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CASE COMMENTS

HORIZONTAL TERRITORIAL RESTRAINTS AND THE PER SE RULE

In *United States v. Sealy, Inc.*,¹ a recent antitrust case before the Supreme Court, it was argued hypothetically that a group of grocers might engage in territorial restraints incident to the use of a common name and common advertisements, and that such an arrangement would not be a per se violation of the Sherman Act.² It was further argued that such an arrangement should be sustained because of the beneficial effect on competition.³ Although the Supreme Court struck down the practices employed in *Sealy*, it stated that such a position certainly would not require condemnation of the "quite different" grocer situation should it ever arise.⁴ This basic issue will be presented to the Supreme Court in a case arising from the Northern District of Illinois.⁵ The decision should clarify the Court's position on horizontal territorial restraints, and it will have important ramifications for small businessmen contemplating cooperative efforts to compete more effectively with larger national organizations.

In *United States v. Topco Associates, Inc.*,⁶ the government sought to enjoin, as unlawful under section one of the Sherman Act,⁷ the activities of a cooperative distributor of private label grocery and other related non-food products in allocating exclusive territories to its member food store chains. Topco Associates, Inc., does not manufacture or process grocery products; it procures and distributes under its own brand name exclusively to its members. Utilizing their collective buying power, the members can

¹388 U.S. 350 (1967). *Sealy* involved price fixing and market division among manufacturers of bedding products.

²15 U.S.C. § 1 (1964), *formerly* ch. 647, § 1, 26 Stat. 209 (1890).

³388 U.S. 350, 357 (1967).

⁴*Id.*

⁵*United States v. Topco Associates*, 5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,388, (N.D. Ill. Nov. 16, 1970).

Direct appeal by the United States from the district court to the Supreme Court is facilitated by the Expediting Act, 15 U.S.C. § 29 (1964), *formerly* ch. 544, § 2, 32 Stat. 823 (1903), which provides:

In every civil action brought in any district court of the United States under any of said Acts, wherein the United States is complainant, an appeal from the final judgment of the district court will lie only to the Supreme Court.

15 U.S.C. § 29.

⁶5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,388. (N.D. Ill. Nov. 16, 1970).

⁷15 U.S.C. § 1 (1964), *formerly* ch. 647, § 1, 26 Stat. 209 (1890).

support a private label program and market a line of quality controlled goods which are cost competitive with the private brands of the larger national chains.

The Topco cooperative is wholly owned and controlled by the member firms who are independent grocers, operating under their own name. There is no pooling of profits, capital or advertising efforts, and each member is free to sell what he wishes, buy from whom he pleases, and price his goods, including Topco brands, as he sees fit.

One of the most significant aspects of the Topco organization is the practice of allocating exclusive territories. To become a member of Topco, a firm must purchase a license which entitles it to the exclusive right to sell Topco brands in its respective area, with the correlative duty not to sell Topco brands outside that area.⁸ It was this system of territorial restraints which the government attacked as a violation of section one of the Sherman Act (hereinafter section one).

The district court concluded that the territorial restraints incident to the trademark licensing provisions were not inherently unreasonable and had no substantial adverse effect on competition.⁹ By viewing the territorial restrictions as subordinate to the otherwise legitimate, pro-competitive purpose of the Topco cooperative, the court found no violation of section one.¹⁰ The case is particularly significant because the court did not hold that the territorial restraints were per se violative of section one as contended by the government.

The issues raised by the principal case present the recurring question of what restraints of trade are prohibited by the Sherman Act. The language of section one, literally interpreted, admits no exceptions; it forbids "every contract . . . in restraint of trade . . ."¹¹ Yet, literal construction has never been utilized by the Supreme Court in cases arising under section one.¹² From the Court's attempts to establish a workable formula

⁸Topco issues three types of licenses: exclusive, nonexclusive and co-extensive. An exclusive territory is one in which the member chain has the exclusive right to sell Topco branded products; a non-exclusive territory is one in which a member may sell Topco branded products, but not to the exclusion of others who may be licensed to sell in the same territory. Co-extensive territories are those in which two or more designated members may sell Topco branded products to the exclusion of all others. 5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,388 at 89,556-57.

⁹5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,388 at 89,558.

¹⁰*Id.* at 89,562.

¹¹15 U.S.C. § 1 (1964), formerly ch. 647, § 1, 26 Stat. 209 (1890) 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

15 U.S.C. § 1.

¹²There is authority that such a literal meaning was given to the Sherman Act by Justice Peckham in *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290, 312 (1897). *See*,

in this area emerged special rules for construction and analysis of cases arising under section one.

The basic concept behind these rules and the doctrinal starting point for analysis of section one cases is the rule of reason. The term "rule of reason" refers to a dichotomy of theory, the foundations of which were laid by the earliest antitrust cases.¹³ By equating "restraint of trade" with unreasonable restraint of trade the Supreme Court has been able to escape the encompassing mandate of section one that every agreement in restraint of trade is illegal.¹⁴ Yet, at the same time the Court has viewed certain restraints as so pernicious to competition that no justification or reasonableness will save the agreement.¹⁵ This corollary of the rule of reason, that some agreements are conclusively presumed to be illegal, is referred to as the *per se* rule.¹⁶

The rule of reason was first explicitly formulated in *Standard Oil Co. v. United States*¹⁷ where Chief Justice White stated the rule as follows: ". . . in every case where it is claimed that an act or acts are in violation of the statute the rule of reason, in the light of the principles of law and the public policy which the act embodies, must be applied."¹⁸ Application of the rule as envisioned by Chief Justice White and applied in subsequent cases,¹⁹ 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.²⁰

e.g., M. HANDLER, ANTITRUST IN PERSPECTIVE 4-7 (1957). However, in a careful analysis of Justice Peckham's language, Professor Bork shows that Peckham was not a mere literalist who advocated a lexicographic interpretation of the Sherman Act. Bork, *The Rule of Reason*, Part I, 74 YALE L.J. 775, 785 (1965).

¹³*E.g.*, *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211 (1899); *United States v. Joint Traffic Ass'n*, 171 U.S. 505 (1898); *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897). *See also* Bork, *The Rule of Reason*, Part I, 74 YALE L.J. 775 (1965).

¹⁴*United States v. Standard Oil Co.*, 221 U.S. 1, 66 (1911); *see also United States v. American Tobacco Co.*, 221 U.S. 106, 181 (1911).

Professor Bork suggests that Chief Justice White was able to deny that the Sherman Act forbade every restraint by equating the term "competition" to rivalry between business units, and that this view which White incorporated into the rule of reason was subsequently accepted in the law. Bork, *The Rule of Reason*, Part II, 75 YALE L.J. 377 n. 5 (1966).

¹⁵For example, in *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 283 (6th Cir. 1898), *modified and aff'd*, 175 U.S. 211 (1899), Judge (later Chief Justice) Taft stated the following about certain restraints which necessarily have a tendency to monopolize: "[T]here is in such contracts no main lawful purpose, to subserve which partial restraint is permitted, and by which its reasonableness is measured . . ." *See also Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958).

¹⁶*Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958).

¹⁷221 U.S. 1 (1911).

¹⁸*Id.* at 66.

¹⁹*E.g.*, *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); *White Motor Co. v. United States*, 372 U.S. 253 (1963).

²⁰Bork, *The Rule of Reason*, Part I, 74 YALE L.J. 775, 805 (1965).

An often quoted statement of the per se rule appears in *Northern Pacific Railway v. United States*²¹ where Justice Black stated that there are certain agreements which, regardless of their competitive effect or business expediency, are conclusively presumed to be unreasonable and thus illegal.²² Once it becomes established in the law that a particular practice is a per se violation, the government need only prove the existence of that practice to obtain a judgment,²³ and the defendant is precluded from introducing evidence to justify the practices or explain their overall competitive effect.²⁴

The factual situation in *Topco* necessitates the application of these basic concepts to an agreement whereby the parties allocate exclusive territories among themselves. While the problem has never been presented to the Supreme Court in a context similar to that of *Topco*, the Court has established guidelines in this area. Agreements to allocate territories have been classified by the Court as either vertical²⁵ or horizontal.²⁶ When the parties to the agreement are located at different levels of distribution, as in

²¹356 U.S. 1 (1958).

²²*Id.* at 5.

²³A. NEALE, *THE ANTITRUST LAWS OF THE UNITED STATES OF AMERICA* 27 (2d ed. 1970). The evidentiary effects of the per se rules are illustrated by *White Motor Co. v. United States*, 372 U.S. 253 (1963), and *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940). In *Socony-Vacuum*, the Court was not interested in the justification for the price fixing or the fact that the prices fixed were reasonable. The per se rules may also be used as a basis for summary judgment. See *Northern Pac. Ry. v. United States*, 356 U.S. 1, 13 (1958).

²⁴The interplay between the rule of reason and the per se rules can produce confusion. For example, when a case is presented in which an antitrust violation is alleged, it is not clear whether the rule of reason is used to make the per se determination, or whether the rule of reason applies only after the case survives the per se test. If it is said that the rule of reason operates in every case, then the effect of the per se rule is to terminate the inquiry as soon as it is determined that the particular case represents a situation traditionally viewed as a per se violation. See, e.g., Rahl, *Price Competition and the Price Fixing Rule—Preface and Perspective*, 57 *Nw. U.L. REV.* 137, 139-42 (1962). This view has been particularly attractive, probably because the converse suggests that the per se determination is reached by a process something short of reason, which of course, is not the case. It would seem more accurate with regard to recent case law to view the application of the rule of reason to the determination of whether the alleged restraint is ancillary and reasonable and thus, not unlawful. For example, in *United States v. Sealy, Inc.*, 388 U.S. 350 (1967), Justice Fortas stated: "[T]heir anti-competitive nature and effect are so apparent and so serious that the courts will not pause to assess them in light of the rule of reason." 388 U.S. at 355. This more than suggests that the rule of reason applies only after the case survives the per se test. The distinction is interesting, but largely academic; regardless of the theory used, the effect of the per se determination is to foreclose any inquiry into justification or reasonableness of the restraint. See, e.g., *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958).

²⁵E.g., *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); *White Motor Co. v. United States*, 372 U.S. 253 (1963).

²⁶E.g., *United States v. Sealy, Inc.*, 388 U.S. 350 (1967); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951); *United States v. National Lead Co.*, 332 U.S. 319 (1947).

a manufacturer-distributor relationship, their agreement is said to be vertically imposed.²⁷ On the other hand, horizontal agreements are those executed among firms located at the same level of distribution,²⁸ such as an agreement between two or more independent manufacturers.²⁹ Critical distinctions have resulted from these classifications. Vertical agreements to allocate territories have traditionally been tested by the rule of reason;³⁰ whereas, horizontal agreements are said to be per se violations of section one.³¹ The Court's rationale behind this distinction is that horizontal restraints have no purpose but to eliminate competition, whereas vertical agreements may or may not have that purpose.³² It has been further stated that vertical territorial arrangements may have valid business justifications and are not necessarily undertaken for anti-competitive purposes.³³ While the vertical-horizontal distinction is by no means an easy one to establish in every case, the Court has provided a paradigm for analysis.

In *Sealy*, the most recent case to present the issue to the Supreme Court, it was stated that the determination of whether an agreement is vertical or horizontal results from an analysis of substance rather than form.³⁴ The government charged that *Sealy* had violated the Sherman Act by conspiring with its manufacturer-licensees to fix the prices at which retail merchants could resell bedding products bearing the *Sealy* name and by allocating mutually exclusive territories among the licensees. *Sealy*, a joint venture corporation whose stock was wholly owned by thirty licensees, was managed and controlled by a board of directors chosen exclusively from the licensees.³⁵ The Court looked to what it called the "central substance of the situation, not its periphery" and found that the exclusive territories are necessarily chargeable to the licensees, whose

²⁷Note 25 *supra*.

²⁸*E.g.*, *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951); *United States v. National Lead Co.*, 332 U.S. 319 (1947).

²⁹*E.g.*, *United States v. Sealy, Inc.*, 388 U.S. 350 (1967). While *Sealy* is the most recent horizontal case to appear before the Court, *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951), is frequently cited as an example of a horizontal case.

³⁰*White Motor Co. v. United States*, 372 U.S. 253 (1963). It should be noted that *White* has been limited by *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), where the Court held that once title to the goods has passed, restraints on alienation are per se unlawful; whereas, if the vertical agreement between the manufacturer and retailer is one of sale on a consignment basis, the rule of reason applies. *Id.* at 381-82.

³¹*Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958). The courts often use "market division" interchangeably with "horizontal territorial agreement."

³²*White Motor Co. v. United States*, 372 U.S. 253, 263 (1963).

³³*United States v. Sealy, Inc.*, 388 U.S. 350, 359 (1967).

³⁴*Id.* at 352.

³⁵*Id.*

interests the arrangement promoted.³⁶ Of particular significance in the determination that *Sealy* was a horizontal case was the fact that licenses were granted or withheld by the licensee-controlled board of directors.³⁷ Even though *Sealy* was incorporated as a separate entity, the Court concluded that it was an instrumentality of the licensees.³⁸

Analysis of the *Topco* organization reveals the presence of each element of the *Sealy* structure which led the Court to conclude that *Sealy* was a horizontal case.³⁹ Yet, the district court, in a departure from traditional doctrine, did not declare the territorial restraints per se unlawful as urged by the government.⁴⁰ It found, pursuant to an examination of power, purpose, and effect—the traditional elements of inquiry under the rule of reason—that the restraints were lawful in light of their overall pro-competitive effect.⁴¹ The question arises therefore, whether the decision by the district court against the government can be justified, in the face of substantial Supreme Court precedent that horizontal territorial agreements are per se unlawful.⁴²

The district court in *Topco* failed to state whether it viewed the agreement as vertical or horizontal or how it avoided the per se rule. A possible basis for the decision may lie in the case of *Sandura v. FTC*⁴³ from which the court quoted in summarizing *Topco's* argument.⁴⁴ In *Sandura* it was held that the pro-competitive effects of a system of exclusive territorial distributorships outweighed any adverse effect which the arrangement might have had on intrabrand competition.⁴⁵ *Sandura* was a floor tile manufacturer which allocated territories to independent franchise licensees.⁴⁶ While noting that the distributorships in *Sandura*

³⁶*Id.* at 353. The following language from *Sealy* further indicates what the Court means by a horizontal agreement:

The territorial arrangements must be regarded as the creature of horizontal action by the licensees. It would violate reality to treat them as equivalent to territorial limitations imposed by a manufacturer upon independent dealers as incident to the sale of a trade-marked product. *Sealy, Inc.*, is an instrumentality of the licensees for purposes of the horizontal territorial allocation. It is not the principal.

388 U.S. at 354.

³⁷*Id.* at 352.

³⁸*Id.*

³⁹*Topco* is wholly owned by its twenty-five member licensees who hold all of its stock. The cooperative is controlled by a board of directors composed of member-licensees, and *Topco* officers are chosen from this board. The granting and withholding of licenses is also controlled by the board.

⁴⁰TRADE REG. REP. (1970 Trade Cas.) ¶ 73,388 at 89,562.

⁴¹*Id.*

⁴²*E.g.*, Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958).

⁴³339 F.2d 847 (6th Cir. 1964).

⁴⁴TRADE REG. REP. (1970 Trade Cas.) ¶ 73,388 at 89,561.

⁴⁵339 F.2d at 857.

⁴⁶*Id.* at 849.

were conferred by the manufacturer rather than by a board of directors composed of member-licensees as in *Topco*, the district court stated that the cases were otherwise “virtually identical.”⁴⁷ It would seem that the court, after explicitly recognizing this distinction between *Sandura* and *Topco*, would also recognize that the distinction was the major factor which led the Supreme Court to conclude that *Sealy* was a horizontal case. If the district court, as implied by its discussion of *Sandura*, viewed the *Topco* agreement as vertical, then the holding on that issue cannot be reconciled with the finding by the Supreme Court that *Sealy* was a horizontal case.⁴⁸

The district court also quoted from the opinion of Chief Justice Hughes in *Appalachian Coals, Inc. v. United States*⁴⁹ which sustained an agreement between major producers of bituminous coal to establish a selling agency with the authority to fix prices.⁵⁰ The industry was in a state of chaos due to diminishing post-war consumption, and the Court perceived the need for intra-industry regulation to stabilize the bituminous coal market.⁵¹ In upholding the agreement, the Court stated: “The mere fact that the parties to an agreement eliminate competition between themselves is not enough to condemn it.”⁵² Although *Appalachian Coals* has never been expressly overruled, it has been emasculated by the per se concept as subsequently developed. The case was limited to its particular facts in *United States v. Socony-Vacuum Oil Co.*⁵³ which held a similar price fixing agreement per se unlawful. In *Virginia Excelsior Mills, Inc., v. FTC*,⁵⁴ the court held, on facts analogous to *Appalachian Coals*, that the agreement in question constituted a per se violation. The defendants attempted to rely upon *Appalachian Coals*, to which the court stated the

⁴⁷5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,388 at 89,561.

⁴⁸Justice Harlan, dissenting to the majority of six, viewed *Sealy* as a vertical arrangement and stated that the particular relationship between *Sealy* and the licensees should only be one factor in the consideration of whether the restraint is an unreasonable one. Justice Harlan focused particularly on the fact that *Sealy* itself was an entity with legitimate business purposes of its own, whose activities have been directed not toward market division among licensees but toward obtaining additional licensees and more intensive sales coverage. *United States v. Sealy, Inc.*, 388 U.S. 350, 361 (1967). It is doubtful that the Court will retreat from the position clearly enunciated in *Sealy* in 1967, and adopt Harlan’s view, which would require drawing such distinctions as horizontally imposed vertical arrangements. Such distinctions would do little more than inspire ingenious counsel to contrive corporate organizations to fit the distinctions. It would seem more rational to avoid such distinctions and focus on the propriety of the per se rule itself.

⁴⁹288 U.S. 344 (1933).

⁵⁰5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,388 at 89,560-61 (N.D. Ill. Nov. 16, 1970).

⁵¹288 U.S. at 361.

⁵²*Id.* at 360.

⁵³310 U.S. 150 (1940).

⁵⁴256 F.2d 538 (4th Cir. 1958).

following: "What contrary suggestion may be found in *Appalachian Coals* . . . has not survived the strong and consistent course of subsequent decision."⁵⁵ The fact that the authorities cited by the district court in *Topco* do not support the result reached does not, however, dispose of the question of the propriety of the per se illegality of agreements such as *Topco*.

The attempt to determine the Supreme Court's rationale underlying the per se approach to horizontal territorial restraints reveals only a few vague and brief statements about antitrust policy. For example, in *White Motor Co. v. United States*,⁵⁶ Justice Douglas characterized horizontal territorial restraints as "naked restraints of trade" with no purpose except the stifling of competition.⁵⁷ Perhaps Justice Harlan gave the most direct statement of the reason when he stated that territorial divisions prevent open competition among parties who would otherwise be competing among themselves.⁵⁸

The Court has also given a non-economic justification for the per se approach. In *Northern Pacific Railway v. United States*,⁵⁷ Justice Black listed those restraints which have been viewed as per se violations.⁶⁰ He stated that the per se approach makes the types of restraints of trade prohibited by the law more certain and avoids complex and protracted litigation.⁶¹ This rule of thumb approach may simplify antitrust litigation in some areas; yet, it is doubtful that expediency alone should support the existence of a conclusive presumption of illegality.⁶²

Thus, the extent of the Court's economic justification for the per se rule against horizontal territorial restraints is that they stifle and prevent open competition.⁶³ Since the Court has provided no definition of

⁵⁵*Id.* at 541.

⁵⁶372 U.S. 253 (1963).

⁵⁷*Id.* at 263.

⁵⁸388 U.S. 350, 359 (1967).

⁵⁹356 U.S. 1 (1958).

⁶⁰In *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1957), Justice Black stated the following:

Among the practices which the courts have heretofore deemed to be unlawful in and of themselves are price fixing, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 210; division of markets, *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, *aff'd*, 175 U.S. 211; group boycotts, *Fashion Originators' Guild v. Federal Trade Comm'n*, 312 U.S. 457; and tying arrangements, *International Salt Co. v. United States*, 332 U.S. 392.

356 U.S. at 5.

⁶¹*Id.* at 5.

⁶²*Cf.* Oppenheim, *Federal Antitrust Legislation: Guideposts to a Revised National Antitrust Policy*, 50 MICH. L. REV. 1139, 1151, 1171 (1952).

⁶³*United States v. Sealy, Inc.*, 388 U.S. 350, 359 (1967) (Harlan, J., dissenting); *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963).

competition,⁶⁴ any conclusion in this area must be based upon an inquiry which goes behind the Court's language to the cases which gave rise to the *per se* rule.

Even though it is often stated that horizontal territorial restraints are *per se* unlawful, the Court has never been presented with a case involving that issue alone. Territorial allocation cases have generally involved price fixing agreements among parties with substantial and often dominant market power. For example, in *Addyston Pipe & Steel Co. v. United States*⁶⁵ the Supreme Court condemned a price fixing and market division agreement among manufacturers supplying about two-thirds of the steel pipe in the United States. Similarly, *Timken Roller Bearing Co. v. United States*⁶⁶ condemned price fixing and allocation of market territories among dominant American, British and French producers of roller bearings. The same result has been reached in several lower court cases involving territorial restraints or agreements not to sell to a competitor's customers.⁶⁷

In *Sealy* the Court did not discuss market power, but viewed the extensive price fixing and territorial allocation agreement as an "aggregation of trade restraints" similar to that condemned in *Timken*.⁶⁸ The language in *Sealy* leaves little room for doubt that the decision was based on more than the presence of territorial restraints: "It may be true, as appellee vigorously argues, that territorial exclusivity served many

⁶⁴Professor Bork suggests the following theory concerning the Court's use of the term "competition":

As so used "competition" does not mean the presence in a market of a sufficient number of sellers to insure competitive behavior but merely a condition of rivalry between business units. This distinction corresponds to the semantic shift between Peckham in *Trans-Missouri* and *Joint Traffic* and White in *Standard Oil* and *American Tobacco*. Peckham was able to read the Sherman Act as forbidding every agreement in restraint of trade by equating that phrase to the elimination of a competitive structure. White was able to deny that the statute forbade every restraint, without changing Peckham's test, by equating the term to the elimination of rivalry. In accordance with White's usage, which has become accepted in the law, references in this article to restrictions or eliminations of competition are to be taken to mean restrictions or eliminations of rivalry.

Bork, *The Rule of Reason*, Part II, 75 *YALE L.J.* 373, 377 n. 5 (1966).

⁶⁵175 U.S. 211 (1899).

⁶⁶341 U.S. 593 (1951).

⁶⁷*United States v. United States Alkali Export Ass'n*, 86 F. Supp. 59 (S.D.N.Y. 1949); *United States v. National Lead Co.*, 63 F. Supp. 513 (S.D.N.Y. 1945), *aff'd*, 332 U.S. 319 (1947); *United States v. General Dyestuff Corp.*, 57 F. Supp. 642 (S.D.N.Y. 1944); *Johnson v. Joseph Schlitz Brewing Co.*, 33 F. Supp. 176 (E.D. Tenn. 1940), *aff'd*, 123 F.2d 1016 (6th Cir. 1941). All of these cases concern arrangements affecting large fractions of market supply.

⁶⁸388 U.S. at 354.

other purposes. But its connection with the unlawful price-fixing is enough to require that it be condemned as an unlawful restraint . . ."⁶⁹ If horizontal territorial restraints are indeed per se unlawful as traditionally stated, then it would seem that the territorial agreement would have been enough in itself to require a finding of illegality. Yet the Court felt constrained to find more than territorial restraints in order to declare the agreement unlawful.

The Court's refusal to accept the government's contention in *Sealy*, that territoriality plus horizontality established a per se violation, has led at least one commentator⁷⁰ to the hypothesis that exclusive territories absent price fixing are arguably defensible.⁷¹ An alternative hypothesis, based on the language in *Sealy* and the absence of any prior cases which actually hold that horizontal territorial restraints are per se illegal, would be that there is no true per se rule in this area. But even if either of these propositions is correct, the question remains as to the merits of refusing to apply the per se rule to horizontal territorial restraints.

Topco presents a model case for the consideration of whether horizontal territorial restraints are so pernicious as to warrant per se illegality. The record in *Topco* is not complicated by any of the elements characteristic of previous horizontal cases such as price fixing agreements,⁷² royalty or bonus sharing plans,⁷³ or dominant market power.⁷⁴ Since the district court did not apply the per se rule, the record provides a basis for analysis in light of the traditional elements of power, purpose, and effect. If *Topco* does not present a situation so detrimental to competition that it should be conclusively presumed to be illegal solely because of the horizontal nature of the agreement, then perhaps the per se rule is inappropriate.

In determining whether an alleged restraint is reasonable, the Supreme Court has distinguished between intrabrand and interbrand competition.⁷⁵ Intrabrand refers to competition between the same brand names, whereas

⁶⁹*Id.* at 356.

⁷⁰McLaren, *Territorial and Customer Restrictions, Consignments, Suggested Resale Prices and Refusals to Deal*, 37 A.B.A. ANTITRUST L.J. 237, 241-42 (1968).

⁷¹The Court in *Sealy* more than hinted at the possibility when it stated that condemnation of the practices employed by *Sealy* certainly would not require the same result in the "quite different" grocer situation should it ever arise. 388 U.S. at 357 (1967). *Cf.* Northern Pac. Ry. v. United States, 356 U.S. 1 (1958). There the Court stated: "As a simple example, if one of a dozen food stores in a community were to refuse to sell flour unless the buyer also took sugar it would hardly tend to restrain competition in sugar if its competitors were ready and able to sell flour by itself." *Id.* at 6-7.

⁷²*E.g.*, United States v. *Sealy, Inc.*, 388 U.S. 350 (1967).

⁷³*E.g.*, United States v. *Addyston Pipe & Steel Co.*, 175 U.S. 211 (1899).

⁷⁴*E.g.*, *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951); *United States v. National Lead Co.*, 332 U.S. 319 (1947).

⁷⁵*United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 382 (1967).

interbrand refers to competition between different brands.⁷⁶ While the district court in *Topco* made no clear finding as to the effect of the Topco agreement on intrabrand competition, it did state that even if intrabrand competition were adversely affected, such effect was far outweighed by the beneficial effect on interbrand competition.⁷⁷ It would seem that the *Topco* agreement not only adversely affects intrabrand competition but eliminates it, since the very effect of the agreement is to give the members an exclusive selling area. Yet, brandname monopoly is no unusual phenomenon in grocery or other markets. The larger national chains operating under a single name have this advantage and the government has conceded its legality.⁷⁸

In *United States v. Arnold, Schwinn & Co.*,⁷⁹ the Supreme Court stated that any conclusion as to the fact that intrabrand competition is substantially eliminated must be drawn in light of the interbrand competition.⁸⁰ In *Schwinn*, the court considered the product market as a whole and focused on the availability of reasonably interchangeable products in the same market area.⁸¹ The Court concluded that since other bicycles were reasonably interchangeable for the Schwinn product and since these substitutes were readily available from competing entrepreneurs in the same area, interbrand competition was not adversely affected.⁸² Apparently the Court's definition of reasonably interchangeable product in cases arising under section one does not take into account such product differentiation variables as promotion, advertising, labeling, and customer loyalty.⁸³ The government sought to use Schwinn's claim of product excellence to show that other bicycles were not reasonably interchangeable. The Court rejected this argument and explicitly stated that it did not regard Schwinn's claim of product excellence as a refutation of its conclusion that other bicycles were reasonable substitutes.⁸⁴ If the Court views other bicycles as reasonably interchangeable for the "Schwinn Racer," then it would seem that the available alternatives to Topco branded food items are also reasonably interchangeable products.

The theory manifested in *Schwinn* that acceptable competition may

⁷⁶*Id.*

⁷⁷5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,388, at 89,562.

⁷⁸*Id.*

⁷⁹388 U.S. 365 (1967).

⁸⁰*Id.* at 381.

⁸¹*Id.*

⁸²*Id.* at 381-82.

⁸³The problems involved in determining the degree of product differentiation and the resulting complications are discussed in J. BAIN, PRICE THEORY 23 (3d ed. 1967). Further discussion appears in E. CHAMBERLAIN, THE THEORY OF MONOPOLISTIC COMPETITION 56-64 (8th ed. 1962).

⁸⁴388 U.S. 365, 381 n. 7 (1967).

coexist with brand name monopoly is not without the support of a noted economist. Professor Chamberlain's theory of monopolistic competition⁸⁵ includes the proposition that "[i]n this field of 'products' differentiated by the circumstances surrounding their sale, we may say, as in the case of . . . trade-marks, that both monopolistic and competitive elements are present . . . Each is subject to the competition of other 'products' sold under different circumstances and at other locations . . ."⁸⁶ In *Topco*, as in *Schwinn*, the brand name products were subject to the competition of other similar products under similar circumstances in the same store as well as in the same location.⁸⁷ Therefore, the competitive elements which were acceptable in *Schwinn* are equally present in *Topco*.

Market power has played a rather vague role in cases arising under section one. Unlike merger⁸⁸ and single-firm monopoly cases,⁸⁹ the courts do not discuss market power with any degree of particularity, nor do they discuss in detail such concepts as per cent of relevant market in cases arising under section one. Yet market power has been mentioned and seems to have been a tacit consideration. In all of the previous cases involving horizontal territorial restraints except *Sealy*, which additionally involved a price fixing agreement, the parties to the arrangement were the leading producers of their respective products.⁹⁰ Likewise, horizontal price fixing cases have involved parties with substantial market power. For example, in *United States v. Trenton Potteries Co.*,⁹¹ the defendants were engaged in the manufacture and distribution of eighty-two per cent of the vitreous pottery fixtures in the United States. Also, in *United States v. Socony-Vacuum Oil Co.*⁹² the defendant companies accounted for eighty-three per cent of all gasoline sold in the Midwestern area during 1935. By contrast, the *Topco* members are not leading sellers in their respective areas. The district court found that retail sales of *Topco* members accounted for an average of approximately six per cent of the total retail sales in each *Topco* area.⁹³ Of this six per cent, one-tenth is attributable to *Topco* brands. Thus, of the total retail food sales in a *Topco* area, an average of six-tenths of one per cent is attributable to *Topco* branded

⁸⁵E. CHAMBERLAIN, *THE THEORY OF MONOPOLISTIC COMPETITION* 56 (8th ed. 1962).

⁸⁶*Id.* at 63.

⁸⁷5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,388 at 89,557.

⁸⁸*E.g.*, *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966).

⁸⁹*E.g.*, *United States v. E. I. Du Pont de Nemours & Co.*, 351 U.S. 377 (1956).

⁹⁰*Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951); *United States v. National Lead Co.*, 332 U.S. 319 (1947); *United States v. Addyston Pipe & Steel Co.*, 175 U.S. 211 (1899).

⁹¹273 U.S. 392, 394 (1927).

⁹²310 U.S. 150, 191 (1940).

⁹³5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,388, at 89,561.

products. Accordingly, it would seem that Topco members are not dominant market forces.⁹⁴

The district court in *Topco* determined that the intent of the agreement by the members was not to restrain competition, but to market a line of private brand names which were cost competitive with other lines of private label goods.⁹⁵ It is not suggested that a proper motive will save an otherwise unlawful agreement, but, under the rule of reason, intent is one relevant consideration along with market power and competitive effect.⁹⁶

Analysis of *Topco* on the basis of power, purpose, and effect reveals an agreement among parties of relatively insignificant power to market a line of private label products which only they can sell in their respective areas. While the *Topco* agreement results in an area brand name monopoly, there is no adverse effect on interbrand competition since reasonably interchangeable products are readily available in *Topco* stores and from competing entrepreneurs in the same area. Cooperative efforts such as those presented in *Topco* provide the already vanishing small businessman with an opportunity to maintain his corporate identity and survive in the face of stifling competition from larger national organizations. If such an agreement is automatically illegal, solely because *Topco* has effected it horizontally, then antitrust doctrine actually enhances the position of parties with real market power by preventing those who have less of it from effectively competing.

While the district court in *Topco* may have reached a desirable result, its failure to adequately deal with the per se problem adds to the unpredictability and doctrinal chaos of antitrust law. It would be far more desirable to face this issue and realign the law to correspond more

⁹⁴Concerning market power, an alternative test utilizing the ability to restrict output has been suggested. This theory would view horizontal agreements with suspicion only if the parties had a large enough share of the market to alter total industry output by changing its own output. This ability to restrict output is objectionable since it allows the party with such power to misallocate resources, fix prices, and frustrate consumer want satisfaction. Bork, *The Rule of Reason*, Part II, 75 YALE L.J. 373, 394 (1966). Under this analysis *Topco* would appear relatively harmless. The *Topco* members do not act in concert, nor do they have the aggregate power to restrict output as required by this theory if they did.

⁹⁵TRADE REG. REP. (1970 Trade Cas.) ¶ 73,388, at 89,558.

⁹⁶The intention to fix prices manifested in *Sealy* is basically the only difference between *Sealy* and *Topco*. *Sealy* had little aggregate market power; there was healthy interbrand competition; equivalent brands were readily available in the same store; and the *Sealy* agreement allowed the member licensees to compete more effectively in the national market. Thus intention, as manifested by price fixing agreements, may well make a difference in *Topco*.