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RESTRAINTS ON TRADE AND THE ORDERLY MARKETING OF GOODS*

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One of the more intriguing aspects of the process by which goods are marketed today is that businessmen have become increasingly reluctant to resort to contractual restrictions on competition which the courts have sanctioned in the past. If a manufacturer is inclined to grant a distributor an exclusive franchise in a particular area, it is not unlikely that he will resist the temptation of entering into a written covenant of exclusiveness.[1] If the manufacturer wants to confine his representative's sphere of operations to a specific territory, or to prevent him from reselling to certain classes of customers, the chances are good that these prohibitions will not be spelled out in the franchise agreement.[2] And if, perhaps in return for his own exclusive grant, the manufacturer should desire undivided loyalty from his outlets, he is apt to be wary of reducing any such requirement to writing.[3] Discretion, in these circumstances, is frequently deemed the better part of valor. Presumably, the feeling is that much the same objectives can be achieved through noncontractual means which incur less antitrust risk.

Why this conservatism? Apart from the imposition of an exclusive dealing obligation on the buyer, which is specifically governed by Section 3 of the Clayton Act,[4] other facets of orderly marketing need only satisfy the less stringent command of the Sherman Law.[5] Since we are not in the realm of restraints which have been classified as illegal *per se*,[6]

* This article is based on a speech delivered by the author before the Section of Antitrust Law of the American Bar Association.

† See Contributors' Section, Masthead, p. 347, for biographical data.

1 See United States v. Sun Oil Co., 1959 Trade Cas. ¶ 69,398, p. 75,507 (E.D. Pa. 1959) ("The giving of an 'exclusive franchise' is not expressed or implied in the written dealer agreement forms, but is one of the understandings had with the dealer at the time he enters into business relations with Sun"); Packard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418 (D.C. Cir.), cert. denied, 355 U.S. 822 (1957); Schwing Motor Co. v. Hudson Sales Corp., 138 F. Supp. 899 (D. Md.), aff'd per curiam, 239 F.2d 176 (4th Cir. 1956), cert denied, 355 U.S. 823 (1957).

2 Cf. Columbus Coated Fabrics Corp., FTC Dkt. 6677, Trade Reg. Rep. ¶ 27,906, p. 36,963 (1959).

3 See, e.g., McElhenney Co. v. Western Auto Supply Co., 1959 Trade Cas. ¶ 69,416 (4th Cir. 1959); Timken Roller Bearing Co., FTC Dkt. 6504, Trade Reg. Rep. ¶ 27,244 (1958); Leo J. Meyberg Co. v. Eureka Williams Corp., 215 F.2d 100 (9th Cir.), cert. denied, 348 U.S. 875 (1954); Hudson Sales Corp. v. Waldrip, 211 F.2d 268 (5th Cir.), cert. denied, 348 U.S. 821 (1954); Nelson Radio & Supply Co. v. Motorola, Inc., 200 F.2d 911 (5th Cir. 1952), cert denied, 345 U.S. 925 (1953); Carter Carburetor Corp. v. Federal Trade Commission, 112 F.2d 722 (8th Cir. 1940), United States v. Sun Oil Co., 1959 Trade Cas. ¶ 69,398 (E.D. Pa. 1959); United States v. J. I. Case Co., 101 F. Supp 856 (D. Minn. 1951).

4 38 Stat. 731 (1914), 15 U.S.C. § 14 (1958).

5 26 Stat. 209 (1890), 15 U.S.C. §§ 1, 2. (1958).

6 Of course, resale price maintenance, which is a method of orderly marketing, is per

we must therefore consider the applicability of the rule of reason. Conceding that trade is restrained by exclusive franchise agreements and territorial and customer restrictions ancillary to a sale of goods—after all, it is their very purpose to restrain—the question remains whether the restraint is unreasonable and therefore unlawful.

I shall explore the status of these restraints at common law and under our antitrust statutes, as well as their economic justification in a society where competition is the order of the day.

Requiring the Seller to Deal Exclusively With the Buyer

Typically, the restraint of a seller at the buyer's behest takes the form of an exclusive franchise or a full output contract. In both instances, the seller disables himself by agreeing not to compete, directly or indirectly, with his customer. Covenants of this type may be denominated exclusive selling arrangements, as distinguished from exclusive dealing agreements which restrain the buyer. The legality of the seller's promise is measured by the general prohibitions of the Sherman Act,[7] and those prohibitions derive their content from the antecedent common law.

The rules governing covenants not to compete were developed initially in cases involving agreements incident to an employment contract or the sale of a business. The principal concerns were with idleness, losing the productive efforts of a useful member of society, and the possibility that the covenantor would become a public charge.[8] Given this origin for the restraint of trade concept, some courts at first were unable to perceive any "restraint" in full output contracts, since the manufacturer was not prevented from carrying on his trade, but, if anything, had an incentive to produce as much as possible.[9] As one judge said: "No restriction is put upon the defendant; he may manufacture as largely as he will."[10] The courts were quicker to see a restraint where the buyer did not obligate himself to take the seller's entire production, but nevertheless bound the seller not to compete with him or deal with

se unlawful unless immunized by fair trade legislation. Schwegmann Bros. v. Calvert Distillers Corp., 341 U.S. 384 (1951). The subject of fair trade, however, opens up so many vistas that it is not feasible to discuss it within the confines of this paper.

7 Section 5 of the Federal Trade Commission Act, which prohibits "unfair methods of competition," can also be invoked (see Hershey Chocolate Corp. v. Federal Trade Commission, 121 F.2d 968 (3d Cir. 1941)), but virtually all of the federal cases involving exclusive selling agreements have been brought under the Sherman Act.

8 See Mitchel v. Reynolds, 1 P. Wms. 181, 190, 24 Eng. Rep. 347, 350 (1711); Darcy v. Allen, 11 Coke 84, 86, 77 Eng. Rep. 1260, 1262 (1602).

9 Long v. Towl, 42 Mo. 545 (1868); Hadden v. Dimick, 31 How. Prac. 196 (Sup. Ct. N.Y. County 1866); Van Marter v. Babcock, 23 Barb. 633, 636 (Sup. Ct. Monroe County 1857); see also Arnot v. Pittston & Elmira Coal Co., 68 N.Y. 558, 566-67 (1877).

10 Hadden v. Dimick, 31 How. Prac. 196, 226 (Sup. Ct. N.Y. County 1866).

his competitors.[11] Eventually, judges also came to realize that a full output contract might restrain the trade of other buyers who had to go elsewhere for supplies.[12] But whatever form exclusive selling took, once a restraint was acknowledged, its validity was generally tested in terms of the rules governing covenants ancillary to the sale of a business.[13]

In his classic synthesis of the pre-Sherman Act authorities in *Addyston Pipe*,[14] Chief Justice Taft, then a Circuit Judge, stated that the common law sustained an agreement ". . . by the seller of property or business not to compete with the buyer in such a way as to derogate from the value of the property or business sold."[15] The only qualification was that the restriction be ". . . such only as to afford a fair protection to the interests of the party in favor of whom it . . . [was] given, and not so large as to interfere with the interests of the public."[16] In apply-

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11 See, e.g., Pacific Factor Co. v. Adler, 90 Cal. 110, 27 Pac. 36 (1891) (option contract); Santa Clara Valley Mill & Lumber Co. v. Hayes, 76 Cal. 387, 18 Pac. 391 (1888) (fixed quantity contract); W. W. Roller & Co. v. Ott, 14 Kan. 609 (1875) (exclusive franchise); Arnot v. Pittston & Elmira Coal Co., 68 N.Y. 558 (1877) (exclusive franchise); Excelsior Quilting Co. v. Creter, 36 Misc. 698, 74 N.Y. Supp. 361 (Sup. Ct. N.Y. County 1902) (fixed quantity contract).

12 See Fargo Glass & Paint Co. v. Globe American Corp., 201 F.2d 534 (7th Cir.), cert. denied, 345 U.S. 942 (1953); Carter-Crume Co. v. Peurrung, 86 Fed. 439 (6th Cir. 1898); Over v. Byram Foundry Co., 37 Ind. App. 452, 77 N.E. 302 (1906).

13 See, e.g., Keith v. Hirschberg Optical Co., 48 Ark. 138, 2 S.W. 777 (1887); Newell v. Meyendorff, 9 Mont. 254, 23 Pac. 333 (1890); Blauner v. Williams Co., 36 Misc. 173, 73 N.Y. Supp. 165 (Sup. Ct. N.Y. County 1901); Van Marter v. Babcock, 23 Barb. 633 (Sup. Ct. Monroe County 1857); Live Stock Ass'n v. Levy, 54 N.Y. Super Ct. 32 (1886); Anheuser-Busch Brewing Ass'n v. Houck, 27 S.W. 692 (Tex. Civ. App. 1894); Clark v. Crosby, 37 Vt. 188 (1864). The validity of the contract was sustained in each of these cases on the ground that the restriction was "partial" or "limited" and not "total" or "general," without any inquiry concerning the effect of the restraint on competition.

There have been many suits to enforce contracts containing exclusive selling clauses where the issue of illegality was neither interposed as a defense nor raised by the court sua sponte. E.g., Rudolph v. Laser, 156 Ark. 5, 245 S.W. 302 (1922); Bride v. Riffe, 93 Neb. 355, 140 N.W. 639 (1913); Meade v. Poppenberg, 167 App. Div. 411, 153 N.Y. Supp. 182 (4th Dep't 1915); Koener v. Henn, 8 App. Div. 602, 40 N.Y. Supp. 1021 (4th Dep't 1896); Kessler v. A. W. Haile Motor Co., 127 Misc. 413, 217 N.Y. Supp. 182 (Sup. Ct. Erie County 1926); Fine v. H. & H. Pioneer Savings Stamp Co., 191 Okla. 685, 132 P.2d 935 (1942); Leisy Brewing Co. v. Schafer, 91 Okla. 105, 216 Pac. 109 (1923); Western Macaroni Mfg. Co. v. Fiore, 47 Utah 108, 151 Pac. 984 (1915); Elk Refining Co. v. Falling Rock Cannel Coal Co., 92 W. Va. 479, 115 S.E. 431 (1922); Thurmond v. Paragon Colliery Co., 82 W. Va. 49, 95 S.E. 816 (1918).

14 United States v. Addyston Pipe & Steel Co., 85 Fed. 271 (6th Cir. 1898), aff'd, 175 U.S. 211 (1899).

15 85 Fed. at 281. Accord, Restatement, Contracts § 516(a) (1932).

16 85 Fed. at 282. Not only was this formulation of the rule applied to sales of chattels [United States v. Bausch & Lomb Optical Co., 45 F. Supp. 387, 398 (S.D.N.Y. 1942), aff'd by an equally divided Court, 321 U.S. 707 (1944); Bascom Launder Corp. v. Telecoin Corp., 204 F.2d 331, 335 (2d Cir.), cert. denied, 345 U.S. 994 (1953); Excelsior Quilting Co. v. Creter, 36 Misc. 698, 701, 74 N.Y. Supp. 361, 363 (Sup. Ct. N.Y. County 1902)], but it was extended to the licensing of motion pictures in United States v. Paramount Pictures, Inc., 66 F. Supp. 323, 341 (S.D.N.Y. 1946), aff'd in pertinent part, 334 U.S. 131 (1948). Motion pictures have traditionally been distributed on an exclusive basis according to a system of staggered runs and clearance. The distributor grants the exhibitor an exclusive license to display the film within his competitive area and covenants not to permit competing exhibitors to show the same picture until a period of time has elapsed following the prior run. In upholding reasonable clearance under the Sherman Act, Judge Augustus Hand held that:

ing this test to exclusive selling agreements, the public interest criterion has become synonymous with absence of monopoly.[17] If the seller monopolizes the product, or if the buyer is endeavoring to corner the market, the restriction is not countenanced.[18] But where there are other suppliers to whom competing buyers can turn, the rule is ". . . virtually one of *per se* legality."[19]

> . . . a grant of a clearance, when not accompanied by a fixing of minimum prices or not unduly extended as to area or duration, affords a fair protection to the interests of the licensee without unreasonably interfering with the interests of the public. At common law a vendor of income-producing property may validly covenant with his purchaser not to compete for a given time or within a given area so long as the restrictions are reasonably necessary to protect the value of the property purchased. . . . It is true that licenses of property rather than sales are here concerned and that the distributors covenant not only not to exhibit the films themselves, but also not to license them to others. Nevertheless, we believe these are not differences which affect the applicability of the common-law rule. . . .

66 F. Supp. at 341.

17 [T]he Sherman Act was not violated, because the manufacturer had no monopoly of the product, and the "restraint of trade" was (a) ancillary to a reasonable main purpose—a source of supply to the distributor—and (b) fairly protective of that distributor's interests but not so large as to interfere with the interests of the public.

Bascom Launder Corp. v. Telecoin Corp., 204 F.2d 331, 335 (2d Cir.), cert. denied, 345 U.S. 994 (1953). It was generally assumed at common law that where no monopoly or attempt to corner the market was involved, the public had no interest in an exclusive selling contract. See, e.g., Excelsior Quilting Co. v. Creter, 36 Misc. 698, 700, 74 N.Y. Supp. 361, 362 (Sup. Ct. N.Y. County 1902) (purchase of fixed quantity with covenant by vendor not to sell to others; "it is really one of individual right, with which the question of public policy has little, if anything, to do."); Newell v. Meyendorff, 9 Mont. 254, 23 Pac. 333 (1890) (exclusive franchise; "the public is not deprived of the alleged restricted party's industry. On the contrary, the contract provides for the placing upon the Montana market the product of the plaintiffs' industry, by the selection and service of a local Montana agent, interested in the success of sales, and to be rewarded by such success"). Cf. Attorney General of Commonwealth of Australia v. Adelaide Steamship Co., [1913] A.C. (P.C.) 781, 796 ("Their Lordships are not aware of any case in which a restraint, though reasonable in the interests of the parties, has been held unenforceable because it involved some injury to the public").

18 Hershey Chocolate Corp. v. Federal Trade Commission, 121 F.2d 968 (3d Cir. 1941); American & British Mfg. Corp. v. New Idria Quicksilver Mining Co., 293 Fed. 509 (1st Cir. 1923); Morey v. Paladini, 187 Cal. 727, 203 Pac. 760 (1922); Santa Clara Valley Mill & Lumber Co. v. Hayes, 76 Cal. 387, 18 Pac. 391 (1888).

19 Packard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418, 420 (D.C. Cir.), cert. denied, 355 U.S. 822 (1957). Exclusive selling arrangements were sustained under the Sherman Act in Lawlor v. National Screen Service Corp., 1959 Trade Cas. ¶ 69,446 p. 75,678 (3d Cir. 1959); Packard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418 (D.C. Cir.), cert. denied, 355 U.S. 822 (1957); Schwing Motor Co. v Hudson Sales Corp., 138 F. Supp. 899 (D. Md.), aff'd per curiam, 239 F.2d 176 (4th Cir. 1956), cert. denied, 355 U.S. 823 (1957); Bascom Launder Corp. v. Telecoin Corp., 204 F.2d 331 (2d Cir.), cert denied, 345 U.S. 994 (1953); Fargo Glass & Paint Co. v. Globe American Corp., 201 F.2d 534 (7th Cir.), cert. denied, 345 U.S. 942 (1953); United States v. Bausch & Lomb Optical Co., 45 F. Supp. 387 (S.D.N.Y. 1942), aff'd by an equally divided Court, 321 U.S. 707 (1944); Carter-Crume Co. v. Peurrung, 86 Fed 439 (6th Cir. 1898); cf. Poller v. Columbia Broadcasting System, Inc., 1959 Trade Cas. ¶ 69,391, p. 75,477 (D.D.C. 1959). Cases upholding similar agreements under analogous state antitrust statutes or common law principles include Milton v. Hudson Sales Corp., 152 Cal. App. 2d 418, 313 P.2d 936 (1957); Rolley, Inc. v. Merle Norman Cosmetics, Inc., 129 Cal. App. 2d 844, 278 P.2d 63 (1954); Superior Coal Co. v. Darlington Lumber Co., 236 Ill. 83, 86 N.E. 180 (1908); Lanyon v. Garden City Sand Co., 223 Ill. 616, 79 N.E. 313 (1906); Match Co. of America v. Acme Match Corp., 285 Ill. App. 197, 1 N.E.2d 867 (1936); American Sand & Gravel Co. v. Chicago Gravel Co., 184 Ill. App. 509 (1914); Heimbuecher v. Goff, Horner & Co., 119 Ill. App. 373 (1905); Pittsburgh Plate Glass Co. v. Paine & Nixon Co., 182 Minn. 159, 234 N.W. 453

This principle was applied a few years ago by two federal Courts of Appeals in the *Schwing*[20] and *Packard*[21] cases, where exclusive automobile dealerships survived attack under Sections 1 and 2 of the Sherman Act. Both courts rejected the notion that the vertical agreement between a single manufacturer and dealer constituted an illicit conspiracy or attempt to monopolize. Of particular interest were the efforts of the plaintiffs, who had been disfranchised as a result of the "exclusive," to bring their grievances within the monopoly exception to the general rule. They urged that the relevant market consisted of Hudson and Packard cars, respectively, rather than all automobiles; hence, they argued, a local monopoly had been conferred on the exclusive dealer. If this reasoning had been accepted, every exclusive franchise involving a trademarked article would be illegal regardless of the vigor of inter-brand competition.[22] But, as Mr. Justice Reed pointed out in the *Cellophane* case, the power that a manufacturer has over the price and production of his branded product does not make an unlawful monopoly. "Illegal power must be appraised in terms of the competitive market for the product."[23] Under this test, far from there being any monopoly, both Hudson and Packard encountered the stiffest competition from the other automobile manufacturers.[24]

(1930); Mar-Hof Co. v. Rosenbacher, 176 N.C. 330, 97 S.E. 169 (1918); Kansas City Pants & Skirt Co. v. Cohlmia, 138 Okla. 151, 280 Pac. 611 (1929); Rice v. State, 108 Okla. 4, 232 Pac. 807 (1924); Walter A. Wood Mowing & Reaping Co. v. Greenwood Hardware Co., 75 S.C. 378, 55 S.E. 973 (1906); Lien v. Northwestern Engineering Co., 73 S.D. 84, 39 N.W.2d 483 (1949); Sunset Oil Co. v. Vertner, 34 Wash. 2d 268, 208 P.2d 906 (1949). See Restatement, Contracts § 516(a), (e), Illustration 7 (1932). But cf. Alexander's Dep't Stores, Inc. v. Ohrbach's, Inc., 266 App. Div. 535, 42 N.Y.S.2d 703 (1st Dep't), appeal dismissed, 291 N.Y. 707, 52 N.E.2d 595 (1943).

Even where alternative sources of supply may have been available, covenants binding the seller not to sell to anyone but the covenantee for an indefinite period, or for a number of years, have been held unenforceable where there was no concomitant obligation on the part of the covenantee to purchase during that period. Larido Corp. v. Crusader Mfg. Co., 4 Misc. 2d 231, 155 N.Y.S.2d 715 (Sup. Ct. N.Y. County 1956); Cole Steel Equipment Co. v. Art-Lloyd Metal Products Corp., 144 N.Y.S.2d 364 (Sup. Ct. N.Y. County 1955) rev'd, 1, App. Div. 2d 148, 148 N.Y.S.2d 440 (1st Dep't 1956); see also Scapa Dryers, Inc. v. Abney Mills, 1959 Trade Cas. ¶ 69,392 (5th Cir. 1959).

Exclusive selling agreements have also been invalidated where they were part and parcel of a price-fixing scheme. E.g., Barataria Canning Co. v. Joulian, 80 Miss. 555, 31 So. 961 (1902; Stewart v. W. T. Rawleigh Medical Co., 58 Okla. 344, 159 Pac. 1187 (1916).

20 Schwing Motor Co. v. Hudson Sales Corp., 138 F. Supp. 899 (D. Md.), aff'd per curiam, 239 F.2d 176 (4th Cir. 1956), cert. denied, 355 U.S. 823 (1957).

21 Packard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418 (D.C. Cir.), cert. denied, 355 U.S. 822 (1957).

22 See Schwing Motor Co. v. Hudson Sales Corp., 138 F. Supp. at 903. But cf. United States v. Guerlain, Inc., 155 F. Supp. 77 (S.D.N.Y. 1957), judgment vacated on motion of the United States, 358 U.S. 915 (1958), dismissed on motion of the United States, 1959 Trade Cas. ¶ 69, 352 p. 75,298 (S.D.N.Y. 1959), criticized in Handler, "Trademarks—Assets or Liabilities?," 48 Trademark Rep. 661 (1958).

23 United States v. E. I. du Pont de Nemours & Co., 351 U.S. 377, 393 (1956).

24 Cf. Paramount Film Distributing Corp. v. Village Theatre, Inc., 228 F.2d 721 (10th Cir. 1955), where a theatre operator claimed that he had been deprived of first-run Paramount pictures as a result of a vertical agreement between Paramount and a former affiliated exhibitor to favor the latter. The trial judge instructed the jury that such an

As a matter of antitrust policy, there are sound reasons for permitting exclusive selling so long as there is effective competition in the relevant market. A manufacturer may find it necessary to offer a measure of security to his dealers in order to build a strong distributing organization. A dealer understandably may be reluctant to invest capital and devote his energies to developing a good will that may be jeopardized if his supplier is free to vie with him either directly or by establishing another outlet in the same area.[25] The less powerful the manufacturer, the more apt the dealer will be to get concrete assurance that this will not occur. The Court of Appeals for the District of Columbia saw this very clearly in the *Packard* case, when it said:

> The short of it is that a relatively small manufacturer, competing with large manufacturers, thought it advantageous to retain its largest dealer in Baltimore, and could not do so without agreeing to drop its other Baltimore dealers. To penalize the small manufacturer for competing in this way not only fails to promote the policy of the antitrust laws but defeats it.[26]

agreement, if proved, was unlawful per se. In reversing, the Court of Appeals held that the legality of the claimed agreement should have been submitted to the jury as an issue of fact under the rule of reason. But it refused to go so far as to hold that an exclusive dealing arrangement between a single distributor and an exhibitor was necessarily lawful. Since Paramount obviously did not enjoy a monopoly position in the distribution of motion pictures, the refusal of the Tenth Circuit to dismiss the complaint is inconsistent with the rationale of Schwing and Packard.

Since the Supreme Court denied certiorari in Packard and Schwing, we do not have a final exposition of the law on exclusive selling. Nevertheless, it is hard to believe that the Court would have declined to review these decisions if it had disagreed with their result. In Packard, the plaintiff had obtained a jury verdict, only to have the judgment overturned as a matter of law by a divided Court of Appeals. In Schwing, the plaintiff never got to trial at all; the District Judge dismissed the complaint and was affirmed on appeal. Bearing in mind that the Supreme Court is a zealous guardian of the right to a jury trial (Beacon Theatres v. Westover, 359 U.S. 500 (1959)), it is a reasonably safe inference that the highest tribunal agrees that exclusive selling arrangements are lawful where there is effective outside competition. Indeed, even so staunch a supporter of strict antitrust enforcement as Mr. Justice Douglas recently intimated that he did not look with jaundiced eye on the "institution of the exclusive agency," which, he remarked, "is, of course, well known in the law." Denver Union Stock Yard Co. v. Producers Livestock Marketing Assn., 356 U.S. 282, 288 (1958). See also Mr. Justice Black in Klor's, Inc. v. Broadway-Hale Stores, 359 U.S. 207, 212 (1959). It is interesting to note, moreover, that in Black & White Taxicab & Transfer Co. v. Brown and Yellow Taxicab & Transfer Co., 276 U.S. 518 (1928), the Court applied the general rule at common law in enforcing a contract under which a railroad granted a taxi company the exclusive privilege of soliciting fares at the railroad's depot. The Court felt that public policy required the utmost liberty of contracting, and that the exclusive arrangement was reasonable because it ". . . makes for good order at railway stations, prevents annoyance, serves convenience and promotes safety of passengers" (Id. at 528-29). See also Delaware, Lackawanna & Western RR. v. Town of Morristown, 276 U.S. 182 (1928); Donovan v. Pennsylvania Co., 199 U.S. 279 (1905).

25 In United States v. Sun Oil Co., 1959 Trade Cas. ¶ 69,398, p. 75,507 (E.D. Pa. 1959), the court found that the defendant "operates under the 'franchise' plan of distribution whereby it does business with a dealer only if the station will not compete to an appreciable degree with another Sun dealer in the immediate adjoining area." The reasoning underlying this policy was explained by Sun as follows: "We believe that in offering to a dealer a franchise to be the sole marketer of our products in a limited market area gives him the opportunity to wholeheartedly develop business for our products, without the fear that he is building up patronage for Sunoco products that may drift to another Sunoco dealer across the street." p. 75,507 n.8.

26 243 F.2d at 421.

In other words, if there is to be vigorous competition between sellers of different brands, it may be necessary to forego a certain degree of intra-brand rivalry. This seems a small price to pay for a concomitant enhancement of competition in the market as a whole. To be sure, the courts do not insist on an affirmative showing that competition will be strengthened by the arrangement. It suffices that no significant deterioration of competitive forces is likely. Thus, where a full output contract is obtained from a non-monopolist, the supplier, of necessity, is unable to satisfy the demand of other potential customers. Yet if there is ample access to the product elsewhere, why should the buyer be precluded from securing an assured source of supply? As a matter of fact, here again competition may be benefited in the long run. In the *Bausch & Lomb* case,[27] although the court condemned an elaborate distribution system designed to fix resale prices, it did not disturb a separate arrangement whereby Bausch & Lomb agreed to manufacture pink-tinted glass only for Soft-Lite and not to compete with it in the sale of lenses made from such glass. The restraining covenant, it stated, was ". . . for the protection of the purchaser who is spending large sums to develop his good will and enlarge the public patronage of a relatively new article of commerce."[28] Furthermore, the court noted, not only did competing lens manufacturers have adequate supplies of pink glass from other sources, but the success of Soft-Lite had actually "stimulated emulation and competition."[29]

Since *Bausch & Lomb*, exclusive selling has rarely come under governmental fire. In a later case, which involved an international cartel, the Department of Justice was unsuccessful in its attempt to enjoin one of the defendants from continuing exclusive distributing arrangements which had not been employed in furtherance of the conspiracy.[30] But by and large the attacks have come from private parties seeking treble damages.[31] And, as we have seen, their efforts to induce the courts

27 United States v. Bausch & Lomb Optical Co., 45 F. Supp. 387 (S.D.N.Y. 1942), aff'd by an equally divided Court, 321 U.S. 707 (1944).

28 45 F. Supp. at 398.

29 Id. at 399.

30 Terming this an "ordinary" commercial practice, the court considered it entirely lawful "absent proof that the designation of an exclusive distributor was made to achieve an illegal end." United States v. Imperial Chemical Industries, Ltd., 105 F. Supp. 215, 244-45 (S.D.N.Y. 1952). Cf. United States v. American Type Founders Co., 1958 Trade Cas. ¶ 69,065, p. 74,206 (D.N.J. 1958), a consent decree enjoining defendant from entering into an agreement with any manufacturer "restricting or preventing any foreign manufacturer from exporting to and selling products in the United States to ultimate consumers, except where defendant has an exclusive distributorship for said products in the United States from such foreign manufacturer." See also United States v. Pitney-Bowes, Inc., 1959 Trade Cas. ¶ 69,235, p. 74,856 (D. Conn. 1959), a consent decree in which defendant was expressly not prohibited "from entering into bona fide exclusive distributorship arrangements for designated territories" with persons not in a particular class.

31 E.g., Lawlor v. National Screen Service Corp., 1959 Trade Cas. ¶ 69, 446, p. 74,678 (3rd

to depart from traditional doctrine have met with signal failure. This is an area, then, where it can be said with some certainty that the antitrust laws do not stand in the way of a normal and reasonable restriction on competition. The rule of reason operates here in full sway.

Confining the Buyer to a Specific Territory

Orderly marketing, of course, is not a one way street. It may not be enough for a manufacturer to give his dealers exclusive franchises in particular territories. To have an efficient system of distribution, it may be necessary for him to place certain checks on the areas in which his goods are resold. Thus, if a dealer is assured that his supplier will not compete with him in his assigned area, the supplier is apt to want assurance that his only link to the public in that locale will fully exploit its market potential. This objective may be thwarted if his dealers cross over into each other's domain and thereby spread themselves too thin.

Suppliers attempted to cope with this problem at an early date by requiring dealers to confine their operations to designated geographical limits. While there is a respectable body of authority, both state[32] and federal,[33] upholding ancillary territorial restrictions as reasonable re-

Cir. 1959); Packard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418 (D.C. Cir.), cert. denied, 355 U.S. 822 (1957); Schwing Motor Co. v. Hudson Sales Corp., 138 F. Supp. 899 (D. Md.), aff'd per curiam, 239 F.2d 176 (4th Cir. 1956), cert. denied, 355 U.S. 823 (1957); Paramount Film Distributing Corp. v. Village Theatre, Inc., 228 F.2d 721 (10th Cir. 1955); Bascom Launder Corp. v. Telecoin Corp., 204 F.2d 331 (2d Cir.), cert. denied, 345 U.S. 994 (1953); Fargo Glass & Paint Co. v. Globe American Corp., 201 F.2d 534 (7th Cir.), cert. denied, 345 U.S. 942 (1953).

32 E.g., Johnston v. Franklin Kirk Co., 83 Ind. App. 519, 148 N.E. 177 (1925); Revlon Products Corp. v. Bernstein, 204 Misc. 80, 119 N.Y.S.2d 60 (Sup. Ct. N.Y. County 1953), aff'd, 285 App. Div. 1139, 142 N.Y.S.2d 364 (1st Dep't 1955); Steinmerman v. Kelly, 150 App. Div. 735, 135 N.Y. Supp. 827 (1st Dep't 1912), aff'd, 220 N.Y. 756, 116 N.E. 1077 (1917); Thomas v. Belcher, 184 Okla. 410, 87 P.2d 1084 (1939); Delk v. City Nat'l Bank of Duncan, 85 Okla. 238, 205 Pac. 753 (1922); Walter A. Wood Mowing & Reaping Co. v. Greenwood Hardware Co., 75 S.C. 378, 55 S.E. 973 (1906); cf. McConkey v. Smith, 112 Kan. 560, 211 Pac. 631 (1923) (relationship between manufacturer and dealer held to be one of agency).

In McConkey v. Smith, supra, where the franchise recited that ". . . this paragraph shall be construed as an agreement between dealer and all other Studebaker dealers who have signed a similar agreement . . ." (id. at 561), the territorial restriction was upheld at the suit of an injured dealer. And Johnston v. Franklin Kirk Co., supra, enforced a provision in a franchise agreement which required a dealer invading the territory of another to pay the latter 10% of the list price of the automobile. In all probability, the federal courts would view these recitals as evidence of an unlawful horizontal agreement between dealers to allocate markets. To sustain a territorial restriction on a buyer, it must appear that the restraint is designed to protect the business of the seller. If it can be shown that this is not the primary objective but rather that the purpose is to spare buyers from competition with one another, the traditional justification for the restraint disappears. Cf. United States v. American Linen Supply Company, 141 F. Supp. 105, 114-15 (N.D. Ill. 1956).

33 Boro Hall Corp. v. General Motors Corp., 124 F.2d 822 (2d Cir.), rehearing denied, 130 F.2d 196 (2d Cir. 1942), cert. denied, 317 U.S. 695 (1943); Phillips v. Iola Portland Cement Co., 125 Fed. 593 (8th Cir. 1903), cert. denied, 192 U.S. 606 (1903); Cole Motor Car Co. v. Hurst, 228 Fed. 280 (5th Cir. 1915), writ of error denied sub nom. Tillar v. Cole Motor Car Co., 246 Fed. 831 (5th Cir. 1917), cert. denied, 247 U.S. 511 (1918); cf. Sinclair Refining Co. v. Wilson Gas & Oil Co., 52 F.2d 974 (W.D.S.C. 1931).

straints of trade, very little case law on this subject has been forthcoming in recent years. Manufacturers resorting to this practice have, without a court test, been succumbing to Sherman Act assaults by the Department of Justice.[34] It is appropriate, therefore, to take a fresh look at the pertinent decisions, their underlying support in the common law, and the basis, if any, for questioning their vitality.

Just as the common law authorized a seller to agree, ancillary to a sale of property, not to compete with the purchaser, so too it permitted an agreement ". . . by the buyer of property not to use the same in competition with the business retained by the seller."[35] In 1874 the Supreme Court applied this principle in enforcing a ten-year covenant by the purchaser of a steamer not to run it in California waters, where it would compete with the seller's steamship business.[36] The theory of the ruling was that the restraint was only as broad and long as was reasonably necessary to avoid interference with the trade retained by the seller, and that "it promoted the general interests of commerce on the Pacific coast."[37] The continued precedential force of this decision

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34 United States v. Bostitch, Inc., 1958 Trade Cas. ¶ 69,207, p. 74,741 (D.R.I. 1958); United States v. American Type Founders Co., 1958 Trade Cas. ¶ 69,065, p. 74,205 (D.N.J. 1958); United States v. American Body and Trailer, Inc., 1958 Trade Cas. ¶ 69,063, p. 74,200 (W.D. Okla. 1958); United States v. Rudolph Wurlitzer Co., 1958 Trade Cas. ¶ 69,011, p. 74,007 (W.D.N.Y. 1958); United States v. Necchi Sewing Machine Sales Corp., 1958 Trade Cas. ¶ 68,957, p. 73,841 (S.D.N.Y. 1958); United States v. AMI Inc., 1957 Trade Cas. ¶ 68,758, p. 73,099 (W.D. Mich. 1957); United States v. J. P. Seeburg Corp., 1957 Trade Cas. ¶ 68,613, p. 72,479 (N.D. Ill. 1957); United States v. American Linen Supply Co., 1956 Trade Cas. ¶ 68,542, p. 72,201 (N.D. Ill. 1956); United States v. Philco Corp., 1956 Trade Cas. ¶ 68,409, p. 71,753 (E.D. Pa. 1956); United States v. Reddi-Whip, Inc., 1955 Trade Cas. ¶ 68,187, p. 70,877 (S.D. Cal. 1955); United States v. Liberty National Life Ins. Co., 1954 Trade Cas. ¶ 67,801, p. 69,582 (N.D. Ala. 1954); United States v. Austenal Laboratories, Inc., 1951 Trade Cas. ¶ 62,880, p. 64,616 (S.D.N.Y. 1951); United States v. Bendix Home Appliances, Inc., 1948-49 Trade Cas. ¶ 62,346, pp. 62,899-900 (S.D.N.Y. 1948); United States v. Libbey-Owens-Ford Glass Co., 1948-49 Trade Cas. ¶ 62,323, p. 62,811 (N.D. Ohio 1948); United States v. A. B. Dick Co., 1948-49 Trade Cas. ¶ 62,233, p. 62,358 (N.D. Ohio 1948). But cf. United States v. Standard Oil Co. of Cal., 1959 Trade Cas. ¶ 69,399, p. 75,533 (S.D. Cal. 1959).

35 United States v. Addyston Pipe & Steel Co., 85 Fed. 271, 281 (6th Cir. 1898), aff'd, 175 U.S. 211 (1899). Accord, Restatement, Contracts § 516(b) (1932).

36 Oregon Steam Navigation Co. v. Winsor, 87 U.S. (20 Wall.) 64 (1874). Accord, Hill v. Staples, 85 Ga. 863, 11 S.E. 967 (1890); Dunlop v. Gregory, 10 N.Y. 241 (1851).

37 Oregon Steam Navigation Co. v. Winsor, 87 U.S. (20 Wall.) 64, 69 (1874). In Fowle v. Park, 131 U.S. 88 (1889), the Court enforced a contract restricting the territorial limits within which the purchaser of a patent medicine formula could manufacture and sell the product. The restraint was unlimited as to time and the Court's decision was rendered more than forty years after the original contract was entered into between the buyer and the seller. The Court reasoned:

> Relating as these contracts did to a compound involving a secret in its preparation; based as they were upon a valuable consideration, and limited as to the space within which, though unlimited as to the time for which, the restraint was to operate, we are unable to perceive how they could be regarded as so unreasonable as to justify the court in declining to enforce them.
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> The vendors were entitled to sell to the best advantage, and in so doing to exercise the right to preclude themselves from entering into competition with those who purchased, and to prevent competition between purchasers; and the purchasers were entitled to such protection as was reasonably necessary for their benefit. . . . If the

under the Sherman Act is demonstrated by the fact that only a few months ago the Fifth Circuit relied on it in sanctioning a similar geographical limitation incident to the sale of a vessel.[38] To Chief Judge Hutcheson, the legality of the covenant was open and shut once he was satisfied that it was reasonable in spatial and temporal coverage: "Ancillary restrictions of this kind," he wrote, have ". . . been uniformly sustained as valid."[39]

There is a close parallel between the restraint in these cases and a territorial restriction in a sale of goods by a manufacturer who does his own wholesaling or retailing in the reserved area. In that situation the manufacturer, like the seller of the steamship, is protecting his retained business from the competition of the purchaser. This eliminates potential competition between supplier and distributor. But that is precisely what happens when part of a business is sold subject to a restrictive covenant given by the buyer.

Does it make any difference if the manufacturer elects not to perform any part of the wholesaling or retailing function himself but to rely on several independent distributors? The effect of a series of territorial restrictions in these circumstances would be to prevent competition between persons at a level in the hierarchy of distribution once removed from the manufacturer, rather than simply between manufacturer and wholesaler or retailer. But it is still the business of the manufacturer that is being protected. He wants to maximize his sales and he thinks this goal can be best served if his representatives concentrate on their local opposition rather than battle each other. Hence, the rationale of the common law rule which permits a seller of property to secure a covenant not to compete is equally apposite here.

While the courts have not analyzed the problem in these terms, they have, nevertheless, applied a rule of reason to the use of territorial restrictions in the marketing of goods.[40] In classifying the restraint as reasonable, they have stressed the non-monopolistic position of the manufacturer and the presence of ample competition at that level[41]—

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public found the balsam efficacious, they were interested in not being deprived of its use, but by whom it was sold was unimportant.
131 U.S. at 97.

38 Tri-Continental Financial Corp. v. Tropical Marine Enterprises, Inc., 265 F.2d 619 (5th Cir. 1959).

39 Id. at 625.

40 See cases cited in notes 32 and 33 supra.

41 Boro Hall Corp. v. General Motors Corp., 124 F.2d 822 (2d Cir.), rehearing denied, 130 F.2d 196 (2d Cir. 1942), cert denied, 317 U.S. 695 (1943); Phillips v. Iola Portland Cement Co., 125 Fed. 593 (8th Cir. 1903), cert. denied, 192 U.S. 606 (1904); Cole Motor Car Co. v. Hurst, 228 Fed. 280 (5th Cir. 1915), writ of error denied sub nom. Tillar v. Cole Motor Car Co., 246 Fed. 831 (5th Cir. 1917), cert. denied, 247 U.S. 511 (1918).

the implication being that the result might well be different if the restriction were obtained by a monopolist.[42]

The first reported case in the federal courts involving this type of restraint reached the Eighth Circuit in 1903.[43] A manufacturer sold cement under a contract precluding the buyer from selling outside of Texas. In holding that the provision did not run afoul of the Sherman Act, the court declared that the manufacturer had no monopoly, that it was surrounded by competing manufacturers, and that the restraint did not have any substantial effect on competition.[44] Twelve years later the Fifth Circuit upheld a similar restriction imposed by an automobile manufacturer on its exclusive agent for certain counties in Texas.[45] Emphasizing the ". . . multitude of other companies from whom purchasers can readily obtain motor cars . . .", and the fact that they, too, utilized this "ordinary instrumentality" of distribution, the court thought it "obvious" that the challenged arrangement was not inimical to competition.[46] The following year the newly created Federal Trade Commission issued a Conference Ruling placing its stamp of approval on the practice.[47] In 1932 the Commission reaffirmed its original stand in a case involving a leading cigar manufactuer who had allocated restricted territories to 46 independent wholesalers and had assigned all its remaining markets to 17 wholly-owned wholesalers.[48] Ten years later, in the Second Circuit's *Boro Hall* decision,[49] ancillary geographical limitations were again labelled reasonable restraints under the Sherman Act. In this case a Chevrolet dealer sought treble damages because General Motors had forbidden it to establish a used car salesroom beyond its designated "zone of influence" in downtown Brooklyn.[50] Since the market was highly competitive, Judge Augustus Hand saw no reason why

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42 The only jurisdiction that has condemned all territorial restrictions, irrespective of the market position of the manufacturer, is Texas, and there the condemnation is the result of a special antitrust statute. Tex. Rev. Civ. Stat. art. 7428 (1948).

43 Phillips v. Iola Portland Cement Co., 125 Fed. 593 (8th Cir. 1903), cert. denied, 192 U.S. 606 (1904). Earlier federal cases involved territorial restrictions ancillary to a sale of part of a business, Oregon Steam Navigation Co. v. Winsor, 87 U.S. (20 Wall.) 64 (1874), or a secret process, Fowle v. Park, 131 U.S. 88 (1889), rather than a sale of goods.

44 Phillips v. Iola Portland Cement Co., 125 Fed. 593, 595 (8th Cir. 1903), cert. denied, 192 U.S. 606 (1904).

45 Cole Motor Car Co. v. Hurst, 228 Fed. 280, 283 (5th Cir. 1915), writ of error denied sub nom. Tillar v. Cole Motor Car Co., 246 Fed. 831 (5th Cir. 1917), cert. denied, 247 U.S. 511 (1918). The court found that the agreement was one of consignment, not of sale, and, therefore, held that the restraints were permissible on that ground as well.

46 228 Fed. at 284.

47 Conference Ruling No. 13, 1 F.T.C. 543 (1916). See also Conference Rulings Nos. 15, 21, 1 F.T.C. 543, 544 (1916).

48 General Cigar Co., Inc., Dkt. 1879, 16 F.T.C. 537 (1932).

49 Boro Hall Corp. v. General Motors Corp., 124 F.2d 822 (2d Cir.), rehearing denied, 130 F.2d 196 (2d Cir. 1942), cert. denied, 317 U.S. 695 (1943).

50 The Chevrolet dealer was free to sell used cars anywhere. The restriction related to the establishment of a used car salesroom outside of the allotted territory.

the manufacturer "should not be allowed to fix a location for the sale of used cars at a place that did not unduly affect other dealers."[51]

After *Boro Hall* was handed down in 1942, the process of adjudicating the legality of territorial restraints ground to a halt. Despite the absence of any prior judicial declaration of invalidity, it was not long before the Department of Justice launched a campaign against the practice. In 1949 it advised the automobile companies that it took a dim view of inhibiting dealers from operating beyond prescribed territories.[52] As a result, the manufacturers revised their franchise agreements to delete the challenged clause.[53] Subsequent consent decrees, although permitting the assignment of primary areas of responsibility to distributors, prohibit any agreement to refrain from selling outside their allotted territories.[54]

On what legal theory is the government proceeding in taking a position so clearly at odds with the decided cases? Certainly, it is relying upon the statement by the Supreme Court in *Bausch & Lomb* that unless a seller acts under fair trade legislation, he "may not lawfully limit by agreement, express or implied, the price at which or the persons to whom its purchaser may resell."[55] *Bausch & Lomb*, however, did not involve territorial restraints—or even customer limitations standing alone. What the Court struck down was an intricate marketing system that was rid-

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51 124 F.2d at 823.

52 See Hearings on Automobile Marketing Legislation Before a Subcommittee of the House Committee on Interstate and Foreign Commerce, 84th Cong., 1st Sess. 89, 362 (1955).

53 Ibid.

54 See United States v. Bostitch, Inc., 1958 Trade Cas. ¶ 69,207 (D.R.I. 1958); United States v. American Type Founders Co., 1958 Trade Cas. ¶ 69,065 (D.N.J. 1958); United States v. Rudolph Wurlitzer Co., 1958 Trade Cas. ¶ 69,011 (W.D.N.Y. 1958); United States v. Necchi Sewing Machine Sales Corp., 1958 Trade Cas. ¶ 68,957 (S.D.N.Y. 1958); United States v. AMI Inc., 1957 Trade Cas. ¶ 68,758 (W.D. Mich. 1957); United States v. J. P. Seeburg Corp., 1957 Trade Cas. ¶ 68,613 (N.D. Ill. 1957); United States v. Philco Corp., 1956 Trade Cas. ¶ 68,409 (E.D. Pa. 1956).

The provisions in the Philco order are typical. The defendant was enjoined from entering into any agreement ". . . limiting or restricting, directly or indirectly, the persons to whom or the territory within which any wholesale distributor or retail dealer may choose to sell Philco products." Philco, however, was permitted to ". . . exercise its right to choose and select its distributors and customers and to designate geographical areas in which such distributors shall respectively be primarily responsible for wholesaling Philco products and to terminate the franchises of distributors who do not adequately represent Philco and promote the sale of all Philco products in areas so designated as their primary responsibility." 1956 Trade Cas. at 71,753.

The Wurlitzer consent judgment contained the following variation of the "primary responsibility" provision:

> . . . Wurlitzer may exercise its right from time to time to choose and select its distributors and customers and to designate geographical areas within which a distributor may agree to devote his best efforts to the sale of coin-operated phonographs and may terminate the contract of any distributor who may fail to devote his best efforts to the sale in the area so designated of coin-operated phonographs manufactured by Wurlitzer or to represent Wurlitzer adequately in said area, and the designation of geographical areas for such specified purposes only shall not be considered a violation of this section IV.

1958 Trade Cas. at 74,008.

55 United States v. Bausch & Lomb Optical Co., 321 U.S. 707, 721 (1944).

dled with illegal resale price fixing agreements. As part and parcel of this price maintenance scheme, wholesalers had been limited to selling to retailers, and retailers to the public.

If the broad dictum of the Court is taken out of context and given a literal interpretation—namely, that a seller cannot by agreement limit "the persons to whom its purchaser may resell"—*any* restriction on a buyer of goods would be unlawful *per se*. This would be true even if the agreement were an isolated one between a single distributor and an insignificant manufacturer trying to break into a local market. The fact that a territorial limitation under these circumstances would not have the slightest adverse effect on competition would be entirely beside the point. Like price fixing, the restraint would permit of no justification. If the Supreme Court intended to lay down any such rule of total prohibition in *Bausch & Lomb*, it hardly seems possible that it would have overturned settled doctrine in such elliptical fashion.[56]

The Department of Justice is apparently proceeding on a second theory as well. When a manufacturer enters into agreements with *several* distributors barring them from marketing his product outside their respective territories, obviously the effect is to eliminate competition at the distributor level in the manufacturer's products. If the distributors had agreed among themselves to achieve this allocation of territories, it would constitute a conspiracy to divide markets and a *per se* violation of the Sherman Act.[57] It may be argued, then, that the legality of a division of territories should not depend on whether it springs from a multiplicity of separate vertical agreements between a manufacturer and his dealers, or from a horizontal understanding among the dealers; either way, the effect on competition is identical. A similar argument was advanced by the Supreme Court when it outlawed vertical resale price maintenance in the *Dr. Miles Medical* case:[58] ". . . the . . . [manufacturer] can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other."[59]

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56 It is significant that Judge Rifkind, the author of Bausch & Lomb in the District Court, saw no reason even to note the case in an article he later wrote on territorial restraints after leaving the bench. Rifkind, Division of Territories, in How to Comply with the Antitrust Laws 127 (1954).

57 Timken Roller Bearing Co. v. United States, 341 U.S. 593, 596 (1951); United States v. National Lead Co., 332 U.S. 319, 328 (1947), affirming 63 F. Supp. 513, 523 (S.D.N.Y. 1945); Addyston Pipe & Steel Co. v. United States, 175 U.S. 211, 241 (1899), modifying 85 Fed. 271, 291 (6th Cir. 1898); United States v. Holophane Co., 119 F. Supp. 114, 119 (S.D. Ohio 1954), aff'd per curiam, 352 U.S. 903 (1956); see Montana-Dakota Utilities Co. v. Williams Electric Cooperative, Inc., 263 F.2d 431, 434 (8th Cir. 1959).

58 Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

59 Id. at 408. There is also the danger that where a network of restrictive territorial

But this reasoning is not ineluctably a sound basis for decision.[60] There are many areas of antitrust where the effect of a transaction is not dispositive of its legality. A manufacturer and dealer may not agree on resale prices, but the franchise of the dealer may be terminated if he cuts prices contrary to the wishes of his supplier.[61] A group of motion picture distributors violate the Sherman Act if they concertedly refuse to grant an exhibitor first-run films, but the deprivation is lawful if each distributor acts independently.[62] A corporation may not be able to expand its operations by merger and still be free to achieve the same result by internal growth.[63] By the same token, a naked covenant not to compete is not the same thing as a covenant not to compete ancillary to a sale.

In the final analysis, the question boils down to this: Are territorial restrictions so intrinsically injurious to competition as to warrant unqualified condemnation? The acknowledged need for orderly marketing and recognition of the efficacy of inter-brand competition prompted the courts to sustain this restraint. A territorial limitation, no less than an exclusive franchise, may contain the seeds from which more intense competition may be spawned. While *Packard* and *Schwing* were concerned with the correlative restraint preventing the seller from dealing with more than one buyer in a designated territory, the philosophy of these cases is equally apt where it is the buyer who is restrained.[64]

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agreements exists, even if the court were inclined to uphold separate vertical agreements, it might infer a conspiracy among the dealers to divide territories with the manufacturer as the hub. Cf. United States v. Masonite Corp., 316 U.S. 265 (1942). Whether or not such a horizontal agreement could he implied in any given case, of course, would depend on the facts. Theatre Enterprises, Inc. v. Paramount Film Distributing Corp., 346 U.S. 537 (1954).

60 It was, however, adopted hy Judge Mack in 1917 when he charged a jury that a network of territorial allocations transgressed the Sherman Act. Lowe Motor Supplies Co. v. Weed Chain Tire Grip Co., Trade Reg. Rep. ¶ 5506, p. 537 (S.D.N.Y. 1917). The case itself is distinguishable on its facts, since it involved a refusal by a manufacturer and its local distributor to deal with a price-cutter as part of an illegal conspiracy to fix resale prices.

61 Compare United States v. Colgate & Co., 250 U.S. 300 (1919), with Federal Trade Commission v. Beech-Nut Packing Co., 257 U.S. 441 (1922). See also United States v. Parke, Davis & Co., 164 F. Supp. 827 (D.D.C. 1958), probable jurisdiction noted, 359 U.S. 903 (1959).

62 Theatre Enterprises, Inc. v. Paramount Film Distributing Corp., 346 U.S. 537 (1954).

63 Corporate stock and asset acquisitions are controlled by Section 7 of the Clayton Act. Such an acquisition violates the statute if there is a reasonable probability that it will result in a substantial lessening of competition in the relevant market. United States v. E. I. duPont de Nemours & Co., 353 U.S. 586 (1957). But Section 7 has no application to internal growth. Neither does Section 1 of the Sherman Act, since the requisite plurality of actors is lacking. Hence, unless the growth is achieved in such a way as to constitute an attempt to monopolize or monopolization in violation of Section 2 of the Sherman Act, it is immune from antitrust attack.

64 The Federal Trade Commission recently intimated as much in Columbus Coated Fabrics Corp., FTC Dkt. 6677, Trade Reg. Rep. ¶ 27,906, p. 36,964 (1959). The respondents, a manufacturer and two distributors of a washahle wall covering, were charged with violating Section 5 of the Federal Trade Commission Act by conspiring to boycott certain dealers, fix dealer resale prices, and establish exclusive sales territories for dis-

In *Schwing*, the court was perfectly willing to assume that the exclusive selling agreement "gives the dealer a monopoly in handling the product of the particular manufacturer in a given area, and thereby enables the dealer to dictate the price at which the products of that manufacturer shall be sold in that area, subject to competition with the products of other manufacturers. . . ."[65] Territorial curbs on the dealer do no more. The dealer may control his own selling price without coping with other dealers marketing the same brand, but he is still "subject to competition with the products of other manufacturers."[66] So long as that competition is healthy, the restraint will not appreciably diminish competitive activity in the market as a whole. And since the practice has a legitimate business purpose—strengthening the manufacturer's channels of distribution—this is just the type of arrangement which the rule of reason was designed to shelter.

Limiting the Persons to Whom the Buyer May Resell

In selecting a method of distribution, a manufacturer may desire to reserve certain key customers for direct sale and employ independent wholesalers to solicit the rest of the trade. Or he may elect to sell exclusively to distributors and leave it to them to call upon the retailer. Sometimes it may even be advantageous for him to have different distributors concentrate on different types of accounts. Then again, he may ignore the intermediate wholesale level and deal only with retail dealers. These and variant patterns of distribution have given rise to contracts of sale limiting the class of customers to whom the purchaser may resell, or preventing any resale at all by a consumer. Such agreements have the same impetus as the geographical restriction on the buyer, give rise to similar antitrust problems, and, despite cases up-

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tributors. The Commission sustained the boycott charge but dismissed the other two for failure of proof. With respect to the claim of unlawful territorial security, it found that the manufacturer had assigned sales areas to certain of its distributors and had requested them not to sell elsewhere; that "In practice, a dealer receiving an order from outside his designated area sends it to . . . [the manufacturer] which, in turn, forwards it to the appropriately located dealer"; that this policy was prompted by the manufacturer's desire ". . . to encourage promotional work (including shows and advertising) by assuring the distributor that he will reap the benefit . . ." and ". . . to insure efficient handling of complaints": but that there was no agreement as to these geographical allocations. Ibid. Having said that there was no agreement, the Commission could have stopped right there. But it went out of its way to add: "There is no evidence of any threat to monopolize, or of injury to competition. The legality of the arrangement presented here is indicated by cases such as Schwing Motor Company v. Hudson Sales Corporation, 138 F. Supp. 899; Packard Motor Car Company v. Webster Motor Car Company, 243 F.2d 418, et seq." Ibid.

[65] 138 F. Supp. at 903. The court tacitly assumed that there would be no invasion of the Baltimore market by a more distantly located Hudson dealer.

[66] Ibid.

holding these restraints under the rule of reason, are opposed by the Department of Justice.

The common law justification for curtailing the buyer's choice of customers is, once again, the reasonableness of safeguarding the seller's business in the face of effective competition from other brands. The restraint is simply one more species of the traditional covenant not to compete by the purchaser of property. It is quite true that this application of the rule clashes with the general principle of law favoring the alienability of personal property once it is transferred to the buyer.[67] For that matter, so does the territorial restriction interfere with free alienation. But most courts have resolved the conflict by carving out an exception where the resale restriction is reasonable.[68]

The Supreme Court has yet to pass upon the validity of a restraint on customer selection when not contaminated by a nexus with an unlawful resale price fixing program. For this reason, *Bausch & Lomb* is not dispositive of the question.[69] Back in 1915 the Court held that a provision in a contract of sale that the goods were for the buyer's consumption, and not for resale, was not "inherently illegal" so as to preclude the seller from recovering the purchase price.[70] But the opinion was confined to this narrow holding and did not explore the reasonableness of the agreement under the Sherman Act. Later, however, two federal Courts of Appeals considered similar covenants restricting the purchaser's right of resale and held that they did not contravene the statute.[71]

Thus, in the *Fosburgh* case,[72] a contract for the sale of sugar contained a clause that the buyer, a candy manufacturer, would use it for manufacturing purposes only and not for resale. The Ninth Circuit, impressed by the fact that the purpose of the provision was to assure equitable distribution of the available supply during a period of severe shortage, concluded that there was no undue restraint of trade. Needless to say, if customer restrictions were illegal *per se*, the fact that economic

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67 See generally, Chafee, "The Music Goes Round and Round: Equitable Servitudes and Chattels," 69 Harv. L. Rev. 1250 (1956); Chafee, "Equitable Servitudes on Chattels," 41 Harv. L. Rev. 945 (1928).

68 See cases cited in notes 32, 33 supra and notes 71, 76, 78, 80 infra. Whenever a seller disposes of part of his business subject to a covenant not to compete, he is to some extent impairing the alienability of the property in the buyer's hands. For the next prospective purchaser may not want to be similarly encumbered. But this consideration has never led to invalidation of the covenant.

69 See text at note 55 supra.

70 D. R. Wilder Mfg. Co. v. Corn Products Refining Co., 236 U.S. 165 (1915).

71 Chicago Sugar Co. v. American Sugar Refining Co., 176 F.2d 1 (7th Cir. 1949), cert. denied, 338 U.S. 948 (1950); Fosburgh v. California & Hawaiian Sugar Refining Co., 291 Fed. 29 (9th Cir. 1923).

72 Fosburgh v. California & Hawaiian Sugar Refining Co., 291 Fed. 29 (9th Cir. 1923).

conditions made the practice expedient would not save it from invalidation.[73] Moreover, in the *Chicago Sugar* case,[74] the Seventh Circuit subsequently upheld the same type of prohibition on resale as a reasonable marketing device without any showing of economic disturbances. The court felt that the restriction was reasonable because, without it, sugar sold by the refiner to consuming manufacturers could have been resold in competition with the distributing trade.[75]

The *Revlon* case[76] in New York exemplifies the use of resale restrictions in connection with a dual system of distribution. The plaintiff, a manufacturer of cosmetics, sold direct to retail stores throughout the country. In addition, it sold to jobbers under contracts limiting each to a specific territory and to resale to beauty parlors and beauty schools. The defendant, a retailer who knew of these limitations, induced a jobber to sell to him directly. Holding that the contract did not restrain trade in violation of the antitrust laws and that an action for inducing its breach would lie, the court stated:

> It is well recognized that a manufacturer need not go into competition against himself. If he elects to deal with a certain class of customers personally he can not be required to allow those to whom he sells for distribution to compete with him for those customers.[77]

That there is no categorical rule against resale restrictions is further illustrated by several decisions, federal and state, permitting sellers to require their customers to dispose of the purchased goods in export channels only.[78] And a host of state cases, which arose during the car shortage following World War II, sustained agreements preventing purchasers of new cars from reselling them for a limited period of time without first offering them to the dealer at a stipulated price.[79] These rulings are

73 See United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); Virginia Excelsior Mills, Inc. v. Federal Trade Commission, 256 F.2d 538 (4th Cir. 1958).

74 Chicago Sugar Co. v. American Sugar Refining Co., 176 F.2d 1 (7th Cir. 1949), cert. denied, 338 U.S. 948 (1950).

75 Though Bausch & Lomb had been on the books for five years, the Seventh Circuit did not mention it.

76 Revlon Products Corp. v. Bernstein, 204 Misc. 80, 119 N.Y.S.2d 60 (Sup. Ct. N.Y. County 1953), aff'd, 285 App. Div. 1139, 142 N.Y.S.2d 364 (1st Dep't 1955).

77 204 Misc. at 81, 119 N.Y.S.2d at 62.

78 United States v. Newbury Mfg. Co., 36 F. Supp. 602 (D. Mass. 1941); P. Lorillard Co. v. Weingarden, 280 Fed. 238 (W.D.N.Y. 1922); Hickok Mfg. Co. v. Fairley Trading Corp., 117 N.Y.S.2d 874 (Sup. Ct. 1952). See also Authors & Newspapers Ass'n v. O'Gorman Co., 147 Fed. 616 (C.C.D.R.I. 1906) (sustaining resale prohibition for one year in connection with sale of books); Bobbs-Merrill v. Straus, 210 U.S. 339 (1908), where a contrary result was reached, may be distinguished on the ground that it involved vertical price control after the first sale of the copyrighted work.

79 Piazza v. Liberty Motors, 34 Ala. App. 376, 43 So. 2d 134, aff'd, 253 Ala. 132, 43 So. 2d 136 (1949); Summers v. Adams Motor Co., 34 Ala. App. 319, 39 So. 2d 300 (1949); Bay Shore Motors v. Baker, 90 Cal. App. 2d 895, 202 P.2d 865 (1949); King Motors v. Delfino, 136 Conn. 496, 72 A.2d 233 (1950); Schuler v. Dearing Chevrolet Co., 76 Ga. App. 570, 46 S.E.2d 611 (1948); Burnett v. Nolen, 336 Ill. App. 376, 84 N.E.2d 155 (1949); Elizabethtown Lincoln Mercury v. Jones, 313 Ky. 321, 231 S.W.2d 42 (1950);

consonant with the willingness of most state courts to enforce reasonable use restrictions attached to sales of chattels.[80]

But an ominous note for orderly marketing was struck this past year by a federal district judge in the *Baldwin-Lima* case.[81] Baldwin, which had the exclusive right to exploit a patented stress gage having several distinct commercial uses, sold the product subject to restrictions which parcelled out different fields of use to various customers. The court held that the sale removed the transaction from the protection of the patent, and that the restraints constituted an allocation of markets among competitors and, hence, a *per se* violation of the Sherman Act—despite the absence of any finding of horizontal agreement among Baldwin's customers. The case, however, is supportable on the alternative ground that the use restrictions were employed in such a manner as to result in a tie-in of other apparatus with the patented gage.[82] Indeed, it was this finding of patent misuse to which the Third Circuit pointed in its affirmance.[83]

Apparently our antitrust enforcement agencies do not see eye to eye on curtailing a buyer's right of customer selection. The attitude of the Department of Justice is clear. It argues that such a restraint is unlawful *per se* under *Bausch & Lomb*.[84] Not only is this evident from

Wade & Dunton, Inc. v. Gordon, 144 Me. 49, 64 A.2d 422 (1949); Stanford Motor Co. v. Westman, 151 Neb. 850, 39 N.W.2d 841 (1949); Larson Buick Co. v. Mosca, 79 N.Y.S.2d 654 (Sup. Ct. Queens County 1948); Thomas B. Martindale, Inc. v. Gorman, 165 Pa. Super. 612, 70 A.2d 409 (1950); Thomas B. Martindale, Inc. v. Dougherty, 68 D. & C. 243 (Pa. C.P. 1949); Becker-Mills, Inc. v. Bosher, 68 D. & C. 115 (Pa. Mun. Ct. 1949).

80 E.g., Meyer v. Estes, 164 Mass. 457, 41 N.E. 683 (1895) (sale of electrotype plates to be used only to illustrate the works of specified publishers and not to be resold or multiplied for purposes of resale); Gano v. Delmas, 140 Miss. 323, 105 So. 535 (1925) (sale of cement for a particular road project and not for resale); Clare v. Ice Cream Cabinet Co., 166 Atl. 722 (N.J. Ch. 1933) (sale of refrigerator to confectioner who promised to use it solely to store Reid ice cream); New York Bank Note Co. v. Hamilton Bank Note Engraving & Printing Co., 180 N.Y. 280, 73 N.E. 48 (1905) (printing presses to be sold with restriction against use in strip-ticket printing); see National Skee-Ball Co. v. Seyfried, 110 N.J. Eq. 18, 158 Atl. 736 (1932) (condition in sale of skee-ball alleys that buyers confine their use to places where no similar alleys were in use not binding on a subsequent purchaser with notice of the condition although condition might have been valid between the immediate parties). But cf. Elijah & Winne v. Mottinger, 161 Iowa 371, 142 N.W. 1038 (1913) (condition in sale of horse and wagon requiring vendee to use only to deliver coal for vendor in Cedar Rapids, Iowa, and containing no time limitation, held void as perpetual restriction on future use or alienation of property). Contra, Neb. Rev. Stat. § 59-805 (1943) (prohibiting sale of any article upon condition that it not be sold again, or any restraint on sale by purchaser).

81 Baldwin-Lima-Hamilton Corp. v. Tatnall Measuring Systems Co., 169 F. Supp. 1 (E.D. Pa. 1958), aff'd, 268 F.2d 395 (3d Cir. 1959).

82 The District Court termed this "a more basic vice" than the allocation of markets. 169 F. Supp. at 30.

83 Baldwin-Lima-Hamilton Corp. v. Tatnall Measuring Systems Co., 268 F.2d 395 (3d Cir. 1959).

84 Parenthetically, it may be noted that the Department might, with equal plausibility, rely on Ethyl Gasoline Corp. v. United States, 309 U.S. 436 (1940), where the Supreme Court also condemned customer restrictions which were an integral part of a plan to control resale prices. Accord, Masters, Inc. v. Sunbeam Corp., 112 F. Supp. 268 (S.D.N.Y.

recent consent decrees,[85] but the Department made its views known in 1949 when it induced the automobile companies to eliminate a clause from their franchise agreements which prevented resale of new cars to non-franchised dealers—a practice known as "bootlegging."[86] And when the automobile industry subsequently sought a special exemption from Congress in 1954 authorizing such a restrictive provision, the Department resisted the measure on the ground that it would sanction three separate antitrust violations: (1) artificial stabilization of prices for new motor vehicles in the face of "price-cutting" by "bootleggers"; (2) a boycott of "bootleggers"; and (3) restrictions on products after sale to dealers who took independent title to the vehicles.[87] The bill passed the House,[88] but never emerged from the Senate.

If customer restrictions are employed to implement a system of resale price maintenance, and the program is not under the aegis of fair trade, *Bausch & Lomb* and kindred cases[89] make it abundantly clear that the Sherman Act is violated. In such a situation the words of Mr. Justice Lurton, written when he was a judge on the Sixth Circuit, would be pertinent: "Restraints which might be upheld if ancillary to some principal contract cannot be enforced if, when unmasked, they appear to be the main purpose of the contract and not subordinate."[90] But it certainly cannot be presumed from the mere presence of a clause restricting customer selection that there is an agreement to fix prices.[91]

To analyze the problem of customer restrictions in terms of a boycott

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1952); W. H. Hill Co. v. Gray & Worcester, 163 Mich. 12, 127 N.W. 803 (1910). See also United States v. Univis Lens Co., 316 U.S. 241 (1942).

85 E.g., United States v. Bostitch, Inc., 1958 Trade Cas. ¶ 69,207, p. 74,741 (D.R.I. 1958); United States v. American Type Founders Co., 1958 Trade Cas. ¶ 69,065, p. 74,205 (D.N.J. 1958); United States v. American Body and Trailer, Inc., 1958 Trade Cas. ¶ 69,063, p. 74,200 (W.D. Okla. 1958); United States v. Rudolph Wurlitzer Co., 1958 Trade Cas. ¶ 69,011, p. 74,007 (W.D.N.Y. 1958); United States v. Necchi Sewing Machine Sales Corp., 1958 Trade Cas. ¶ 68,957, p. 73,841 (S.D.N.Y. 1958); United States v. AMI Inc., 1957 Trade Cas. ¶ 68,758, p. 73,099 (W.D. Mich. 1957); United States v. J. P. Seeburg Corp., 1957 Trade Cas. ¶ 68,613, p. 72,479 (N.D. Ill. 1957); United States v. Philco Corp., 1956 Trade Cas. ¶ 68,409, p. 71,753 (E.D. Pa. 1956); United States v. Reddi-Wip, Inc., 1955 Trade Cas. ¶ 68,187, p. 70,877 (S.D. Cal. 1955).

86 See, Hearings on Automobile Marketing Legislation Before a Subcommittee of the House Committee on Interstate and Foreign Commerce, 84th Cong., 1st Sess. 89 (1955). Typically, the nonfranchised dealer or "bootlegger" obtains his cars from an overstocked franchised dealer and drives them to another city, where he advertises them "same as new" for much less than list prices.

87 Hearings on Agreements Restricting Certain Sales of Motor Vehicles for Resale Before the House Committee on Interstate and Foreign Commerce, 83d Cong., 2d Sess. 5-6 (1954).

88 H.R. Rep. No. 9769, 83d Cong., 2d Sess. (1954).

89 See note 84 supra. See also Victor Talking Machine Co. v. Kemeny, 271 Fed. 810 (3d Cir. 1921).

90 This point was made in John D. Park & Sons Co. v. Hartman, 153 Fed. 24, 45 (6th Cir. 1907), the forerunner of the Dr. Miles case. The "main purpose" which the Sixth Circuit referred to was "to benefit . . . [the manufacturer's] vendees and subvendees by breaking down their competition with each other." "Any benefit to the retained business" of the manufacturer, the court felt, was incidental to this primary objective. Ibid.

91 Roux Distributing Co., FTC Dkt. 6636, Trade Reg. Rep. ¶ 27,855 (1959).

seems quite strained.[92] Though group boycotts are unlawful *per se*,[93] the term connotes a refusal to deal stemming from a horizontal agreement among competitors, not a vertical arrangement between seller and buyer. If a dealer's promise to a manufacturer, that he will resell only to consumers, is deemed a boycott of other dealers, by a parity of reasoning a manufacturer's promise to grant a dealer an exclusive franchise is equally a boycott of other dealers. Yet it was precisely this line of argument that the courts rejected in *Schwing* and *Packard* when they refused to treat an exclusive selling agreement as an unlawful vertical conspiracy.[94] Even more recently, when the Supreme Court reiterated in the *Klor's* case that group boycotts are illegal as a matter of law, Mr. Justice Black was careful to draw a distinction between such a collective restraint and "a manufacturer and a dealer agreeing to an exclusive distributorship."[95]

Although the Federal Trade Commission also opposed the anti-bootlegging bill in 1954 because it interfered with the right of an individual trader to select his customers,[96] this agency does not subscribe to the proposition that customer restrictions are illegal *per se*. The question was presented to the Commission last year in the *Roux* case.[97] The respondent, which sold beauty preparations, channeled the distribution of its products through three groups: jobbers, drug wholesalers and

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92 This analysis, in all probability, was suggested to the government by the reference to Fashion Originators' Guild v. Federal Trade Comm., 312 U.S. 457 (1941), in Bausch & Lomb:

> A distributor of a trade-marked article may not lawfully limit by agreement, express or implied, the price at which or the person to whom its purchaser may resell, except as the seller moves along the route which is marked by the Miller-Tydings Act. . . . Even the additional protection of a copyright . . . or of a patent . . . add nothing to a distributor's power to control prices of resale by a purchaser. The same thing is true as to restriction of customers. Fashion Originators' Guild v. Trade Comm'n, 312 U.S. 457, 465. . . .

321 U.S. at 721.

Since Fashion Originators' Guild held that a concerted refusal to deal by a group was unlawful per se, the Department of Justice would presumably argue that the requisite concert of action may be found in the mere agreement between a manufacturer and his dealer restricting the latter's right of customer selection—even though the manufacturer himself does not agree to refrain from dealing with those customers who are outside the franchise of the dealer.

93 Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959).

94 This does not negate the possibility that where there is a multiplicity of agreements between a manufacturer and his dealers containing customer restrictions, a court might conclude that the arrangements were in fact the product of a conspiracy among the dealers in which the manufacturer participated. See note 59, supra. If that factual determination were made, the horizontal allocation of customers would be unlawful. See note 57, supra. The discussion in the text presupposes that each contract between manufacturer and dealer is separately negotiated and that there is no agreement among the dealers themselves.

95 359 U.S. at 212.

96 Hearings on Agreements Restricting Certain Sales of Motor Vehicles for Resale Before the House Committee on Interstate and Foreign Commerce, 83d Cong., 2d Sess. 3-4 (1954). The Commission also felt that the proposed legislation was unnecessary because "bootlegging" could be controlled by comporting with fair trade laws.

97 Roux Distributing Co., note 91, supra.

beauty supply dealers. Jobbers were confined to selling to the other two groups;[98] drug wholesalers were to cultivate the drug and department store trade; and beauty supply dealers were to obtain business only from beauty salons and the like. In holding that this method of distribution was not proscribed by the antitrust laws,[99] the Commission specifically distinguished *Bausch & Lomb* because of its price-fixing aspects and cited the Sugar cases with approval.[100]

However, the *Roux* decision seems to rest on the curious basis that there was no showing that "drug wholesalers and beauty supply dealers, the two principal classes of customers involved, were ever in substantial competition" with each other.[101] For this reason the Commission failed to see how the restraint on customer selection might substantially lessen competition. This implies that customer limitations would pass muster if employed by a manufacturer setting up a distributing organization for the first time, but not if used to revise an existing marketing system under which distributors had been competing with each other for the same accounts. Such a partial concession to legality, of course, would have limited practical value.

It is difficult to see why a distinction should be drawn depending on whether the competition being avoided is potential or actual. If there are sound reasons for preventing the rise of intra-brand competition in the first place, they apply with equal force to its eradication. The fact that an exclusive selling franchise may have the effect of severing existing dealers—rather than merely preventing their appointment—does not make for illegality.[102] The same rule should apply to customer restrictions. Unless it can be said that the restraint will significantly diminish the vitality of competition in the relevant market, it should be permitted as reasonably calcnlated to strengthen the hand of the manufacturer in competing with others. As in the case of the territorial limitation, this is an area where glib references to the elimination of competition tend to obscure the pro-competitive features of the restriction.

98 Jobbers were also permitted to sell to each other—presumably on an exchange basis.

99 The complaint was brought for alleged violation of Section 5 of the Federal Trade Commission Act, which interdicts "unfair methods of competition." The Commission expressly recognizes that the statute encompasses practices which do not rise to the level of a Sherman Act infraction. Hence its holding means that neither statute was violated.

100 Roux Distributing Co., note 91, supra.

101 Id. at pp. 36,925-26.

102 Packard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418 (D.C. Cir.), cert. denied, 355 U.S. 822 (1957); Schwing Motor Co. v. Hudson Sales Corp., 138 F. Supp. 899 (D. Md.), aff'd per curiam, 239 F.2d 176 (4th Cir. 1956), cert. denied, 355 U.S. 823 (1957).

REQUIRING THE BUYER TO DEAL EXCLUSIVELY WITH THE SELLER

When a seller of goods goes beyond circumscribing the freedom of his dealers in marketing his own product and impinges on their right to handle the wares of his competitors, his problem becomes more difficult. Once he requires his outlets, by express contract or implied understanding, to purchase his merchandise to the exclusion of rival brands, not only must he satisfy the general command of the Sherman Law, but also the more specific and exacting requirements of the Clayton Act.[103] Even if the buyer's exclusive dealing promise does not rise to the level of an unreasonable restraint of trade, it may nevertheless substantially lessen competition within the meaning of Section 3 of the 1914 enactment. This renders quite academic the common law indulgence of exclusive dealing arrangements[104] and their early history under the Sherman Act.[105] Today, when a sale of goods is involved,[106] and

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103 Section 3 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.

38 Stat. 731 (1914), 15 U.S.C. § 14 (1958).

104 At common law the vast majority of exclusive dealing agreements were sustained. See, e.g., Pullman Palace Car Co. v. Texas & Pacific Ry., 11 Fed. 625 (C.C.E.D. Tex. 1882); National Furnace Co. v. Keystone Mfg. Co., 110 Ill. 427 (1884); Brown v. Rounsavell, 78 Ill. 589 (1875); Palmer v. Stebbins, 20 Mass. (3 Pick.) 188 (1826); Matthews v. Associated Press, 136 N.Y. 333, 32 N.E. 981 (1893); Live Stock Ass'n v. Levy, 54 N.Y. Super. 32 (1886); Restatement, Contracts § 516(e) (1932).

105 The earliest decisions involving exclusive dealing under the Sherman Act dealt with arrangements which did not expressly bind the purchaser to deal exclusively with one seller or to refrain from dealing with others, but merely induced him to eschew competing goods by offering him price rebates or discounts as an incentive. In this form, the courts could discern neither a contract nor a restraint of trade in violation of the Sherman Act. Whitwell v. Continental Tobacco Co., 125 Fed. 454 (8th Cir. 1903); In re Corning, 51 Fed. 205 (N.D. Ohio 1892); In re Terrell, 51 Fed. 213 (C.C.S.D.N.Y. 1892); In re Greene, 52 Fed. 104 (C.C.S.D. Ohio 1892). It was because of this body of law that Congress felt that the Sherman Act did not effectively cope with the problem of exclusive dealing. 51 Cong. Rec. 9161 (1914); see Dictograph Products, Inc. v. Federal Trade Commission, 217 F.2d 821, 826 (2d Cir. 1954), cert. denied, 349 U.S. 940 (1955). Yet where exclusive dealing was the result of express contract, it was condemned because of excessive duration in United States Telephone Co. v. Central Union Telephone Co., 202 Fed. 66 (6th Cir.), cert. denied, 229 U.S. 620 (1913); because it was used by a monopolist to drive out competition in United States v. Great Lakes Towing Co., 208 Fed. 733 (N.D. Ohio 1913), modified, 217 Fed. 656 (N.D. Ohio 1914), appeal dismissed, 245 U.S. 675 (1917); and because the exclusive was part and parcel of price-fixing or boycott schemes. Standard Sanitary Mfg. Co. v. United States, 226 U.S. 20, 46-49 (1912); Continental Wall Paper Co. v. Louis Voight & Sons Co., 212 U.S. 227 (1909); Montague & Co. v. Lowry, 193 U.S. 38 (1904); Wheeler-Stenzel Co. v. National Window Glass Jobbers' Ass'n, 152 Fed. 864 (3d Cir. 1907); Chesapeake & Ohio Fuel Co. v. United States, 115 Fed. 610 (6th Cir. 1902). No court during the period antedating the Clayton Act had occasion to adjudicate the legality

the exclusive dealing arrangement is challenged in a civil action under both the Sherman and Clayton Acts, the courts frequently predicate their determination solely on Section 3 and withhold judgment on the superfluous Sherman Act claim.[107]

While an exclusive dealing agreement restrains the buyer from patronizing others and narrows the channels of trade open to competing sellers, it may nonetheless further legitimate economic aims. The seller hopes to increase his sales and insure superior customer service by requiring his dealers to focus all their efforts on promoting his line. Moreover, it is likely that dealers handling the goods of one supplier will carry a full stock, rather than a limited number of fast-moving items. And when one dealer is the sole representative of a manufacturer in a specific territory, it is particularly important that the dealer devote his entire energy to pushing that single line. When the "exclusive" takes the form of a requirements contract, it may enable the seller to reduce selling expenses, protect himself against price fluctuations, obtain a predictable market and perhaps even establish a foothold against entrenched competitors.[108]

Nevertheless, these cogent business reasons failed to sway a five member majority of the Supreme Court in *Standard Stations*.[109] Expressing the fear that the judiciary was not qualified to conduct an economic inquiry to determine the probable effect of exclusive dealing agreements on competition, the Court fashioned a rule bordering on *per se* illegality. Section 3 is violated, it held, whenever "competition has been foreclosed in a substantial share of the line of commerce affected."[110] Such unlawful foreclosure followed automatically from

under the Sherman Act of an express exclusive dealing agreement of reasonable duration when not accompanied by any extrinsic unlawful purpose.

106 By its terms, Section 3 of the Clayton Act applies only to a sale or lease of commodities. Thus, where land or a service is involved, only the Sherman Act provides a basis for challenge. See Northern Pacific Railway Co. v. United States, 356 U.S. 1 (1958); Times-Picayune Pub. Co. v. United States, 345 U.S. 594 (1953).

107 See, e.g., Standard Oil Co. of California v. United States, 337 U.S. 293 (1949); Tampa Electric Co. v. Nashville Coal Co., 168 F. Supp. 456 (M.D. Tenn. 1958); United States v. Sun Oil Co., 1959 Trade Cas. ¶ 69,398 (E.D. Pa. 1959). But cf. United States v. American Can Co., 87 F. Supp. 18 (N.D. Cal. 1949), discussed note 120, infra.

108 See Standard Oil Co. of California v. United States, 337 U.S. 293, 306-07 (1949). Mr. Justice Frankfurter also said that exclusive dealing arrangements ". . . may well be of economic advantage to buyers as well as to sellers, and thus indirectly of advantage to the consuming public. In the case of the buyer, they may assure supply, afford protection against rises in price, enable long-term planning on the basis of known costs, and obviate the expense and risk of storage in the quantity necessary for a commodity having a fluctuating demand." Id. at 306.

109 Standard Oil Co. of California v. United States, 337 U.S. 293 (1949).

110 Id. at 314. While the Supreme Court acknowledged that tying arrangements, as distinguished from exclusive dealing agreements, "serve hardly any purpose beyond the suppression of competition" (id. at 305), it declined to apply different standards of legality under Section 3 to the two restraints. Nevertheless, the Court promulgated a rule of comparative quantitative substantiality for "exclusives" in Standard Stations when it stressed

the fact that Standard had requirements contracts with service stations accounting for 6.7% of gasoline sales in a seven state Western area.[111] It made no difference that the defendant did not dominate the market, that it had not improved its competitive position while its contracts were operative, and that their term was relatively short. Once it appeared that the contracts embraced a substantial share of the market, nothing else mattered.[112]

A wave of criticism erupted in the wake of this rule of "quantitative substantiality."[113] The Attorney General's Committee pointed out that although the Court had postulated "'foreclosure' of competitors from a significant market as the index of illegality," it "assumed rather than demonstrated that Standard's requirements contracts actually 'foreclosed' competitors from market access."[114] In dwelling on the elimination of Standard's retail stations as outlets for its competitors, the Court had ignored the more pertinent question of whether an adequate number of other equally desirable dealers remained available to competitors. For if the other oil companies, despite their inability to sell to Standard's dealers, had good distribution, there could be no substantial lessening of competition.[115]

When the Federal Trade Commission announced its *Maico* decision[116] in 1953, it seemed to some that the tide might be turning. While the

foreclosure from a "substantial share of the line of commerce affected." On the other hand, under International Salt Co. v. United States, 332 U.S. 392 (1947), a tying arrangement transgresses Section 3 when more than an insignificant or insubstantial quantum of commerce is involved—in that case, $500,000 worth of salt; in other words, a standard of absolute quantitative substantiality governs in the case of tie-ins.

According to the Supreme Court's most recent restatement, a tie-in violates the Sherman Act when there is "sufficient economic power to impose an appreciable restraint on free competition in the tied product" and a "not insubstantial" amount of commerce is tied; the Clayton Act is infringed when either condition is present. See Northern Pacific Railway Co. v. United States, 356 U.S. 1, 11 (1958).

111 The Court also held that Standard violated Section 3 by entering into "exclusives" with respect to 5% of the lubricating oil and 2% of the tires and batteries sold in the relevant area.

112 Although the government's complaint alleged that Standard had taken over an undue concentration of the better service station locations, it offered no substantiation at the trial. And when Standard attempted to prove that it had not pre-empted the choice sites, the trial judge rejected its proffer as immaterial. See Brief for Appellants, p. 12, Standard Oil Co. of California v. United States, 337 U.S. 293 (1949).

113 See, e.g., Handler, Antitrust in Perspective c. II (1957); Lockhart & Sacks, "The Relevance of Economic Factors in Determining Whether Exclusive Arrangements Violate Section 3 of the Clayton Act," 65 Harv. L. Rev. 913 (1952); McLaren, "Related Problems of Requirements Contracts and Acquisitions in Vertical Integration Under the Anti-Trust Laws," 45 Ill. L. Rev. 141 (1950).

114 Att'y Gen. Nat'l Comm. Antitrust Rep. 142 (1955).

115 Since Standard's major competitors also distributed their gasoline under requirements contracts, it is conceivable that the cumulative foreclosure of retail outlets by the seven leading oil companies hindered the smaller producers from gaining effective access to the consumer. But neither the trial judge nor the Supreme Court purported to fasten liability on Standard because its major competitors, acting independently and not in concert, chose to engage in similar practices.

116 Maico Co., Dkt. 5822, 50 F.T.C. 485 (1953).

courts might feel ill-equipped to sift and evaluate relevant economic data, the Commission, mindful of its *raison d'etre,* felt no similar inadequacy. Hence, it reversed the hearing examiner, who had condemned Maico's exclusive dealing agreements under the *Standard Stations* formula; and it ordered him to receive evidence that respondent's competitors had grown in number, that their volume had increased, that Maico's share of the market had decreased, and that its dealers constituted a small percentage of hearing aid outlets in the country.[117]

It soon became apparent, however, that *Maico* had not ushered in a new era for exclusive dealing. The courts have not paid the slightest attention to it,[118] and the Commission is simply patient enough to listen to the respondent's evidence before finding a violation.[119] The cold fact is that in the past ten years, exclusive dealing agreements have almost invariably failed to survive judicial or administrative scrutiny under Section 3.[120]

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117 On remand, Maico consented to an order prohibiting it from enforcing or entering into exclusive dealing agreements. Maico Co., Dkt. 5822, 51 F.T.C. 1197 (1955).

118 Since Maico, no court has departed from the mechanistic approach sanctioned in Standard Stations. Dictograph Products, Inc. v. Federal Trade Commission, 217 F.2d 821 (2d Cir. 1954), cert. denied, 349 U.S. 940 (1955); Anchor Serum Co. v. Federal Trade Commission, 217 F.2d 867 (7th Cir. 1954); Tampa Electric Co. v. Nashville Coal Co., 168 F. Supp. 456 (M.D. Tenn. 1958); United States v. Sun Oil Co., 1959 Trade Cas. ¶ 69,398 (E.D. Pa. 1959). They have echoed the rationale of pre-Maico judicial decisions in Section 3 cases. Automatic Canteen Co. v. Federal Trade Commission, 194 F.2d 433 (7th Cir. 1952), rev'd on other grounds, 346 U.S. 61 (1953); Pennsylvania Water & Power Co. v. Consolidated Gas, Electric Light & Power Co., 184 F.2d 552 (4th Cir.), cert. denied, 340 U.S. 906 (1950); Red Rock Bottlers, Inc. v. Red Rock Cola Co., 1952 Trade Cas. ¶ 67,375 (N.D. Ga. 1952); see Transamerica Corp. v. Board of Governors, 206 F.2d 163, 170 (3d Cir.), cert. denied, 346 U.S. 901 (1953). Indeed, the courts in Pennsylvania Water and Red Rock indicated a willingness to invalidate an exclusive dealing arrangement on the authority of Standard Stations without even probing the question of quantitative significance.

119 Harley-Davidson Motor Co., Dkt. 5698, 50 F.T.C. 1047 (1954); Revlon Products Corp., Dkt. 5685, 51 F.T.C. 260 (1954), motion to reopen denied, 51 F.T.C. 466 (1954); Beltone Hearing Aid Co., Dkt. 5825, 52 F.T.C. 830 (1956); Outboard, Marine & Mfg. Co., Dkt. 5882, 52 F.T.C. 1553 (1956).

120 The only case since Standard Stations in which a defendant has escaped liability under Section 3 is United States v. J. I. Case Co., 101 F. Supp. 856 (D. Minn. 1951). There, Judge Nordbye rested his decision on two grounds: (1) that the government failed as a matter of fact to sustain its charge that the defendant had entered into agreements with a substantial number of its dealers requiring them to refrain from purchasing farm machinery from others; and (2) that there was no showing of either actual or probable substantial lessening of competition, since the government relied on evidence pertaining to less than one-half of one per cent of the nation's farm equipment dealers.

In United States v. American Can Co., 87 F. Supp. 18 (N.D. Cal. 1949), the court held that the defendant's five-year requirements contracts unreasonably restrained trade in violation of the Sherman Act because the dominant power in the industry foreclosed competitors from a substantial market, namely, $250 million worth of business annually. The court, however, refused to outlaw all requirements contracts, holding that, in view of the necessities of the industry, contracts having a duration of one year would be reasonable, since they ". . . would permit competitive influences to operate at the expiration of said period of time. . . ." Id. at 31. Oddly enough, without advancing any reason for its action, the court summarily dismissed the government's contention that the requirements contracts also offended Section 3 of the Clayton Act. Id. at 32. It held, however, on another branch of the case, that the defendant had violated Section 3 by the use of tying restrictions.

As far as the courts are concerned, *Standard Stations* reigns supreme.[121] This is in marked contrast to their rejection of its doctrine in antimerger proceedings under Section 7 of the Clayton Act. Despite the Supreme Court's ruling in *duPont-General Motors*,[122] judges have balked at invalidating an acquisition merely because it involves a substantial share of the market, and have insisted on a factual showing of probable anticompetitive effects.[123] Yet, for some strange reason, they outlaw an "exclusive" without such proof.

This mechanical approach is graphically illustrated by the recent decision of the District Court in *Sun Oil*.[124] The supply contracts of Sun Oil Company, unlike those of Standard of California, did not oblige independent service stations to buy exclusively from Sun, but the trial judge nevertheless sustained the government's contention that there was a tacit understanding to that effect. And once that finding was made, the result was a foregone conclusion. Sun sold 8.4% of the gasoline through approximately 7.3% of the stations in its eighteen state market area. Since other suppliers were denied access to this substantial number of Sunoco outlets, the "exclusives" were *ipso facto* unlawful under *Standard Stations*.

Not only are the findings bereft of any suggestion that Sun's competitors had trouble reaching the consumer, but they imply the contrary. Over 99% of the branded gasoline purchased by the motoring public in the relevant market was dispensed at stations which carried the products of a single supplier.[125] Indeed, the court specifically acknowledged that "Sun's marketing practice with respect to gasoline does not foreclose all its competitors from selling their brand of gasoline at Sun's independent dealer stations for such competitors choose not to sell to Sun dealers."[126] Nor was this choice peculiar to the major oil companies. The court referred to four small companies which followed the same policy of dealing primarily with "undivided" stations. Moreover, it noted that "even new competitors seek to establish their own outlets, either by erecting new stations or by winning existing wholesale distrib-

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121 See note 118 supra.
122 United States v. E. I. du Pont de Nemours & Co., 353 U.S. 586 (1957).
123 American Crystal Sugar Co. v. Cuban-American Sugar Co., 259 F.2d 524 (2d Cir. 1958); United States v. Columbia Pictures Corp., 169 F. Supp. 888 (S.D.N.Y. 1959); United States v. Brown Shoe Co., 1956 Trade Cas. ¶ 68,244 (E.D. Mo. 1956); cf. United States v. Bethlehem Steel Corp., 168 F. Supp. 576 (S.D.N.Y. 1958); see also Transamerica Corp. v. Board of Governors, 206 F.2d 163 (3d Cir.), cert. denied, 346 U.S. 901 (1953). The Commission is in accord. Brillo Mfg. Co., FTC Dkt. 6557, Trade Reg. Rep. ¶ 27,243 (1957).
124 United States v. Sun Oil Company, 1959 Trade Cas. ¶ 69,398 (E.D. Pa. 1959).
125 Id. at p. 75,506.
126 Id. at p. 75,511.

utors or retail dealers from other suppliers."[127] If there were any small marketers who were willing but unable to sell their petroleum products on a split-pump basis at Sunoco stations, the court did not mention them.

The *Sun Oil* case thus presses Section 3 to the point where a violation will be conclusively presumed from the denial of access to channels of distribution which are not desired by the allegedly victimized competitors. As another federal judge recently remarked in upsetting a requirements contract under Section 3: ". . . the Court's function is not to determine whether the contract is advantageous or desirable from the standpoint of the parties *or of the public* but whether it is legal."[128] The plain implication of this observation is that the standard of legality does not necessarily coincide with the public interest.

The Federal Trade Commission, on the other hand, continues to adhere to *Maico* and refuses to endorse the strictly quantitative principle enunciated in *Standard Stations*.[129] Instead, it inquires whether competitors lack access to the market through equally suitable avenues of distribution. Thus far, however, a finding that the "exclusives" cover a substantial segment of the market has invariably been accompanied by a determination that competitors have been foreclosed from the better outlets and relegated to inferior marketing channels.[130] And once such qualitative foreclosure is established, the Commission disregards other economic evidence.

Thus, in the eyes of the Commission, it appears to be no defense that the industry has witnessed the emergence of new competitors, or that some companies have flourished despite the exclusive dealing policy,

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[127] Id. at p. 75,506.

[128] Tampa Electric Co. v. Nashville Coal Co., 168 F. Supp. 456, 463 (M.D. Tenn. 1958) (emphasis supplied). The contract obligated an electric utility company to purchase all the coal required at one of its plants in Florida from one supplier for a period of twenty years. Purchases were expected to be 450,000 tons at first, as compared with total annual coal consumption of 700,000 tons in all of Peninsular Florida. And much larger purchases were anticipated by the utility in later years. The court deemed it irrelevant that coal was a newcomer to the Florida market, accounting for less than 6% of the state's consumption of fuel and that the use of coal by the buyer ". . . might stimulate the market and induce other consumers to convert to coal . . ." from oil. Id. at 460. For ". . . the inescapable fact persists that the Potter-Tampa contract for a period of 20 years excludes competitions of the Seller from a substantial amount of trade . . ." Id. at 461.

[129] In an article written prior to his appointment to the Federal Trade Commission, the present Chairman expressed the hope that the Commission would continue to pursue this approach. Kintner, "Exclusive Dealing," 3 Prac. Law 69, 76 (1957).

[130] Dictograph Products, Inc., Dkt. 5655, 50 F.T.C. 281 (1953), aff'd, 217 F.2d 821 (2d Cir. 1954), cert. denied, 349 U.S. 940 (1955); Harley-Davidson Motor Co., Dkt. 5698, 50 F.T.C. 1047 (1954); Revlon Products Corp., Dkt. 5685, 51 F.T.C. 260 (1954), motion to reopen denied, 51 F.T.C. 466 (1954); Beltone Hearing Aid Co., Dkt. 5825, 52 F.T.C. 830 (1956); Outboard, Marine & Mfg. Co., Dkt. 5882, 52 F.T.C. 1553 (1956). But in Federal Trade Commission v. Motion Picture Advertising Service Co., 344 U.S. 392 (1953), a case arising under Section 5 of the Federal Trade Commission Act, the Commission limited its cease and desist order to exclusive dealing agreements having a duration longer than one year.

at least where the respondent has simultaneously maintained or increased its market position.[131] Conversely, if competitors have actually lost sales, this is deemed persuasive evidence of a violation.[132] Also deemed to be insufficient as a defense is the fact that the respondent forged its distributing organization out of raw recruits, rather than experienced dealers.[133] Neither the quality of the respondent's product[134] nor the desire to protect good will[135] is a legal justification. For quality is merely offered to show that the respondent's success is not attributable to its policy of exclusive dealing—which is irrelevant if competitors are kept from choice outlets; and good will can be preserved by requiring that appropriate specifications be maintained.[136] Finally, it makes no difference that the genesis of the contracts might have been dealer demand rather than manufacturer insistence,[137] or that dealers are free to cancel their franchise and take on a competitive line.[138]

Less clear is the significance of the fact that the seller's competitors likewise adhere to exclusive dealing policies. The cumulative effect of such adherence has been adverted to by the courts and the Commission on a number of occasions,[139] but it has never been made the basis for

131 Dictograph Products, Inc., Dkt. 5655, 50 F.T.C. 281 (1953), aff'd, 217 F.2d 821 (2d Cir. 1954), cert. denied, 349 U.S. 940 (1955); Outboard, Marine & Mfg. Co., Dkt. 5882, 52 F.T.C. 1553 (1956); Revlon Products Corp. Dkt. 5685, 51 F.T.C. 260 (1954), motion to reopen denied, 51 F.T.C. 466 (1954). No case has arisen since Standard Stations in which the respondent's business decreased during the operative period of its exclusive dealing arrangements. Conceivably, the Commission would deem this a material factor if the rest of the industry did not suffer a comparable decline.

132 Anchor Serum Co., Dkt. 5965, 50 F.T.C. 681 (1954), aff'd, 217 F.2d 867 (7th Cir. 1954); Dictograph Products, Inc., Dkt. 5655, 50 F.T.C. 281 (1953), aff'd, 217 F.2d 821 (2d Cir. 1954), cert. denied, 349 U.S. 940 (1955); Timken Roller Bearing Co., F.T.C. Dkt. 6504, Trade Reg. Rep. ¶ 27,244 (1958); Outboard, Marine & Mfg. Co., Dkt. 5882, 52 F.T.C. 1553 (1956); Harley-Davidson Motor Co., Dkt. 5698, 50 F.T.C. 1047 (1954).

133 Dictograph Products, Inc. v. Federal Trade Commission, 217 F.2d 821 (2d Cir. 1954), cert. denied, 349 U.S. 940 (1955); Outboard, Marine & Mfg. Co., Dkt. 5882, 52 F.T.C. 1553 (1956).

The Commission's approach suggests several questions which remain unanswered. If a manufacturer, through aggressive merchandising and at substantial cost, succeeds in building up the best distributor organization in the business must he then make his distributors available to his competitors on the theory that their outlets are inferior? Does it make any difference that the nature of the business is such that distributors can be trained in fairly short order without undue cost?

134 Dictograph Products, Inc. v. Federal Trade Commission, 217 F.2d 821 (2d Cir. 1954), cert. denied, 349 U.S. 940 (1955); Outboard, Marine & Mfg. Co., Dkt. 5882, 52 F.T.C. 1553 (1956); Beltone Hearing Aid Co., Dkt. 5825, 52 F.T.C. 830 (1956).

135 Harley-Davidson Motor Co., Dkt. 5698, 50 F.T.C. 1047 (1954).

136 Cf. International Business Machines Corp. v. United States, 298 U.S. 131 (1936).

137 Anchor Serum Co. v. F.T.C., 217 F.2d 867 (7th Cir. 1954); Outboard, Marine & Mfg. Co., Dkt. 5882, 52 F.T.C. 1553 (1956).

138 Outboard, Marine & Mfg. Co., Dkt. 5882, 52 F.T.C. 1553 (1956); Beltone Hearing Aid Co., Dkt. 5825, 52 F.T.C. 830 (1956).

139 Standard Oil Co. of California v. United States, 337 U.S. 293 (1949); Dictograph Products, Inc. v. Federal Trade Commission, 217 F.2d 821 (2d Cir. 1954), cert. denied, 349 U.S. 940 (1955); United States v. Sun Oil Co., 1959 Trade Cas. ¶ 69,398 (E.D. Pa. 1959); Beltone Hearing Aid Co., Dkt. 5825, 52 F.T.C. 830 (1956); cf. Signode Steel Strapping Co. v. Federal Trade Commission, 132 F.2d 48, 54 (4th Cir. 1942).

decision. However, in one case Commissioner Mason intimated that the possibility that competitors might emulate the respondent in the future was a relevant consideration.[140] This is the same "chain reaction" theory later articulated by Judge Weinfeld when he enjoined the proposed acquisition of Youngstown by Bethlehem Steel.[141]

Under a strict quantitative test, the question of what other competitors are doing is apt to be academic, since in most cases liability can be bottomed solely on the relative quantum of commerce affected by the single seller whose agreements are being questioned. Under *Maico,* however, it is more likely that the result will hinge on whether the policy of competitors is taken into account. For although the respondent alone may not foreclose the better outlets, market access may nevertheless be impeded where other leading competitors have similar exclusive arrangements with their dealers.

In summary, thus far the doctrinal cleavage between the Commission and the judiciary has not brought administrative absolution to any exclusive dealing agreement which would be prohibited by the courts. In any event, so long as judges continue to invoke *Standard Stations,* most exclusive dealing arrangements will be vulnerable. Here, then, is a technique of orderly marketing which is still fraught with antitrust danger. The hopes inspired by the *Maico* rationale and the recommendation of the Attorney General's Committee have not been realized. It is small wonder that sellers have become chary of imposing this contractual restriction on their customers.

Refusals to Deal as a Method of Securing Orderly Marketing

It remains to consider whether the objectives of orderly marketing can be achieved and legal risks minimized through the seller's refusal to deal with distributors whose policies are not to his liking.

While the Supreme Court has pointed out that the right of customer selection is "neither absolute nor exempt from regulation,"[142] it has, thus far, imposed only two qualifications: the refusal to deal must be the product of independent decision by a single trader not acting in concert with others; and the refusal may not be employed to achieve, maintain or extend monopoly power.[143] It has often been said, therefore,

140 Revlon Products Corp., Dkt. 5685, 51 F.T.C. 260, 279 (1954), motion to reopen denied, 51 F.T.C. 466 (1954).

141 United States v. Bethlehem Steel Corp., 168 F. Supp. 576, 618 (S.D.N.Y. 1958).

142 Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 625 (1953), quoting Lorain Journal Co. v. United States, 342 U.S. 143, 155 (1951).

143 See Lorain Journal Co. v. United States, 342 U.S. 143 (1951); Eastman Kodak Co. v. Southern Photo Materials Co., 273 U.S. 359 (1927); Federal Trade Commission v. Beech-Nut Packing Co., 257 U.S. 441 (1922).

that absent conspiracy or monopoly, a seller may decline to deal with a customer for any reason or no reason.[144] Very recently, however, the Sixth Circuit indicated that an individual refusal to deal violates the Sherman Act when it is animated by an unlawful antitrust purpose, even in the absence of a monopolistic scheme embraced by Section 2.[145] Thus, in the *Englander Motors* case, the court stated that "use of a short term cancellation provision [in a franchise agreement] for the purpose of violating the law is itself a violation of the antitrust law."[146] But this minority position cannot be squared with the wording of Section 1 of the Sherman Act, which encompasses contracts, combinations and conspiracies, and not individual action.

The prevailing attitude of the courts is that, barring an attempt to monopolize, a manufacturer may drop a dealer who handles a competing line without subjecting himself to antitrust liability at the suit of the disfranchised dealer.[147] The reasoning of these cases runs as follows: even if the manufacturer entered into unlawful exclusive dealing arrangements with others, the plaintiff was not injured as a proximate result of those agreements, but rather because of a refusal to deal; and the refusal to deal is lawful irrespective of its purpose.[148]

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144 E.g., McElhenney Co. v. Western Auto Supply Co., 1959 Trade Cas. ¶ 69,416, p. 75,609 (4th Cir. 1959); Naifeh v. Ronson Art Metal Works, Inc., 218 F.2d 202, 206 (10th Cir. 1954); Nelson Radio & Supply Co. v. Motorola, Inc., 200 F.2d 911, 915 (5th Cir. 1952), cert. denied, 345 U.S. 925 (1953); Green v. Victor Talking Machine Co., 24 F.2d 378, 382 (2d Cir.), cert. denied, 278 U.S. 602 (1928).

145 Englander Motors, Inc. v. Ford Motor Co., 267 F.2d 11 (6th Cir. 1959).

146 Id. at 15.

147 Allied Equipment Co. v. Weber Engineered Products, Inc., 237 F.2d 879, 883 (4th Cir. 1956); Leo J. Meyberg Co. v. Eureka Williams Corp., 215 F.2d 100 (9th Cir.), cert. denied, 348 U.S. 875 (1954); Hudson Sales Corp. v. Waldrip, 211 F.2d 268 (5th Cir.), cert. denied, 348 U.S. 821 (1954); Nelson Radio & Supply Co. v. Motorola, Inc., 200 F.2d 911, 915 (5th Cir. 1952), cert. denied, 345 U.S. 925 (1953). See also McElhenney Co. v. Western Auto Supply Co., 1959 Trade Cas. ¶ 69,416 (4th Cir. 1959); Osborn v. Sinclair Refining Co., 171 F. Supp. 37, 44 (D. Md. 1959).

Automobile manufacturers no longer have this untrammeled right of customer selection. The Automobile Dealer Franchise Act, 70 Stat. 1125 (1956), 15 U.S.C. § 1221 (1958), permits a dealer to recover damages from a manufacturer who has cancelled or failed to renew his franchise unless the manufacturer has acted in "good faith." According to the statute, "good faith" means

> the duty of each party to any franchise, and all officers, employees, or agents thereof to act in a fair and equitable manner toward each other so as to guarantee the one party freedom from coercion, intimidation, or threats of coercion or intimidation from the other party: Provided, That recommendation, endorsement, exposition, persuasion, urging or argument shall not be deemed to constitute a lack of good faith.

See Staten Island Motors, Inc. v. American Motors Sales Corp., 169 F. Supp. 378 (D.N.J. 1959).

148 However, a competing seller, as distinguished from a disfranchised dealer, might bring a treble damage action predicating his claim of injury squarely on an alleged exclusive dealing agreement between the manufacturer and compliant dealers, wholly apart from the refusal to sell to dealers who handled competitive wares. Moreover, as is indicated by McElhenney Co. v. Western Auto Supply Co., 1959 Trade Cas. ¶ 69,416 (4th Cir. 1959), the disfranchised dealer himself may claim damages resulting from coercive practices during the period prior to his severance.

Is this, then, a way of circumventing *Standard Stations*?[149] Certainly it is not a safe way. Where Section 3 is sought to be vindicated by the Attorney General or the Commission, rather than by a private party, there is no need to show injury to business or property resulting from a violation of the antitrust laws. It suffices to show the violation, and refusals to deal, though lawful in themselves, are frequently deemed probative of illegality. If the seller makes known his preference for exclusive representation, and if those dealers who insist on handling competing lines are cut off, the courts and the Commission may infer that the seller and his existing dealers are parties to exclusive dealing arrangements.[150] Needless to say, the single trader doctrine provides small comfort to a businessman bent on achieving exclusive representation if it merely absolves him of treble damage liability but does not insulate against suit by the government.

Although it has repeatedly been said that the privilege of customer selection does not depend on the motive or purpose underlying its exercise, the question of intent looms large in importance in a Section 3 proceeding when the government endeavors to prove an agreement by evidence of cancellation or threats to cancel dealer franchises. It is one thing if the government can show that franchises were terminated only because the dealer refused to handle the defendant's line on an exclusive basis. It is quite another if the defendant can establish that termination was due to the "non-progressiveness of the dealer rather than . . . the furtherance of any policy of competitive restraint."[151] In practice, this may often be a shadowy distinction, since failure to do an effective

149 The gravamen of a Section 3 violation is the forbidden condition, agreement or understanding of exclusivity . . . . It makes no difference whether this is voluntary or is imposed by coercion, but without such agreement, condition or understanding, there can be no statutory infraction. It is only in the presence of this essential element that consideration must be given as to whether competition may be substantially lessened or whether there is any tendency toward monopoly.

McElhenney Co. v. Western Auto Supply Co., 1959 Trade Cas. ¶ 69,416, pp. 75,610-11 (4th Cir. 1959).

150 The finding in United States v. Sun Oil Company, 1959 Trade Cas. ¶ 69,398, p. 75,521 (E.D. Pa. 1959), is typical:

In those cases where the dealers proved unyielding or remained undecided, Sun sent them written notice of cancellation or termination. These notices brought some of them around to Sun's point of view, while the others ceased to do business with Sun rather than comply with its demands. This conduct of eliminating 'unfavorable' dealers was far removed from 'selection of customers' by Sun.

Accord, Carter Carburetor Corp. v. Federal Trade Commission, 112 F.2d 722, 732 (8th Cir. 1940); Outboard, Marine & Mfg. Co., Dkt. 5882, 52 F.T.C. 1553 (1956); General Motors Corp., Dkt. 5620, 50 F.T.C. 54, 69 (1953); Champion Spark Plug Co., Dkt. 3977, 50 F.T.C. 30, 48 (1953); see also McElhenney Co. v. Western Auto Supply Co., 1959 Trade Cas. ¶ 69,416, p. 75,610 (4th Cir. 1959). In United States v. J. I. Case Co., 101 F. Supp. 856, 864 (D. Minn. 1951), no sinister inference was drawn from the defendant's refusal to renew certain dealerships since such conduct was attributed in large part to the "non-progressiveness of the dealer" and instances of coercion and pressure on dealers were deemed to be sporadic and de minimis.

151 Ibid.

merchandising job may be caused, in large part, by the fact that the multiple-line dealer has too many irons in the fire. Nevertheless, in the absence of an express covenant, the manufacturer is free to argue that his refusals to deal were actuated by considerations other than noncompliance with a requirement of exclusive dealing.[152] Since the existence of an implied agreement is an issue of fact and not an automatic inference from refusals to deal,[153] the manufacturer may very well carry the day.[154]

When it comes to prescribing the territories within which distributors may operate, and the classes of customers to whom they may resell, the Clayton Act is no longer an obstacle and there is less need for avoiding a contractual commitment. However, since the legality of these restrictions under the Sherman Act is disputed in government circles, sellers may want to proceed cautiously. Does the refusal to deal present an attractive alternative under these circumstances?

Since the government does not object to the assignment of primary areas of responsibility to dealers, and the termination of dealerships for failure to provide proper representation, the manufacturer may be able to control the disposition of his goods by acting within this framework. The leeway authorized in the consent decrees, however, does not furnish the same degree of protection as a vertical agreement containing territorial or customer restrictions. A dealer who periodically invades the bailiwick of another may nevertheless competently exploit his own area. In that event, a refusal to deal might be difficult to explain on any score other than the dealer's peregrinations. But why, it may be asked, should the manufacturer stop supplying a roving dealer whose sales are up to expectations in his home market? What difference does it make to the supplier if one dealer picks up business at the expense of another, provided their sales do not decline in the aggregate?

Putting to one side such complications as customer service and fulfillment of warranties, the second dealer may counterattack, and before long the manufacturer's whole marketing structure may crumble. To obviate this possibility he may feel impelled to cut off dealers who sell outside their assigned territories even though his sales are not immediately affected. If he does act in these circumstances, once again he will have two strings to his bow. A fact finder might or might not infer a

152 See Osborn v. Sinclair Refining Co., 171 F. Supp. 37 (D. Md. 1959); United States v. J. I. Case Co., 101 F. Supp. 856 (D. Minn. 1951).

153 Theatre Enterprises, Inc. v. Paramount Film Distributing Corp., 346 U.S. 537 (1954).

154 E.g., Theatre Enterprises, Inc. v. Paramount Film Distributing Corp., 346 U.S. 537 (1954); Osborn v. Sinclair Refining Co., 171 F. Supp. 37 (D. Md. 1959); United States v. J. I. Case Co., 101 F. Supp. 856 (D. Minn. 1951).

restrictive agreement between the supplier and each of his retained dealers. And in the event of an adverse determination on this factual issue, the manufacturer may still prevail on the ultimate question of the legality of the restriction under the Sherman Act.

Turning to restrictions on the seller, there is little necessity to avoid an express covenant in most instances since the law gives wide latitude to exclusive selling arrangements. Furthermore, although a seller can see to it that his purchaser has an exclusive franchise or full output contract simply by withholding supplies from everybody else, it is the buyer who desires protection and he may want a firm commitment. Of course, if the seller is in a superior bargaining position, he may not be obliged to restrain himself by contract. But even then, one who loses his dealership as a result of the grant of an exclusive franchise may claim, as in *Packard,* that he was ousted because of an informal understanding between the manufacturer and the favored dealer.

In sum, the refusal to deal is a highly useful tool in building a marketing organization which will promote the interests of the manufacturer. While it does not possess all the advantages of a contractual restraint, it compensates for any shortcomings by increasing the difficulty of establishing an agreement, a *sine qua non* of a Section 1 violation. At the same time, it does not grant legal immunity since the refusal to deal itself may permit, though not require, an inference of agreement between the manufacturer and those who retain their franchises. Hence, a seller who tries to solve his marketing problems in this way should be alert to the possibility that he may ultimately have to defend his conduct on the same basis as if he had entered into a binding restriction.

Conclusion

While the Department of Justice seems to be championing unfettered competition in the distribution of goods, the courts have not followed suit. Except for exclusive dealing arrangements, which were singled out for special treatment by the Clayton Act, reasonable restrictions ancillary to a sale of chattels have continued to receive judicial approval under the Sherman Act. This has been strikingly evident where the restraint is on the seller. When it is the buyer who is restrained, the authorities are of less recent vintage and uncertainty has been engendered by dicta which are incompatible with traditional doctrine.

Because of these cross-currents, the refusal to deal has, to a large extent, replaced contractual restrictions as an instrumentality of orderly marketing. But since customer selection and rejection may itself be probative of a tacit agreement, the courts in time will probably have to grapple anew with these restrictions. When they do, it is to be hoped that they will not resort to a slide-rule guide and shrink from analyzing the true impact of the arrangements on competition.[155]

155 The appropriate methodology is indicated by Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 615 (1953): ". . . [O]ur inquiry to determine reasonableness under § 1 must focus on 'the percentage of business controlled, the strength of the remaining competition [and] whether the action springs from business requirements or purpose to monopolize.' "