and the Commission to the arrangement involved in cases to be discussed hereafter, they will be treated according to their category as defined hereinabove.[38]

An early federal decision[39] regarding closed territories involved an action by the seller of cement for breach of contract. The purchaser defended on the ground that the sales contract prohibited him from shipping or selling the cement outside of Texas. In upholding this restriction against a Sherman Act charge, the court emphasized the fact that the defendant had no monopoly, was surrounded by competing manufacturers, and that the restraint had no substantial effect on competition at the buyer or seller levels.[40] Other early federal and state court decisions tended to assume the legality of exclusive territory arrangements without making detailed analyses or distinctions in their form, purposes, or effects.[41]

Closed territories were treated as "virtually *per se* legal" by the district court in *Boro Hall Corp. v. General Motors Corp.*[42] On

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[37] *Cf.* United States v. Consolidated Laundries Corp., 1961 Trade Cas. ¶ 70,039 (2d Cir.), where defendants contended the trial court had erred in applying a *per se* rule to allocation of customers by competitors. The court noted that competitors' territorial division of markets has been held to be *per se* illegal and concluded that there was no "significant difference between an allocation of customers and an allocation of territory." This case is distinguishable from the question here at issue since it involved horizontal agreements between competitors and, as already noted, horizontal customer allocation is a greater restraint than horizontal geographical division of territories and since the latter is *per se* illegal, so is the former, a fortiori.

[38] *Caveat:* Because the courts and the Commission have not classified cases within the categories used herein, the cases must necessarily be reclassified according to the writer's own opinion based on a reading of facts as disclosed in the decisions. Whether the courts or the Commission would have agreed with the writer's classifications had they adopted the same categories is problematical.

[39] Phillips v. Iola Portland Cement Co., 125 Fed. 593 (8th Cir. 1903), *cert. denied,* 192 U.S. 606 (1904).

[40] *Id.* at 595.

[41] See note 2 *supra.*

[42] 37 F. Supp. 999 (S.D.N.Y. 1941), *aff'd,* 124 F.2d 822 (2d Cir.), *re-*

defendant's motion, the court dismissed the complaint for failure to state a cause of action, without considering affidavits filed on behalf of the parties. Plaintiff Chevrolet dealer had been assigned a particular territory as its "zone of influence" and the complaint alleged that defendants prohibited plaintiff from establishing a used car outlet and from "solicitation, by mail or otherwise," beyond his assigned territory.[43] The court emphasized the "special relation" that plaintiff dealer bore to defendants in using defendants' trademarks and good will in his business, and could find nothing unreasonable in defendants' preventing plaintiff from trading on defendants' good will in areas assigned to others.[44] According to the court, "the solicitation of business in other areas might very well conflict with the business of other dealers of Chevrolets and thus adversely affect the business of defendants."[45]

The district court's decision in *Boro Hall* presents a clear holding on the legality of closed territories. The court of appeals in affirming did not feel that it had to go as far as the district court by considering the defendants' affidavit. According to the court of appeals, defendants' uncontradicted affidavit established that plaintiff was prohibited only from establishing a used car outlet where it would "unduly prejudice" its other Chevrolet dealers. The affidavit was said to negative the allegation that plaintiff could sell only within his "zone of influence."[46] Thus, the more limited holding of the court of appeals restricts its affirmance to the legality of what in effect was an exclusive selling arrangement, presaging *Schwing* and *Packard.* The result is that, aside from the untested district court dicta in *Boro Hall,* there is no definitive federal court decision on closed territories. One reason for the dearth of authority in this area is the success of the Justice Department in getting manufacturers to agree to cease utilizing close territories and customer allocation.[47]

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hearing denied, 130 F.2d 196 (2d Cir. 1942), *cert. denied,* 317 U.S. 695 (1943).

[43] 37 F. Supp. at 1000.

[44] *Id.* at 1001.

[45] *Ibid.*

[46] 124 F.2d at 823.

[47] As a result of pressure from the Department of Justice in 1949, automobile manufacturers revised their franchise agreements to delete restrictions on their dealers which inhibited them from operating outside their designated territories. See *Hearings on H.R. 528, H.R. 2688, and H.R. 6544 Before the Subcommittee on Automobile Marketing Legislation of the House Committee on Interstate and Foreign Commerce,* 84th Cong., 1st Sess. 89, 362 (1956). Manufacturers succumbed in a series of consent decrees which, while allowing exclusive selling, prohibit closed territories or customer allo-

On the state level,[48] the North Carolina Supreme Court recently upheld closed territorial restraints imposed by an automobile manufacturer on one of its franchised dealers in *Waldron Buick Co. v. General Motors Corp.*[49] Plaintiff dealer sought treble damages under the state antitrust law[50] against General Motors and Folger, another franchised Buick dealer, on the ground that defendants had forced plaintiff to cease its sales activities within Folger's closed territory, comprising the city of Charlotte and suburban areas immediately adjacent thereto. Plaintiff had advertised in newspapers and over the radio in Charlotte, and had employed salesmen and "bird dogs"[51] in Folger's closed territory. The court assumed for purposes of its decision that plaintiff sustained "some loss" as a

cation. See United States v. American Linen Supply Co., 1956 Trade Cas. ¶ 68,542 (N.D. Ill.); United States v. J. P. Seeburg Corp., 1957 Trade Cas. ¶ 68,613 (N.D. Ill.); United States v. AMI Inc., 1957 Trade Cas. ¶ 68,758 (W.D. Mich.); United States v. American Type Founders Co., 1958 Trade Cas. ¶ 69,065 (D.N.J.); United States v. Audiofidelity, Inc., 1960 Trade Cas. ¶ 69,760 (S.D.N.Y.); United States v. Hambro Automotive Corp., 1960 Trade Cas. ¶ 69,620 (S.D.N.Y.); United States v. Necchi Sewing Machine Sales Corp., 1958 Trade Cas. ¶ 68,957 (S.D.N.Y.); United States v. Rudolph Wurlitzer Co., 1958 Trade Cas. ¶ 69,011 (W.D.N.Y.); United States v. American Body & Trailer, Inc., 1958 Trade Cas. ¶ 69,063 (W.D. Okla.); United States v. Philco Corp., 1956 Trade Cas. ¶ 68,409 (E.D. Pa.); United States v. Bostitch, Inc., 1958 Trade Cas. ¶ 69,207 (D.R.I.). Current Department of Justice activity is illustrated by its latest civil antitrust action, Civil No. 7546, M.D. Pa., Feb. 9, 1962, against the York Corporation of Delaware, a wholly owned subsidiary of Borg-Warner, charging it has violated section 1 of the Sherman Act by allegedly requiring its distributors to agree to contracts limiting both territories and customers, and forbidding the distributors to compete with York in selling Borg-Warner air-conditioning and refrigeration equipment to the United States Government or for export or marine use. *Cf.* pending criminal action in United States v. General Motors Corp., Criminal No. 30132, S.D. Cal., Oct. 12, 1961.

[48] As to the possible conflict between state antitrust legislation and the federal antitrust acts, see Note, *The Commerce Clause and State Antitrust Regulation*, 61 COLUM. L. REV. 1469 (1961).

[49] 254 N.C. 117, 118 S.E.2d 559 (1961).

[50] The North Carolina antitrust statute, N.C. GEN. STAT. § 75-1 (1960), follows the general format of section 1 of the Sherman Act, stating that "every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce in the State of North Carolina is hereby declared to be illegal." The state act specifically provides, in § 75-5(b)(6), that it is unlawful "while engaged in buying or selling any goods in this State, to have any agreement or understanding, express or implied, with any other person not to buy or sell such goods within certain territorial limits within the State, with the intention of preventing competition in selling or to fix the price or present competition in buying such goods within these limits."

[51] A "bird dog" is "one with whom an arrangement is made to search out and refer prospective customers to the dealer." 254 N.C. at 123-24, 118 S.E.2d at 564.

result of the territorial restriction.[52] After approving the doctrine of ancillary restraints as the applicable test,[53] the court stated the issue to be whether the closed territory arrangement between General Motors and Folger was lawful.[54] Having by this oblique approach read-out the alleged restraint on plaintiff as the controlling issue, the court then upheld the arrangement between General Motors and Folger as a reasonable restraint. Perhaps the court's misdirected inquiry can be attributed to its inability to find an analogy in its search for precedent. Grasping at straws, the court cited *Schwing* and *Packard* as involving the same basic question. To fit the case to the Procrustean bed of *Schwing* and *Packard,* the court found it necessary to judge the arrangement in light of its restraint on General Motors,[55] as in exclusive selling, rather than as a restraint on plaintiff, as in closed territory arrangements—which, indeed, it was.[56]

The Federal Trade Commission first had occasion to consider the legality of closed territories under section 5 of the FTC Act in 1932 when, on stipulated facts, it dismissed without opinion the complaint in *General Cigar Co.*[57] Commissioner McCulloch filed a vigorous dissent which set out the basic arguments opposed to the use of closed territories. Respondent cigar manufacturer had assigned closed territories to forty-six independent wholesalers and seventeen sales branches of its own. While there was no "formal contract," the distributors accepted the territories as assigned and co-operated with each other and with respondent to contain distributors' sales activities within their assigned territories.[58] The logic of Commissioner McCulloch's dissent proceeds briefly as follows: (1) an agreement between competitors to divide the market constitutes a violation of the Sherman Act;[59] (2) a series of vertical

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[52] *Id.* at 124, 118 S.E.2d at 565.

[53] *Id.* at 126, 118 S.E.2d at 566.

[54] *Id.* at 126-27, 118 S.E.2d at 567.

[55] *Id.* at 127, 118 S.E.2d at 567.

[56] The restriction as described in the decision was clearly a closed territory arrangement, the court holding: "General Motors agreed that Folger was to have exclusive rights in respect of selling and soliciting sales within said Charlotte area. In this connection, it is noted that General Motors did not impose or attempt to impose any restrictions on [plaintiff's] sales activities *except within said Charlotte area,* whether the prospect involved resided in Charlotte or elsewhere." *Id.* at 125, 118 S.E.2d at 565. (Emphasis is by the court.)

[57] 16 F.T.C. 537 (1932).

[58] *Ibid.*

[59] Addyston Pipe & Steel Co. v. United States, 175 U.S. 211 (1899). *But cf.* United States v. Pan American World Airways, Inc., 193 F. Supp. 18 (S.D.N.Y. 1961), *appeal granted,* 30 U.S.L. WEEK 3225 (U.S. Jan. 16, 1962) (No. 583).

agreements between a manufacturer and his distributors has the same effect as horizontal agreements between competitors and therefore stands on the same footing; (3) agreements having the effect of fixing or stabilizing prices are *per se* illegal; (4) closed territorial agreements are therefore *per se* illegal because all competition in respondent's products is eliminated and the absence of competition necessarily affects prices.

Almost three decades passed before the Commission again considered the legality of closed territories. The question was recently presented in *Snap-On Tools Corp.*[60] where it was alleged that respondent manufacturer of a full line of tools had required its dealers to enter into contracts which, *inter alia,* (1) established resale prices for respondent's products; (2) restricted the territory within which and the persons to whom the dealer could sell; and (3) provided that a dealer may not engage in a similar business within the state for one year after termination of his dealership agreement.

At the close of the Commission's case-in-chief, the hearing examiner held that a prima facie case had been proved as to the charge of resale price maintenance, but had not been made on the other two charges.[61] According to the examiner the maintenance of closed territories is not unlawful *per se,* and the Rule of Reason should be applied to the facts in each case to determine whether the practice is "reasonably likely" to have a substantial adverse effect on competition. Respondent marketed its products primarily through independent "vendors on wheels," operating from walk-in trucks in which they carried a stock of tools most frequently sold. The examiner felt that giving these dealers a closed territory was the only way that respondent could adequately develop the market, other than through a large corps of its own employed salesmen. This practice was said to assure that regular, periodic calls were made on the trade with adequate service to customers and attention to their complaints. The examiner emphasized the keen inter-brand competition and felt that this fact attenuated any benefit denied purchasers by not being able to "play off" one Snap-On dealer against another in an effort to get a better price.

The Commission disagreed with the examiner's consideration of the practices individually and felt that they should be considered together as a single method of doing business.[62] So considered, the

[60] No. 7116, FTC, November 1, 1961.
[61] Opinion of the Commission, *id.* at p. 2.
[62] The Commission, on January 21, 1960, affirmed the examiner's order

Commission held that the closed territory arrangement was part of an over-all plan to eliminate competition between respondent's dealers and thereby "buttressed" respondent's resale price maintenance.[63] The Commission stated that the practice of playing off one dealer against the other was "the essence of competition,"[64] disregarding the extensive inter-brand competition found to exist by the examiner. *Packard* and *Schwing* were distinguished as being exclusive selling arrangements involving no restraint on the dealers.[65] Similarly, *Boro Hall* was distinguished as not restricting the dealer in his sales activities beyond his assigned territory, other than the restriction on the location of his place of business.[66] Lending its approval to exclusive selling arrangements, the Commission suggested that Snap-On might assign areas of primary responsibility to its dealers and insist that they provide adequate sales coverage and service within such territories.[67] *General Cigar* was dispatched in a footnote stating that the grounds of the decision are unclear in the absence of a majority opinion and, without distinguishing it or overruling it, commented that it had "little precedential significance now."[68] Whether or not the Commission would outlaw closed territories when not found to be part of an illegal course of dealing is problematical. The individual treatment of this practice in *Snap-On* presents strong implication that it might.[69]

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of October 5, 1959, as to resale price maintenance, but remanded on the other two charges, directing the examiner to consider them in light of respondent's over-all course of doing business, rather than individually. The examiner in his second opinion of January 6, 1961, arrived at the same negative result, concluding that these practices were not illegal when considered separately and that they were not elements of an illegal plan. Finally, on the second appeal, on November 1, 1961, the Commission reversed, holding that the practices were illegal when considered as elements of respondent's method of competition.

[63] No. 7116, FTC, November 1, 1961, at p. 6.

[64] *Ibid.*

[65] *Id.* at p. 8.

[66] *Ibid.*

[67] *Ibid.*

[68] *Id.* at p. 8 n.8.

[69] Like the Antitrust Division of the Justice Department, see note 47 *supra,* the trial staff of the Federal Trade Commission takes the position that vertical closed territorial arrangements are *per se* illegal. As stated by the Chief of the Division of General Trade Restraints of the Commission: "Regardless of economic necessity, agreements to divide a market even as to a single product must be struck down as illegal *per se.*" Address by Rufus E. Wilson, The Federal Bar Association and The Foundation of the Federal Bar Association Briefing Conference on Antitrust Laws and Trade Regulations, January 5, 1962.

GEOGRAPHICAL CUSTOMER ALLOCATION

The status of geographical customer allocations has been the subject of recent conflicting decisions which may soon be resolved. The eighth count in *Reliable*[70] charged that plaintiff was unable to procure Volkswagen products following the termination of its franchise as a result of agreements that the distributors would sell Volkswagen products only to franchised dealers within their designated exclusive territories. In considering defendants' motion to dismiss this count the court stated the initial question, in the absence of allegations of public injury, to be whether the complaint stated a *per se* violation of section 1 of the Sherman Act. Judge Forman noted that, whereas in *United States v. Volkswagen of America* the government took the position that the territorial agreements and franchise system of marketing were devised to implement a conspiracy to fix prices, *Reliable* contained no such allegations or any allegation of practices "concededly illegal *per se*."[71] The court quoted with approval the language in *Schwing* to the effect that exclusive territorial arrangements by definition involve a "limited monopoly" to sell the manufacturer's product within the assigned territory, and approved the conclusion of *Schwing* that such exclusive agency agreements are nevertheless not *per se* illegal.[72] In spite of the fact that compared to *Schwing* and *Packard,* the present case involved additional steps in the distribution channel between the manufacturer and the dealer, *i.e.,* the product passed from the manufacturer through its exclusive importer to the distributor, the court was not persuaded that this system should constitute a *per se* violation of the Sherman Act.

Perhaps if the decision rested at this point the holding would clearly stand for the proposition that closed territory arrangements between a manufacturer, his distributors and dealers must be judged by the Rule of Reason. Unfortunately Judge Forman added, almost parenthetically, that in its present posture the case presented only a unilateral refusal to deal.[73] This apparent reference to the *Colgate* doctrine dilutes his statement that such agreements are not illegal *per se*. On the facts as alleged it is difficult to understand why the *Colgate* doctrine should even be raised in considering this count in-

[70] Reliable Volkswagen Sales & Serv. Co. v. World-Wide Automobile Corp., 182 F. Supp. 412 (D.N.J. 1960).
[71] *Id.* at 425.
[72] *Id.* at 427.
[73] *Ibid.*

asmuch as the complaint specifically alleged a vertical agreement between the manufacturer, his exclusive importer and distributors to abide by the territorial restrictions. It would appear that this single unrelated statement may have been an unfortunate afterthought which portends considerable weakening of the decision as precedent.

In *United States v. White Motor Co.*,[74] the first case dealing with exclusive territorial arrangements to be litigated by the Justice Department, the defendant truck manufacturer was charged with conspiring with its dealers and distributors in violation of section 1 of the Sherman Act by entering into agreements providing that (1) each distributor and dealer was to sell White trucks only to dealers or other buyers having a place of business or purchasing headquarters within his assigned territory, and if he sold outside such assigned territory he was to pay certain sums of money to the dealer or distributor in whose territory such White trucks were first registered or placed in initial service; (2) distributors and dealers were not to sell White trucks to others for resale or to any federal or state government or any department or political subdivision thereof, such sales being reserved exclusively to White for direct sales; and (3) distributors were to sell to dealers and distributors and dealers were to sell to customers designated by White as National Accounts, Fleet Accounts, and to federal and state governments at prices fixed by White. White was a party to all selling agreements with distributors and direct dealers as well as selling agreements between its distributors and their dealers, using standard form selling agreements in each instance.

The government sought an injunction against each of these practices and, on motion for summary judgment, defendant admitted most factual allegations but denied all charges of illegality. The court first found that defendant's resale price maintenance was a *per se* violation of the Sherman Act. The government contended that the allocation of territories and customers must also be illegal *per se* when combined with the allegedly *per se* illegal price fixing agreements "as all elements of competition among the various selling units involved are thereby eliminated."[75] However, the court did not feel that it had to rely on this "guilt by association" theory in concluding that these practices are also *per se* illegal. In so holding,

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[74] 194 F. Supp. 562 (N.D. Ohio 1961), *appeal filed,* 30 U.S.L. WEEK 3228 (U.S. Dec. 21, 1961) (No. 619).

[75] *Id.* at 577.

it rejected White's argument that it should be allowed to introduce evidence to show that these practices do not unreasonably restrain trade and that enjoining them would reduce, rather than foster, competition in the sale of motor trucks.

The court noted the distinction between exclusive selling arrangements and, as in this case, agreements that distributors and dealers will not sell to anyone located outside of their assigned territories. While recognizing the legality of exclusive selling agreements, it concluded that the Supreme Court has "consistently" held that allocation of markets among competitors violates the Sherman Act.[76] The court attempted a superficial survey of cases to support this conclusion without making any attempt to distinguish between the horizontal nature of the cases relied on and the vertical arrangements at issue.

The reliance on cases involving horizontal agreements between competitors to allocate markets among themselves might be thought to support an inference that the court was deciding the case on the basis of the horizontal nature of the agreements between White and its distributors and dealers, inasmuch as White was said to be competing with its distributors and dealers in selling to certain customers, viz., so-called "National Accounts" and "Government Accounts." Similarly, in distinguishing *Schwing* it was noted that the court there recognized that a horizontal conspiracy between competitors would be illegal.[77] However, the court makes it clear that it thinks a series of vertical agreements dividing markets stands on the same footing as vertical price fixing agreements under *Dr. Miles,* stating:[78]

> White can fare no better in a system of identical contracts with its distributors and dealers allocating territories and customers than could the distributors and dealers themselves "if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other."

While the district court's language seems to hold that all geographical customer allocations are illegal *per se,* whether vertical or horizontal, the Supreme Court might not get to this issue by interpreting the decision in light of the peculiar factual situation

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[76] *Id.* at 578. [77] *Id.* at 582. [78] *Id.* at 585.

involved. Thus, the holding might be left standing on the basis of the horizontal nature of the agreements or because the customer allocations "buttressed" White's resale price maintenance, or both. It can only be hoped that the Supreme Court will take this opportunity to shed some light on the question whether the *per se* doctrine should be extended to cover vertical geographical customer allocation arrangements.[79]

The Federal Trade Commission upheld customer allocations in *Roux Distrib. Co.*[80] Respondent reclassified all of its wholesale customers into three categories. Some of the wholesalers had previously sold to accounts in more than one such category and respondent required each wholesaler to choose one classification and to agree to sell only to accounts specified therein. The three classifications and their respective customer allocations were as follows:[81]

1. Jobber—one who subjobs, sells to, trades or exchanges Roux products with drug wholesalers or beauty supply dealers or other jobbers.
2. Drug wholesaler—one who sells Roux products to drug stores, toilet goods counters of department stores and similar retailers only.
3. Beauty supply dealers—one who sells Roux products to beauty salons, beauty schools and beauty operators only.

Respondent "vigorously enforced" these classifications and discontinued selling to any wholesaler who sold outside of his designated classification.[82] In dismissing, the hearing examiner had relied on the *Colgate* doctrine, holding the practices at issue involved nothing more than unilateral refusals to sell.[83] On appeal, however, Commissioner Anderson, speaking for the Commission, stated that

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[79] In granting summary judgment on the theory that the challenged practices are each *per se* violations of the Sherman Act, Judge Kalbfleisch in *White* stated that he was merely performing his function as a trial judge in interpreting and applying the law. He indicated that the decision did not "necessarily reflect his personal attitude or philosophy upon the subject," but thought that "arguments as to the business necessity of agreements of this type must be addressed to the Congress rather than to the Courts." *Id.* at 588. Several bills which would permit the assignment of "protected" territories in automobile dealer franchise contracts have been introduced during recent sessions of Congress, but none has been enacted. See, *e.g.*, S. 997, S. 2042, S. 2047, S. 2151, and H.R. 881, 86th Cong., 1st Sess. (1959) (S. 997 covered "complex mechanical products"); H.R. 10201, 86th Cong., 2d Sess. (1960); H.R. 1212, and H.R. 1215, 87th Cong., 1st Sess. (1961).

[80] 55 F.T.C. 1386 (1959).

[81] *Id.* at 1386-87.

[82] *Id.* at 1387.

[83] *Ibid.*

the issue was clearly the "more fundamental" question whether a manufacturer could place such restrictions on the resale of its products.[84] While recognizing that allocation of customers of a purchaser would "under some circumstances" violate both the Sherman and FTC Acts, "particularly" where an integral part of a price fixing scheme per *Bausch & Lomb,* the Commission rejected the *per se* approach, concluding that even under the broader reach of section 5 there must be evidence of anticompetitive effects.[85]

More recently, in *International Staple & Mach. Co.,*[86] respondent was charged with an illegal method of distribution which contained multiple restrictions on its distributors and dealers. The complaint charged that respondent had violated section 3 of the Clayton Act and section 5 of the FTC Act by exclusive dealing arrangements wherein its distributors and dealers were restrained from using or dealing in competitors' products, and section 5 by geographical customer allocations. Where a distributor sold in his territory with subsequent shipment into another's closed territory he was expected to split the sales profit with the latter.[87] Without citing a single case in support of its finding, the hearing examiner concluded that respondent's geographical customer allocation "has had the tendency, capacity, or effect of obstructing, hindering and preventing competition in the sale of respondent's wide crown staples and wide crown stapling machines."[88] The Commission adopted the initial decision without modification or comment.[89] The theory of the decision again was that such practices precluded competition between dealers in respondent's products, the same as if the dealers had so agreed between themselves.[90]

In *Sandura Co.,*[91] now pending appeal before the Commission, the hearing examiner found that respondent had violated section 5 as charged by its use of resale price maintenance, closed territories, and customer allocation. Respondent sold its vinyl floor and wall coverings through a franchise system by which it appointed distributors

[84] *Id.* at 1387-88. [85] *Id.* at 1388.
[86] No. 8083, FTC, September 21, 1961.
[87] Commission's Exhibits 30A-B, 32A-C, and 75A-C. See also Commission's proposed finding number 18, and respondent's proposed findings number 8 and 11.
[88] International Staple & Mach. Co., No. 8083, FTC, September 21, 1961, at p. 6.
[89] Commission Decision, No. 8083, FTC, November 7, 1961.
[90] *Id.* at p. 5.
[91] No. 7042, FTC, September 15, 1961.

to closed territories and required these exclusive distributors to sell only to designated "franchised" dealers located within the distributor's closed territory. By the interrelation of respondent's dealer franchise system with its distributor franchise system, the examiner found that a dealer had to do business with the distributor in whose territory he was located.[92] The examiner rejected respondent's contention that the system was voluntary and therefore within the *Colgate* refusal to deal exception, and found that the practices do, in fact, involve mutual undertakings or agreements requiring the distributors to stay within their assigned territories except to the extent that there may be territory which has not been assigned to another distributor.[93] According to the examiner, respondent's closed territories were necessary to help it maintain its suggested resale prices.[94]

Respondent had experienced difficulty getting established in the industry and claimed that its exclusive franchise system enabled it to compete more effectively with its larger established competitors. This system was said to encourage the distributors to share burdensome advertising costs and to more aggressively promote respondent's products within their assigned territories.[95] The examiner was content, however, to find the necessary injury to competition in the elimination of intra-brand competition between respondent's distributors, even assuming that there had been no lessening of interbrand competition in the industry and, in fact, that respondent thereby strengthened its position vis-à-vis its larger competitors.[96] The examiner held respondent's distribution system illegal *per se* on the basis of *White,* rejecting respondent's attempt to distinguish *White* on the ground that defendant there was in partial competition with its distributors, holding that this was not the basis of the court's holding and, moreover, that respondent was also in partial competition with its distributors in its sales to mail order houses.[97] In any event, the examiner refused to distinguish between horizontal and vertical geographical allocation of customers under the reasoning of *Dr. Miles,* holding both to be *per se* illegal.[98]

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[92] *Id.* at p. 23.
[93] *Id.* at p. 28.
[94] *Id.* at p. 24.
[95] *Id.* at p. 30.
[96] *Id.* at p. 32.
[97] *Id.* at p. 34.
[98] *Id.* at pp. 35-36. The examiner attempted to distinguish *Roux* on the basis of a statement in Roberts Co., No. 6943, FTC, March 17, 1959, at p. 12, to the effect that "the *Roux* case was not premised upon a charge of conspiracy or agreement." Sandura Co., No. 7042, FTC, September 15, 1961,

CONCLUSION

It is readily discernible from the above review that the enigmatic status of exclusive territorial arrangements under the antitrust laws is mainly the result of unclear, if not hopelessly tangled, decisions. As a starting point for cutting the Gordian knot, it is suggested that the courts and the Commission take a more critical look at the facts of each case to determine the real purposes and effects of the subject restraint. There are substantial differences in the extent of the restraint involved in exclusive selling, closed territories and geographical customer allocation. In exclusive selling, the seller agrees not to sell to another in the exclusive distributor's assigned territory. The restraint on the distributor is greater in closed territories in that not only must his place of business be restricted to his own territory, but he must not promote or make sales in another's closed territory. The restriction on the distributor is complete when it is added, under geographical customer allocation, that he cannot sell to anyone residing outside his own territory. While the courts and the Commission have uniformly conceded that exclusive selling is "virtually *per se* legal," the latter two categories are still in doubt.

The basic argument advanced by advocates of the *per se* illegal approach to territorial restraints on distributors is founded on the reasoning of *Dr. Miles.* In striking down Dr. Miles' policy of vertical resale price maintenance the Supreme Court noted the *per se* illegality of horizontal resale price fixing and, referring to the vertical nature of the agreements at issue, stated:[99]

> As to this, the complainant [Dr. Miles] can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other. If the immediate advantage they would thus obtain would not be sufficient to sustain such a direct agreement, the asserted ulterior benefit

at p. 40. The examiner failed to note that *Roberts* had pointed out that "the facts in [*Roux*] are far removed from those [in *Roberts*]." In addition, as already noted above, the complaint in *Roux* specifically charged "that respondent has required its wholesale customers to agree to restrict their sales to a limited class of accounts." 55 F.T.C. at 1386.

[99] Dr. Miles Medical Co. v. John D. Parks & Sons Co., 220 U.S. 373, 408 (1911).

> to the complainant can not be regarded as sufficient to support its system.
>
> But agreements or combinations between dealers, having for their sole purpose the destruction of competition and the fixing of prices, are injurious to the public interest and void. They are not saved by the advantages which the participants expect to derive from the enhanced price to the consumer.

The applicability of this line of reasoning to vertical territorial restraints on distributors may at first blush seem inescapable. However, proponents of the analogy either fail to recognize or choose to disregard the obvious difference in the effects of price fixing and territorial restraints. Resale price fixing not only restrains intra-brand competition but may also restrain inter-brand price competition by depriving the distributor of sufficient pricing flexibility to compete effectively with price competition of rival brands. Thus, in an attempt to concentrate on inter-brand competition the manufacturer may unwittingly deny to his distributors an essential competitive weapon. On the other hand, in vertical allocation of territories and customers the distributor has retained all competitive tools, price and non-price, to compete effectively with rival brands. Whereas price fixing necessarily puts a brake on "competition" in the broad inter-brand sense, such exclusive territorial arrangements may in fact augment competition. Therefore, there is nothing in *Dr. Miles,* to borrow a phrase from Holmes' dissent,[100] "that by ineluctable logic requires the conclusion" that vertical exclusive territorial arrangements are *per se* illegal. Indeed, the differences in the nature of the territorial restraints require the application of the Rule of Reason to determine their effect on competition in each instance.

Assuming that the *per se* approach is rejected, there remains the vital question of what tests of reasonableness should apply to territorial restraints. It has been shown that territorial restrictions of this nature are in effect elements of vertical integration by contract. Logically then it would seem that the proper tests should be similar to those applied under the Rule of Reason in vertical integration through mergers. The qualitative approach of the Rule of Reason should include a consideration of structural and functional performance factors such as those suggested in *United States v. Columbia*

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[100] *Id.* at 411.

Steel Co.[101] and reiterated in *Times Picayune Publishing Co. v. United States*,[102] *i.e.*, "the percentage of business controlled, the strength of the remaining competition [at the buyer and seller levels and] whether the action springs from business requirements or purpose to monopolize."

Having arrived at the proper qualitative *method* of examination, there remains the question of what standard of proof should be required—the Sherman Act requirement of undue restraint, absent monopolization or a purpose to monopolize, or the incipiency test of section 5 of the FTC Act. Initially, it would be preferable to adopt a monolithic standard by a coalescence of those under the applicable antitrust laws. Guilt or innocence should not hinge on who decides the case—the courts or the Commission. Perhaps it would be too much to expect the Commission to abdicate the broader reach of section 5, but it should at least require a showing of a reasonable probability that the practice would have the proscribed adverse effect on competition.

Perhaps most importantly, the relevant market and line of commerce must be defined by considering competition at each level of distribution. Whether the line of commerce is established by determining a product's "peculiar characteristics and uses,"[103] or its "reasonable interchangeability"[104] with competing products, the im-

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[101] 334 U.S. 495, 522 (1948).

[102] 345 U.S. 594, 615 (1953). This is the test advocated under the merger analogy by THE REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 28 (1955). Mr. Justice Brandeis in Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918), stated the relevant factors to be considered in applying the Rule of Reason as follows: "The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition, or whether it is such as may suppress or even destroy competition. To determine that question, the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint, and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences." See generally Montague, *"Per Se Illegality" and the Rule of Reason*, 12 A.B.A. ANTITRUST SECTION 69 (1958).

[103] See United States v. E. I. du Pont de Nemours & Co., 353 U.S. 586 (1957). *Cf.* American Crystal Sugar Co. v. Cuban-American Sugar Co., 259 F.2d 524 (2d Cir. 1958).

[104] See United States v. E. I. du Pont de Nemours & Co., 351 U.S. 377 (1956). *Cf.* Union Carbide Corp., No. 6826, FTC, September 25, 1961.

portant test should be whether the practice tends unreasonably to restrain competition between competing brands of the relevant product—without restricting the inquiry to effects on intra-brand competition in which each manufacturer has a "natural monopoly."[105]

It is possible that out of the pending litigation there may come some order to the chaotic status of vertical territorial arrangements. The Supreme Court, in considering the appeal in *White,* and the Commission, in the pending appeal in *Sandura,* have the opportunity to clarify the law. However, the question regarding the legality of such territorial arrangements may be avoided again by emphasizing the alleged horizontal nature of the restraints, or by finding a single over-all method of competition involving illegal price fixing as well as vertical territorial restrictions. Either or both of these factors may so color any forthcoming decision as to render it valueless on the single issue of exclusive territories. As a final observation, it might be worth mentioning that although there is ample precedent for enjoining legal with illegal practices where they are common elements of the same method of distribution, it by no means is compulsory that such be the result indiscriminately, and the policy of our antitrust laws may militate against throwing out the baby with the bath.

[105] See CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION (7th ed. 1956). *Cf.* United States v. Guerlain, Inc., 155 F. Supp. 77 (S.D.N.Y. 1957), *judgment vacated on motion of the United States,* 172 F. Supp. 107 (S.D.N.Y. 1959), (defendant's own trademarked perfumes held to constitute relevant market).