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as an important reference point from which to analyze the proper federal-state distribution of the copyright power.

RICHARD FRANK BIRIBAUER

## EXCEPTIONS TO *SCHWINN'S* PER SE RULE: THEIR VALIDITY AND IMPLICATIONS FOR THE FUTURE

Agreements which in some manner affect the flow of goods and services from the producer to the ultimate consumer are relatively common in the commercial world. However, since § 1 of the Sherman Act<sup>1</sup> forbids contracts and other agreements "in restraint of trade," such agreements are subject to attack by the federal government, disadvantaged competitors, customers and other aggrieved parties<sup>2</sup> on the grounds that the resulting restrictions are anticompe-

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<sup>1</sup>Section One of the Sherman Act, 15 U.S.C. § 1 (1970), provides:

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: *Provided*, That nothing contained in sections 1 to 7 of this title shall render illegal, contracts or agreements prescribing minimum prices for the resale of a commodity which bears, or the label or contained of which bears, the trademark, brand, or name of the producer or distributor of such commodity and which is in free and open competition with commodities of the same general class produced or distributed by others, when contracts or agreements of that description are lawful as applied to intrastate transactions, under any statute, law, or public policy now or hereafter in effect in any State, Territory, or the District of Columbia in which such resale is to be made, or to which the commodity is to be transported for such resale, and the making of such contracts or agreements shall not be an unfair method of competition under section 45 of this title: *Provided further*, That the preceding proviso shall not make lawful any contract or agreement, providing for the establishment or maintenance of minimum resale prices on any commodity herein involved, between manufacturers, or between producers or between wholesalers, or between brokers, or between factors, or between retailers, or between persons, firms, or corporations in competition with each other. Every person who shall make any contract or engage in any combination or conspiracy declared by sections 1 to 7 of this title to be illegal shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

<sup>2</sup>Section Sixteen of the Clayton Act, 15 U.S.C. § 26 (1970), permits private individuals to institute antitrust suits. See note 83 *infra*. At the same time, § 4 of the Clayton Act, 15 U.S.C. § 15 (1970), provides for recovery of treble damages in private antitrust suits. See note 84 *infra*.

titive and therefore illegal restraints of trade. In some litigation based on § 1, courts interpret restraint of trade to mean unreasonable restraint of trade, and in such cases, the agreements involved are analyzed in light of the rule of reason.<sup>3</sup> Application of the rule "requires an evaluation of the purpose and effect of the agreement and the relative power of the parties in the determination of whether the practices in question constitute an unreasonable, and thus unlawful, restraint of trade."<sup>4</sup> In contrast, some restraints scrutinized under § 1 are considered so "pernicious"<sup>5</sup> that it is conclusively presumed that their only purpose is the elimination of competition;<sup>6</sup> such practices are classified as per se unreasonable and are therefore unlawful.<sup>7</sup> For instance, unless permitted by state fair trade laws,<sup>8</sup> resale price maintenance agreements are per se unlawful.<sup>9</sup>

Since the depth of a trial court's inquiry and the amount of evidence it will consider depend upon whether the per se rule or the rule of reason is applied, the procedural choice between the two rules is often determinative of the final, substantive outcome of the litigation. Procedurally, application of the rule of reason permits a full evidentiary hearing and a case-by-case consideration of all available facts.<sup>10</sup> It allows an examination of a restrictive agreement's purpose

<sup>3</sup>See, e.g., *United States v. Joint Traffic Ass'n*, 171 U.S. 505 (1898); *U.S. v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897); *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), *modified and aff'd*, 175 U.S. 211 (1899). "[T]he rule of reason, in the light of the principles of law and the public policy which the act embodies, must be applied." *Standard Oil Co. v. United States*, 221 U.S. 1, 66 (1911). See Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, Part I*, 74 YALE L.J. 775 (1965).

<sup>4</sup>Comment, *Horizontal Territorial Restraints and the Per Se Rule*, 28 WASH. & LEE L. REV. 457, 459 (1971).

<sup>5</sup>E.g., *Northern Pacific Ry. v. United States*, 356 U.S. 1, 5-8 (1958).

<sup>6</sup>See, e.g., *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963).

<sup>7</sup>See, e.g., *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960) (vertical price fixing); *Klor's, Inc. v. Broadway-Hale Stores*, 359 U.S. 207 (1959) (group boycotts); *Northern Pacific Ry. v. United States*, 356 U.S. 1 (1958) (tying arrangements in the form of "preferential routing" clauses); *Timkin Roller Bearing Co. v. United States*, 341 U.S. 593 (1951), and *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), *modified and aff'd*, 175 U.S. 211 (1899) (market division); *International Salt Co. v. United States*, 332 U.S. 392 (1947) (tying arrangements); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940) (horizontal price fixing).

<sup>8</sup>Section One of the Sherman Act, 15 U.S.C. § 1 (1970), grants states the power to pass legislation permitting "fair trading" of products in intrastate transactions. For text of § 1 of the Sherman Act, see note 1 *supra*.

<sup>9</sup>E.g., *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707 (1944); *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

<sup>10</sup>Oppenheim, *Federal Antitrust Legislation: Guideposts to a Revised National Antitrust Policy*, 50 MICH. L. REV. 1139, 1151 (1952) [hereinafter cited as Oppenheim].

and effect<sup>11</sup> and "opens the way to reliance upon a broad range of discretion in weighing the evidence of defenses of justification compatible with the purposes of the antitrust statutes."<sup>12</sup> On the other hand, once a particular fact situation, practice or procedure has been classified as among those considered per se unreasonable, any inquiry into the particular facts alleged in justification of that situation, practice or procedure is foreclosed.<sup>13</sup> In essence, "[t]he per se illegality doctrine operates by converting predetermined single-fact categories into fixed rules of law."<sup>14</sup> However, per se rules dictated by the Supreme Court are generally phrased in such sweeping terms that the results of their literal application to specific fact situations are often unacceptable to the lower courts.<sup>15</sup> Consequently, whenever a new per se rule is enunciated, exceptions to that rule almost inevitably emerge from subsequent litigation.<sup>16</sup> The exceptions arising out of the per se rule formulated to govern the restraints in *United States v. Arnold, Schwinn & Co.*<sup>17</sup> vividly illustrate this phenomenon.<sup>18</sup> An analysis of those exceptions indicates three things: (1) in many circumstances where the *Schwinn* per se rule appears to apply, trial courts are nonetheless often willing to inquire into the purpose of the

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<sup>11</sup>The words power, purpose and effect are often used together when analyzing restraints of trade. However, the existence of "power" becomes crucial only when the actual offense of monopolizing is charged in violation of § 2 of the Sherman Act. Only purpose and effect are requisite for a finding that § 1 has been violated. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224 n.59 (1940).

<sup>12</sup>Oppenheim, *supra* note 10, at 1151.

<sup>13</sup>*Northern Pacific Ry. v. United States*, 356 U.S. 1, 5, 8 (1958).

<sup>14</sup>Oppenheim, *supra* note 10, at 1151-52.

<sup>15</sup>See Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, Part I*, 74 YALE L.J. 775 (1965):

Alongside cases announcing a sweeping per se formulation of the law there has always existed a line of cases refusing to apply it. Doubtless some of the cases in the latter group were wrongfully decided, but it would be naive to write them all off as simply incorrect or aberrational. The persistent refusal of courts to honor the literal terms of the per se rules against price-fixing and market-division agreements demonstrates a deep-seated though somewhat inarticulate sense that those rules, as usually stated, are inadequate.

*Id.* at 777. See notes 57-61 and accompanying text *infra*.

<sup>16</sup>For an unsuccessful attempt to create an exception to the per se rule enunciated in *United States v. Sealy, Inc.*, 388 U.S. 350 (1967), which forbade horizontally imposed territorial restrictions, see *United States v. Topco Associates, Inc.*, 319 F. Supp. 1031 (N.D. Ill. 1970), *rev'd and remanded*, 405 U.S. 596 (1972). See also Note, *The Supreme Court, 1971 Term*, 86 HARV. L. REV. 241-47 (1972); Comment, *Horizontal Territorial Restraints and the Per Se Rule*, 28 WASH. & LEE L. REV. 457 (1971).

<sup>17</sup>388 U.S. 365 (1967).

<sup>18</sup>See notes 62-180 and accompanying text *infra*.

restraints, their effect and other business or economic justifications; (2) the *Schwinn* per se rule is therefore not as rigid as some others, such as the per se rule applying to resale price maintenance schemes;<sup>19</sup> and (3) the *Schwinn* per se rule can rather easily be avoided in many situations.

### *Schwinn and Its Legacy*

An understanding of *Schwinn* and the subsequent lower court limitations of its per se rule necessitates some knowledge of the nature of trade restraints. Trade restraints, or restrictive agreements, are classified according to their source. *Schwinn* presented a problem of both horizontal and vertical trade restraints, though the Supreme Court considered only the vertical restrictions since no appeal was taken from the district court's disposition of the horizontal elements of the case.<sup>20</sup> Vertical restrictions result from agreements between firms at successive stages of the distribution system; *i.e.*, they occur between manufacturer and wholesaler, wholesaler and retailer, manufacturer and retailer or they may occur in consequence of an agreement among all three levels of a particular distribution system. Horizontal restrictions result from agreements among firms at the same stage of the distribution process. The parties are often competitors or at least prospective competitors. When analyzing and classifying restrictive agreements, however, the distinction between vertical and horizontal restraints often becomes blurred and there is no readily applied bright-line test by which to categorize them.<sup>21</sup>

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<sup>19</sup>Note 9 *supra*.

<sup>20</sup>*Schwinn's* distributors had organized themselves to form the Schwinn Cycle Distributors Association. The district court found that the distributors' acquiescence in the territorial restrictions was "horizontal in nature, and whether agreed upon after being imposed or even merely suggested from above in a vertical manner by the manufacturer [did] not alter its illegality and violation of Section 1 of the Sherman Act." *United States v. Arnold, Schwinn & Co.*, 237 F. Supp. 323, 342 (N.D. Ill. 1965). The district court holding in this regard was consistent with the Supreme Court's decision in *United States v. General Motors Corp.*, 384 U.S. 127 (1966). See note 21 *infra*. The district court also found that a conspiracy existed between Schwinn and four midwestern cycle distributors by which certain overlapping counties were divided by the distributors and that those distributors refused to compete against each other in the rigidly divided counties. Without actually classifying the conspiracy as either vertical or horizontal, the court held that it was a violation of § 1 of the Sherman Act. 237 F. Supp. at 342. The court further ruled that the horizontal restrictions, the conspiracy and the vertically imposed portions of the territorial restrictions on the sale of bicycles which the distributors had purchased all constituted per se violations of § 1 of the Sherman Act. *Id.* at 343.

<sup>21</sup>For instance, General Motors inserts "location clauses" in all of its dealers contracts which permit the dealer to sell only from a location approved by General Motors.

As a practical matter, the imposition of trade restraints results in a form of market control which lies between the extremes of completely independent dealing and total vertical or horizontal integration.<sup>22</sup> Those who adopt restrictive agreements generally seek to justify them as a means of effectively penetrating market areas<sup>23</sup> or of promoting new products and services,<sup>24</sup> or as a mechanism whereby competition from mass merchandisers,<sup>25</sup> large chain stores<sup>26</sup> and well-established competitors<sup>27</sup> can be met. Such trade restraints inevitably limit competition in at least one facet of the market place, but at the same time they *may* actually strengthen competition in some other respect.<sup>28</sup>

In *Schwinn*, the Supreme Court was confronted with a system of vertically imposed customer and territorial restrictions which Schwinn contended were necessary to meet the competition of mass merchandisers such as Sears and Montgomery-Ward.<sup>29</sup> Besides the assertion made in *Schwinn*, a number of other contentions have also been made in defense of such vertical restrictions. First, they may expand market access. Distributors are often unwilling to accept new products unless they receive guarantees of exclusive distributorship<sup>30</sup> and of freedom from intrabrand competition. This may be an especially important consideration with new, high risk products.<sup>31</sup> Second, such agreements often increase market exposure and ensure that

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However, several Los Angeles area dealers violated this clause and sold through discount houses causing complaints on the part of other dealers. General Motors then enforced the location clauses against the errant dealers. Without ruling on the validity of the location clauses, the Supreme Court ruled that because the dealers' complaints resulted in action by General Motors and also because the dealers "policed" the system, the result was a "classic [horizontal] conspiracy in restraint of trade." *United States v. General Motors Corp.*, 384 U.S. 127, 140 (1966).

<sup>22</sup>*Cf. Preston, Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards*, 30 LAW. & CONTEMP. PROB. 506 (1965) [hereinafter cited as Preston].

<sup>23</sup>*Snap-on Tools Corp. v. FTC*, 321 F.2d 825 (7th Cir. 1963).

<sup>24</sup>See generally *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961). See also, *Jerrold Electronics Corp. v. Wescoast Broadcasting Co.*, 341 F.2d 653 (9th Cir.), *cert. denied*, 382 U.S. 817 (1965).

<sup>25</sup>*United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967).

<sup>26</sup>*United States v. Topco Associates, Inc.*, 405 U.S. 596 (1972).

<sup>27</sup>*Sandura Co. v. FTC*, 339 F.2d 847 (6th Cir. 1964).

<sup>28</sup>See notes 29-36 and accompanying text *infra*.

<sup>29</sup>*United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 374-75 (1967).

<sup>30</sup>See notes 62-66 and accompanying text *infra*.

<sup>31</sup>See, e.g., *Sandura Co. v. FTC*, 339 F.2d 847 (6th Cir. 1964). See generally *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961); *Jerrold Electronics Corp. v. Wescoast Broadcasting Co.*, 341 F.2d 653 (9th Cir.), *cert. denied*, 382 U.S. 817 (1965).

new products receive proper "exploitation," an opportunity that otherwise might not be available. If a manufacturer can guarantee a specific area or group of customers to a distributor, that distributor may be willing to undertake more extensive promotional and service obligations with respect to a particular product.<sup>32</sup> Third, by limiting territories or customer groupings, markets may be more readily identified and more thoroughly penetrated.<sup>33</sup> Finally, such restrictions allow manufacturers to select dealers consistent with the image promoted through their advertising and other merchandising efforts.<sup>34</sup> In short, restrictive agreements as to territory and customers often permit more concentrated effort and prevent overlapping of promotional expenditures and activity.<sup>35</sup> Depending on the industry and existing trade practices, some vertical restraints will not alter patterns of distribution to any significant degree while others will alter those patterns drastically. Regardless, vertically imposed restrictive agreements, like mergers, inevitably reduce the number of independent decisions made within a market area.<sup>36</sup>

The particular system of vertical restrictions in *Schwinn* was imposed on distributors and retailers through the use of franchise agreements.<sup>37</sup> Under those agreements, distributors were assigned territories in which they had exclusive rights; they were not permitted to sell outside of their assigned areas and could sell only to franchised retail dealers.<sup>38</sup> Schwinn also imposed customer restrictions on its

<sup>32</sup>Cf. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, Part II*, 75 YALE L.J. 373, 435 (1966).

<sup>33</sup>See Preston, *supra* note 22, at 511; Zimmerman, *Distribution Restrictions After Schwinn and Sealy*, 12 ANTITRUST BULL. 1181, 1182-83 (1967).

<sup>34</sup>Some manufacturers desire to cultivate an image of product excellence and consequent consumer satisfaction. See *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 381 n.7 (1967).

<sup>35</sup>Preston, *supra* note 22, at 511.

<sup>36</sup>Implicit in a number of Supreme Court decisions is the conviction that small independent businessmen should be preserved. See, e.g., *Brown Shoe Co. v. United States*, 370 U.S. 294, 333, 346 (1962). Restrictive agreements reduce the freedom of those businessmen to trade as they desire. Consequently, where restraints act to stifle competition while simultaneously limiting the independent dealers' freedom of action, they are generally per se invalid. See, e.g., *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964). Unfortunately, the per se ruling does not always have the desired effect of preserving independent businessmen. See note 54 *infra*.

<sup>37</sup>One writer contends that the restrictions were not imposed by use of the franchise agreements. See Keck, *The Schwinn Case*, 23 BUS. LAW. 669 (1968). However, the assumption that they were imposed by franchise agreements pervades both the district court and Supreme Court opinions.

<sup>38</sup>388 U.S. at 371.

retail dealers, who could sell only to consumers. They were also forbidden from selling to unfranchised dealers for the purpose of further sale.<sup>39</sup> An important part of the Schwinn distribution and franchising system was the "Schwinn Plan" which accounted for seventy-five percent of all sales.<sup>40</sup> Under the Schwinn Plan distributors took orders from retail dealers. Schwinn then shipped bicycles directly to the retailer, extended credit and paid a commission to the distributor.<sup>41</sup> Although agency and consignment arrangements were used to a small degree,<sup>42</sup> the remainder of Schwinn's sales was largely to distributors who then resold the bicycles to franchised retailers.<sup>43</sup> Thus the Schwinn Plan, coupled with customer and territorial restrictions on agency, consignment, Schwinn Plan and regular sales gave Schwinn effective control of its distribution system without the need for vertical integration.<sup>44</sup>

Though the district court found the customer restrictions valid, it ruled that the territorial restrictions on the resale of bicycles purchased by wholesale distributors constituted a per se violation of § 1 of the Sherman Act.<sup>45</sup> The Supreme Court affirmed the district court as to the illegality of territorial restrictions but reversed as to the

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<sup>39</sup>*Id.* at 370-71.

<sup>40</sup>*Id.* at 370 n.3.

<sup>41</sup>*Id.* at 370.

<sup>42</sup>*United States v. Arnold, Schwinn & Co.*, 237 F. Supp. 323, 328 (N.D. Ill. 1965). By the time the litigation reached the Supreme Court, agency arrangements accounted for a relatively minor part of Schwinn's sales, and consignment arrangements had been eliminated altogether. 388 U.S. at 370 n.3. Perhaps Schwinn eliminated the consignment arrangements because they are a relatively expensive and complicated method of distribution due to the extensive record-keeping requirements of a consignment system and the need for detailed contractual provisions. For example, under the method used by Schwinn, bicycles were shipped to distributors' warehouses while Schwinn insured the bicycles and continued to carry them on its books and balance sheet as part of manufacturer's inventory. When a bicycle was withdrawn for delivery to a retail dealer, the distributor remitted the "wholesale" price of the bicycle to Schwinn. By means of this rather complicated process, Schwinn retained title to all consigned bicycles and accessories until it received the full distributor's purchase price. *United States v. Arnold, Schwinn & Co.*, 237 F. Supp. 323, 328 (N.D. Ill. 1965).

<sup>43</sup>237 F. Supp. at 328.

<sup>44</sup>See note 54 *infra* and text accompanying notes 22-28 *supra*.

<sup>45</sup>237 F. Supp. at 343. The district court further held on the basis of other evidence that horizontal restraints along with a conspiracy to divide territories and to eliminate intraband competition existed, all of which constituted per se violations of § 1. *Id.* at 342-43. See note 20 *supra*. The Government also charged price fixing by Schwinn alone and a conspiracy to fix prices between Schwinn and its dealers. On this matter the district court ruled that the evidence was inadequate and found for Schwinn and its dealers. 237 F. Supp. at 328-33. The Government did not appeal the district court's price fixing determination.



customer restrictions, holding instead that the same principle must apply to both types of restrictions.<sup>46</sup> The Court concluded that it is *per se* unreasonable for a manufacturer to restrict the customers with whom wholesale distributors and retail dealers can trade after the manufacturer has parted with dominion over the product.<sup>47</sup>

Once the manufacturer has parted with title and risk, he has parted with dominion over the product, and his effort thereafter to restrict territory or persons to whom the product may be transferred—whether by explicit agreement or by silent combination or understanding with his vendee—is a *per se* violation of § 1 of the Sherman Act.<sup>48</sup>

At the same time, the Supreme Court stated that agency or consignment arrangements and the Schwinn Plan restrictive distribution system might not be justified in all situations by the presence of competition from mass merchandisers or even by a demonstrated need to meet that competition.<sup>49</sup> However, the Court ruled that such vertically imposed restraints would not constitute *per se* violations of the antitrust laws where price fixing was absent and where alternative supplies of similar, competitive products were available to unfranchised distributors and retailers.<sup>50</sup> After determining that price fixing was not at issue and that alternative, competitive products did exist,<sup>51</sup> the Supreme Court examined the Schwinn Plan and the agency and consignment arrangements under the rule of reason. In its rule of reason analysis, the Court stated that two further factors were required before such restraints would be ruled valid: (1) the manufacturer must retain actual ownership of the goods in question including dominion, title and risk of loss; and (2) the distributors or retailers must be indistinguishable in function from agents or salesmen.<sup>52</sup> Finding both of these factors present, the Court upheld the validity of the Schwinn Plan and of the agency and consignment methods of distribution.<sup>53</sup> The *Schwinn* opinion explicitly recognized that application of the *per se* rule to such arrangements would dis-

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<sup>46</sup>388 U.S. at 379.

<sup>47</sup>*Id.*

<sup>48</sup>*Id.* at 382.

<sup>49</sup>*Id.* at 381.

<sup>50</sup>*Id.*

<sup>51</sup>*Id.* The Government had alleged price fixing in its original complaint, but the district court found inadequate evidence to support the charge. 237 F. Supp. at 328-33. The Government did not appeal this determination. See note 45 *supra*.

<sup>52</sup>388 U.S. at 381.

<sup>53</sup>*Id.* at 382.

courage franchising, thereby severely hampering the smaller businessman in his effort to compete with mass merchandisers, as well as accelerating the trend toward vertical integration.<sup>54</sup>

Notwithstanding the Court's concern for the small businessman, the per se rule enunciated in *Schwinn* elicited a considerable amount of criticism,<sup>55</sup> as have per se rules in general.<sup>56</sup> Forbidding vertically

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<sup>54</sup>*Id.* at 380. In spite of the Supreme Court's concern for the small businessman and desire to avoid vertical integration where possible, *Schwinn* has found that the strictures imposed by the decision have made it advantageous, from a marketing standpoint, to integrate. Pollock, *Alternative Distribution Methods After Schwinn*, 63 Nw. U.L. Rev. 595, 610 n.60 (1968) [hereinafter cited as Pollock], citing Keck, *The Schwinn Case*, 23 Bus. Law. 669, 686-87 (1968). The integration resulted despite Government assurances in its brief that forward integration was "unlikely," "an entirely remote possibility," and "wholly lacking in credibility." Pollock, *supra*, at 610 n.60, citing Brief for Appellant at 29, 50, *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1968).

The argument is often made that decisions such as *Schwinn* encourage vertical integration by forbidding marketing arrangements among firms at different levels of the distribution process (*i.e.*, vertical agreements) altogether or by subjecting them to close scrutiny. If a firm's financial status forecloses the option of vertical integration, it may become a prime takeover target for another corporation or it may even go bankrupt. Critics contend that prohibitions against vertical marketing agreements "enhance the advantage integrated firms have over their unintegrated competitors. . . . [U]nless the antitrust laws tolerate these restrictions, this application of the Sherman Act will deter use of the franchise device and merely accelerate the disappearance of smaller independent concerns." Zimmerman, *Distribution Restrictions After Sealy & Schwinn*, 12 ANTITRUST BULL. 1181, 1183 (1967). It should be noted that this quote is taken out of context. The author of the quoted article was First Assistant in the Antitrust Division of the Justice Department at the time of *Schwinn* and *Sealy*. This part of his article merely discusses what those who desire to consummate vertical agreements allege will be the result of the Antitrust Division's actions.

In certain instances, such as the *Schwinn* situation, the critics have been proven correct. However, there are significant factors which discourage vertical integration. First, distribution is a capital intensive, low profit activity. Many firms prefer to apply their capital elsewhere if their marketing goals can be achieved by other means. Second, most distributors carry a wide variety of products, thus spreading their overhead over a wider base. Third, complicated management and service problems exist at the lower levels of distribution which discourage forward integration when workable alternatives are available. See generally Preston, *supra* note 22. As a result, there are many instances where vertical integration occurs only as a last resort, if at all.

<sup>55</sup>See, *e.g.*, Handler, *The Twentieth Annual Antitrust Review—1967*, 53 VA. L. REV. 1667 (1967). "Form [was] exalted over substance to a degree unparalleled in the history of antitrust." *Id.* at 1684. See also Keck, *The Schwinn Case*, 23 Bus. Law. 669 (1968); McLaren, *Territorial and Customer Restrictions, Consignments, Suggested Resale Prices and Refusals to Deal*, 37 A.B.A. ANTITRUST L.J. 137 (1968); Williams, *Distribution and the Sherman Act—The Effects of General Motors, Schwinn, and Sealy*, 1967 DUKE L.J. 732; Pollock, *supra* note 54. "[T]he teaching of *Schwinn* is that in antitrust cases form is more important than substance." Pollock, *supra* note 54, at

imposed customer and territorial restraints on goods purchased by distributors and retailers constituted a new application of the *per se* rule, one that has resulted in a number of judicially created excep-

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595. Since Mr. Pollock served as counsel to Arnold, Schwinn & Co. throughout the litigation, his opinion of the decision is hardly surprising.

Part of the reason for the criticism leveled at the *Schwinn* decision may lie in the fact that four years earlier the Supreme Court refused to affirm summary judgment against a truck manufacturer even though vertical customer and territorial restrictions existed along with unlawful price fixing. *White Motor Co. v. United States*, 372 U.S. 253 (1963). The district court had ruled that White Motor's franchise contracts as well as the price fixing agreements were *per se* invalid. 194 F. Supp. 562 (N.D. Ohio 1961). The Court affirmed the price fixing portion of the lower court judgment but held that the legality of the territorial and customer limitations embodied in the franchise contracts should be determined only after a full trial. On this matter, the Court stated that it did "not know enough of the economic and business stuff out of which the arrangement emerge[d] to be certain [of their effect on competition]." 372 U.S. at 263. However, instead of a new trial White Motors agreed to a consent decree. Consequently, the extensive information which the Supreme Court envisioned would result from a full trial was never forthcoming. Thus, only four years after *White Motors* with little new information available on the actual effect of vertically imposed customer and territorial restrictions on goods purchased by distributors and retailers, it is understandable that the *Schwinn* decision would cause considerable consternation and comment. A decision finding the customer and territorial restraints unlawful under the rule of reason may have been more palatable to the antitrust defense bar and would probably have elicited fewer unfavorable comments.

A second factor which may have prompted some of the adverse commentary is the questionable validity of the Court's partial reliance on "the ancient rule against restraints on alienation." 388 U.S. at 380. "With all deference, 'the ancient rule against restraints on alienation' would appear to be no more relevant to the solution of current distribution problems than the Rule in *Shelley's Case* would be for solving problems in the merger field." Pollock, *supra* note 54, at 601.

A third factor which may have caused some of the criticism is the fact that Schwinn has integrated forward as a result of the decision. Schwinn has absorbed the distribution function into its corporate structure despite assurances to the Court in the Government brief that such a move on Schwinn's part was highly unlikely. See note 54 *supra*.

<sup>56</sup>"There has been much recent commentary on the wisdom of *per se* rules." *United States v. Topco Associates, Inc.*, 405 U.S. 596, 609 n.10 (1972), *citing* Comment, *Horizontal Territorial Restraints and the Per Se Rule*, 28 WASH. & LEE L. REV. 457 (1971); Averill, *Sealy, Schwinn and Sherman One: An Analysis and Prognosis*, 15 N.Y.L.F. 39 (1969); Note, *Selected Antitrust Problems of the Franchisor: Exclusive Agreements, Territorial Restrictions, and Franchise Termination*, 22 U. FLA. L. REV. 260 (1969); Sadd, *Antitrust Symposium: Territorial and Customer Restrictions After Sealy and Schwinn*, 38 U. CIN. L. REV. 249 (1969); Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, Part I*, 74 YALE L.J. 775 (1965).

In *Topco*, Mr. Justice Marshall stated that "courts are of limited utility in examining difficult economic problems." 405 U.S. at 609. Without *per se* rules, he argued that courts would be "free to ramble through the wilds of economic theory" leaving uncertainty in their wake. *Id.* at 609 n.10. However, lower courts often refuse to apply *per se* rules according to their literal terms. Knowing this, businessmen and lawyers attempt to circumvent *per se* rules and out of their efforts lower courts often fashion

tions.<sup>57</sup> Though some per se rules, such as that governing resale price maintenance, are quite rigorously applied,<sup>58</sup> attempts by businessmen to circumvent per se rules and the subsequent limitation of those rules by the lower courts are relatively common occurrences in anti-trust law.<sup>59</sup> Thus, an important part of the *Schwinn* legacy is the exceptions which have arisen to the per se rule enunciated therein, accompanied by a concomitant degree of uncertainty as to exactly what vertical customer and territorial restrictions the courts will allow.<sup>60</sup> Yet many businessmen would probably prefer this uncertainty to the results of a strict application of the rule.

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exceptions to and limitations upon those rules. Thus it sometimes becomes doubtful as to exactly what restraints the courts will allow and which ones they will forbid by application of a per se rule. See notes 62-180 and accompanying text *infra*. Consequently, the quality of certainty which Mr. Justice Marshall attributes to per se rules is often ephemeral.

Furthermore, the courts' inability to deal with complex economic concepts and problems may not be as great as Mr. Justice Marshall asserts. In the same term in which the *Topco* opinion was written, the Court went to great lengths to commend a district court for its treatment of a problem requiring "predictions and assumptions concerning future economic and business events." *Ford Motor Co. v. United States*, 405 U.S. 562, 578 (1972); *United States v. Topco Associates, Inc.*, 405 U.S. 596, 622 n.10 (1972) (Burger, C.J., dissenting). This was an explicit recognition that courts are quite capable of dealing with economic realities and their ramifications.

Perhaps a significant part of the rationale behind per se rules lies in the fact that their application to a particular case or set of facts shortens the trial drastically. Once certain restraints, such as price fixing, are found to exist, it is conclusively presumed that their only purpose is the elimination of competition and they are per se unreasonable. *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963). Further inquiry into their effect is not required thus reducing the length of trial regarding the per se aspects of the case. *Schwinn* provides an example of the length of time required for a full inquiry. The trial consumed seventy days of actual litigation, not to mention pretrial hearings and related matters to which the district court had to devote its time. Furthermore, a record of twenty-three volumes evolved from the trial proceedings. Without the benefit of per se rules, four such trials would keep a district court judge busy for an entire year. Nonetheless, while application of a per se rule may speed resolution of a particular case, there is no assurance either that justice is done or that the intent of Congress is fulfilled. Indeed, the gist of many of the articles criticizing per se rules seems to be that expediency alone should not support a conclusion of presumptive or per se illegality.

<sup>57</sup>See notes 62-180 and accompanying text *infra*.

<sup>58</sup>See, e.g., *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707 (1944); *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

<sup>59</sup>See Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, Part I*, 74 *YALE L.J.* 775 (1965). See note 15 *supra*.

<sup>60</sup>In a recent opinion, Mr. Justice Marshall stated that per se rules contribute to certainty in the law. *United States v. Topco Associates, Inc.*, 405 U.S. 596, 609 n.10 (1972). When exceptions to those rules arise, however, uncertainty may actually result instead of certainty. See note 56 *supra*.

The restrictions which the Supreme Court found per se invalid in *Schwinn* had the purpose and effect of directly limiting the customers to whom and the territories in which distributors and retailers could sell after the manufacturer had parted with dominion over the bicycles.<sup>61</sup> However, an analysis of the exceptions which have emerged in response to the *Schwinn* per se rule indicates that where trade restrictions result in indirect customer or territorial limitations, lower courts have exhibited considerable tolerance. Those exceptions also reveal a variety of ways to avoid the consequences of that rule.

### *Exceptions to Schwinn Under Exclusive Distributorship Rulings*

One method manufacturers have adopted to avoid the *Schwinn* per se rule is the use of exclusive distributorships implemented through unilateral refusals to deal with particular distributors or retailers.<sup>62</sup> Such vertical confinements have long been held valid.<sup>63</sup> Exclusive distributorships implemented through unilateral refusals to deal occur when a manufacturer selects one dealer in a particular area to distribute or retail his products and simultaneously refuses to sell to any other dealer within that area.<sup>64</sup> Where the geographical area in question is quite large, the practical effect of an exclusive distributorship may be the indirect imposition of customer and territorial restraints. Nonetheless, absent any monopolistic, predatory, coercive or other improper motive or purpose, exclusive distributorships implemented through unilateral refusals to deal are permitted in recognition of the right of each businessman to trade as he desires.<sup>65</sup> Indeed, the *Schwinn* decision explicitly recognized and approved their

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<sup>61</sup>388 U.S. at 382. See notes 45-48 and accompanying text *supra*.

<sup>62</sup>See, e.g., *Colorado Pump & Supply Co. v. Febco, Inc.*, 472 F.2d 637 (10th Cir.), cert. denied, 411 U.S. 987 (1973); *Ark Dental Supply Co. v. Cavitron Corp.*, 461 F.2d 1093 (3d Cir. 1972); *Elder-Beerman Stores Corp. v. Federated Dep't Stores, Inc.*, 459 F.2d 138 (6th Cir. 1972); *Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors, Ltd.*, 416 F.2d 71 (9th Cir. 1969), cert. denied, 396 U.S. 1062 (1970); *Peerless Dental Supply Co., Inc. v. Weber Dental Mfg. Co.*, 283 F. Supp. 288 (E.D. Pa. 1968).

<sup>63</sup>E.g., *Schwinn Motor Co. v. Hudson Sales Corp.*, 239 F.2d 176 (4th Cir. 1956), cert. denied, 355 U.S. 823 (1957). See generally Barber, *Refusals to Deal under the Federal Antitrust Laws*, 103 U. PA. L. REV. 847 (1955) [hereinafter cited as Barber].

<sup>64</sup>Agreements resulting from unilateral refusals to deal present a separate problem. See, e.g., Barber, *supra* note 63; Levi, *The Parke, Davis-Colgate Doctrine: The Ban on Resale Price Maintenance*, 1960 SUPREME COURT REV. 258. See also Albrecht v. Herald Co., 390 U.S. 145 (1968).

<sup>65</sup>See generally cases cited in note 62 *supra*. The use of promises of exclusive distributorship by manufacturers has been held a valid bargaining tool where coercive purpose is not present. *Webster Motor Car Co. v. Packard Motor Car Co.*, 243 F.2d 418 (D.C. Cir.), cert. denied, 355 U.S. 822 (1957); *Nelson Radio & Supply Co. v. Motorola, Inc.*, 200 F.2d 911 (5th Cir. 1952), cert. denied, 345 U.S. 925 (1953).

use as long as other similar products are readily available to competing distributors and retailers.<sup>66</sup>

One of several recent cases in which the exclusive distributorship concept was analyzed and applied consistently with its underlying rationale was *Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors, Ltd.*<sup>67</sup> In *Seagram*, the Ninth Circuit was confronted with a situation wherein a large distiller, Seagram & Sons, became dissatisfied with the performance of its Hawaiian distributor, Hawaiian Oke.<sup>68</sup> For this reason and also because it was necessary as a means of more effectively promoting its entire product line, Seagram switched exclusive distributors which forced Hawaiian Oke out of business. Hawaiian Oke then sued for treble damages and the jury returned a verdict in its favor. On appeal, the Ninth Circuit reversed, ruling that a manufacturer may properly grant a distributor an exclusive distributorship or franchise even if the result operates to "cut off" another distributor.<sup>69</sup> Though the effect of Seagram's change of distributors and subsequent refusal to deal was Hawaiian Oke's insolvency and elimination as a competitor, the court of appeals found that Seagram's purpose had not been to force insolvency upon Hawaiian Oke. Accordingly, the Ninth Circuit held that exclusive distributorship agreements are permissible as long as their purpose is not the economic elimination of the former exclusive distributor<sup>70</sup> or some other anticompetitive or monopolistic objective.<sup>71</sup> The court

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<sup>66</sup>United States v. Arnold, Schwinn & Co., 388 U.S. 365, 376 (1967):

[A manufacturer] of a product other and equivalent brands of which are readily available in the market may select his customers, and for this purpose he may "franchise" certain dealers to whom, alone, he will sell his goods. . . . If the restraint stops at that point—if nothing more is involved than vertical "confinement" of the manufacturer's own sales of the merchandise to selected dealers, and if competitive products are readily available to others, the restriction, on these facts alone, would not violate the Sherman Act.

See also REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY ANTITRUST LAWS 27-29 (1955); Fulda, *Individual Refusals to Deal: When Does Single-Firm Conduct Become Vertical Restraint?*, 30 LAW & CONTEMP. PROB. 590 (1965); Turner, *The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655 (1962).

Whether other competitive products are available is usually a question for the jury. See, e.g., *Cherokee Laboratories, Inc. v. Rotary Drilling Serv., Inc.*, 383 F.2d 97, 105 (5th Cir. 1967), cert. denied, 390 U.S. 904 (1968).

<sup>67</sup>416 F.2d 71 (9th Cir. 1969), cert. denied, 396 U.S. 1062 (1970).

<sup>68</sup>416 F.2d at 80.

<sup>69</sup>*Id.* at 76. The Ninth Circuit also rejected Hawaiian Oke's other claims that it had been eliminated as a distributor as a result of a group boycott, intercorporate conspiracy or intracorporate conspiracy.

<sup>70</sup>*Id.* at 76-84.

<sup>71</sup>*Id.* at 82.

ruled that none of these elements existed and further stated that in the absence of an improper purpose, the validity of exclusive distributorships has long been recognized.<sup>72</sup>

In contrast, some courts have found it necessary to stretch the exclusive distributorship concept to a significant degree. One case which arguably lies within this group is *Williams v. Independent News Co.*,<sup>73</sup> in which the Third Circuit virtually restructured a contract in order to find an exclusive distributorship agreement, thereby permitting a vertical trade confinement or restraint. Independent News Co., a comic book distributor, had an exclusive distributorship<sup>74</sup> agreement with a comic book publisher to market all of its comic books. Any unsold comic books were returned to the publisher for subsequent disposal as off-sale full-copy return comic books, which are defined as noncurrent comic books not purchased on the retail market and returned to the publisher through the distribution chain with their covers and full contents intact.<sup>75</sup> Upon receiving the noncurrent comics, the publisher credited Independent's account for

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<sup>72</sup>*Id.* at 76, citing *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 376 (1967); *Lawlor v. National Screen Serv. Corp.*, 352 U.S. 992 (1957); *United States v. Columbia Steel Co.*, 334 U.S. 495, 522, 524-25 (1948).

<sup>73</sup>485 F.2d 1099 (3d Cir. 1973).

<sup>74</sup>The Third Circuit actually referred to the arrangement as an exclusive dealership rather than an exclusive distributorship. The two terms are not mutually exclusive but they are distinct concepts, though courts often improperly use them interchangeably. Exclusive distributorships occur when a manufacturer selects one dealer in a particular area to distribute or retail its products. This does not mean that the dealer is forbidden to handle other competing lines. On the other hand, an exclusive dealership results when a distributor or retailer chooses to deal in the product of only one manufacturer to the exclusion of all competing manufacturers' products. A dealer may be the only dealer for a particular product within a given area and at the same time handle only that one product thereby being both an exclusive distributor and an exclusive dealer. Ideally, it is the manufacturer who chooses to use only one distributor or retailer in a particular area and it is the dealer who chooses to handle only one of several similar and competing products. However, sometimes the manufacturer forces an exclusive dealership on a distributor or retailer through the use of contract termination threats, intimidation and coercion. When this occurs, the exclusive arrangement is invalid and cannot be enforced by the manufacturer. *See, e.g.*, *Englander Motors, Inc. v. Ford Motor Co.*, 267 F.2d 11 (6th Cir. 1959); *Webster Motor Car Co. v. Packard Motor Car Co.*, 243 F.2d 418 (D.C. Cir.), *cert. denied*, 355 U.S. 822 (1957); *Schwing Motor Co. v. Hudson Sales Corp.*, 239 F.2d 176 (4th Cir. 1956), *cert. denied*, 355 U.S. 823 (1957). Such holdings are not uncommon outside the automobile and oil industries. *See, e.g.*, *Dictograph Prods., Inc. v. FTC*, 217 F.2d 821 (2d Cir. 1954), *cert. denied*, 349 U.S. 940 (1955) (enforcement of exclusive dealing contracts with threats, intimidation and coercion forbidden; enforcement of sales contracts with distributors and dealers by provisions which permit termination on short notice also forbidden).

<sup>75</sup>485 F.2d at 1101.

the comics' full wholesale price<sup>76</sup> and then sold them at a drastically reduced rate to a third party who agreed to use them only as premiums.<sup>77</sup> Instead, the third party sold them to Williams. Williams in turn distributed them to other wholesalers who sold them to small retailers, such as "mom and pop" type stores,<sup>78</sup> which did not ordinarily sell current cover comic books. The small retailers subsequently sold the noncurrent comics for less than one-third their normal retail price since the cost of those comic books to the third party who supplied Williams was very small. Yet because a comic book's information is not of a timely nature, noncurrent comics with their covers and full contents intact are of exactly the same value as current comic books to one who has not previously been exposed to a particular issue<sup>79</sup>—they are nondifferentiated products.<sup>80</sup> Thus, due to their lower cost and equivalent "informational" value, the noncurrent comics competed directly with the more recent editions which Independent wholesaled through the current comic book chain of distribution.<sup>81</sup>

When Independent received word from its wholesalers of this cut-rate competition, it asked the publisher to "police" its off-sale full-

<sup>76</sup>*Id.* at 1108 (Adams, J., dissenting).

<sup>77</sup>"A premium is a comic book given away to children by a businessman as a gift or in a prize-bag in order to attract business. Comic book premiums do not [directly] compete with current cover comics because they are not sold to the public." *Id.* at 1102 n.3.

<sup>78</sup> Apparently there exists a good size market for these no longer current comics. There was testimony that these off-sale comics were distributed by Williams' wholesalers to "mom and pop" type stores which did not handle current cover comic books, and which could sell these off-sale comics for only four or five cents per copy. As appellant testified: "A comic book, if a certain person has never read it . . . is the same as new to the party purchasing it."

*Id.* at 1102 n.2.

<sup>79</sup>Note 78 *supra*.

<sup>80</sup>Product differentiation occurs when a manufacturer attempts to make his product different from other brands in the eyes of the consumer even though no real difference exists. Each manufacturer tries to inculcate in the consumer's mind a feeling that his product is superior to and slightly different from competitors' products. By doing so, the manufacturer hopes partially to avoid price competition. Product differentiation results from a combination of manufacturers' responses to specialized consumer desires and of consumers' tastes responding to manufacturers' differentiation efforts, such as advertising. Product differentiation may also result from natural causes as well as human efforts. See P. SAMUELSON, *ECONOMICS* 463-66 (8th ed. 1970).

Thus, nondifferentiated products are those which are identical in all ways and are incapable of differentiation regardless of any attempted efforts by the manufacturer. Since the content of both the current and noncurrent comic books was identical and they were exactly the same in appearance, they were nondifferentiated products.

<sup>81</sup>485 F.2d at 1105.



copy return sales.<sup>82</sup> The publisher did so and thereafter refused to sell any more returned comics to Williams' supplier. Williams instituted suit requesting equitable relief under § 16 of the Clayton Act<sup>83</sup> and treble damages pursuant to § 4 of the Clayton Act<sup>84</sup> for violation of § 1 of the Sherman Act.<sup>85</sup> The jury found for Independent on a general verdict.<sup>86</sup>

On appeal, Williams contended that the agreement between Independent and the publisher covered only current comic books.<sup>87</sup> He emphasized that after returning any unsold comics to the publisher and receiving full credit, Independent had parted with title, dominion and risk of loss. He therefore argued that as a result of the *Schwinn* decision, it was a per se violation of § 1 of the Sherman Act for Independent to control the destiny and conditions of resale of the

<sup>82</sup>*Id.* at 1105, 1112.

<sup>83</sup>Section 16 of the Clayton Act, 15 U.S.C. § 26 (1970), provides in pertinent part:

Any person, firm, corporation, or association shall be entitled to sue for and have injunctive relief, in any court of the United States having jurisdiction over the parties, against threatened loss or damage by a violation of the antitrust laws, including sections 13, 14, 18, and 19 of this title, when and under the same conditions and principles as injunctive relief against threatened conduct that will cause loss or damage is granted by courts of equity, under the rules governing such proceedings, and upon the execution of proper bond against damages for an injunction improvidently granted and a showing that the danger of irreparable loss or damage is immediate, a preliminary injunction may issue.

<sup>84</sup>Section 4 of the Clayton Act, 15 U.S.C. § 15 (1970), provides:

Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

<sup>85</sup>Note 1 *supra*.

<sup>86</sup>350 F. Supp. 159 (E.D. Pa. 1972).

<sup>87</sup>485 F.2d at 1103. Williams also alleged that a conspiracy existed between Independent and the publisher, the purpose of which was to eliminate Williams from competition in violation of § 1 of the Sherman Act. The Third Circuit held that Independent's request that the publisher "police" its noncurrent sales was merely an attempt by Independent to enforce its exclusive distributorship rights. *Id.* at 1106.

Williams further contended that the trial court's instructions to the jury were improper. The dissent convincingly developed the point that the charge erroneously concentrated on the distribution system as a whole and failed to instruct the jury properly on either the significance of the distinct segments of the distribution system or the combination aspects of the case. *Id.* at 1110 (Adams, J., dissenting). Nevertheless, the majority held that Williams' objection to the trial court's instructions was invalid. *Id.* at 1108.

noncurrent comic books.<sup>88</sup> However, the Third Circuit ruled that Independent's exclusive distributorship contract applied to both current and noncurrent comic books,<sup>89</sup> even though no mention of the noncurrent comics was made in the contract<sup>90</sup> and in spite of the fact that Independent had never distributed any noncurrent comic books.<sup>91</sup> The circuit court further ruled that by requesting the publisher to "police" its noncurrent comic book sales, Independent was merely attempting to enforce its exclusive distributorship rights.<sup>92</sup> Under a *Schwinn* analysis, it appears that restrictions did exist on the disposition of the off-sale comic books and that a ruling that per se violations were present would have been in harmony with *Schwinn*. Finding that an exclusive distributorship contract existed as to both current and noncurrent comics required the court to stretch both the exclusive distributorship concept and the facts. However, the end result was demonstrably correct. A finding in favor of Williams would have put the comic book publisher in the anomalous position of competing with himself at the retail level, while simultaneously diluting the value of Independent's exclusive distributorship.<sup>93</sup> The noncurrent comic book sales would have cut directly into Independent's current issue sales and overall profit, since comic books are nondifferentiated products.<sup>94</sup> Furthermore, because the publisher sold the noncurrent comics to the third party at a drasti-

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<sup>88</sup>*Id.* at 1104.

<sup>89</sup>*Id.* at 1106.

<sup>90</sup>"There is no restriction in the contract on the distribution . . . of off-sale full-copy return . . . comics. And there is no provision requiring Independent's approval before . . . distribution of [those] books." *Id.* at 1104.

<sup>91</sup>*Id.*

<sup>92</sup>*Id.* at 1106.

<sup>93</sup>Initially, such a situation might appear to be one of simple intraband competition but such is not the case. Intraband competition normally occurs only between firms handling the same product at the same level of the distribution process. For example, wholesalers who distribute the same brand may serve customers in a common area and their pricing policies regarding that particular brand constitute intraband competition. It is an extremely rare and perhaps nonexistent case when a manufacturer engages in price competition with himself. The comic book publisher, and to some degree Independent, were in positions normally occupied by a manufacturer. Thus, their situation is best conceptualized by considering the case of a typical manufacturer. One might argue that automobile manufacturers compete with themselves, since used cars compete with new ones, and that comic book publishers should do likewise. However, the market for new durable goods such as automobiles is quite different from the market for used durable goods—they are differentiated products. See note 80 *supra*. In contrast, there is no difference between current and noncurrent comic books to a consumer who has not read the particular issue in question—they are nondifferentiated products. See notes 78-81 and accompanying text *supra*.

<sup>94</sup>See note 80 *supra*.

cally reduced price,<sup>95</sup> the publisher's overall profit also would have declined. Had the publisher been forced to continue his sales of non-current comics to Williams' supplier, it is conceivable that at some point the profits of both the publisher and Independent might have been eliminated altogether.

One significant difference between the situation facing the Third Circuit in *Williams* and that confronting the Ninth Circuit in *Seagram* should be noted. Seagram & Sons made no attempt to control those to whom its new distributor could sell after Seagram parted with title, dominion and risk of loss. In *Williams*, after returning unsold comics to the publisher and receiving full credit, Independent also parted with title, dominion and risk of loss.<sup>96</sup> Yet it attempted to limit those to whom the publisher could distribute or sell the noncurrent comic books. Though the Third Circuit stretched the facts and the exclusive distributorship concept considerably in order to avoid *Schwinn*, the *Williams* decision was economically sound. It maintained the value of Independent's exclusive distributorship contract while simultaneously preserving the profitability of both Independent and the publisher,<sup>97</sup> a result which would not have been possible under a strict application of the *Schwinn* per se rule.<sup>98</sup>

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<sup>95</sup>See text accompanying notes 76-77 *supra*.

<sup>96</sup>See text accompanying notes 87-88 *supra*.

<sup>97</sup>See notes 93-95 and accompanying text *supra*. Preservation of profitable operations will not always justify either vertical or horizontal restrictions. The Supreme Court has often stated that self-interest alone is not adequate to justify restraints of trade. See, e.g., *United States v. Topco Associates, Inc.*, 405 U.S. 596, 611-12 (1972); *Albrecht v. Herald Co.*, 390 U.S. 145, 151-54 (1968); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 375 (1967); *United States v. General Motors Corp.*, 384 U.S. 127, 139-47 (1966).

<sup>98</sup>One other case involving the validity of an exclusive distributorship arrangement is also worthy of note. In *Colorado Pump & Supply Co. v. Febco, Inc.*, 472 F.2d 637 (10th Cir.), *cert. denied*, 411 U.S. 987 (1973), a manufacturer had switched to an exclusive distributorship thus cutting off a former distributor who sued for treble damages. In this respect, the Tenth Circuit's finding of legality was very similar to the result reached in *Seagram*. 472 F.2d at 640. However, there was also a contract provision which authorized the new distributor to sell within a specific territory. The court held that the contract provision was simply a description of the distributor's primary marketing area and since there was no evidence that his sales were confined solely to the described area, no per se violation existed. *Id.* at 640-41. Referring to *Schwinn*, the Tenth Circuit stated that the per se illegality of the territorial restrictions in that case was "predicated on the 'firm and resolute' insistence on compliance" and that the firmness "was grounded upon the communicated danger of termination." *Id.* at 639, citing *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 372 (1967). *Accord*, *Janel Sales Corp. v. Lanvin Parfums, Inc.*, 396 F.2d 398, 406 (2d Cir.), *cert. denied*, 393 U.S. 938 (1968). See also *Interphoto Corp. v. Minolta Corp.*, 295 F. Supp. 711 (S.D.N.Y.), *aff'd*, 417 F.2d 621 (2d Cir. 1969).

*Exceptions Based on Products Liability*

The Third Circuit also deviated from *Schwinn* in *Tripoli Co. v. Wella Corp.*,<sup>99</sup> a four-three en banc decision. Wella manufactured a line of fifty-two different beauty and barber supplies, only two of which were sold on a retail basis. The remainder was sold exclusively for professional use in barber and beauty shops through Tripoli, a wholesaler which purchased the products for further distribution to the trade. When Wella learned that Tripoli was retailing to the public products intended solely for barbers and beauticians, it cancelled Tripoli's contract. Tripoli then sued for treble damages claiming that the *Schwinn* decision forbade such restrictions. As justification for the resale restrictions, Wella alleged that because the products were dangerous in untrained hands, the restrictions were necessary to protect the public against injury and the manufacturer against potential product liability.<sup>100</sup> At trial, Wella's motion for summary judgment was granted.

On appeal, the Third Circuit ruled that every manufacturer-imposed resale restriction does not constitute a per se violation of the antitrust laws and that as in all antitrust cases, *Schwinn* must be read "in its factual context."<sup>101</sup> For this proposition, the Third Circuit borrowed from *Schwinn* itself: "Under the Sherman Act, it is unreasonable *without more* for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it."<sup>102</sup> The court noted that no territorial restriction was imposed on Tripoli and that *some* of Wella's products could cause irritation to hypersensitive skin, brittleness of hair or perhaps blindness.<sup>103</sup> The Third Circuit further noted that barbers and beauticians must be licensed, at least partly because of potential injury to customers from unskilled application of certain specialized beauty products.<sup>104</sup> Finding no indication that Wella was trying to avoid either intrabrand or interbrand competition within its chosen professional market, the majority ruled that customer limitations are proper when their purpose is to insulate a manufacturer from liability and protect the public from harm.<sup>105</sup> Yet only a few of the restricted products posed any danger to the public and

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<sup>99</sup>425 F.2d 932 (3d Cir.), *cert. denied*, 400 U.S. 831 (1970).

<sup>100</sup>*Id.* at 938.

<sup>101</sup>*Id.* at 936.

<sup>102</sup>*Id.* citing 388 U.S. 365, 379 (1965) (court's emphasis).

<sup>103</sup>*Id.* at 937.

<sup>104</sup>*Id.* at 938.

<sup>105</sup>*Id.*

even their potential for harm appeared questionable. As the dissent emphasized, while many individuals are susceptible to injury because of allergic or other reaction to products which normally cause no ill effects, it "would be astonishing if this well known fact would justify a producer's restriction on the ultimate marketing of his products to physicians and druggists."<sup>106</sup>

A summary judgment in favor of Wella does not appear warranted on the facts presented, at least under a literal application of the per se rule enunciated in *Schwinn*. After a full hearing, the rule of reason<sup>107</sup> could properly have been applied to those few products which might conceivably have caused harm. But restraints on the remaining products would be per se invalid under a *Schwinn* analysis and that determination would foreclose any inquiry into the reasonableness or justification for those restraints.<sup>108</sup> Nonetheless, the Supreme Court denied Tripoli's petition for certiorari.<sup>109</sup> It would be surprising if the Court considered unimportant a case which quite arguably falls directly within the *Schwinn* per se rule and yet produces a conflicting result. Thus, the certiorari denial may indicate two things regarding *Schwinn's* per se rule: (1) the possibility of consumer injury will weigh heavily in the determination of an exception's validity even where potential for harm is slight; and (2) the Court will allow a manufacturer to limit his market to a particular class or profession as long as customer and territorial restrictions are not imposed which have the purpose and effect of limiting either interbrand or intra-brand competition within the manufacturer's chosen market. One other factor, the availability of other similar products on the regular consumer market, might also enter into future decisions. As a quick perusal of almost any magazine will attest, there is a wide variety of competing beauty aids on the market. Had competition in this area been less intense, a different decision might have resulted at all court levels, especially with regard to those Wella products without harmful potential.

The possibility of harm to consumers was also a factor in *Polytechnic Data Corp. v. Xerox Corp.*<sup>110</sup> In *Polytechnic*, a manufacturer of copying machines required that lessees use only metering

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<sup>106</sup>*Id.* at 941 (Freedman, J., dissenting).

<sup>107</sup>See notes 3-4 and accompanying text *supra*.

<sup>108</sup>See, e.g., *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 5-8 (1958). On the interplay between per se rules and the rule of reason, see Comment, *Horizontal Territorial Restraints and the Per Se Rule*, 28 WASH. & LEE L. REV. 457, 460 n.24 (1971).

<sup>109</sup>*Cert. denied*, 400 U.S. 831 (1970).

<sup>110</sup>362 F. Supp. 1 (N.D. Ill. 1973).

devices approved by Underwriters' Laboratories, a national testing organization.<sup>111</sup> Though the case actually involved a tying arrangement rather than vertically imposed customer or territorial restrictions, tying arrangements are also vertical in nature and the policy considerations which determine their validity may provide valuable guidance in future litigation concerning other vertical restrictions.

A tying arrangement involves an agreement by a party to sell a particular product but only on the condition that the buyer purchase another, or "tied," product or at least agree that he will not purchase the tied or similar product from another supplier.<sup>112</sup> Section Three of the Clayton Act governs these arrangements.<sup>113</sup> They are "unreasonable in and of themselves whenever a party has sufficient economic power with respect to the tying product appreciably to restrain free competition in the market for the tied product and a 'not in substantial' amount of interstate commerce is affected;"<sup>114</sup> *i.e.*, they are per se invalid under § 1 of the Sherman Act and § 3 of the Clayton Act.<sup>115</sup> On the other hand, where a party imposes conditions premised upon *legitimate* business interests as justification for a tying arrangement,

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<sup>111</sup>*Id.* at 3.

<sup>112</sup>*Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 5-6 (1958). "For our purposes a tying arrangement may be defined as an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier." *Id.* at 5-6 (footnote omitted).

<sup>113</sup>Section 3 of the Clayton Act, 15 U.S.C. § 14 (1970), provides:

It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

<sup>114</sup>*Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 6 (1958), *citing International Salt Co. v. United States*, 332 U.S. 392, 396 (1947).

<sup>115</sup>*International Salt Co. v. United States*, 332 U.S. 392, 396 (1947). It has been argued that tie-ins are tested under different criteria when attacked as violative of § 1 of the Sherman Act than when suit is brought under § 3 of the Clayton Act. Turner, *The Validity of Tying Arrangements Under the Antitrust Laws*, 72 HARV. L. REV. 50 (1958). *But see Fortner Enterprises, Inc. v. United States Steel Corp.*, 394 U.S. 495 (1969); *United States v. Loew's, Inc.*, 371 U.S. 38 (1962).

that arrangement will be tested under the rule of reason.<sup>116</sup> In addition, when products are leased rather than sold, as in *Polytechnic*, rules established for use of the leased machinery and attachments thereto must not be disguised restraints of trade, although such rules may set reasonable standards which all suppliers of attachment devices must meet.<sup>117</sup>

While only Xerox's own metering device had been approved by the testing laboratory at the time of suit, the *Polytechnic* court noted that other devices were not foreclosed from prospective approval and use.<sup>118</sup> Thus, the purpose of the restrictions imposed by Xerox was not the economic elimination of competitors from the metering device market. Accordingly, the court ruled that no antitrust violation occurs when a manufacturer implements a policy designed to insulate itself from product liability suits as long as that policy actually promotes public safety and protects the manufacturer's equipment from harm.<sup>119</sup>

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<sup>116</sup>*E.g.*, *Polytechnic Data Corp. v. Xerox Corp.*, 362 F. Supp. 1, 6 (N.D. Ill. 1973). See notes 117-119 and accompanying text *infra*.

<sup>117</sup>*International Salt Co. v. United States*, 332 U.S. 392, 398 (1947).

<sup>118</sup>362 F. Supp. at 8.

<sup>119</sup>*Id.* at 6.

It is well settled that a manufacturer can adopt and implement a policy which is designed to protect its property and the users of its property . . . [in order] to promote safety. *Weather Wise Co. v. Aeroquip Corp.*, 468 F.2d 716 (5th Cir. 1972), *cert. denied*, 410 U.S. 990 (1973); *Bridge Corp. of America v. American Contract Bridge League, Inc.*, 428 F.2d 1365 (9th Cir. 1970), *cert. denied*, 401 U.S. 940 (1971); *Kendall Elevator Co. v. LBC & W Associates of South Carolina, Inc.*, 350 F. Supp. 75 (D.S.C. 1972). Indeed, even absolute restrictions have been permitted where necessary to protect legitimate business interests such as product or personal safety. *Tripoli Co. v. Wella Corp.*, 425 F.2d 932 (3d Cir.), *cert. denied*, 400 U.S. 831 (1970). 362 F. Supp. at 6. "The right of a lessor of equipment to establish conditions or specifications to which other products must conform in order to be used in combination with the lessor's own products has been preserved for many years in classic antitrust cases." *Id.* at 6-7 n.8, *citing* *International Salt Co. v. United States*, 332 U.S. 392, 397 (1947); *IBM v. United States*, 298 U.S. 131, 139-40 (1936).

"One's ownership rights in tangible personal property include a right to prohibit the attachment of devices thereto, or to retain authority to decide whether such attachment shall be made." 362 F. Supp. at 10, *citing* *In Re Farrell Publishing Corp.*, 165 F. Supp. 40 (S.D.N.Y. 1958), *aff'd sub nom. Hendler v. Cuneo Eastern Press, Inc.*, 279 F.2d 181 (2d Cir. 1960); *Bliss v. Southern Pac. Co.*, 212 Ore. 634, 321 P.2d 324 (1959); *Illinois Bell Telephone Co. v. Miner*, 11 Ill. App.2d 44, 136 N.E.2d 1 (1956); *Krause v. Hartford Accident & Indem. Co.*, 331 Mich. 19, 49 N.W.2d 41 (1951). *But see* *United States v. U.S. Int'l Cigar Mach. Co.*, 1956 Trade Cases ¶ 68,871 (S.D.N.Y. 1956) (manufacturer of cigar making machinery and subsidiary distributor prohibited by consent decree from forbidding alterations of or attachments to leased machinery).

In *Polytechnic*, the possibility of personal injury from the use of unapproved metering devices appears to have been more real than the potential for harm from the beauty aids in *Tripoli*.<sup>120</sup> Furthermore, like the customer and territorial restrictions in *Tripoli*, the metering device tying arrangement in *Polytechnic* was also vertically imposed, and there are a number of similarities between tying agreements and other vertical restrictions.<sup>121</sup> Thus, as a means of avoiding the *Schwinn* per se rule, *Polytechnic* may provide well-founded analogies for future cases where vertical restrictions are combined with valid possibilities of consumer injury or product liability.

### *Implications for the Future*

In *Schwinn*, the Supreme Court stated that agency or consignment restrictive distribution schemes might not be justified in all situations by the presence of competition from mass merchandisers or even by a demonstrated need to meet that competition, but that such vertically imposed restraints would not constitute per se violations of the antitrust laws in the presence of two factors: (1) the absence of price fixing; and (2) the existence of alternative supplies of similar, competitive products for unfranchised wholesalers and retailers.<sup>122</sup> In this respect, the ruling parallels the Court's earlier

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*See also* *IBM v. United States*, 298 U.S. 131, 139-40 (1936): "Appellant is not prevented from proclaiming the virtues of its own cards and warning against the danger of using, in its machines, cards which do not conform to the necessary specifications, or even from making its leases conditional upon the use of cards which conform to them."

<sup>120</sup>See notes 105-108 and accompanying text *supra*.

<sup>121</sup>There are many similarities between tying arrangements and vertically imposed customer and territorial restraints. Vertical customer and territorial restrictions are imposed by a manufacturer on a distributor or retailer and dictate the customers to whom or the territory in which those businessmen may sell a manufacturer's product. See notes 29-48 and accompanying text *supra*. Similarly, in *Polytechnic*, the manufacturer imposed restrictions on its lessees as to the meter manufacturers with whom they could deal; *i.e.*, lessees could utilize only Underwriters' Laboratories approved meters. Xerox actually took the restrictions one step further and, rather than applying them to distributors or retailers as in the case of customer or territorial restrictions, applied them to the ultimate consumer. Thus, on the facts presented in *Polytechnic*, it is possible to conceptualize the tying arrangement as a customer restriction carried beyond its usual limit and applied to the ultimate consumer.

<sup>122</sup>388 U.S. at 381.

We do not suggest that the unilateral adoption by a single manufacturer of an agency or consignment pattern and the *Schwinn* type of restrictive distribution system would be justified in any and all circumstances by the presence of the competition of mass merchandi-



decision in *Simpson v. Union Oil Co.*<sup>123</sup> In *Simpson*, a retail dealer sued for treble damages when Union Oil refused to renew his lease solely because the dealer sold consigned gasoline for a price lower than that fixed by Union. The Court stated that a consignment agreement valid under private contract law does not insulate the price fixing portions of the contract from the scrutiny of the antitrust laws and that the public policy expressed in those laws must predominate.<sup>124</sup> The Court would not permit a comparison between a simple agency arrangement and Union Oil's large, complicated distribution system:

[A]n owner of an article may send it to a dealer who may in turn undertake to sell it only at a price determined by the owner. There is nothing illegal about that arrangement. When, however, a "consignment" device is used to cover a vast gasoline distribution system, fixing prices through many retail outlets, the antitrust laws prevent calling the "consignment" an agency, for then the end result of *United States v. Socony-Vacuum Oil Co.* . . . would be avoided merely by clever manipulation of words, not by differences in substance.<sup>125</sup>

The Court held that Union's distribution scheme involved price fixing and was therefore a *per se* violation of the Sherman Act.<sup>126</sup> Thus, *Schwinn* and *Simpson* are complementary holdings. *Simpson* stands for the proposition that a consignment arrangement, valid *inter se*, cannot immunize a price fixing scheme;<sup>127</sup> *i.e.*, valid consignment agreements and antitrust violations are by no means mutually exclusive.<sup>128</sup> *Schwinn*, although sanctioning consignment and agency methods of distribution in limited situations, expressly makes those methods illegal *per se* when ancillary to price fixing.<sup>129</sup>

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sers and by the demonstrated need of the franchise system to meet that competition. But certainly, in such circumstances, the vertically imposed distribution restraints—*absent* price fixing and in the presence of adequate sources of alternative products to meet the needs of the unfranchised—may not be held to be *per se* violations of the Sherman Act. The Government, in this Court, so concedes in this case.

*Id.*

<sup>123</sup>377 U.S. 13 (1964).

<sup>124</sup>*Id.* at 18.

<sup>125</sup>*Id.* at 21-22 (footnote omitted).

<sup>126</sup>*Id.* at 24. See also *Atlantic Refining Co. v. FTC*, 344 F.2d 579 (6th Cir. 1965).

<sup>127</sup>377 U.S. at 24.

<sup>128</sup>The same is true of valid agency agreements—agency agreements valid *inter se* may also be declared in violation of the antitrust laws. *Sun Oil Co. v. FTC*, 350 F.2d 624 (7th Cir. 1965).

<sup>129</sup>388 U.S. at 375, 381.

The effect of *Schwinn* and *Simpson* is shown by the decision in *United States v. General Electric Co.*<sup>130</sup> The *General Electric* court was confronted with a situation in which General Electric controlled fifty percent of the "large lamp"<sup>131</sup> market in the United States. As the parties stipulated, the consignment arrangements were valid agency contracts under private contract law.<sup>132</sup> Under the General Electric consignment plan, GE set prices and assumed all risk of fire, obsolescence and market price decline.<sup>133</sup> Since GE controlled fifty percent of the large lamp market, the overall effect of its consignment system was undoubtedly greater than that of the Union Oil system in *Simpson*. Yet the GE system had been upheld by two previous decisions<sup>134</sup> and one consent decree.<sup>135</sup> Nonetheless, the district court held that the effect of the consent decree and the two previous *General Electric* cases had been essentially negated by subsequent antitrust law developments, particularly the *Schwinn* and *Simpson* decisions.<sup>136</sup> The consignment arrangement was therefore ruled a per se violation of the Sherman Act, since its only purpose was improper price fixing<sup>137</sup> which both *Simpson* and *Schwinn* had expressly forbidden in conjunction with consignment arrangements.<sup>138</sup> But where a consignment system is adopted in a good faith effort to meet competition and no anticompetitive elements are present, the arrangement will avoid per se invalidity and will be tested under the rule of reason.<sup>139</sup>

In addition to agency and consignment agreements, exclusive distributorship arrangements,<sup>140</sup> and the possible injury or product lia-

<sup>130</sup>358 F. Supp. 731 (S.D.N.Y. 1973).

<sup>131</sup>"Large lamp" is a trade term describing most types of electric lights used for interior lighting including incandescent light bulbs, fluorescent lights and certain high intensity discharge bulbs. *Id.* at 733 n.1.

<sup>132</sup>*Id.* at 734.

<sup>133</sup>*Id.*

<sup>134</sup>*United States v. General Electric Co.*, 272-U.S. 476 (1926); *United States v. General Electric Co.*, 82 F. Supp. 753 (D.N.J. 1949).

<sup>135</sup>1954 Trade Cas. ¶ 67,714 (D.N.J.).

<sup>136</sup>358 F. Supp. at 734-38.

<sup>137</sup>*Id.* at 743. *Accord*, *Lyons v. Westinghouse Elec. Corp.*, 235 F. Supp. 526 (S.D.N.Y. 1964).

<sup>138</sup>*United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 375 (1967); *Simpson v. Union Oil Co.*, 377 U.S. 13, 24 (1964).

<sup>139</sup>*United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 381 (1967). *See also* *Ludwig v. American Greetings Corp.*, 282 F.2d 917 (1960) (consignment system adopted in good faith effort to meet competition upheld where no anticompetitive elements exist).

<sup>140</sup>See notes 62-98 and accompanying text *supra*.

bility exceptions,<sup>141</sup> there are several other methods by which a manufacturer may avoid the *Schwinn* per se rule and still exert a large degree of vertical control over the distribution process without vertical integration. The most common of these are primary responsibility covenants, location clauses and profit pass-overs. To some extent, they are complementary devices and may be used individually or in combination.

Primary responsibility covenants impose certain requirements on distributors, dealers, retailers or franchisees as a condition of continuing their relationship with the manufacturer.<sup>142</sup> Members of the distribution chain are free to sell in any territory and to any customer they choose, but are required to expend an agreed amount of effort within a specified territory on such things as advertising, promotion and customer service. Primary responsibility covenants are especially important where effective local sales efforts are crucial.<sup>143</sup> Such agreements have been explicitly permitted by a large number of consent decrees.<sup>144</sup>

While primary responsibility covenants set certain areas in which specific efforts must be expended, location clauses designate the location of a dealer's or franchisee's place of business and require the manufacturer's or franchisor's permission to operate at another location.<sup>145</sup> Such clauses were specifically upheld in a 1942 case, *Boro Hall Corp. v. General Motors Corp.*,<sup>146</sup> though the dissent argued that they were prima facie unreasonable when used to control the place of sale of new cars.<sup>147</sup> As pointed out in the most recent *General Electric*

<sup>141</sup>See notes 99-121 and accompanying text *supra*.

<sup>142</sup>See Pollock, *supra* note 54, at 604.

<sup>143</sup>See generally Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, Part II*, 75 YALE L.J. 373, 435 (1966); Preston, *supra* note 22.

<sup>144</sup>Pollock, *supra* note 54, at 604, citing *United States v. American Type Founders Co.*, 1958 Trade Cas. ¶ 74,203 (D.N.J.); *United States v. Bostitch, Inc.*, 1958 Trade Cas. ¶ 74,739 (D.R.I.); *United States v. Necchi Sewing Mach. Sales Corp.*, 1958 Trade Cas. ¶ 73,838 (S.D.N.Y.); *United States v. Rudolph Wurlitzer Co.*, 1958 Trade Cas. ¶ 74,006 (W.D.N.Y.); *United States v. AMI, Inc.*, 1957 Trade Cas. ¶ 73,097 (W.D. Mich.); *United States v. J.P. Seeburg Corp.*, 1957 Trade Cas. ¶ 72,476 (N.D. Ill.); *United States v. Philco Corp.*, 1956 Trade Cas. ¶ 71,751 (E.D. Pa.). The Justice Department endorsed the use of primary responsibility covenants in *United States v. Sealy, Inc.*, 388 U.S. 350 (1967). "Insistence that each licensee shoulder primary responsibility for cultivating a particular territory would (without precluding competition among the licensees) serve the interest of the Sealy group as a whole better than an ironclad division of territories." Pollock, *supra* note 54, at 604 n.46, quoting Brief for Appellant, at 20-21, *United States v. Sealy, Inc.*, 388 U.S. 350 (1967).

<sup>145</sup>Pollock, *supra* note 54, at 603.

<sup>146</sup>124 F.2d 822 (2d Cir. 1942), cert. denied, 317 U.S. 695 (1943).

<sup>147</sup>*Id.* at 824 (Frank, J., dissenting). The Supreme Court recently had an opportun-

decision,<sup>148</sup> however, there have been significant changes in the interpretation of the antitrust laws over the past several years.<sup>149</sup> It is therefore unlikely that such clauses will escape close scrutiny where they are used in a coercive manner<sup>150</sup> or where their presence has a deleterious effect upon competition. On the other hand, where their sole purpose is the thorough penetration of a market area,<sup>151</sup> their validity will probably be upheld. Because of the complexities in determining the nature of their use, it is likely that location clauses will

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ity to examine location clause provisions in *United States v. General Motors Corp.*, 384 U.S. 127 (1966). However, the Court found it unnecessary to reach the questions concerning the validity of those clauses:

The Government invites us to join in the assumption, only for purposes of this case, that the "location clause" encompasses sales by dealers through the medium of discounters. But it urges us to hold that, so construed, the provision is unlawful as an unreasonable restraint of trade in violation of the Sherman Act.

We need not reach these questions concerning the meaning, effect, or validity of the "location clause" or of any other provision in the Dealer Selling Agreement, and we do not. We do not decide whether the "location clause" may be construed to prohibit a dealer, party to it, from selling through discounters, or whether General Motors could by unilateral action enforce the clause, so construed. We have here a classic conspiracy in restraint of trade: Joint, collaborative action by dealers, the appellee associations, and General Motors to eliminate a class of competitors by terminating business dealings between them and a minority of Chevrolet dealers and to deprive franchised dealers of their freedom to deal through discounters if they so choose. Against this fact of unlawful combination, the "location clause" is of no avail. Whatever General Motors might or might not lawfully have done to enforce individual Dealer Selling Agreements by action within the borders of those agreements and the relationship which each defines, is beside the point. And, because the action taken constitutes a combination or conspiracy, it is not necessary to consider what might be the legitimate interest of a dealer in securing compliance by others with the "location clause," or the lawfulness of action a dealer might individually take to vindicate this interest.

*Id.* at 139-40 (footnote omitted). The Court determined that the arrangement constituted a horizontal conspiracy in restraint of trade. *Id.* at 141, 143. See note 21 *supra*.

<sup>148</sup>*United States v. General Elec. Co.*, 358 F. Supp. 731 (S.D.N.Y. 1973). See notes 122-139 and accompanying text *supra*.

<sup>149</sup>358 F. Supp. at 735, 738.

<sup>150</sup>When coupled with termination clauses, location clauses could conceivably be used in a coercive manner similar to the way in which oil companies have used consignment agreements. See, e.g., *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964); *Sun Oil Co. v. FTC*, 350 F.2d 624 (7th Cir. 1965), *cert. denied*, 382 U.S. 982 (1966); *Atlantic Refining Co. v. FTC*, 344 F.2d 599 (6th Cir. 1965). See also *Englander Motors, Inc. v. Ford Motor Co.*, 267 F.2d 11 (6th Cir. 1959).

<sup>151</sup>For a thorough discussion of market coverage and penetration, see Preston, *supra* note 22.

be tested by the rule of reason<sup>152</sup> and no per se rule will be fashioned to govern them.

Profit pass-overs will probably be given much the same treatment; they are generally combined with primary responsibility covenants.<sup>153</sup> Profit pass-overs require a distributor or retailer who sells outside his primary responsibility area to give a certain percentage of his gross receipts to the individual or firm in whose primary area the sale was made,<sup>154</sup> thus compensating that firm for the advertising and sales expenditures undertaken in cultivating its particular primary area.<sup>155</sup> In short, these arrangements prevent one firm from taking advantage of the marketing efforts made by another firm selling the same product and thereby receiving a "free ride."<sup>156</sup> Like primary responsibility covenants, profit pass-overs are most common where local sales effort is vital, though it is extremely rare when a manufacturer of any product relies solely upon national advertising. In almost any sales campaign, local advertising is of some importance.<sup>157</sup> Without profit pass-over arrangements, an interloper could receive a large share of the advantages flowing from another firm's efforts without making any expenditures on its own part. The immediate result of such a situation would probably be reduced advertising and other market penetration efforts by the firm with primary responsibility for the particular area,<sup>158</sup> or some form of retaliation damaging to the manufacturer's overall market position. The ultimate consequence would be reduced sales of the manufacturer's product within the specific market area.

According to a recent district court decision, *Superior Bedding, Inc. v. Serta Associates, Inc.*,<sup>159</sup> the only relevant question in considering the validity of profit pass-overs is whether the pass-over requirement makes it impossible for a firm to make sales at a profit outside its own primary area.<sup>160</sup> The court found that the particular pass-over rate under consideration had a direct relation to fixed promotional expenses, such as sales and advertising costs, and still permitted an

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<sup>152</sup>See notes 3-4 and accompanying text *supra*.

<sup>153</sup>See text accompanying notes 142-44 *supra*.

<sup>154</sup>*Superior Bedding Co. v. Serta Associates, Inc.*, 353 F. Supp. 1143, 1150 (N.D. Ill. 1973).

<sup>155</sup>*Id.*

<sup>156</sup>Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, Part II*, 75 YALE L.J. 373, 435 (1966).

<sup>157</sup>*Id.* "The fact that many firms use a variety of forms of advertising and other sales efforts indicates that these forms are not perfect substitutes." *Id.*

<sup>158</sup>*Id.*

<sup>159</sup>353 F. Supp. 1143 (N.D. Ill. 1973).

<sup>160</sup>*Id.* at 1150.

outsider to sell within the area at a profit.<sup>161</sup> It therefore upheld the pass-over's validity.<sup>162</sup>

A hypothetical can be constructed, however, in which the validity of a pass-over provision is far more questionable than the provision in *Superior Bedding*. Suppose an automobile manufacturer assigns primary responsibility areas to each of its dealers within which the individual dealer is obligated to use his best efforts to promote the manufacturer's product. Assume further that the wholesale price of automobiles to the dealers is eighty percent of the suggested retail price but that the manufacturer refunds to the dealers an additional eight percent of the suggested retail price for each unit sold within the individual dealer's primary responsibility area.<sup>163</sup> Referring to *Superior Bedding*, the principal test for the validity of the hypothetical pass-over is whether a dealer can make a profit on sales outside of his own primary responsibility area without the eight percent refund.<sup>164</sup>

Before applying the *Superior Bedding* test to the hypothetical, however, four preliminary observations should be made: (1) the manufacturer's marketing goal is thorough penetration of each primary responsibility area; (2) a dealer's sales effort in another's primary area contributes relatively little to the manufacturer's overall marketing program; (3) an incentive system will help the manufacturer achieve his marketing goal and simultaneously ensure that each dealer's greatest effort is expended within his own primary responsibility area; and (4) the closer the incentive is to determining whether a dealer profits or loses on a particular sale, the more effective that incentive will be in controlling a dealer's activities and contributing to the achievement of the manufacturer's marketing goals. With these observations and the importance of the manufacturer's marketing goals<sup>165</sup> in mind, it is probable that the twenty percent discount

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<sup>161</sup>*Id.*

<sup>162</sup>*Id.* at 1151. In the *Superior Bedding* case, Serta hired Arthur Young & Co., a nationally known accounting firm, to determine the fixed expenses. From an average figure, an appropriate pass-over percentage was determined, which the court held valid. *Id.*

<sup>163</sup>See P. AREEDA, ANTITRUST ANALYSES, PROBLEMS, TEXT, CASES 429 (¶ 519) (1967).

<sup>164</sup>Note that in *Superior Bedding*, the payments were made from one dealer to another, not from the manufacturer to the dealer as in the hypothetical. However, the *Superior Bedding* pass-over requirement was imposed from above, and therefore its purpose and effect was probably identical to that in the hypothetical, and both can therefore be termed pass-overs.

<sup>165</sup>This refers to the importance of the manufacturer's marketing goals from his own perspective. From the general public's point of view, the goals may be of little or no significance. On the other hand, they may be of extreme importance to the public

on the wholesale price covers only a dealer's overhead, including such things as salaries, advertising, trade-in allowances, utilities and rental or mortgage payments. If so, the additional eight percent refund on all sales within the primary responsibility area represents the difference between making a profit and barely breaking even on each individual sale. Thus, the eight percent refund provision appears to fall directly within the *Superior Bedding* proscription.

Nonetheless, the manufacturer might argue, and perhaps validly so, that even if the eight percent refund provision does represent the difference between tangible profit and loss on an individual sale, a dealer's sales outside of his area of primary responsibility still contribute to his marginal revenue, thus allowing fixed overhead expenses to be absorbed by more sales units. However, it is doubtful whether dealers keep records which are detailed enough to reflect a true picture of the dealership's marginal revenue and marginal costs.<sup>166</sup> Consequently, the ultimate effect of the eight percent refund would be the almost total discouragement of sales outside a dealer's primary responsibility area—a result virtually identical to the restrictions in *Schwinn*, though arguably less direct. Since the automobile manufacturer parted with dominion, title and risk of loss when he received payment from the dealer, the pass-over arrangement in the hypothetical might be declared a per se violation of the Sherman Act because of its similarities to the *Schwinn* restrictions, or a new per se rule might be fashioned to govern such situations.

On the other hand, a rule of reason analysis using the *Superior Bedding* test will likely prove adequate in the absence of widespread abuse of the pass-over arrangement. That test is not concerned with

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and have substantial effects on the price paid for goods and services. The manufacturer's marketing goals may be adverse to the public's interest or at least potentially so and therefore fall under the scrutiny of the antitrust laws.

<sup>166</sup>Marginal cost is the amount which the sale of one additional unit or automobile adds to total costs. Conversely, it is the amount of expense which can be saved by not making a particular sale. Marginal cost is the equivalent of the total variable costs of "production" for that one unit; i.e., the marginal cost of each additional automobile sale is the amount which that unit adds to variable costs including sales commissions, mileage charges, etc.

If a dealer only breaks even on sales outside of his primary responsibility area, it may still be advantageous for him to sell outside his primary area, at least up to some point. Each additional sale gives a dealer a wider base over which to spread his fixed costs and thus fixed costs per unit or per sale decline. As long as the reduction in fixed costs per unit exceeds the variable costs added by each sale outside the primary responsibility area, the dealer can "profitably" continue those sales. See P. SAMUELSON, *ECONOMICS* 428-40 (8th ed. 1970); C.L. HARRISS, *THE AMERICAN ECONOMY* 392-95 (6th ed. 1968).

the businessman's overall profit—it focuses only on whether an entrepreneur can make a profit on each individual unit sold outside of his primary responsibility area. Therefore, applying the *Superior Bedding* standard to the hypothetical, if the eight percent refund represents the difference between profit and loss on an automobile sold outside a dealer's primary area, the arrangement would be invalid.

Another factor should also be considered in analyzing the hypothetical or any pass-over type of device. A manufacturer's wholesale prices to competitors need not be identical, but any price variance must reflect only the different costs of doing business with the respective competitors.<sup>167</sup> Where price discrimination exists, a cause of action arises under the Robinson-Patman Act.<sup>168</sup> Thus, a pass-over arrangement might also be open to attack on grounds of price discrimination.<sup>169</sup> Regardless, the solution offered to this hypothetical is admittedly conjectural, but it illustrates the type of analysis which is required where a profit pass-over device has been adopted in an effort to maintain a large degree of vertical control while simultaneously avoiding the *Schwinn* per se rule.

One further means of avoiding *Schwinn* might also be permitted. Prior to the *Schwinn* decision, it was thought that a new and relatively weak competitor could impose certain vertical territorial and customer restraints as an incentive to distributors and retailers to accept his products. Several cases had permitted such restrictions.<sup>170</sup> In one case, *Sandura Co. v. FTC*,<sup>171</sup> a struggling manufacturer desired to expand his sales but had few funds available for an advertising campaign. Consequently, in return for assuming the majority of the promotional expenses, distributors were offered closed territories with the exclusive right to sell to retailers within those areas. The Sixth Circuit held that the case was "barren of credible evidence that the public would be benefited by requiring that Sandura distributors be allowed to intrude on each other's territory."<sup>172</sup> The court concluded that, rather than increasing competition, the elimination of the closed territorial arrangements would actually impair it;<sup>173</sup> i.e., the

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<sup>167</sup>See, e.g., *FTC v. Morton Salt Co.*, 334 U.S. 37 (1948).

<sup>168</sup>15 U.S.C. § 13 (1970).

<sup>169</sup>The price discrimination claim in *Superior Bedding* was rejected. 353 F. Supp. at 1151.

<sup>170</sup>*Sandura Co. v. FTC*, 339 F.2d 847 (6th Cir. 1964); *Snap-on Tools Corp. v. FTC*, 321 F.2d 825 (7th Cir. 1963). See generally *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961).

<sup>171</sup>339 F.2d 847 (6th Cir. 1964).

<sup>172</sup>*Id.* at 858.

<sup>173</sup>*Id.* at 859.



restrictions promoted the economic well-being of the struggling firm while also promoting interbrand competition and were therefore valid. Though the Supreme Court's decision in *White Motor Co. v. United States*<sup>174</sup> appeared to declare that restrictions would be permitted in such special circumstances, the sweeping per se rule enunciated in *Schwinn* created a considerable amount of doubt whether even interim restrictive measures would be tolerated as a means of protecting new firms or products. Unfortunately, no definitive answer has emerged which would resolve those doubts. Nevertheless, there is language in *Schwinn* itself which indicates that the struggling corporation will be given special consideration. The Supreme Court noted that Arnold, Schwinn & Co. was neither "a newcomer, seeking to break into or stay in the bicycle business . . . [nor] a 'failing company.'" <sup>175</sup> Had either situation existed, the court indicated that the vertical restraints might have been "sheltered by the rule of reason because [they were] not anticompetitive."<sup>176</sup> Thus, future litigants may find that *Schwinn* provides an exception to its own per se rule where special circumstances exist.<sup>177</sup>

### *Conclusion*

When first enunciated, the *Schwinn* per se rule prompted a con-

<sup>174</sup>372 U.S. 253 (1963).

<sup>175</sup>388 U.S. at 374.

<sup>176</sup>*Id.*

<sup>177</sup>*Worthen Bank & Trust Co. v. National BankAmericard, Inc.*, 485 F.2d 119 (8th Cir. 1973), *cert. denied*, \_\_\_ U.S. \_\_\_, 94 S. Ct. 1417 (1974), may also allay some doubts as to whether a special circumstances exception exists. In *Worthen*, a bylaw of a national credit card organization forbade its members from joining competing credit card organizations but did not attempt to limit customers or territories, fix interest charges or limit discounts the member banks could give merchants. Though vertical restraints were not at issue, it is possible that a differently drafted complaint might properly have brought the question before the court. Since the requirement was imposed by the organization on all its members, the bylaw was arguably vertically initiated and therefore similar to the *Schwinn* situation, though the argument is not a particularly strong one. A ruling of this nature might depend on whether all members of the organization sat on the board and actually made policy decisions or whether policy was determined by only a few member banks. See generally *United States v. Sealy, Inc.*, 388 U.S. 350 (1967). Such a determination might also lead to a conclusion similar to those which have emerged from the cases concerning the exclusive arrangements which automobile manufacturers and oil companies have at times attempted to force on their dealers. See note 74 *supra*.

In any event, there were two per se rules which very probably did apply to the arrangement, those governing group boycotts [*e.g.*, *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959); *Fashion Originators' Guild of America, Inc. v. FTC*, 312 U.S. 457 (1941)] and horizontal restraints of trade [*e.g.*, *United States v. Topco Associates, Inc.*, 405 U.S. 596 (1972); *United States v. Sealy, Inc.*, 388 U.S. 350

siderable amount of controversy.<sup>178</sup> Fear was expressed that manufacturers would eliminate the independence of their distributors and dealers by one of two methods: (1) adoption of extensive agency and consignment distribution systems; or (2) vertical integration.<sup>179</sup> It was also postulated that those manufacturers who could not afford either of these alternatives due to limited financial resources would be forced to continue imposing territorial and customer restrictions, thereby risking lawsuits, or be compelled to settle for more inefficient methods of distribution.<sup>180</sup>

Certainly some fears have been realized. However, the attempts by businessmen to circumvent the *Schwinn* per se rule and the subsequent limitations imposed upon that rule by the lower courts have blunted the effect of the *Schwinn* decision to a very large degree. Utilization of exclusive distributorships in combination with primary responsibility covenants, location clauses and profit pass-overs still gives businessmen wide leeway in designing a distribution system. In addition, there are the possibilities offered by agency or consignment arrangements and the injury or product liability exceptions. Thus, the supposed harshness of the *Schwinn* per se rule has been muted by exceptions and other methods of avoidance. An entrepreneur continues to enjoy great flexibility in determining the type of distribution system that best conforms to the particular needs of his business.\*

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(1967)]. Yet the Eighth Circuit refused to apply either one saying that the credit card industry was a relatively new and very important one, doing over \$8 billion of business per year. Consequently, the court ruled that it would be a mistake to determine a case of such importance on the basis of a per se rule and remanded it to the district court for a full hearing on the purpose and effect of the restrictive bylaw. 485 F.2d at 129-30. Cf. *White Motor Co. v. United States*, 372 U.S. 253 (1963). The fact that the Supreme Court denied certiorari may indicate that an inquiry will be permitted into the purpose and effect of a trade restraint, other than resale price maintenance, whenever new circumstances arise, even though a per se rule applies to that situation. It is worth noting that the Antitrust Division of the Justice Department filed an amicus brief in *Worthen* urging the Eighth Circuit to take the course of action which it followed.

<sup>178</sup>See, e.g., Handler, *The Twentieth Annual Antitrust Review—1967*, 53 VA. L. REV. 1667 (1967). See also Keck, *The Schwinn Case*, 23 BUS. LAW. 669 (1968); McLaren, *Territorial and Customer Restrictions, Consignments, Suggested Resale Prices and Refusals to Deal*, 37 A.B.A. ANTITRUST L.J. 137 (1968); Williams, *Distribution and the Sherman Act—The Effects of General Motors, Schwinn and Sealy*, 1967 DUKE L.J. 732; Pollock, *supra* note 54.

<sup>179</sup>Pollock, *supra* note 54, at 605.

<sup>180</sup>*Id.*

\*This note was completed prior to the decisions in *Adolph Coors Co. v. FTC*, 1974 Trade Cas. ¶ 75,090 (10th Cir.), and *GTE Sylvania, Inc. v. Continental TV, Inc.*, 1974 Trade Cas. ¶ 75,072 (9th Cir.).