

WASHINGTON UNIVERSITY LAW QUARTERLY

VOLUME 58

NUMBER 4

1980

VIABILITY OF THE ANTITRUST PER SE ILLEGALITY RULE: SCHWINN DOWN, HOW MANY TO GO?

WILLIAM S. STEWART*
BARRY S. ROBERTS**

Continental T.V., Inc. v. GTE Sylvania, Inc.,¹ which overruled *United States v. Arnold, Schwinn and Co.*,² prompted an avalanche of legal commentaries,³ a fact in itself suggestive of a landmark case. One leading author characterized the case as a "watershed decision which should greatly influence future developments in the antitrust field."⁴ Numerous commentators openly question whether the decision will lead to the demise of other per se rules⁵ of illegality. Will the applica-

* Professor, University of North Carolina, Graduate School of Business Administration. B.S., Georgia Institute of Technology; LL.B., Harvard University.

** Associate Professor of Legal Studies, University of North Carolina Graduate School of Business Administration. B.A., 1970, Pennsylvania State University; J.D., 1973, University of Pennsylvania School of Law; LL.M., 1976, Harvard University.

1. 433 U.S. 36 (1977).

2. 388 U.S. 365 (1967). See notes 12-25 *infra* and accompanying text.

3. Bork, *Vertical Restraints: Schwinn Overruled*, 1977 SUP. CT. REV. 171; Handler, *Changing Trends in Antitrust Doctrines: An Unprecedented Supreme Court Term—1977*, 77 COLUM. L. REV. 979 (1977); Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions*, 78 COLUM. L. REV. 1 (1978); Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. CHI. L. REV. 1 (1977); Weisberg, *Continental T.V. v. GTE Sylvania: Implications for Horizontal, as Well as Vertical, Restraints on Distributors*, 33 BUS. LAW. 1757 (1978); *The Supreme Court, 1976 Term*, 91 HARV. L. REV. 70, 231 (1977); Note, *Antitrust-Vertical Restrictions—Rule of Reason*, 1977 WIS. L. REV. 1240 (1977).

4. Handler, *supra* note 3, at 980. Professor Bork has stated that the new *Sylvania* approach "is capable of altering the entire corpus of antitrust jurisprudence, which now stands in considerable need of repair." Bork, *supra* note 3, at 172.

5. Section 1 of the Sherman Antitrust Act prohibits restraints of trade. 15 U.S.C. § 1 (1976). See note 17 *infra*. If interpreted literally every contract would be illegal; hence, the test formu-

tion of the rule of reason test⁶ to vertical nonprice restraints affect the established per se approach to tying arrangements,⁷ horizontal territorial restrictions,⁸ horizontal price-fixing,⁹ resale price maintenance,¹⁰ and concerted refusals to deal?¹¹ Will *Sylvania* turn antitrust law

lated is one based on the reasonableness of the restraint. See *National Soc'y of Professional Eng'rs v. United States*, 435 U.S. 679 (1978); *Chicago Bd. of Trade v. United States*, 246 U.S. 231 (1918).

Certain categories of restraints, however, are deemed unreasonable by their very nature and thus are per se illegal. There "are agreements whose nature and necessary effect are so plainly anticompetitive that no elaborate study . . . is needed to establish their illegality—they are 'illegal per se.'" *National Soc'y of Professional Eng'rs v. United States*, 435 U.S. at 692. In the oft-quoted words of Mr. Justice Black:

[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of *per se* unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable—an inquiry so often wholly fruitless when undertaken.

Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958). See *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1 (1979).

6. The rule of reason is the prevailing standard of section 1 of the Sherman Act. See 433 U.S. at 49. *But see* Posner, *supra* note 3, at 14. The standard is generally defined by the oft-quoted words of Mr. Justice Brandeis:

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.

Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918), *quoted in* 433 U.S. at 49 n.15. Both Pitofsky and Posner, however, state that this test presents no guidance for the lower courts. See generally Pitofsky, *supra* note 3, at 11; Posner, *supra* note 3, at 13-16; ABA Antitrust Section, Monograph No. 2, *Vertical Restrictions Limiting Intra-brand Competition* 53-71 (1977) [hereinafter cited as *Monograph No. 2*].

7. See generally Posner, *supra* note 3, at 11-12.

8. See notes 77-108 *infra* and accompanying text. For purposes of this Article the term territorial allocation or restrictions will encompass customer allocation or restrictions unless otherwise specified.

9. This issue is beyond the scope of this Article; however, it does appear that such restraints shall properly remain per se illegal.

10. See notes 45-76, 109-28 *infra* and accompanying text.

11. See notes 129-57 *infra* and accompanying text.

“topsy turvy”?

This Article explores these significant questions four years after the momentous *Sylvania* decision. The impact of *Sylvania* on various anti-trust restraints is first examined in a descriptive fashion. Then, a principled approach for dealing generally with this type of economic-legal problem is suggested.

I. THE INEVITABILITY OF *SYLVANIA*

The extremely harsh treatment accorded *United States v. Arnold, Schwinn & Co.*¹² by both courts¹³ and commentators¹⁴ presaged a *Sylvania*-type decision but not one of its breadth.¹⁵ The *Schwinn* Court¹⁶ found a per se violation of the antitrust laws¹⁷ when a manufacturer¹⁸

12. 388 U.S. 365 (1967).

13. See, e.g., *Wilson v. I.B.E. Indus., Inc.*, 510 F.2d 986 (5th Cir. 1975); *Adolph Coors Co. v. FTC*, 497 F.2d 1178 (10th Cir. 1974); *Scooper Dooper, Inc. v. Kraftco Corp.*, 494 F.2d 840, 847 n.13 (3d Cir. 1974); *Good Investment Promotions, Inc. v. Corning Glass Works*, 493 F.2d 891, 893 (6th Cir. 1974); *Colorado Pump & Supply Co. v. Febco, Inc.*, 472 F.2d 637, 639, 642 (10th Cir.), cert. denied, 411 U.S. 987 (1973). See generally Robinson, *Recent Antitrust Developments: 1974*, 75 COLUM. L. REV. 243, 275-76 (1975) (calling GTE *Sylvania, Inc. v. Continental T.V., Inc.*, 537 F.2d 980 (9th Cir. 1976), “aberrational” in following the *Schwinn* ruling). See also *Tripoli Co. v. Wella Corp.*, 425 F.2d 932, 936 (3d Cir.) (distinguishing *Schwinn* on its facts), cert. denied, 400 U.S. 831 (1970); *Janel Sales Corp. v. Lanvin Perfumes, Inc.*, 396 F.2d 398, 406 (2d Cir.) (same), cert. denied, 393 U.S. 938 (1968).

14. See, e.g., M. HANDLER, TWENTY-FIVE YEARS OF ANTITRUST 731, 1056 (1973) (“In my view, the most egregious error in all of antitrust was that committed by Justice Fortas in *Schwinn*.”); Baker, *Vertical Restraints in Times of Change: From White to Schwinn to Where?*, 44 ANTITRUST L.J. 537 (1975); Pollock, *Antitrust Problems in Franchising*, 15 N.Y.L.F. 106, 110-13 (1969); Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282, 283-99 (1975); Robinson, *supra* note 13, at 270 (“Perhaps no decision in the annals of antitrust has evoked more criticism.”); *The Supreme Court, 1966 Term*, 81 HARV. L. REV. 69, 235-39 (1967); Note, *Territorial Restrictions and Per Se Rules—Re-evaluation of the Schwinn and Sealy Doctrines*, 70 MICH. L. REV. 616 (1972).

15. Professor Robinson, noting that the two imposed restrictions were clearly distinguishable, stated that the *Sylvania* decision was not preordained by *Schwinn*. Robinson, *supra* note 13, at 277-78. See also 433 U.S. at 59-65 (White, J., concurring); *GTE Sylvania, Inc. v. Continental T.V., Inc.*, 537 F.2d 980, 989-1000 (9th Cir. 1976) (en banc).

16. The decision in which Justices Warren, Brennan, Black, and Douglas joined was authored by Mr. Justice Fortas. Mr. Justices Stewart and Harlan dissented. Mr. Justices Clark and White did not participate in the decision.

17. Section 1 of the Sherman Anti-Trust Act, 15 U.S.C. § 1 (1976) provides in part: “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 declared to be illegal.”

18. For purposes of simplification, this Article employs a two tier distribution system: Manufacturer/supplier and dealer/distributor.

retained control or authority over its product after it sold the good.¹⁹ The *Schwinn* Court rested its decision in part on the ancient rule against restraints on alienation.²⁰ The Court made a fanciful distinction between the sale of a product and the distribution of the same good through a consignment or agency relationship.²¹ Thus, if a manufacturer parts with dominion over its goods, the imposition of a territorial or customer restriction on its purchasers is a per se violation.²² When title, dominion, and risk are retained, however, a court will inspect the manufacturer's restrictions under a rule of reason analysis.²³

Perhaps the confusion stemming from the harsh treatment accorded the *Schwinn* decision derived partly from the unexpectedness of the decision. The government did not proffer a per se illegality standard,²⁴ either at trial or on appeal, but merely supported a presumptive illegality standard.²⁵ Four years earlier the Court in *White Motor Co. v. United States*²⁶ rejected per se illegality of nonprice vertical restrictions until an adverse economic and business impact of the practice could be demonstrated. Until that time the Court felt it premature to express a "view one way or the other on the legality of such an arrangement."²⁷ Nor did *White Motor*, contrary to some beliefs,²⁸ adopt a rule of reason

19. Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion. . . . If the manufacturer parts with dominion over his product or transfers risk of loss to another, he may not reserve control over its destiny or the conditions of its resale.

388 U.S. at 379.

20. This rationale has been criticized as being "a mischievous precedent which rested on a nonexistent principle of ancient property law and which was historically incorrect." Handler, *supra* note 3, at 980-81. See also M. HANDLER, *supra* note 14, at 1056; Posner, *supra* note 14, at 295-96; Robinson, *supra* note 13, at 270-71.

21. When the manufacturer retains title, dominion, and risk over the product through an agency or consignment relationship, the appropriate test is one of reasonableness. 388 U.S. at 380.

22. See note 19 *supra*. Note that the Court spoke in terms of restriction on "areas or persons." 388 U.S. at 379.

23. See note 21 *supra*.

24. See Posner, *supra* note 3, at 2-3. Note that Professor Posner was the government attorney who both briefed and argued the case and who has since taken "a 180-degree turn." *Id.* at 2.

25. *Id.* at 2-3. See also *Monograph No. 2, supra* note 6, at 51 n.196.

26. 372 U.S. 253 (1963). Interestingly, Mr. Justice Clark, who dissented in *White Motor*, was the designated trial judge in *Sylvania*.

27. *Id.* at 261. The government first adopted the position that such restraints were per se illegal in 1949. See L. SULLIVAN, ANTITRUST § 143 (1977); *Monograph No. 2, supra* note 6, at 6.

28. See, e.g., *In re Nissan Antitrust Litigation*, 577 F.2d 910, 915 (5th Cir. 1978), cert. denied, 439 U.S. 1072 (1979); *Pitchford Scientific Instruments Corp. v. Pepi, Inc.*, 435 F. Supp. 685, 686

standard.²⁹ The *White Motor* Court adopted no standard at all.

In overruling *Schwinn*, Mr. Justice Powell, writing for the majority in *Continental T.V., Inc. v. GTE Sylvania, Inc.*,³⁰ extended the *Schwinn* decision to its furthest possible breadth³¹ by equating Sylvania's location clause³² in both "intent and competitive impact"³³ with *Schwinn*'s

(W.D. Pa. 1977); Note, *Vertical Restraints and the Demise of Schwinn: Sylvania and the Rule of Reason*, 42 ALB. L. REV. 137, 146 (1977).

29. See notes 26-27 *supra* and accompanying text. The courts never had an opportunity to reconsider the case because it was settled under a consent decree prior to the retrial. [1964] (CCH) Trade Cas. ¶ 71,195 (N.D. Ohio).

30. 433 U.S. 36 (1977). In *Sylvania* the manufacturer, GTE Sylvania, Inc., had a distribution system whereby it sold its televisions to both uncontrolled and company controlled middlemen, who in turn resold the televisions to independent retailers. When Sylvania's market share declined in 1962 to between one and two percent of the national market, the company decided to limit its number of retail franchises to attract higher quality and more aggressive retailers. It therefore required authorized retailers to sell Sylvania products only at their approved and franchised locations. These locations were not exclusive areas of distribution; Sylvania reserved the right to determine the number of retailers in any area.

Controversy arose when Sylvania decided to franchise Young Brothers, a San Francisco retailer of televisions, even though Continental T.V., an established Sylvania retailer, was located only one mile away. Continental complained that franchising Young Brothers was not consistent with Sylvania's marketing policy. When Sylvania ignored Continental, Continental cancelled their outstanding Sylvania order and placed an order with Phillips, another television manufacturer.

Continental then requested that they be allowed to start a new franchise in Sacramento. Sylvania denied the request on the ground that no new franchise was needed in Sacramento. Nevertheless, Continental leased a store in Sacramento and began stocking it with Sylvania products. Sylvania then reduced Continental's authorized credit from \$300,000 to \$50,000, "allegedly for unrelated reasons." *Id.* at 39. Continental refused to pay its debts to John P. Maquire Co., Inc., the finance company handling Sylvania's accounts. Sylvania then disenfranchised Continental. Continental brought this action alleging that Sylvania's newly established distribution system was a per se illegal territorial allocation under the *Schwinn* doctrine. *Id.* at 38-42.

31. The Court interpreted the *Schwinn* holding as declaring per se illegal all territorial and customer restrictions without regard to possible differences between airtight restrictions and less severe restrictions such as location clauses, areas of primary responsibility clauses, and profit pass-over clauses. 433 U.S. at 45. *But see Id.* at 59 (White, J., concurring); Pitofsky, *supra* note 3, at 8-9.

At this point it would be beneficial to define the above-named less restrictive clauses:

- (a) Location clauses—establish the site at which the distributor may sell or manufacture (in the case of a licensee) the specified goods;
- (b) areas of primary responsibility—establish areas in which the distributor must make its best efforts to distribute the goods and often will be prevented from selling outside of its area;
- (c) profit pass-over—establish that a dealer making a sale outside of its assigned territory must compensate the distributor in whose area the sale was consummated.

See *Monograph No. 2, supra* note 6, at 3, 4; Pitofsky, *supra* note 3, at 4.

32. See note 31 *supra*.

33. 433 U.S. at 46.

airtight territorial and customer restrictions.³⁴ Powell then addressed whether *Schwinn* should be abrogated or followed.³⁵ The Court, however, foreclosed itself from distinguishing the *Schwinn* decision on the basis of differences in the anticompetitive nature of the two different restrictions.³⁶

After summarily dismissing the sale-no sale dichotomy³⁷ the Court determined that a rule of reason analysis should be followed because "there has been no showing . . . that vertical restrictions have or are likely to have a 'pernicious effect on competition' or that they 'lack any redeeming virtue.'" ³⁸ Significantly, the Court ruled that any "departure from the rule of reason standard must be based upon demonstrable economic effect."³⁹ A determination must be made whether the restriction is supported by economic utility, *i.e.*, redeeming virtue.⁴⁰

In holding that the vertical restraints imposed by Sylvania were economically efficient and therefore justified, the Court paid particular attention to the economic analysis of Professors Bork and Posner.⁴¹

In support of vertical nonprice restraints, the Court recognized the following justifications: (1) The attraction of aggressive and competent distributors to new manufacturers and entrants into the market;⁴² (2) the promotion of point-of-sale services and the avoidance of the "free-rider" problem;⁴³ and (3) the promotion of safe and quality products.⁴⁴

34. *Id.* An airtight territorial restriction prohibits a distributor from selling to anybody outside of its assigned territory, and an airtight customer restriction prevents a distributor from selling to other customers. See Pitofsky, *supra* note 3, at 4 n.10.

35. The Court decimated the *Schwinn* distinction between sales and consignment transactions in holding that the two had the same effect on competition. 433 U.S. at 52-57. Moreover, the *Sylvania* opinion was not a reincarnation of the *White Motor* case, which simply refused to determine prior to a complete trial the appropriate standard. It is clear that *Sylvania* elected to follow the rule of reason approach. See notes 26-29 *supra* and accompanying text.

36. See notes 30-35 *infra* and accompanying text.

37. 433 U.S. at 57. Not even the standard opponent of vertical territorial restraints could support this distinction. See generally Comanor, *Vertical Territorial and Customer Restrictions: White Motor and its Aftermath*, 81 HARV. L. REV. 1419, 1422 (1968).

38. 433 U.S. at 58 (elucidating the *per se* test). See note 5 *supra*.

39. 433 U.S. at 58-59.

40. It has been contended that *Sylvania* was a one-sided decision in that it only focused on the redeeming virtue side of the balance and ignored the harmful effects of the restraint. See Pitofsky, *supra* note 3, at 8-9; *The Supreme Court, 1976 Term*, 91 HARV. L. REV. 70, 237 (1977). *But see* Bork, *supra* note 3, at 172, 186, who contends that the pre-*Sylvania* Court only looked to the anticompetitive side of the balance.

41. 433 U.S. at 55-56.

42. *Id.* at 55.

43. *Id.*

44. *Id.* at 55 n.23.

The Court's rationale jeopardizes several of its earlier holdings applying the per se illegality doctrine. This Article now focuses on this aspect of the *Sylvania* decision.

II. THE IMPACT OF THE *SYLVANIA* RULING ON OTHER PER SE CATEGORIES

A. *Resale Price Maintenance*

Mr. Justice White in his concurring opinion in *Sylvania* ably disclosed the majority's internal inconsistency in relying on the purely economic approach of Professors Bork and Posner with respect to exclusive territories and also reaffirmed the per se illegality of vertical price restraints.⁴⁵ Both Professors strongly insist that "any argument that can be made on behalf of exclusive [vertical] territories can [equally] be made on behalf of resale price maintenance."⁴⁶ Recognizing this difference of opinion, the majority stated that "[t]he per se illegality of price restriction has been established firmly for many years and involves significantly different questions of analysis and policy."⁴⁷ These two categories of restraints, according to the Court, are clearly distinguishable. First, "unlike nonprice restrictions, 'resale price' maintenance is not designed to, but almost invariably does in fact, reduce price competition not only among sellers of the affected product but quite as much between that product and competing brands."⁴⁸ Second, resale price maintenance, unlike territorial allocation, may assist horizontal cartelization. Third, Congress repealed the fair trade laws.⁴⁹

Both Professors Bork and Posner immediately attacked these "significant differences."⁵⁰ The Court, according to Professor Bork, failed to comprehend the unitary character of vertical restraints and wrongfully

45. See *id.* at 51 n.18; *id.* at 69 n.10 (White, J., concurring).

46. *Id.* at 69 n.10 (White, J., concurring) (quoting Posner, *supra* note 14, at 293-97). See also Bork, *supra* note 3, at 173; Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division* (part II), 75 YALE L.J. 373, 391-464 (1966).

47. 433 U.S. at 51 n.18.

48. *Id.* (emphasis in original) (quoting Justice Brennan's concurring opinion). Interestingly, the Court quoted Professor Posner in support of this proposition without including Professor Posner's rebuttal to this assertion. "There is no excuse . . . for distinguishing between price fixing and market division . . ." Posner, *supra* note 14, at 297.

49. 433 U.S. at 51 n.18.

50. Bork, *supra* note 3; Posner, *supra* note 3.

differentiated indistinguishable business practices.⁵¹ The legal doctrine that the Court established fails to conform to economic reality. “[I]t draws lines and makes distinctions that do not exist in the world it purports to describe and control.”⁵² It totally ignores microeconomic theory.⁵³ Therefore, Bork concludes that the two economic justifications espoused by the Court are easily disposed of as insignificant⁵⁴ and that the legislative rationale is a mere congressional misunderstanding that is not written into law.⁵⁵

Professor Posner combines the economic rationales into one: resale price maintenance is utilized to facilitate manufacturer cartelization and thereby decreases interbrand competition.⁵⁶ He dismisses this rationale, however, as being unsupportable. He argues that no distinction exists between the possible roles of price and nonprice vertical restrictions in assisting manufacturer collusion,⁵⁷ even though the majority quoted Professor Posner in its attempt to establish such a distinction.

Lower courts were confronted with the problem of whether to adopt the reasoning of *Sylvania* or to follow its literal language when judging the validity of vertical price restrictions. The First Circuit in *Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc.*⁵⁸ elucidated an extremely interesting and unique approach. Judge Coffin reasoned in *Eastern Scientific* that a resale price restriction imposed to enforce a territorial limitation could obviously have no greater anticompetitive effect than an absolute territorial restriction and thus was not a per se violation of the antitrust laws.⁵⁹ The restriction confronting the court was a prohibition by the manufacturer on its distributors against selling

51. Bork, *supra* note 3, at 171, 173.

52. *Id.* at 173.

53. *Id.*

54. *Id.* at 190. Moreover, he significantly concludes that all vertically imposed restrictions should be considered valid. *Id.* at 180-81; Bork, *supra* note 44, at 397. *But see* Comanor, *supra* note 37, who suggests that all vertical territorial restrictions should be per se illegal.

55. Bork, *supra* note 3, at 190. *But see* Pitofsky, *supra* note 3, at 27.

56. Posner, *supra* note 3, at 708. Professor Posner is incorrect in so doing, however, because they are two distinct, although at times, interrelated reasons. The first reason, note 46 *supra* and accompanying text, extends to the situation in which a competitor, whose price is fixed by a manufacturer, not only cannot compete on price with intrabrand products, but also is prevented from adjusting its price to reflect interbrand competition.

57. Posner, *supra* note 3, at 7-8.

58. 572 F.2d 883 (1st Cir.), *cert. denied*, 439 U.S. 833 (1978).

59. *Id.* at 885-86. *See* Knutson v. Daily Review, Inc., 468 F. Supp. 226, 231 n.7 (N.D. Cal. 1979).

its product below list price outside of the distributors' assigned territory. The distributors were free to establish the price within their area of primary responsibility.⁶⁰ In circumflexing the *Sylvania*-reinforced ban against vertical price-fixing, the court refused to characterize such a restriction as "the kind that require[s] per se treatment."⁶¹

The court reasoned that the entire thrust of *Sylvania* was to avoid formalistic line drawing and to rely on sound economic analysis.⁶² It believed that any other ruling would place form over substance:

Certainly, if the price at which Heerbrugg [the manufacturer] instruments would be competitive outside of Rhode Island is less than list price, requiring Eastern [the distributor] to sell at list does no more nor less than prohibit Eastern from selling outside of Rhode Island altogether. In the unlikely event that Heerbrugg instruments are competitive at list prices or at higher than list prices, requiring Eastern to sell at list will have less of an anti-competitive effect than restricting its sale to Rhode Island regardless of price. Thus the resale price restriction in the present case produces the same anti-competitive effect as pure territorial restrictions but to a lesser degree. If the Supreme Court holds that pure territorial restrictions should be analyzed under the rule of reason, we can see no reason based on substantive economic effect why a similar but less anti-competitive scheme should be treated differently.⁶³

This was logic that the Supreme Court would have extreme difficulty circumventing and that, in fact, they elected not to confront.⁶⁴

The Fifth Circuit in *In re Nissan Antitrust Litigation* similarly eschewed application of the per se test to an alleged price-fixing case. The court refused to characterize the restraint as a price-fixing agreement.⁶⁵ Once again a court seemingly struggles to avoid the inflexibility of the per se doctrine.⁶⁶ The word "seemingly" is employed in the

60. 572 F.2d at 884.

61. *Id.* at 885. See *Appalachian Coals, Inc. v. United States*, 288 U.S. 344 (1933); *Chicago Bd. of Trade v. United States*, 246 U.S. 231 (1918).

62. 572 F.2d at 885.

63. *Id.* at 885-86.

64. The Supreme Court denied certiorari on October 2, 1978. 439 U.S. 833 (1978).

65. *In re Nissan Antitrust Litigation*, 577 F.2d 910 (5th Cir. 1978), *cert. denied*, 439 U.S. 1072 (1979).

66. *Nissan* concerned an action by a Datsun automobile purchaser against the manufacturer and its American distribution branch for allegedly conspiring to fix prices through a dealer cooperative advertising program. Nissan-USA, under the program, would reimburse its dealers for any advertisement provided it did not list any price other than its suggested retail price and that it did not compare itself to another dealer. The funds used to pay for the approved advertisements were obtained by charging each dealer a set sum, based on the suggested retail price on each car it

previous sentence because of the near utter confusion presented by the *Nissan* opinion. The court either had extreme difficulty in interpreting *Sylvania* and its predecessors or was simply undiscerning in its choice of words. For instance, the court indicated that *Sylvania* represented a return "to the rule of reason that had governed vertical restriction prior to *United States v. Schwinn*"—a clearly incorrect appraisal of the holding in *White Motor*.⁶⁷

Moreover, the *Nissan* court concluded that *Sylvania* mandated that any "departure from the rule of reason standard [in *vertical restraint cases*] must be based upon demonstrable economic effect."⁶⁸ Did the court simply make a careless overstatement,⁶⁹ misread *Sylvania*, or elect to apply *Sylvania's* underlying principles (*i.e.*, extend the Posner and Bork rationale to all vertical restraints including price-fixing)?

sold, which sum was then matched by Nissan. A dealer, nevertheless, was free to sell at any price—although the plaintiff contended that the above-described program severely limited one's ability to compete on price.

The court initially distinguished this situation from those presented in *United States v. Sealy, Inc.*, 388 U.S. 350 (1967), and *United States v. Serta Assocs.*, 296 F. Supp. 1121 (N.D. Ill. 1968), *aff'd*, 393 U.S. 534 (1969) (both horizontal restraint decisions) on the ground that it found the restriction to be vertical in nature. The court proceeded to refuse to characterize the agreement as a price restraint and therefore upheld the lower court's *Sylvania* type rule of reason analysis to the questioned restriction, which the jury found to be reasonable.

Looking at the provisions of the co-operative advertising plan, imposed by the manufacturer upon all of its franchises, we cannot say as a matter of law that the plan, in the absence of an agreement to fix prices, was on its face of such an anticompetitive nature and effect that it negated the rule generally applied in the appraisal of vertical restraint cases.

577 F.2d at 916. Based on the evidence disclosed, it is certainly arguable that the court appropriately refused to characterize the restriction as a price-fixing agreement. See *Appalachian Coals, Inc. v. United States*, 288 U.S. 344 (1933); *Chicago Bd. of Trade v. United States*, 246 U.S. 231 (1918). But see *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940); *United States v. Serta Assocs.*, 296 F. Supp. 1121 (N.D. Ill. 1968), *aff'd*, 393 U.S. 534 (1969).

67. As already indicated the law prior to *Schwinn* was in doubt because the Court in *White Motor* refused the opportunity to enunciate the proper standard until it had greater experience examining the questioned restraint. See notes 24-29 *supra* and accompanying text. See generally *Monograph No. 2*, *supra* note 6, at 6-8. It had no support for its position. See also *Sandura Co. v. FTC*, 339 F.2d 847 (6th Cir. 1964); *Snap-On-Tools Corp. v. FTC*, 321 F.2d 825 (7th Cir. 1963).

For a Note making the same mistake, see Note, *Vertical Restraints and the Demise of Schwinn*, *supra* note 28, at 146.

68. 577 F.2d at 915 (quoting 433 U.S. at 58-59) (emphasis added). Significantly, note that the underscored parenthetical portion of this quotation was inserted in the statement by the court of appeals.

69. The court may have been limiting its definition of vertical restraints to nonprice restrictions. In defining "vertical restraints," however, the court stated that they are "those limitations imposed by a manufacturer on his own dealers . . . , which may have independent and valid business justifications." 577 F.2d at 915.

One cannot resolve this question because the court determined that the restraint could not be characterized as price-fixing and hence any statement made concerning such restrictions was purely dictum. Nevertheless, the court's need to distinguish between price restraints and other vertical restraints indicates a recognition of some difference. The distinction, however, may simply be that vertical price restraints may fit into the category of restrictions that demonstrate a per se economic effect. Any interpretation of this decision or conclusions drawn from it must reflect its ambiguities and difficulties in distinguishing between vertical price and nonprice restraints and between vertical and horizontal restraints.⁷⁰

Other lower federal courts have had difficulty in analyzing and applying the *Sylvania* doctrine. In *Pitchford Scientific Instruments Corp. v. Pepi, Inc.*⁷¹ a district court also misapprehended the holding of *White Motor*⁷² and failed to properly interpret the *Sylvania* holding. In *Pitchford* Judge Dumbauld initially recognized the problem that *Sylvania* would cause in vertical price-fixing cases. After all, any argument made in support of vertical territorial allocations could also be made in justification of vertical price-fixing.⁷³ The court, however, proceeded to determine that the case involved a horizontal agreement to divide territories and thus was not governed by *Sylvania*. In so holding, the court aptly demonstrated the confusion⁷⁴ created by *Sylvania* by stating that *Sylvania* dealt only with and was limited to location clauses.⁷⁵ More serious territorial restrictions were erroneously believed not to be covered by the decision.⁷⁶

More complete and adequate guidance is obviously essential for an

70. See note 66 *supra*.

71. 435 F. Supp. 685 (W.D. Pa. 1977).

72. The court improperly stated that the *Sylvania* decision "reverted to the standards of *White*." *Id.* at 686. The Court actually went beyond *White Motor* to an acceptance of the rule of reason standard for nonprice vertical restrictions. The district court, interestingly, did follow the above-quoted remark with a statement appropriately describing *White Motor* as "where 'the Court had refused to endorse a *per se* rule for vertical restrictions.'" *Id.*

73. *Id.* at 688 (citing Mr. Justice White's concurring opinion in 433 U.S. at 69 n.10 and Judge Browning's dissenting opinion in 537 F.2d at 1019). See notes 45-57 *supra* and accompanying text.

74. The court itself stated that "it is probable that the Continental T.V. [*Sylvania*] case will produce as much confusion and controversy as the Schwinn case which it superseded." 435 F. Supp. at 687.

75. *Id.* at 688.

76. See 433 U.S. at 51 n.18, 58 n.29. See also *General Beverage Sales Co. v. East-Side Winery*, 568 F.2d 1147 (7th Cir. 1978).

orderly and principled approach to resale price maintenance. The *Sylvania* holding indicates one result, but its reasoning suggests an opposite effect.

B. *Horizontal Territorial Allocation*

The *Sylvania* Court explicitly stated that its ruling did not extend to horizontal territorial restraints and that the per se rule established in *United States v. Topco Associates, Inc.*⁷⁷ remained fully intact.⁷⁸ With approximately equal zeal, legal commentators criticized the Court's reaffirmation of *Topco* as economically incorrect and premised instead on mere judicial convenience.⁷⁹

Attorney David Weisberg levels the most comprehensive assault on *Sylvania*.⁸⁰ He contends that the reasoning and logic of *Sylvania* demand rejection of the *Topco* rationale. Weisberg attempts to substantiate this conclusion by reviewing *Topco*, its underpinnings, and re-examining the validity of these supporting reasons in light of *Sylvania*. Weisberg lays out and refutes three rationales that form the basis of the *Topco* decision. First, horizontal territorial restraints interfere with economic freedom.⁸¹ Secondly, the overall economic impact of horizon-

77. 405 U.S. 596 (1972). In *Topco* a number of small and medium-sized grocers joined forces to establish a private label chain of products in order to compete more effectively with the large national grocery chains. To maintain an effective private label program, the annual sales must exceed 250 million dollars and hence the need to bind together.

The district court, applying a rule of reason analysis, found the association to be pro-competitive and therefore valid. The Supreme Court, however, reversed, holding that horizontal territorial allocations are per se illegal on the grounds that such restraints are classic examples of unreasonable restraints of trade and that it is not for the courts, but for Congress, to balance differing competitive forces, i.e., intrabrand competition against interbrand competition.

Chief Justice Burger filed a scathing dissent in which he contended that the majority erroneously employed a per se test without economic justification, misinterpreted judicial precedent, and failed to properly employ the per se test. For strong praise of Justice Burger's dissent, see Handler, *supra* note 3, at 986-87.

At this junction it would be appropriate to define interbrand and intrabrand competition. Interbrand competition is competition among sellers of the same general/generic product and intrabrand competition is that competition between distributors of the same branded product. See 433 U.S. at 52 n.19.

78. 433 U.S. at 57-58 nn.27-28. Note that the Court did not cite *United States v. Sealy, Inc.*, 388 U.S. 350 (1967), a case the Court heavily relied on in *Topco* and a decision rendered the same day as *Schwinn* and authored by the same Justice—Fortas.

79. See, e.g., Bork, *supra* note 3, at 177; Handler, *supra* note 3, at 986-87; Posner, *supra* note 3, at 9-10; and Weisberg, *supra* note 3.

80. See Weisburg, *supra* note 3.

81. *Id.* at 1764-67. The *Sylvania* restriction imposes a greater restraint in that it is imposed by another party but in *Topco* the restraint was self-imposed.

tal territorial restraints cannot be evaluated. A court cannot balance the increase in interbrand competition against the decrease in intrabrand competition.⁸² Third, horizontal territorial restraints have historically been condemned.⁸³ Although Weisberg refutes each rationale, he fails to compare the anticompetitive effects of the horizontal and the vertical territorial restrictions, perhaps because he was simply arguing against the imposition of a per se rule of illegality against all horizontal nonprice restraints.⁸⁴

Professor Posner asserts that the Court's ardent adoption of the "free-rider" justification severely jeopardizes the validity of the *Topco* line of reasoning.⁸⁵ Professor Bork advocates legal recognition of ancillary⁸⁶ horizontal territorial allocations unless the parties possess market control.⁸⁷

*Ohio-Sealy Mattress Mfg. Co. v. Sealy, Inc.*⁸⁸ (*Sealy II*) is the most significant horizontal territorial allocation case decided subsequent to *Sylvania*.⁸⁹ In *United States v. Sealy*⁹⁰ (*Sealy I*) a group of small mat-

82. *Id.* The economic balance performed in *Sylvania* is equally applicable to horizontal restraints.

83. *Id.* Pre-*Topco* cases did not demand the *Topco* decision. Even if they did, *Schwinn* was decided the same day as *Topco's* prime precedent—*Sealy*.

84. Mr. Weisberg may not have been contending that all horizontal nonprice restraints come under a rule of reason standard, but rather that they should not all be conclusively presumed to be per se illegal.

85. Posner, *supra* note 3, at 10-11. For an explanation of the free-rider justification, see notes 161-71 *infra* and accompanying text.

86. An ancillary restraint is one that is subordinate to the main purpose of the restriction. The ancillary restraint doctrine provides that a restraint is reasonable if it is: (1) reasonably necessary to accomplish the primary purposes; (2) not unreasonably anticompetitive; and (3) not imposed by a monopolist. *Monograph No. 2, supra* note 6, at 55 and cases cited therein.

Professor Bork distinguishes ancillary restraints from naked restraints by defining the latter as "agreements eliminating competition which have no efficiency-creating potential." Bork, *supra* note 46, at 384.

87. Bork, *supra* note 46, at 391-97. He contends that because the agreement cannot increase a party's revenues by allowing output restriction, the only plausible explanation is manufacturing efficiency. He has frequently contended that businessmen are in business to earn money. He eliminates the possibility of increased profit from decreasing output by outlawing cartels that control market price. "A prerequisite for restriction of output is a large enough share of the market so that the firm can alter total industry output significantly by changing its own output." *Id.* at 394.

88. 585 F.2d 821 (7th Cir. 1978), *cert. denied*, 440 U.S. 930 (1979).

89. At the time of this second suit Sealy continued to license its trademark to various manufacturers who jointly owned over 98% of the Sealy stock. However, in the interim between *Sealy I* and the present litigation Sealy acquired the rights to manufacture and sell in seven of its assigned territories.

90. 388 U.S. 350 (1967).

dress manufacturers combined to form a common trademark (Sealy) and product. The manufacturers licensed the product to themselves for production and distribution. In holding the restraint to be a per se violation of the antitrust laws the Court noted that the case presented "an aggregation of trade restraints" including unlawful resale price-fixing activity.⁹¹ Following *Sealy I*,⁹² the association, Sealy, Inc., attempted to preserve the greatest degree of market division legally permissible through a series of interrelated territorial restrictions. The devised system consisted of location clauses,⁹³ areas of primary responsibility,⁹⁴ profit pass-over clauses,⁹⁵ exclusive territories,⁹⁶ and right of first refusal to purchase.⁹⁷

The plaintiff in *Sealy II* (Ohio-Sealy) argued that the elaborate plan maintained the illegal territorial allocation of *Sealy I* through more subtle means.⁹⁸ Ohio-Sealy contended that the diverse means employed by Sealy to divide territories, although arguably valid when standing alone, are per se illegal when viewed in conjunction with each

91. *Id.* at 354.

92. The final decree in *Sealy I* provided that Sealy was prevented from entering into any arrangement "to limit or restrict any manufacturer in any substantial way to sales of Sealy products within a prescribed territory." [1967] Trade Cas. (CCH) ¶ 72,327, at 84,856 (N.D. Ill.).

The Chief of the Division's Midwest Office stated that the Division did not feel the language prohibited the implementation of location clauses, areas of primary responsibility or profit pass-over clauses. The validity of these methods would have to be determined in due course. 585 F.2d at 826.

93. Licensees were permitted to manufacture Sealy products only from designated locations. Location clauses were upheld by the Court in *Sylvania*; *Salco Corp. v. General Motors Corp.*, 517 F.2d 567 (10th Cir. 1975); *Boro Hall Corp. v. General Motors Corp.*, 124 F.2d 822 (2d Cir. 1942), *cert. denied*, 317 U.S. 695 (1943).

94. The Sealy licensing agreement provided that each licensee was responsible for its own designated area and that once its designated quota was met royalties paid to Sealy would be cut in half. Such agreements have traditionally been upheld by the courts. *See, e.g.*, *Colorado Pump & Supply Co. v. Febco Inc.*, 472 F.2d 637 (10th Cir.), *cert. denied*, 411 U.S. 987 (1973); *Kaiser v. General Motors Corp.*, 396 F. Supp. 33 (E.D. Pa. 1975), *aff'd without opinion*, 530 F.2d 964 (3d Cir. 1976).

95. Sealy's profit pass-over clause contained two elements: (a) a 1% service charge to the holder of the rights of the invaded territory as a compensatory fee for repairs and (b) a charge based upon a formula to reimburse the invaded territory holder for promotional expenses. Such claims have generally been upheld as reasonable restraints of trade. *See, e.g.*, *White Motor Co. v. United States*, 372 U.S. 253, 270-71 (1963) (Brennan, J., concurring); *Superior Bedding Co. v. Serta Assocs.*, 353 F. Supp. 1143 (N.D. Ill. 1972).

96. Sealy agreed not to license anyone else in the businesses' designated areas.

97. This provision merely granted Sealy, Inc. the right of first refusal to purchase a selling licensee's business at the contractually agreed on selling price between the licensee and its prospective buyer.

98. 585 F.2d at 824, 826. *But see Monograph No. 2, supra* note 6, at 4.

other.⁹⁹ Mindful of the horizontal¹⁰⁰ nature of the restraint, the court recognized that any substantial limitation on a licensee's sales territory was traditionally deemed a per se violation,¹⁰¹ unless, as defendant contended, the *Sylvania* decision altered this general rule. The court rejected the defendant's contention, however, and affirmed the trial court's per se ruling.¹⁰² Judge Pell specifically relied on *Sylvania*'s footnote 28, which "expressly reaffirmed the appropriateness of the per se rule for horizontal territorial limits."¹⁰³ The *Sealy II* court refused to balance the interbrand competitive effect against the intrabrand competitive effect on the ground that *Sylvania* rejected this very argument.¹⁰⁴ "Limitations imposed by a single independent manufacturer on its distributors" were considerably more suspect in the court's eyes than "[a] horizontal agreement among potential competitors to develop a national brand and not to compete with each other in selling it."¹⁰⁵

Other federal courts have relied on the *Sylvania* decision in arriving at the same conclusion. Courts continue to universally apply the per se illegality doctrine to horizontal market division¹⁰⁶ unpersuaded by the

99. See notes 93-97 *supra* for judicial authority supporting the general nature of each of the imposed restraints.

100. "It is indisputably clear that any restraints applied to the independent businesses which are licensees result directly from the concerted action of their horizontal potential competitors." 585 F.2d at 827.

101. *Id.* (citing *United States v. Topco Assocs.*, 405 U.S. 596 (1972)); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951); *United States v. National Lead Co.*, 332 U.S. 319 (1947); *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211 (1899). *But see* note 85 *supra* and accompanying text (acknowledging that *Sealy I* involved an aggregation of restraints including price-fixing, which the court explicitly recognized in note 4, 585 F.2d at 824 n.4, although specifically circumventing the problem by relying on the *Topco* decision).

102. The court held that although restrictions when standing alone may be innocent they lose their validity when utilized in conjunction with additional restraints of trade. 585 F.2d at 827-28. The court then proceeded to analyze each of the above-mentioned restrictions stating: (a) Location clauses—due to the nature of the product and high transportation costs—such clauses tend to forestall competition, especially if locations are carefully selected, as *Sealy* is alleged to have done; (b) area of primary responsibility—was not discussed; (c) profit pass-over clauses—were found to be unreasonable and unduly burdensome, the payment far exceeded the true cost; (d) right of first refusal clause—was found to be employed only against the plaintiff and in order to protect the defendant's licensees; and (e) exclusive territories—see point (a) above.

103. 585 F.2d at 830 (referring to 433 U.S. at 58 n.28).

104. *Id.* at 831 (citing 433 U.S. at 57 n.27).

105. *Id.*

106. See, e.g., *In re Nissan Antitrust Litigation*, 577 F.2d 910 (5th Cir. 1978), *cert. denied*, 439 U.S. 1072 (1979) (dicta); *United States v. Cadillac Overall Supply Co.*, 568 F.2d 1078 (5th Cir.), *cert. denied*, 437 U.S. 903 (1978); *Newberry v. Washington Post Co.*, 438 F. Supp. 470 (D.D.C. 1977) (dicta); *Pitchford Scientific Instruments Corp. v. Pepi, Inc.*, 435 F. Supp. 685 (W.D. Pa. 1977); *In re Coca-Cola Co.*, 91 F.T.C. 517 (1978).

efforts of legal commentators.¹⁰⁷ One of these cases, however, further raises the interesting question of the effect that the *Sylvania* ruling will have on maximum vertical price restraints.¹⁰⁸

C. *Maximum Vertical Price Restrictions*

Before *Sylvania* several legal commentators, including Professor Posner, asserted that *Albrecht v. Herald Co.*,¹⁰⁹ a decision that extended the per se rule to agreements establishing maximum resale prices, was erroneous and economically unjustified. *Sylvania*, Posner contends, "demolish[ed] *Albrecht*."¹¹⁰ A persuasive argument advanced in support of this contention suggests that the manufacturer is powerless to prevent a distributor from exploiting its exclusive territory without the right to establish a maximum price. The justification for some territorial market division mandates that a manufacturer be allowed to prevent its distributors from extracting unfair and excessive profits from their intrabrand monopoly.¹¹¹ Interestingly, the Eighth Circuit in *Albrecht* adopted this precise argument.¹¹² The Supreme Court rejected this argument in *Albrecht* because it was unconvinced that allowing one form of illegal restraint (price-fixing) would blunt the pernicious consequences of another illegal activity (market division).¹¹³ The *Sylvania* ruling, however, places this argument in serious question and rekindles the position proffered by the Eighth Circuit.

The most significant post-*Sylvania* decision wrestling with this problem is *Newberry v. Washington Post Co.*¹¹⁴ The Washington Post provided two channels for distribution of its newspaper—one set of dealers provided home delivery while a second group of dealers provided serv-

107. See notes 79-87 *supra* and accompanying text.

108. See *Newberry v. Washington Post Co.*, 438 F. Supp. 470 (D.D.C. 1977).

109. 390 U.S. 145 (1968). The Court, recognizing the differences between minimum price-fixing and maximum price-fixing, found the restriction to be per se illegal because it: (1) Substituted the judgment of the manufacturer for that of the market and might hurt the distributor's ability to perform point-of-sale services and to adequately compete; (2) aided market concentration; and (3) may actually serve as a minimum price.

110. See Posner, *supra* note 3, at 12. See also Handler, *supra* note 3, at 987; Pitofsky, *supra* note 3, at 16 n.59; *The Supreme Court, 1976 Term*, 91 HARV. L. REV. 70, 241 (1977).

111. Pitofsky, *supra* note 3, at 16 n.59; *The Supreme Court, 1976 Term*, 91 HARV. L. REV. 70, 241 (1977).

112. 367 F.2d 517 (1966), *rev'd*, 390 U.S. 145 (1968).

113. 390 U.S. at 154 stating: "The assertion that illegal price fixing is justified because it blunts the pernicious consequence of another distribution practice is unpersuasive."

114. 438 F. Supp. 470 (D.D.C. 1977).

ice to newstands, vending machines, and the like. The Post assigned each home dealer a designated area, although their contracts did not prohibit them from selling outside of their specified territory. In addition, the suggested price to home subscribers was included in each edition of the paper as well as in the recommended billing forms and procedures given to its dealers. The dealers and the Post entered into no agreement as to price. In the controversy that arose the plaintiffs charged that the described distribution system illegally divided the market as well as fixed the price.

The court held against the plaintiffs on the first claim because under the applicable rule of reason test¹¹⁵ the vertical territorial allocation¹¹⁶ was justified because of its economic and administrative efficiencies.¹¹⁷ The purpose of the restraint was to promote efficient, prompt service with full market penetration; the territorial restraint accomplished these purposes at a consistently reasonable price.¹¹⁸

In discussing the claim that the Post prevented the distributor from selling above the suggested price the court indicated that *Sylvania* unequivocally adhered to the proposition that any agreement or coercion to establish price is per se illegal.¹¹⁹ The court, however, in an extremely puzzling opinion circumvented this mandate by finding that neither coercion, nor an express or implied agreement existed to establish the distributors' prices.¹²⁰ Rather than rule that a manufacturer

115. See 433 U.S. at 47-59.

116. See 438 F. Supp. at 474 n.5, ruling that the mechanism was vertically imposed because "the scheme was initiated and orchestrated by the Post, and thus was vertical in effect as well as appearance."

117. *Id.* at 474-76.

118. *Id.* at 475. See *Knutson v. Daily Review, Inc.*, 468 F. Supp. 226, 232 n.7 (N.D. Cal. 1979).

119. 438 F. Supp. at 479 (citing *Sylvania*).

120. The court rejected the plaintiffs' contentions that there was an express agreement, implicit agreement, and/or coercion. Concerning the first of these, the court found no evidence to support the claim. Regarding the plaintiffs' economic theory of implied agreement, the court rejected this on two grounds: (1) The Post maintained its price through legitimate, lawful means, and the Post established economically viable prices that the distributors recognized, and (2) the distributors were free to raise or lower prices as they desired, and the Post had never taken sanctions against anyone—although it is not clear that anyone prior to Newberry ever challenged the Post, see notes 125-29 *infra* and accompanying text. Finally, the court held that there was no implicit coercion and "[t]he suggestions that these staunch plaintiff dealers were afraid to act in their best independent interest is not worthy of belief." 438 F. Supp. at 476-80.

The Authors may be foolish but it is their belief that the Post would hold tremendous power over these small, independent distributors and they would not likely challenge such power.

has the right to minimize its distribution costs¹²¹ and prevent its distributors from exploiting their area of primary responsibility, the court relied on a fictional absence of an express or implied agreement and the lack of any coercion on the part of the Post.¹²² Thus, the court, in essence, relied on the questionable¹²³ holding of *United States v. Colgate & Co.*¹²⁴

In the one instance in which a distributor, Newberry, actually challenged the suggested price,¹²⁵ the Post retaliated by increasing its price to Newberry by a sum equal to Newberry's price increase to its home subscribers.¹²⁶ Under these facts the court found a violation of the antitrust laws based on the defendant's retaliatory action, which the court believed removed the case from the *Colgate* reasoning. Therefore, the Post forfeited its sheltered position because of its enforcement of its suggested retail price. Apparently the court recognized the *Colgate* doctrine in one breath and totally undercut its viability in another. *Newberry* leaves a bare minimum of the *Colgate* doctrine.¹²⁷ A manufacturer may only establish a suggested retail price and refuse to deal with those who do not obey the request. This reading of *Newberry* is consistent with the conclusions of several commentators.¹²⁸

121. The court interestingly recognized this point when it stated:

There may well have been some concern in the minds of some dealers, including some plaintiffs, that if a price increase by them resulted in appreciable loss of their circulation, as it well might have, the Post would have a contract option to consider termination. This, however, was not a threat but a business reality derived from factors inherent in the business at hand.

Id. at 479.

122. *Id.* at 476-80.

123. See *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); *Eiberger v. Sony Corp.* of Am., 459 F. Supp. 1276 (S.D.N.Y. 1978). See generally P. AREEDA, *ANTITRUST ANALYSIS* (2d ed. 1974); E. GELLHORN, *ANTITRUST LAW AND ECONOMICS* 273-77 (1976); L. SULLIVAN, *supra* note 27, at 392-95; Pitofsky & Dan, *Is the Colgate Doctrine Dead?*, 37 *ANTITRUST L.J.* 772 (1968); Posner, *supra* note 14, at 287-89.

Note that the Post switched from an independent distribution system to an agency system to avoid the ill effects of the *Albrecht* decision.

124. In *United States v. Colgate & Co.*, 250 U.S. 300 (1919), the Supreme Court, bound to follow the trial court's interpretation that the criminal indictment did not charge Colgate with an unlawful agreement, merely held that the Sherman Act does not prohibit a manufacturer from exercising freedom of choice with whom to deal.

125. Subsequent to the filing of the action two other distributors raised their prices and met the same resistance that Newberry had met. 438 F. Supp. at 481 n.9.

126. *Id.* at 480-81.

127. This is precisely what commentators have alleged has occurred to the *Colgate* doctrine and why they question its viability. See note 123 *supra* and accompanying text.

128. See generally note 123 *supra* and authorities cited therein.

Regardless of the viability of the *Colgate* doctrine, the *Newberry* decision leaves significant questions by holding in favor of *Newberry*, but against the distributors that alleged the Post coerced them to follow the suggested retail price. Should the cause of action depend on one's willingness to fight an extremely one-sided battle? More importantly, should a manufacturer not be allowed to minimize its cost of distribution and prevent its distributors from exploiting the retail customer? The *Sylvania* decision leaves the per se rule against maximum vertical price restraints in serious doubt.

D. *Boycotts and Concerted Refusals to Deal*

The impact of *Sylvania* on concerted refusals to deal¹²⁹ can only be determined after defining the scope of the restraint. Confusion has long existed on whether the per se rule extended beyond horizontal boycotts to vertical refusals to deal.¹³⁰ Traditionally, the bulk of the evidence and logic rested with limiting the extent of the per se rule to horizontal restraints.¹³¹ In *Klor's, Inc. v. Broadway-Hale Stores, Inc.*¹³² the Supreme Court explicitly distinguished a joint boycott from a single manufacturer's refusal to deal or its establishment of an exclusive relationship with another.¹³³

The *Sylvania* decision lends further credence to the *Klor's* holding.¹³⁴ Courts have interpreted *Sylvania* to hold that a rule of reason

129. The terms boycott and concerted refusals to deal are, as does the judiciary, used interchangeably herein despite the sound argument objecting to this. See L. SULLIVAN, *supra* note 27, at 231-32. The terms are qualified by recognizing that only some concerted refusals to deal, the broader term, are per se illegal and others will be tested under a rule of reason analysis.

130. See generally Note, *Vertical Agreements to Terminate Competing Distributors: Oreck Corp. v. Whirlpool Corp.*, 92 HARV. L. REV. 1160 (1979).

131. See, e.g., *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959); *Byars v. Bluff City News Co.*, 609 F.2d 843 (6th Cir. 1979); *Mutual Fund Investors v. Putnam Management Co.*, 553 F.2d 627 (9th Cir. 1977); *Packard Motor Car Co. v. Webster Motor Car Co.*, 243 F.2d 418 (D.C. Cir.), *cert. denied*, 355 U.S. 822 (1957). See also P. AREEDA, *supra* note 123, at 377; L. SULLIVAN, *supra* note 27, at § 91; Note, *Vertical Agreements to Terminate Competing Distributors*, 92 HARV. L. REV. 1160 (1979).

132. 359 U.S. 207 (1959).

133. *Id.* at 212-13.

134. See, e.g., *Daniels v. All Steel Equip., Inc.*, 590 F.2d 111 (5th Cir. 1979); *Gough v. Rossmoor Corp.*, 585 F.2d 381 (9th Cir. 1978), *cert. denied*, 440 U.S. 936 (1979); *Oreck Corp. v. Whirlpool Corp.*, 579 F.2d 126 (2d Cir.) (en banc), *cert. denied*, 439 U.S. 946 (1978). See generally Note, *Vertical Agreement to Terminate Competing Distributors: Oreck Corp. v. Whirlpool Corp.*, 92 HARV. L. REV. 1160 (1979).

test should govern all¹³⁵ nonprice vertical restraints, including concerted refusals to deal.¹³⁶ “[N]o vertical restrictions save price fixing are per se illegal.”¹³⁷ After all, a manufacturer may freely hire and terminate its distributors for any legitimate business reason. The courts continue to view horizontal refusals to deal as per se illegal.¹³⁸

The primary distinction, therefore, is whether the concerted refusal to deal is vertically or horizontally imposed. Is such a distinction appropriate? One significant question is whether the distinction should be based on a vertical/horizontal dichotomy or on unilaterality of action. Two recent cases highlight this problem. The first of these two decisions, *Oreck Corp. v. Whirlpool Corp.*,¹³⁹ followed the vertical/horizontal dichotomy while the second opinion, *Cernuto, Inc. v. United Cabinet Corp.*,¹⁴⁰ seemingly¹⁴¹ adhered to the unilaterality of action concept.

In *Oreck* Whirlpool Corporation manufactured vacuum cleaners under both its own name and under the Kenmore name.¹⁴² Oreck exclusively distributed the vacuum cleaners sold under the Whirlpool name. Sears, Roebuck & Co. exclusively distributed the Kenmore vacuum cleaners. Oreck alleged that its exclusive distributorship agreement with Whirlpool was not renewed because of the existence of an unlawful conspiracy between Whirlpool and Sears.¹⁴³ Oreck further contended, and the trial court agreed, that a per se rule was applicable because the agreement was intended to restrain price competition and/or was a group boycott.¹⁴⁴ The Second Circuit, sitting en banc,

135. This is so unless a per se standard can be justified under economic scrutiny. 433 U.S. at 58-59.

136. See cases cited at note 134 *supra*. See also *National Auto Brokers Corp. v. General Motors Corp.*, 572 F.2d 953 (2d Cir. 1978), *cert. denied*, 439 U.S. 1072 (1979).

137. *Gough v. Rossmoor Corp.*, 585 F.2d 381, 387 n.9 (9th Cir. 1978), *cert. denied*, 440 U.S. 936 (1979) (citing *National Auto Brokers Corp. v. General Motors Corp.*, 572 F.2d 953 (2d Cir. 1978), *cert. denied*, 439 U.S. 1072 (1979)).

138. See, e.g., *Cernuto, Inc. v. United Cabinet Corp.*, 595 F.2d 164 (3d Cir. 1979); *Gough v. Rossmoor Corp.*, 585 F.2d 381, 387 (9th Cir. 1978), *cert. denied*, 440 U.S. 936 (1979); *Oreck Corp. v. Whirlpool Corp.*, 579 F.2d 126, 131 (2d Cir.) (en banc), *cert. denied*, 439 U.S. 946 (1978); *Evans-ton Motor Co. v. Mid-Southern Toyota Distribs., Inc.*, 436 F. Supp. 1370 (N.D. Ill. 1977).

139. 579 F.2d 126 (2d Cir.) (en banc), *cert. denied*, 439 U.S. 946 (1978).

140. 595 F.2d 164 (3d Cir. 1979).

141. See notes 144-53 *infra* and accompanying text for an explanation of the “seemingly” qualification.

142. Kenmore is a trademark of Sears, Roebuck and Company.

143. 579 F.2d at 128.

144. *Id.* at 130.

however, rejected both of these contentions, while primarily focusing on the latter.¹⁴⁵

Judge Anderson, writing for the court, distinguished between vertical and horizontal restraints and concluded that the restraint imposed by Whirlpool was vertical. Therefore, the exclusive distributorship arrangement was tested under a rule of reason analysis. The arrangement was not a per se illegal group boycott of a horizontal nature.¹⁴⁶ The court carefully distinguished *United States v. General Motors Corp.*¹⁴⁷ on grounds that *General Motors* involved a price-fixing conspiracy.

The second case, *Cernuto, Inc. v. United Cabinet Corp.*,¹⁴⁸ embodied a similar factual situation. Cernuto alleged that one of its competitors, Famous Furnace & Supply Co., and its supplier, United Cabinet Company, conspired to terminate Cernuto as a distributor of United to protect Famous from Cernuto's price competition. Once again a terminated distributor contended that voiding the relationship constituted a per se violation of the antitrust laws and an illegal group boycott motivated by an intent to restrain price competition. In initially reviewing the appeal the court announced an incredible holding: "[U]nder the circumstances present here the plaintiff may recover only if the challenged conduct is termed a *per se* violation of the Sherman Act, because under a 'rule of reason' analysis the necessary anti-competitive effect as to a particular commodity in a relevant market cannot be proven."¹⁴⁹ The court's reasoning that a restraint can be considered reasonable but nevertheless might be deemed per se illegal is extremely perplexing. The Supreme Court recently has vigorously opposed such reasoning: "There are, thus, two complementary categories of antitrust

145. In so doing, the court affirmed the earlier panel decision also written by Judge Anderson. *Oreck Corp. v. Whirlpool Corp.*, 563 F.2d 54 (2d Cir. 1977), *aff'd on rehearing*, 579 F.2d 126 (2d Cir.) (en banc), *cert. denied*, 439 U.S. 946 (1978). Moreover, concerning the price-fixing allegation, which never reached the jury, the court found that there was no evidence presented supporting the contention that Oreck's termination was to maintain the price structure. Oreck had total freedom to establish its own price and, in fact, was underpriced by Sears. 579 F.2d at 131.

146. 579 F.2d at 132. The court did, however, note that this case differed from the traditional termination of an exclusive dealer in that Whirlpool did not replace Oreck with another distributor. The court resolved the controversy in Whirlpool's favor since there was no anticompetitive effect on the market. *Id.* at 133-34.

147. 384 U.S. 127 (1966) (a group of General Motors (G.M.) dealers combined to attempt to prevent G.M. from selling to discount sellers).

148. 595 F.2d 164 (3d Cir. 1979).

149. *Id.* at 165.

analysis. In the first category are agreements whose nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality—they are “illegal *per se.*”¹⁵⁰ *Per se* rules are designed to prohibit conduct “that is *clearly* anticompetitive.”¹⁵¹

In reversing the trial court’s grant of summary judgment for defendants Judge Adams carefully distinguished the general judicial tolerance for unilateral decisions made by a manufacturer in organizing its distribution system¹⁵² from the *Cernuto* fact pattern. The court contrasted *Cernuto* with the *Sylvania* decision and other unilateral cases on two grounds: One, the horizontal nature of the *Cernuto* case; and two, the impact of the restraint on price maintenance.¹⁵³ The *Cernuto* court viewed the controversy as horizontal in nature because of the impact and coercion on another retail customer and apparently rejected the *Oreck* line of analysis.¹⁵⁴ Judge Adams considered the alleged conspiratorial effect on price equally important in distinguishing the distributor termination from acceptable manufacturer practices.

At this juncture of the opinion the nature and extent of its holding and the significance of the interplay between the horizontal and price maintenance elements become extremely puzzling.¹⁵⁵ The court first indicated that it might not have reached the same result in *Oreck*, but proceeded to demonstrate that *Oreck* differed in that Whirlpool was not motivated by a desire to fix prices.¹⁵⁶ More importantly, the court’s

150. *National Soc’y of Professional Eng’rs v. United States*, 435 U.S. 679, 692 (1978). *But see* *Catalano, Inc. v. Target Sales, Inc.*, 605 F.2d 1097, 1099 (9th Cir. 1979), *rev’d per curiam*, 100 S. Ct. 1925 (1980) (competing wholesalers’ agreement that required retailers to pay cash on delivery found *per se* illegal price-fixing).

151. Pitofsky, *supra* note 3, at 12 (emphasis added). Moreover, Pitofsky goes on to modify this standard: “Considerable experience has revealed that such conduct *almost always* results in adverse competitive effects, and *almost never* is justified by business reasons sufficiently persuasive to counteract those adverse effects.” *Id.* (emphasis in original).

Mr. Justice Powell, the author of the majority’s opinion in *Sylvania*, on the other hand, was especially demanding of a factual showing of “unmistakable evils of an arrangement in the actual operation” before it would be declared *per se* illegal. Handler, *supra* note 3, at 983.

152. *Sylvania*, it was believed, was consistent with this line of judicial tolerance (favoring unilateral decisions of a manufacturer). 595 F.2d at 167.

153. *Id.* at 167-70.

154. The court reasoned that the decision to refuse to deal with *Cernuto* was not freely taken by Famous, the manufacturer, but was in fact precipitated by *Cernuto*’s competitor, United. Thus, the court held that the restraint was primarily horizontal in nature. *Id.* at 167-68. See note 146 *supra* and accompanying text.

155. 595 F.2d at 169-70.

156. *Id.* at 170. The court also distinguished *Packard Motor Car Co. v. Webster Motor Car*

ultimate holding interconnects the horizontal and price maintenance grounds:

Thus, despite *Packard* and *Oreck*, the situation present in this case may be fairly considered to raise the possibility of a *per se* violation of the Sherman Act. Given the alleged anticompetitive and arguably horizontal impact of United's decision, and given the price orientation of the alleged conspiracy, we cannot say that a *per se* violation of the Act may not be shown. If Cernuto can prove at trial that United, Lappin and Famous conspired to protect Famous from price competition by Cernuto, and that United and Lappin terminated Cernuto at Famous' request and in pursuit of a price related end, then it can prevail on a price-fixing theory notwithstanding its failure to show any impact on competition involving kitchen cabinet sales in Western Pennsylvania. . . . [I]f defendants can demonstrate that their actions were not motivated solely by consideration of price then the use of a *per se* rule *might* be inappropriate.¹⁵⁷

One cannot be sure whether *Cernuto* actually abandoned the traditional definition of group boycotts or simply relied on illegality of price-fixing. Nevertheless, Judge Adams clearly indicated that he is not adverse to the idea of expanding the *per se* illegality of group boycotts to vertical restraints.

The impact of *Sylvania* on the area of boycotts primarily depends on the definition of the restraint. If the traditional concept is not followed, *i.e.*, one includes vertical, non-unilateral agreements, then *Sylvania* obviously is relevant. On the other hand, if the traditional definition of boycotts is appropriate, then *Sylvania's* influence must be limited to analogy and comparison.

III. TOWARD A PRINCIPLED APPROACH

The lesson is clear. The antitrust laws, which are designed to promote competition and the free market system,¹⁵⁸ must pay deference to economic analysis and reality. The problem, however, is how to best accomplish these goals. Which approach and whose analysis is most

Co., 243 F.2d 418 (D.C. Cir.), *cert. denied*, 355 U.S. 822 (1957), on the grounds that it involved a failing company as well as a mere attempt to obtain an exclusive distributorship. *Packard Motor* did not involve price-fixing. 595 F.2d at 169.

157. 595 F.2d at 170 (emphasis added).

158. See generally P. AREEDA, *supra* note 123; L. SULLIVAN, *supra* note 27; H. THORELLI, *THE FEDERAL ANTITRUST POLICY* (1955); Gelhorn, *The New Gibberish at the FTC*, REG., May/June 1978, at 37.

satisfactory? *Sylvania* preaches the merit of economic analysis,¹⁵⁹ but fails to conduct a thorough and insightful investigation. There is a drastic need for comprehensive analysis and research to predict more adequately the effect of various restraints on the free market system.

A. *A Re-examination of Sylvania*

The "impressive" economic analysis¹⁶⁰ undertaken in the *Sylvania* opinion focused principally on the "free-rider" concept.¹⁶¹ The Court's¹⁶² other justifications presented sound, but neither novel nor overwhelming, support for its decision to apply a rule of reason standard to all vertical nonprice restrictions.¹⁶³ Both pre- and post-*Sylvania* commentators have strenuously debated this issue.¹⁶⁴ The most amazing result is the prominent division of opinion—Professors Bork and Posner on one side and Professors Sullivan, Areeda, and Pitofsky on the other side.¹⁶⁵ Clearly, economic analysis does not lead one to an inevitable conclusion.

The logical starting point for analyzing and understanding this quagmire lies with the economic argument underlying the *Sylvania* decision: A manufacturer will strive to obtain a high volume, low mark-up distri-

159. 433 U.S. at 59.

160. See generally Bork, *supra* note 3 (sophisticated analysis of economic efficiencies); Posner, *supra* note 3.

161. See notes 43 *supra* and 166-71 *infra* and accompanying text.

162. See notes 42-44 *supra* and accompanying text.

163. Other courts had previously recognized that special consideration should be given to new entrants and failing companies. *United States v. Arnold, Schwinn and Co.*, 388 U.S. 365 (1967); *Sandura Co. v. FTC*, 339 F.2d 847 (6th Cir. 1964); *United States v. Jerrold Elecs. Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961). Moreover, the product safety and quality justification has been advanced in *Tripoli Co. v. Wella Corp.*, 425 F.2d 932 (3d Cir.), *cert. denied*, 400 U.S. 831 (1970) and *In re Adolph Coors Co.*, 3 TRADE REG. REP. (CCH) [Transfer Binder 1973-1976], at ¶ 20,403 (F.T.C. 1973), *aff'd*, 497 F.2d 1178 (10th Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975). Both present well reasoned, but limited justifications.

Note that both the *Sylvania* Court and Professor Posner believe that some vertical restraints may be proven to be unreasonable and, according to *Sylvania*, possibly even shown to be per se illegal, but Professor Bork believes all vertical restraints are per se legal.

164. See note 165 *infra*.

165. See Bork, *supra* note 3; Bork, *supra* note 46, at 465-73; Posner, *supra* note 3; Posner, *supra* note 14, at 283-85. *But see* P. AREEDA, *supra* note 123, at § 503; L. SULLIVAN, *supra* note 27, at § 145; Pitofsky, *supra* note 3. Professor Posner, moreover, has recognized this deep rooted dispute: "Not all economists and lawyers knowledgeable in economics who write on monopoly questions, perhaps not even most, view restricted distribution so benignly." Posner, *supra* note 3, at 5.

bution system.¹⁶⁶ A manufacturer arguably only will impose restrictions on product distribution if restrictions will increase distributive efficiency. A manufacturer will attempt to minimize distribution costs in order to increase sales revenues and profits.¹⁶⁷

This fundamental principle forms the basis of the "free-rider" concept. A manufacturer may desire to restrict competition among its dealers "to increase the amount of nonprice competition among his dealers in order to stimulate the provision of point-of-sale services in the distribution of his product."¹⁶⁸ If the consumer prefers the additional services at a passed-on cost, the manufacturer gains distributive efficiency, thereby promoting interbrand market position. Furthermore, competition in becoming an exclusive distributor will force distributors to expend excess profits from the curtailed interbrand competition on the desired nonprice point-of-sale services.¹⁶⁹

Without implementation of market division, or resale price maintenance,¹⁷⁰ advocates of this theory maintain that market imperfections will prevent distributors from providing these economically efficient point-of-sale services. A distributor will not furnish these types of services, (*e.g.*, skilled sales personnel, large inventories, service facilities, advertisements), if free-riders who do not provide such services would underprice the distributor. The cost to the provider of such services will exceed those of sellers who avoid service expenses. The free-rider allegedly will prevent the manufacturer from obtaining the economically efficient and optimal amount of point-of-sale services. No distributor will provide such services even though the manufacturer receives an overall benefit.

Closely related, if not part of the free-rider rationale, is the argument that territorial allocation will prevent intrabrand competitors from

166. See Bork, *supra* note 46, at 402-03; Posner, *supra* note 14, at 283-84; Pitofsky, *supra* note 3, at 10.

167. Posner, *supra* note 14, at 283. See also Bork, *supra* note 46, at 402-03 ("The manufacturer would never impose a limitation upon competition among its resellers which had the effect of restricting output further, for that would decrease the manufacturer's net revenue."). Areeda states that any "[e]xcessive' dealer profit resembles a 'tax' on the product." P. AREEDA, *supra* note 123, at § 502. But see *id.* at § 503.

168. P. AREEDA, *supra* note 123, at § 503.

169. *Id.* See Bork, *supra* note 46, at 446-49; Posner, *supra* note 3, at 4.

170. See notes 192-201 *infra* and accompanying text. As noted at note 189 *infra*, the "free-rider" concept was initially utilized to justify resale price maintenance. See Bork, *supra* note 46, at 453-54.

“skimming the cream.”¹⁷¹ The argument is that competitors will invade another’s territory and underprice the local distributor who spent considerable sums of money establishing readily identifiable and committed customers.¹⁷² The invader will reap the harvest of another’s hard work. More significantly, once a distributor loses these easy, profitable sales, it will be unable to rebound in low profit sales and therefore will deny the manufacturer deeper market penetration.¹⁷³

Several other justifications have been offered in support of the contention that vertical restrictions will increase interbrand competition.¹⁷⁴ The redeeming virtue of these restraints, however, is their ability to facilitate point-of-sale services and deep market penetration. The remaining justifications—the attraction of quality distributors and capital to new or failing entrants,¹⁷⁵ the promotion of health and safety,¹⁷⁶ and the avoidance of duplicative and inefficient services¹⁷⁷ are either invalid or simply devoid of support.¹⁷⁸

Are these redeeming virtues sufficient to justify all vertical nonprice restraints?¹⁷⁹ Or, does *Sylvania*, like *Schwinn*, go overboard in its ulti-

171. See *In re Coca-Cola Co.*, 91 F.T.C. 517 (1978) (appeal pending); P. AREEDA, *supra* note 123, at § 517; L. SULLIVAN, *supra* note 27, at § 145; *Monograph No. 2*, *supra* note 6, at 4, 41, 67. Significantly, all of these authorities with the exception of the neutral *Monograph* are not strong supporters of vertical restraints.

Concerning the term “skimming the cream,” see note 172 *infra*. For a rebuttal of this justification see note 201 *infra*.

172. Hence, the close connection to the free-rider concept. Moreover, the expression “cream skimming” derives from the fact that these customers have already been established and are easily sold with a limited amount of effort and expense.

173. See note 171 *supra* and note 201 *infra* and accompanying text. See also P. KOTLER, *PRINCIPLES OF MARKETING* 66-92, 422-43 (1980).

174. See notes 175-78 *infra* and accompanying text for a compilation of these justifications.

175. See note 163 *supra* and accompanying text.

176. *Id.*

177. See *In re Coca-Cola Co.*, 91 F.T.C. 517 (1978) (appeal pending); *Monograph No. 2*, *supra* note 6, at 41; Pitofsky, *supra* note 3, at 25; notes 114-18 *supra* and accompanying text.

178. Interestingly, most of these justifications have been put forth by the opponents, not the proponents, of vertical territorial allocations. These virtues have included the following: (a) The obtainment of economies of scale, see P. AREEDA, *supra* note 123, at § 517; L. SULLIVAN, *supra* note 27, at § 145; Pitofsky, *supra* note 3, at 25-26; (b) the historical success of such restraints, see P. AREEDA, *supra* note 123, at § 517; L. SULLIVAN, *supra* note 27, at § 145; (c) dealer good-will through high dealer profit, see P. AREEDA, *supra* note 123, at § 517; L. SULLIVAN, *supra* note 27, at § 145; (d) the maintenance of geographic price discrimination, see *Copper Liquor, Inc. v. Adolph Coors Co.*, 506 F.2d 934, 942 n.5 (5th Cir. 1975); P. AREEDA, *supra* note 123, at § 525; Comanor, *supra* note 37.

179. See note 163 *supra*.

mate conclusion?¹⁸⁰ The point-of-sale/free-rider justification raises several significant issues. First, if business individuals¹⁸¹ and segments of society are critical of interfering with the workings of the marketplace, whether by government or otherwise, how can they propose the allowance of a managed market? Why not let the market determine what is economically efficient and desirable?¹⁸² Is it not a misallocation of resources,¹⁸³ as well as contrary to the goals of antitrust law, for a mechanism other than the marketplace to determine the consumers' needs? If purchasers desire such services, the market should reveal that inclination, unless this is a situation in which the market cannot properly perform due to certain imperfections. Will the consumer actually purchase a good after receiving the desired point-of-sale services from the provider or will he furtively patronize the neighboring discounter? The consumer inherently finds himself in the "double bind."¹⁸⁴ He will regret not purchasing from the provider of these important services, but bemoan the decision to pay a greater price. Some argue the irrelevancy of this discussion because the market still can make the decision through the manufacturer and the manufacturer's desire for economic efficiency.¹⁸⁵ Nevertheless, further detailed and comprehensive research is needed to answer this question.

Regardless of whether the market could, or should, properly handle the free-rider problem, one must determine the benefit gained from allowance of such restrictions. Are the restrictions obviously economically beneficial? The Federal Trade Commission observed that a manufacturer, by granting exclusive territories, may be preventing distributor free-riding at the expense of permitting the distributor to take a free-ride on the consumer.¹⁸⁶ The consumer "may end up paying for

180. See generally Pitofsky, *supra* note 3, at 2.

181. An extremely commonplace occurrence within the corridors and offices of corporate America is the severe condemnation of government and society for its interference with the free market system. See generally M. FRIEDMAN, *CAPITALISM AND FREEDOM* (1962); L. SILK & D. VOGEL, *ETHICS AND PROFITS* (1976).

182. See P. AREEDA, *supra* note 123, at § 517; L. SULLIVAN, *supra* note 27, at § 145; Comanor, *supra* note 37, at 1433; Pitofsky, *supra* note 3, at 23.

183. Professor Bork has already recorded his objection to such reasoning: "[T]he manufacturer will employ vertical restraints, only if consumers respond more to the information provided than they would to lower prices without the information." Bork, *supra* note 3, at 181.

184. Hardin, *The Tragedy of the Commons*, *SCIENCE* 1243 (Dec. 1968).

185. See, e.g., Bork, *supra* note 3, at 181.

186. See *In re Coca-Cola Co.*, 91 F.T.C. 517, 630 n.33 (1978) (appeal pending). But see Comanor, *supra* note 37, at 1433; Pitofsky, *supra* note 3, at 20-23.

any excessive advertising, merchandising, or local sales efforts which would be discouraged in favor of price competition."¹⁸⁷

Proponents of the free-rider concept contend that any profit above the competitive level would be channeled back into point-of-sale services to prevent the manufacturer from terminating the distributor's exclusive territory.¹⁸⁸ Therefore, the manufacturer will be able to regulate the level of point-of-sale services through assignment of specified market areas.¹⁸⁹ Moreover, the manufacturer will compare cost efficiency of added services against consumer reaction to decreased prices,¹⁹⁰ thus preventing consumers from paying for services that they do not desire.

But will a distributor automatically reinvest all of its monopoly profits into nonprice competitive services? Will a manufacturer only compare consumer reaction to additional information against consumer reaction to a price decrease? Alternatively, will the manufacturer also look to promotion of dealer goodwill and contentment? Economic logic suggests that the distributor, at a minimum, will utilize portions of additional revenue as a reasonable return for his extra expenditures and services.¹⁹¹ More importantly, human nature reveals that the distributor will attempt to retain as much of the monopoly profit as possible. The question therefore focuses on the manufacturer's motivation in limiting this desire. Will it generally be in the manufacturer's best interest to force its distributors to reinvest all of their excess profits? Or, are there equally commanding, if not compelling, reasons for allowing the distributor to reap some monopoly profit? The answer, of course, lies in whether the manufacturer will receive sufficient benefit to outweigh the added cost of distribution.

Unlike avid proponents of the permissibility of vertical restraints, the Authors believe that a cost/benefit analysis demonstrates that under

187. *In re Coca-Cola Co.*, 91 F.T.C. 517, 603 n.33 (1978).

188. Bork, *supra* note 46, at 430-38; Posner, *supra* note 3, at 4-5; Posner, *supra* note 14, at 284-85 ("Competition to become an exclusive dealer will assure that dealers do not exploit their monopoly to the detriment of the manufacturer.").

189. This argument was principally used with, and is better suited for use with, resale price maintenance. The argument is that a manufacturer can specifically determine the amount of point-of-sale services by establishing the resale price. The distributor will continue spending sufficient sums of money on nonprice competition "until the marginal cost of distribution has risen to meet the resale price." Posner, *supra* note 14, at 284.

190. Bork, *supra* note 3, at 181.

191. C. McCONNELL, *ECONOMICS* (7th ed. 1978).

certain conditions, though not in all, allowance of high dealer profit will result in a long term benefit to the manufacturer. Initially, one should recognize that the manufacturer, by allowing high dealer profit, may enhance its interbrand competitive position by creating dealer goodwill and encouraging dealer sales efforts. In other words, the manufacturer might be willing to motivate the dealer into favoring its product over those of its competitors.¹⁹² Moreover, the cost to attract these aggressive, loyal, and competent distributors may be minimal. If the cross-elasticity of the manufacturer's goods is low, then the consumer, and not the manufacturer, will compensate the dealer for additional services and profits.¹⁹³ Proponents, however, probably would counter this contention by asserting that the manufacturer is indirectly subsidizing the distributor's profit by forfeiting its own interest. A proper analysis, therefore, must supply a rationale for manufacturer allegiance to such "irrational" conduct. The underlying justification varies with the manufacturer's market position.

The manufacturer appears foolish in forfeiting any marginal revenue if it possesses significant market power.¹⁹⁴ By its very position, the manufacturer does not face any strong interbrand competition and is not threatened by the ready loss of customers (low cross-elasticity).¹⁹⁵ Therefore, the manufacturer possesses a levered position in dealing with its distributors who will be hard pressed to obtain additional profits from the manufacturer. On the other hand, a conservative manufacturer, which is a common sight in today's market place,¹⁹⁶ might very well elect to please its established distributors. After all, the manufacturer obtained its present dominant position through the support of such distributors. Why should the manufacturer "rock the boat"?

By maximizing distributor goodwill and earning a handsome profit,

192. P. AREEDA, *supra* note 123, at §§ 514, 523.

193. Comanor, *supra* note 37, at 1430. See also Mr. Donald Turner's argument as presented in *Monograph No. 2*, *supra* note 6, at 38.

194. This term is used to indicate that the manufacturer, and it alone, has the power to control price in the relevant market. Hence, the importance of both market share and product differentiation. See generally *Monograph No. 2*, *supra* note 6, at 60-67.

195. Unlike the Court in *United States v. E.I. DuPont de Nemours & Co.*, 351 U.S. 377 (1956), cross-elasticity cannot simply be determined by examining the decrease in demand due to further price increases. See E. GELHORN, *supra* note 123, at 120-25; Stocking & Muller, *The Cellophane Case and the New Competition*, 45 AM. ECON. REV. 29, 57-62 (1955).

196. Big business today is more concerned with steady growth and financially secure investments than they are with rapid and spectacular, although risky, adventures. J.K. GALBRAITH, *ECONOMICS AND THE PUBLIC PURPOSE* (1973).

the manufacturer could secure its market position by increasing entry barriers. An established distributor would be unwilling to push a competing product fearing that it would offend the dominant company and jeopardize its own high profit. Then, those that desire to enter the market would have to vertically integrate or develop new distributors. Both vertical integration and development of new distributors require large additional capital outlays. The manufacturer, therefore, might logically elect to protect its long run market position at the expense of some negligible short run return. At the same time the manufacturer will eliminate potential competition and/or avoid establishing new, unproven distributors or jeopardizing capital on a vertically integrated distribution system. Economic analysis cannot be pursued in a vacuum; one must consider business and social psychology as well as long run market position.

The willingness of established, but nondominant, companies to forego additional revenues also can be explained by their desire to enhance market position and long run revenues. Because suppliers function in a competitive environment, a supplier might "bribe" its distributors into favoring its product. With the manufacturer's assistance, loyal and motivated distributors may successfully convince consumers of the uniqueness and desirability of a basically fungible product—product differentiation. By establishing its own market the manufacturer and its distributors could conceivably increase profitability at the consumer's expense.

Frequently point-of-sale services are unnecessary and the "free-rider" problem does not actually exist. Many products do not require that dealers provide elaborate showrooms, sophisticated sales personnel, or complete repair facilities. Often there are reasonable and less restrictive alternatives.¹⁹⁷ It seems odd that the limited free-rider justification should be the primary reason for validating all vertical non-price restraints. Why do manufacturers not confronted with the free-

197. See Pitofsky, *supra* note 3; *The Supreme Court, 1976 Term*, 91 HARV. L. REV. 70, 235-36 (1977). For instance, if the manufacturer desires point-of-sale repair facilities why cannot it provide the service or reimburse the dealer for such service? If local advertising is desired the manufacturer can either do it itself or mandate that all distributors spend \$X or Y% on advertisements. Moreover, clauses and areas of primary responsibility frequently adequately meet the manufacturer's needs.

Regarding the least restrictive alternative in general, see *American Motor Inns, Inc. v. Holiday Inns, Inc.*, 521 F.2d 1230, 1248-49 (3d Cir. 1975); *Copper Liquor, Inc. v. Adolph Coors Co.*, 506 F.2d 934 (5th Cir. 1975); *Monograph No. 2*, *supra* note 6, at 58-60; Pitofsky, *supra* note 3, at 33-34.

rider problem use territorial market division? What justifications do they have? “[I]f the restraint is shown to be excessive for the manufacturer’s needs, then its presence invites suspicion”¹⁹⁸

What alternatives exist for suppliers who do not elect to appease their distributors? What risks are they voluntarily encountering? Will they be able, financially or otherwise, to vertically integrate or replace their present distributors with equally competent dealers?¹⁹⁹ How will such a reorganization affect their image and clientele? Will their customers remain loyal to their product or to their old distributors? Or, if the distributors remain with the manufacturer, will they be equally loyal and aggressive?

Is the above-mentioned analysis limited to single brand distributors or is it also applicable to multibrand distributors? Regarding the latter, will not the originating manufacturer’s competitors probably meet the price challenge with a similar ante of their own? The question remains whether they will respond timely to the challenge—or will the distributors and/or the consuming public already be swayed toward the product. Competition and market advancement demand risk taking and competitive aggressiveness. Finally, a manufacturer might impose vertical nonprice restrictions due to coercion from a retail cartel. Such conduct does pose a real concern despite its illegality.²⁰⁰

Legitimate²⁰¹ and illegitimate reasons exist, therefore, for imposition of vertical market restraints. Before suggesting an appropriate approach for handling this quandry, one must determine whether all vertical restraints should be treated equally. Do location clauses, areas of primary responsibility, and the like have the same competitive effect and impact as airtight territorial restrictions? The majority in *Sylvania* answered this question in the affirmative, but Mr. Justice White and the Ninth Circuit distinguished these types of restraints.²⁰² The Authors

198. *White Motor Co. v. United States*, 372 U.S. 253, 270 n.9 (1963) (Brennan, J., concurring).

199. A manufacturer must determine whether it can directly or indirectly raise the capital and whether the new distributors will be as economically and politically efficient.

200. See, e.g., 433 U.S. at 58 n.28; Bork, *supra* note 46, at 405; Pitofsky, *supra* note 3, at 26-27.

201. The “cream skimming” justification has clearly and properly been demonstrated to be invalid. Professor Areeda suggests that this invidious sounding conduct can only mean that a distributor is merely being denied supra-profits by the existence of intrabrand competition. What is “cream,” but low cost or high profit sales, i.e., monopoly profit, that intrabrand competition might eliminate. P. AREEDA, *supra* note 123, at § 517; L. SULLIVAN, *supra* note 27, at § 145.

202. The restraints were believed to be clearly less anticompetitive. See generally Pitofsky, *supra* note 3; Robinson, *supra* note 13, at 277. *Schwinn* was also distinguished on the contrasting market power between the two companies—Schwinn’s large and *Sylvania*’s small.

agree with Mr. Justice White and the Ninth Circuit. Restraints that limit intrabrand competition cannot be equated with restraints that totally eliminate competition. In its haste to overrule the *Schwinn* precedent the *Sylvania* Court ignored economic realities.²⁰³ A curtailment of all intrabrand competition cannot always have the same effect as a less rigorous limitation on intrabrand competition. For instance, a dealer will generally be in a superior bargaining position if it can purchase its cola soft drink supply from several suppliers rather than only one. This is true even though the dealer must travel greater distances to pick up its orders from other suppliers.²⁰⁴ Of course, the seemingly more moderate restraints can be equally anticompetitive depending on the actual restriction employed. In the above example, the alternative locations can be spaced so far apart as to negate their viability.²⁰⁵ Despite the handicap, the intrabrand competition might provide sufficient competitive pressure to moderate the behavior of the local supplier, especially where interbrand competition is negligible.²⁰⁶

In light of the concepts discussed above, the Authors suggest that courts adhere to the following guidelines pertaining to nonprice vertical restraints:

(1) All airtight vertical territorial restrictions imposed by a supplier that dominates over fifty percent of the market should be declared *per se illegal*.

(2) All less restrictive vertical territorial restraints imposed by a dominant firm should be *carefully scrutinized* under a *presumption of illegality*.

(3) All airtight vertical territorial restrictions imposed by a manufacturer without market power²⁰⁷ should be *carefully scrutinized* under a *rule of reason*²⁰⁸ analysis, with special emphasis on whether a *less re-*

203. Recall that the final decree in *Schwinn* permitted the use of location clauses.

204. *In re Coca-Cola Co.*, 91 F.T.C. 517 (1978) (appeal pending). Although the example used herein is a location clause, the analysis equally applies to areas of primary responsibility and profit pass-over clauses.

205. *See Ohio-Sealy Mattress Mfg. Co. v. Sealy, Inc.*, 585 F.2d 821 (7th Cir. 1978), *cert. denied*, 440 U.S. 930 (1979).

206. *See In re Coca-Cola Co.*, 91 F.T.C. 517 (1978) (appeal pending).

207. The lesser the power the greater the restraint's chance of survival. *See generally Monograph No. 2, supra* note 6, at 63-64.

208. In employing the rule of reason analysis a court should consider the limited justifications already discussed, health and safety, and the avoidance of duplicative and costly services. *See* notes 176-77 *supra* and accompanying text.

strictive alternative would suffice²⁰⁹ and on *market structure*.²¹⁰

(4) All less restrictive vertical territorial restraints imposed by non-dominant companies are to be judged according to a rule of reason analysis which includes consideration of market structure with a presumption of legality for any firm with less than ten percent of the market.

(5) All vertically imposed nonprice restraints employed by a new entrant or failing company should be rebuttably presumed to be legal.²¹¹

B. *Guidelines for Various Other Market Restrictions*

1. *Resale Price Maintenance*

The arguments against declaring all vertical nonprice restraints legal or falling under a rule of reason analysis apply with greater force to resale price maintenance agreements.²¹² The Supreme Court recently acknowledged that “[p]rice is the ‘central nervous system of the economy,’ and an agreement that ‘interfere[s] with the setting of price by free market forces’ is illegal on its face.”²¹³ Moreover, considering that

209. The less restrictive alternative is not generally proposed because it is desired to avoid second guessing business judgments. See *American Motor Inns, Inc. v. Holiday Inns, Inc.*, 521 F.2d 1230 (3d Cir. 1975); M. HANDLER, *supra* note 14, at 707. By providing airtight restraints, however, business individuals are put on notice as to their questionable validity and can act accordingly.

210. The greater the likelihood of oligopolistic pricing, the greater is the need for intrabrand competition. A court should be careful to assess the market structure to properly predict the effect of any market restriction. When dealing with oligopolies, which generally avoid price competition, one must recognize the great interdependence of these firms and hence their conservative competitive policies. See P. AREEDA, *supra* note 123; E. GELHORN, *ANTITRUST LAW AND ECONOMICS* (1972); P. SAMUELSON, *ECONOMICS* (1973); L. SULLIVAN, *supra* note 27.

Conduct which might be acceptable in a competitive market might be unreasonable in an oligopolistic situation. See *United States v. Container Corp. of Am.*, 393 U.S. 333 (1969). Frequently an oligopolistic market will produce restricted output and increased prices without any formal agreement; the firms will recognize their interdependence and act as monopolists. The courts must carefully scrutinize prices and nonprice leadership.

The more likely one will be faced with an oligopolistic pricing structure the greater the need for intrabrand competition. *Monograph No. 2, supra* note 6, at 63-64; Comanor, *supra* note 37, at 1436-39.

211. See, e.g., *Monograph No. 2, supra* note 6, at 68-69; Comanor, *supra* note 37, at 1437-38; Posner, *supra* note 14, at 293. For the other limited justifications previously discussed, see note 208 *supra*.

212. Bork, *supra* note 3, at 176-77; Posner, *supra* note 14, at 292-95.

213. *National Soc’y of Professional Eng’rs v. United States*, 435 U.S. 679, 692 (1978) (quoted in *Cernuto, Inc. v. United Cabinet Corp.*, 595 F.2d 164, 168 (3d Cir. 1979)).

Despite this contention it is recognized that territorial restrictions might have a greater anticompetitive effect than price-fixing agreements because with the former there might not be any need to

oligopolies (any four firms with sixty percent or more of the market) theoretically refrain from price competition,²¹⁴ allowance of resale price maintenance will tremendously affect such markets. As already indicated,²¹⁵ the more likely one is faced with the lack of interbrand price competition, the greater the need for intrabrand price competition.

Therefore, the Authors propose that any manufacturer that possesses market power or competes in an oligopolistic market and is one of the oligopolistic companies should be per se prohibited from establishing resale price maintenance. All other cases should be analyzed under a rule of reason analysis, with a presumption of legality in favor of failing companies, new entrants, and those with a diminutive market share.

2. *Horizontal Territorial Allocation*

The Authors propose that the present per se rule continue, with an exception for small competitors who jointly organize to more competently compete with their larger competitors. An example is the *Topco* arrangement.²¹⁶ This exemption, however, should not pertain to combinations in which the resulting organization possesses market dominance. In these situations, the presently imposed per se illegality rule should remain in effect. Under this newly proposed rule of reason exception courts should carefully scrutinize the necessity for territorial allocation and should only permit an airtight arrangement when less restrictive means are unavailable. Additionally, courts should carefully analyze relevant market structure.

3. *Vertical Maximum Resale Price*

A distributor should not be automatically in violation of the antitrust laws by merely attempting to minimize its cost of distribution and preventing its distributors from exploiting their market position. The

compete on price or nonprice terms, depending on the consumer's mobility. See *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 553 n.25 (1978); P. AREEDA, *supra* note 123, at § 516; L. SULLIVAN, *supra* note 27, at 224-25; *Monograph No. 2, supra* note 6, at 44; Posner, *supra* note 14, at 292.

214. See note 210 *supra* and accompanying text.

215. *Id.*

216. See Posner, *supra* note 3, at 9-10. Professor Posner, *supra* note 14, at 298-99, stretches this test beyond the guidelines proposed herein by stating that all horizontal territorial allocations should be per se legal if they result in less than two-thirds control of the market.

per se rule, as applied to vertical maximum pricing, was never justified²¹⁷ and now, in light of *Sylvania*, is absurd. Once again, the appropriate standard should be reasonableness and not a label.²¹⁸

4. *Boycotts and Concerted Refusals to Deal*

The traditional rule that horizontal agreements to boycott or refusals to deal are per se illegal, with its numerous exceptions, should remain intact. Vertical termination agreements of distributors also should continue to be judged under a rule of reason analysis. Greater emphasis, however, should be placed on market power and structure in applying the rule of reason. For instance, in *Oreck* the court should have carefully scrutinized Sears' involvement in Whirlpool's termination of Oreck and should not have hesitated to find an illegal restraint of trade if Sears did actively assert its influence.²¹⁹

217. See, e.g., *Monograph No. 2*, *supra* note 6, at 85-87; Pitofsky, *supra* note 3, at 32-33; Posner, *supra* note 14, at 290-92; Posner, *supra* note 3, at 12.

218. The Authors reserve comment on horizontally imposed maximum price-fixing, e.g., *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211 (1951).

219. *Byars v. Bluff City News Co.*, 609 F.2d 843 (6th Cir. 1979); *Golden Gate Acceptance Corp. v. General Motors*, 597 F.2d 676 (9th Cir. 1979).

