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Dealer Location Clauses and the Per Se Rule: From Schwinn to GTE Sylvania

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DEALER LOCATION CLAUSES AND THE PER SE RULE: FROM *SCHWINN TO GTE SYLVANIA*

I. Introduction

Restraints affecting trade can be termed either "horizontal" or "vertical." A horizontal restraint exists if competitors "at the same level of the market structure" agree to minimize competition.[1] The effect of such a restraint is to lessen substantially or eliminate *interbrand* competition in a particular area. Thus, consumers are given no choice between brands when purchasing a particular product. Such limitations are per se violations of section 1 of the Sherman Act.[2]

A vertical restraint results from an agreement between firms at "successive stages of the distribution system."[3] A vertical restraint may limit *intrabrand* competition, but consumers and distributors alike might actually benefit from such a restriction[4] depending upon

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1. United States v. Topco Associates, Inc., 405 U.S. 596, 608 (1972).

2. *Id.* Horizontal territorial limitations are naked restraints of trade with no purpose except stifling competition. White Motor Co. v. United States, 372 U.S. 253, 263 (1963).

Section 1 of the Sherman Act reads in pertinent part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . . .

15 U.S.C. § 1 (Supp. IV, 1974).

It has been held that the Sherman Act:

> [R]ests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of the country's economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time producing an environment conducive to the preservation of our democratic political and social institutions.

Northern Pac. Ry. v. United States, 356 U.S. 1, 4 (1958).

3. *See, e.g.*, Note, *Exceptions to Schwinn's Per Se Rule: Their Validity and Implications for the Future*, 31 WASH. & LEE L. REV. 643, 646 (1974). For example, a vertical restraint may occur between a manufacturer and a wholesaler, a wholesaler and a retailer, a manufacturer and a retailer, or they may occur as a result of an agreement among all three levels of a particular distribution system. *Id.*

4. Proponents of vertical restraints argue first, that distributors would be unwilling to handle a manufacturer's product unless they are afforded some protection against "cutthroat" intrabrand competition; second, restraints are necessary to prevent dealers from invading another dealer's territory and relying on the latter's advertising, while the former dealer saves promotional costs, and therefore, reaps greater profits; third, such restraints are designed to motivate dealers to increase their depth of coverage in narrowly defined areas rather than "skimming" choice customers over a wide area, and fourth, such restraints insulate a dealer from intrabrand competition, thus providing the dealer with the necessary

the degree to which competition was limited.[5]

In a recent decision, the Court of Appeals for the Ninth Circuit held that the legality of a dealer-location clause,[6] which designated the location of the dealer's place of business and required the manufacturer's approval as a prerequisite to the dealer opening a second outlet at a new location, should be judged under the "rule of reason."[7] The purpose of this Note is to examine vertically imposed dealer-location clauses, to view their effect upon competition and consumers, and to determine whether such restraints are per se illegal[8] under section 1 of the Sherman Act, or whether they require analysis under the rule of reason.[9]

II. The Per Se Rule

United States v. Arnold, Schwinn & Co.[10] marked a change in the attitude of the Supreme Court[11] towards vertically imposed terri-

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motivation to provide better service for the manufacturer's product. GTE Sylvania, Inc. v. Continental T.V., Inc., 537 F.2d 980, 1002 n.37 (9th Cir. 1976), *cert. granted*, 45 U.S.L.W. 3299 (U.S. Oct. 19, 1976) (No. 76-15).

5. R. WARREN, ANTITRUST IN THEORY AND PRACTICE 129, 136 (1975).

6. *See generally* Pollock, *Alternative Distribution Methods After Schwinn*, 63 Nw. U.L. REV. 595, 603 (1968).

7. GTE Sylvania, Inc. v. Continental T.V., Inc., 537 F.2d 980, 988 (9th Cir. 1976), *cert. granted*, 45 U.S.L.W. 3299 (U.S. Oct. 19, 1976) (No. 76-15). The court stated:

> We are convinced that a contrary holding would constitute an unwarranted "body blow" to legitimate business enterprise and would place our free capitalistic system under stifling restraints, never contemplated or intended by the Congress.

Id.

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

> [T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.

For examples of per se illegalities, see United States v. Topco Associates, Inc., 405 U.S. 596 (1972) (horizontal territorial restrictions); United States v. Parke, Davis & Co., 362 U.S. 29 (1960) (vertical price fixing); Klor's, Inc. v. Broadway-Hale Stores, 359 U.S. 207 (1959) (group boycotts); International Salt Co. v. United States, 332 U.S. 392 (1947) (tying arrangements); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940) (horizontal price fixing).

9. *See* Chicago Board of Trade v. United States, 246 U.S. 231 (1918). Restraints analyzed under the rule of reason require a consideration of the facts peculiar to the business in which the restraint is applied, the nature of the restraint and its effects on competition, and the history of the restraint and the reason for its adoption. *Id.* at 238.

10. 388 U.S. 365 (1967).

11. Four years earlier in White Motor Co. v. United States, 372 U.S. 253 (1963), the Supreme Court declined to adopt a per se rule for vertical territorial and customer restrictions. The Court stated:

torial[12] and customer[13] restrictions. Schwinn marketed its bicycles either by direct sale, by consignment, or through an agency relationship to wholesale distributors or to franchised retailers. It instructed the distributors to sell only to franchised Schwinn accounts and only in their respective territories.[14] Similarly, Schwinn franchised retailers only as to designated locations, authorized them to sell only to consumers and not unfranchised retailers, and required them to purchase only from or through the distributor authorized to serve that particular area.[15] The net effect of this system was to prevent intrabrand competition.

While indicating that "an appraisal of the market impact" of the Schwinn restraints was appropriate,[16] the Court reached for the so-called "ancient rule against restraints on alienation"[17] and proceeded to establish a per se rule. Conveniently, the Court failed to note that this common law rule of property law was not of the per se variety.[18] It ruled that any attempt to restrain alienation of a product after parting with title and risk is per se unreasonable and in violation of section 1 of the Sherman Act, regardless of any busi-

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> We intimate no view one way or the other on the legality of such an arrangement, for we believe that the applicable rule of law should be designed after a trial. . . . [W]e know too little of the actual impact of both that [territorial] restriction and the one respecting customers to reach a conclusion . . . .

Id. at 261. Moreover, the Court noted: "We do not know enough of the economic and business stuff out of which these arrangements emerge . . . ." *Id.* at 263.

12. A vertically imposed territorial restraint exists when a manufacturer transfers his products with the restriction that they be resold only in a particular territory. *See* Note, *Restricted Channels of Distribution Under the Sherman Act*, 75 HARV. L. REV. 795 (1962).

13. A customer resale restraint prohibits the resale of the product to a particular class of customers. *Id.*

14. 388 U.S. at 371.

15. *Id.* at 370-71.

16. *Id.* at 373. The Court stated: "The Government does not contend that a *per se* violation of the Sherman Act is presented by the practices which are involved in this appeal . . . . Accordingly, we are remitted to an appraisal of the market impact on these practices." *Id.*

17. 2 COKE, INSTITUTES OF THE LAWS OF ENGLAND § 360 (Day ed. 1812).

18. *See* Pollock, *supra* note 6, at 607. *See also* Mitchel v. Reynolds, 1 P. Wms. 181, 24 Eng. Rep. 347 (K.B. 1711), where the court stated:

> To conclude: In all restraints of trade, where nothing more appears, the law presumes them bad; but if the circumstances are set forth, that presumption is excluded, and the Court is to judge of those circumstances, and determine accordingly; and if upon them it appears to be a just and honest contract, it ought to be maintained.

24 Eng. Rep. at 352.

ness justification.[19]

In dissent, Justice Stewart argued that invalidation of franchising arrangements would force suppliers to abandon franchising and to integrate forward to the detriment of small business.[20] He found no justification to accord different treatment to a sale, as opposed to a consignment or agency relationship.[21] Justice Stewart concluded that the use of the ancient rule against restraints on alienation was not proper because the rule historically proscribed only unreasonable restraints.[22] Finally, he argued that contemporary business problems required a "more reasoned and sensitive" approach than the simple acceptance of the ancient rule.[23]

Broadly stated, *Schwinn* stands for the proposition that all post-sale vertical restraints are per se illegal. However, two Supreme Court Justices have stated that *Schwinn* applied the "rule of reason."[24] Numerous legal commentators have criticized the soundness of the decision,[25] and at least one commentator has classified the

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19. 388 U.S. at 379-82. Note that the Court declined to extend a per se rule to vertical restraints in consignment or agency relationships and held that such arrangements were to be judged under the rule of reason. *Id.* at 380. *See also* note 3 *supra*.

20. *Id.* at 387 (Stewart, J., dissenting). *See generally* Keck, *The Schwinn Case*, 23 BUS. LAW. 669, 687 (1968).

21. 388 U.S. at 389. Justice Stewart stated:

> [The court] does not demonstrate that these restrictions are in their actual operation somehow more anticompetitive or less justifiable merely because the contractual relations between *Schwinn* and its jobbers and dealers bear the label "sale" rather than "agency" or "consignment." Such irrelevant formulae are false guides to sound adjudication in the antitrust field: "Our choice must be made on the basis not of abstractions but of the realities of modern industrial life."

Id., *citing* Standard Oil Co. v. United States, 337 U.S. 293, 320 (1949) (opinion of Douglas, J.). *See also* note 19 *supra*.

22. *Id.* at 391. Partial restrictions could be justified when ancillary to a legitimate business purpose and not unduly anticompetitive in effect.

23. *Id.* at 392.

24. Justice Douglas has stated, "Under our decisions [including *Schwinn*] the legality of exclusive territorial franchises . . . would have to be tried as a factual issue . . . ." Albrecht v. Herald Co., 390 U.S. 145, 155-56 (1968) (Douglas, J., concurring).

Chief Justice Burger has stated, that in *Schwinn*, "the Court made it clear that it was proceeding under the 'rule of reason,' and not by *per se* rule . . . ." United States v. Topco Associates, Inc., 405 U.S. 596, 617-18 (1972) (Burger, C.J., dissenting) (footnote omitted).

25. *See generally* Keck, *supra* note 20; Pollock, *supra* note 6; Williams, *Distribution and the Sherman Act—The Effects of General Motors, Schwinn and Sealy*, 1967 DUKE L.J. 732 (1967); Note, *Restrictive Distribution Arrangements after the Schwinn Case*, 53 CORNELL L. REV. 514 (1967); Note, *Territorial Restrictions and the Per Se Rules—A Re-evaluation of the Schwinn and Sealy Doctrines*, 70 MICH. L. REV. 616 (1972); Comment, *The Impact of the Schwinn Case on Territorial Restrictions*, 46 TEXAS L. REV. 497 (1968).

rule as "dubious."[26] Such a label attaches, because the Government did not ask for a per se rule[27] and because such a rule required the overruling in part of previous case law.[28] Additionally, the rule could be used to stifle the resourcefulness of small business and modern marketing methods.[29] Moreover, through the use of "consignment" or "agency" methods of distribution, the effect of the rule could be avoided.[30]

When judging the legality of a restraint unaccompanied by another per se violation, courts must first determine whether the restraint is horizontal or vertical. If horizontal, the inquiry can end because a finding of a per se illegality is appropriate.[31] If vertical, it is arguable that courts should look to the impact of the restriction on the marketplace.[32] Thus, for vertical restraints which completely eliminate competition, such as some territorial and customer restrictions, the courts seem willing to find a per se violation.[33] However, for those vertical restraints having a less onerous effect on competition, the courts often apply the rule of reason.[34] For example, in *United States v. Glaxo Group Ltd.*,[35] a vertically imposed customer restriction on the resale of drugs, allegedly to insure the maintenance of uniform health and safety standards, was held to be a per se violation.[36] The court concluded that any possibility of applying the rule of reason to a sale situation was foreclosed by *Schwinn*.[37] In *Adolph Coors Co. v. FTC*,[38] the Tenth Circuit indicated that it was "compelled" to apply the *Schwinn* per se rule to vertically imposed territorial restrictions, but also "believed" that the Supreme Court should make an exception when a unique prod-

26. *See* Keck, *supra* note 20 at 669.

27. *Id. See also* note 16 *supra*.

28. *See* Keck, note 20 *supra*, at 669. *See also* note 11 *supra*.

29. *See* Keck, note 20 *supra*, at 669.

30. *Id.* The independence of a franchisee could also be eliminated through vertical integration. Such methods of distribution would not fall within the strictures of the *Schwinn* per se rule. *See* note 19 *supra*.

31. *See* note 2 *supra* and accompanying text.

32. *See* note 16 *supra* and accompanying text.

33. *See* text accompanying notes 35-41 *infra*.

34. *See* text accompanying notes 42-85 *infra*.

35. 302 F. Supp. 1 (D.D.C. 1969), *rev'd on other grounds*, 410 U.S. 52 (1973). *Contra*, Carter-Wallace Inc. v. United States, 449 F.2d 1374 (Ct. Cl. 1971).

36. 302 F. Supp. at 11.

37. *Id.*

38. 497 F.2d 1178 (10th Cir.), *cert. denied*, 419 U.S. 1105 (1974).

uct requires such restraints in order to insure its marketability.[39]

Similarly, the *Schwinn* per se rule has been applied to vertical prohibitions affecting the resale of trading stamps to a particular customer,[40] and where the enforcement of vertically imposed territorial and customer restrictions effectively prevented a wholesaler from purchasing herbicides.[41]

III. Exceptions to the Per Se Rule

A. Partial Restraints

Some restraints do not completely eliminate competition. Such restraints dictate specific policies for the distribution of goods, but they do not limit the sale of goods to a geographically defined territory or to any particular class of customers. Seemingly, these restraints are susceptible to inclusion within the literal language of *Schwinn*. However, they have been upheld against claims that they fall within the prohibitions of *Schwinn's* per se rule.[42] Included among these devices is the dealer-location clause.[43]

In *GTE Sylvania, Inc. v. Continental T.V., Inc.*,[44] the appellant manufacturer, Sylvania, implemented its "elbow room policy" (*i.e.*, a "straight line distribution system") under which sales were made from the factory to franchised dealers, who in turn sold to consumers.[45] Through franchising, Sylvania hoped to strengthen its market share position by expanding its dealer base.[46] The elements of this policy included dealer-location constraints,[47] whereby the franchisee agreed not to sell Sylvania products from a location other than the

39. *Id.* at 1187. The court of appeals reasoned that factors such as speed of delivery, quality control of the product, refrigerated delivery, and the condition of the product at the time of delivery may justify restraints of trade that would be unreasonable when applied to marketing standardized products. *Id.*

40. Eastex Aviation, Inc. v. Sperry & Hutchinson Co., 367 F. Supp. 868 (E.D. Tex. 1973), *aff'd*, 522 F.2d 1299 (5th Cir. 1975).

41. Reed Bros., Inc. v. Monsanto Co., 525 F.2d 486 (8th Cir. 1975), *cert. denied*, 423 U.S. 1055 (1976).

42. GTE Sylvania, Inc. v. Continental T.V., Inc., 537 F.2d 980, 995 n.25 (9th Cir. 1976), *cert. granted*, 45 U.S.L.W. 3299 (U.S. Oct. 19, 1976) (No. 76-15).

43. Note that the decree of the district court on the *Schwinn* remand upheld the validity of a location clause. 291 F. Supp. 564 (N.D. Ill. 1968).

44. 537 F.2d 980 (9th Cir. 1976), *cert. granted*, 45 U.S.L.W. 3299 (U.S. Oct. 19, 1976) (No. 76-15).

45. *Id.* at 983.

46. *Id.*

47. *Id.*

one originally authorized, unless Sylvania approved the new location.[48]

Continental, an authorized Sylvania dealer already franchised to sell in several locations,[49] sought the manufacturer's approval to sell Sylvania merchandise from a new location.[50] After Sylvania failed to approve,[51] Continental proceeded to sell Sylvania goods at the new location without the manufacturer's approval.[52]

Allegedly due to concerns over the dealer's ability to satisfy its debts,[53] Sylvania terminated Continental's franchise.[54] Continental sought damages, arguing that Sylvania started the credit actions to enforce the locations restrictions[55] and asserting that Sylvania's "elbow room policy" was a policy in restraint of trade, constituting a per se violation of section 1 of the Sherman Act.[56]

The district court judge submitted a jury instruction incorporating the theory of per se illegality espoused in *Schwinn*,[57] and the jury

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48. *Id.*

49. *Id.* at 984.

50. *Id.*

51. Sylvania believed that distribution in the area was already sufficient and that additional Sylvania outlets would be undesirable. *Id.* at 984-85.

52. *Id.* at 985.

53. Sylvania had received information of the criminal record of Continental's principal shareholder and chief operating officer. Additionally, Sylvania learned that Continental had increased its obligations to Philco, while maintaining a high credit limit with Sylvania. Further, obligations owed to Sylvania by Continental and held by Maguire for the benefit of Sylvania were past due. Continental indicated that all obligations would be paid, as soon as, the dispute over the locations practice was resolved.

As a result of their concern, Sylvania placed a credit hold on Continental's orders and reduced its credit line from $300,000 to $50,000. Continental reacted by withholding all payments due. Thereafter, Maguire repossessed Sylvania goods in Continental's possession, levied attachments on Continental's place of business and bank account, and caused the closing of some of Continental's stores and warehouses. Similarly, Continental's bank terminated Continental's consumer financing program and called for the payment of a commercial loan. *Id.* at 985.

54. *Id.*

55. *Id.*

56. *Id.*

57. The jury instruction read:

> Therefore, if you find by a preponderance of the evidence that Sylvania entered into a contract, combination or conspiracy with one or more of its dealers pursuant to which Sylvania exercised dominion and control over the products sold to the dealer, after having parted with title and risk to the products, you must find any effort thereafter to restrict outlets or store locations from which its dealers resold the merchandise which they had purchased from Sylvania to be a violation of Section 1 of the Sherman Act, regardless of the reasonableness of the location restrictions.

returned a verdict in favor of Continental.[58] Also, the court found that Sylvania's credit concerns were not the true reasons for its actions[59] and entered a limited injunction prohibiting Sylvania from enforcing its locations clause.[60] The Ninth Circuit reversed, holding that the district court judge committed error in submitting a per se instruction and that the legality of the locations clause should be judged under the rule of reason.[61]

The majority reasoned that *Schwinn* had been applied too literally and without reference to its facts.[62] For example, Schwinn's territorial and customer restrictions absolutely prevented dealers from selling to customers outside of their designated territory.[63] However, Sylvania's dealers could advertise and sell to customers from any area, and "were limited only as to the location of the franchisee's place of business."[64] The effect of the Schwinn restrictions was to destroy intrabrand competition, because a potential purchaser could buy only from the authorized dealer for his territory.[65] In contrast, Sylvania franchised at least two dealers in major markets, thus preserving intrabrand competition by giving the potential purchaser a choice between competing dealers.[66]

While conceding that the locations practice did "check" intra-

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Id. at 987.

The dissent argued that the district judge did not submit a per se instruction, but instead presented the jury with the issue of whether Sylvania had entered into a post-sale contract, combination, or conspiracy in restraint of trade. *Id.* at 1006 (Kilkenny, J., dissenting).

58. The jury assessed damages in the amount of $591,505. *Id.* at 985-86.

59. *Id.* at 986.

60. *Id.*

61. *Id.* at 988.

62. The court expressed the view that:

> [E]ach case arising under the Sherman Act must be determined upon the particular facts disclosed by the record, and . . . the opinions in those cases must be read in the light of their facts and of a clear recognition of the essential differences in the facts of those cases, and in the facts of any new case to which the rule of earlier decisions is to be applied.

Id. at 989 (citations omitted).

63. *Id.* at 989-90.

64. *Id.* at 990. The court stated:

> Thus a critical and very obvious distinction . . . is that *Schwinn* involved a restriction on the locations and types of permissible *vendees*, while Sylvania only imposed restrictions on the permissible locations of *vendors*.

Id.

65. *Id.*

66. *Id.*

brand competition to a certain extent,[67] the court of appeals concluded that "rather than unreasonably restricting competitive market forces, [the practice] actually had a procompetitive effect."[68] It enabled Sylvania, a marginal producer, to achieve the status of a viable competitor[69] in an oligopolistic industry.[70] The court stated:[71]

> Whether some diminution in intrabrand competition is justified when it averts the loss of one competitor in an industry that is already oligopolistic should ultimately be a question for the finder of the facts. Our choice of a rule of reason test over a *per se* rule of illegality means only that the critical policy question will at least be asked and answered.

As further justification for a rule of reason test the court looked to decisions involving exclusive dealerships.[72] In *Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors, Ltd.*,[73] the Ninth Circuit concluded that it was not a *per se* violation for a manufacturer to give a distributor an exclusive franchise, even if it meant "cutting off another distributor."[74] Accordingly, the *Sylvania* majority argued that if exclusive dealerships are legal, it must also be legal to enforce the promise of exclusivity by withholding from maverick dealers, such as Continental, the power to sell from an unauthorized location within the first dealer's exclusive territory.[75] In contrast,

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67. *Id.* at 1000.

68. *Id.* at 1001.

69. Sylvania's share of the market in 1962 was 2 percent and by 1965 it was 5 percent. *Id.* at 1002.

70. *Id.* at 1001-02. An oligopoly exists when a small number of producers sell only a standardized product. United States v. E.I. duPont de Nemours & Co., 118 F. Supp. 41, 49 (D. Del. 1953), *aff'd*, 351 U.S. 377 (1956).

71. 537 F.2d at 1002. The court noted that any reduction of intrabrand competition resulting from the locations practice did not lead to the evils generally associated with an unreasonable restraint of trade because the television industry experienced both an increase in volume and a decrease in price during the critical time period. *Id.*

72. An exclusive dealership exists when a manufacturer promises not to employ another dealer or to sell to anyone else within a designated geographic area. *Id.* at 997.

73. 416 F.2d 71 (9th Cir. 1969), *cert. denied*, 396 U.S. 1062 (1970).

74. 416 F.2d at 76. *See also* Ark Dental Supply Co. v. Cavitron Corp., 461 F.2d 1093 (3d Cir. 1972); Anaya v. Las Cruces Sun News, 455 F.2d 670 (10th Cir. 1972).

75. 537 F.2d at 997. Assuming the application of a per se rule to exclusive dealerships, once a dealer is "*franchised anywhere he is franchised everywhere.*" *Id.* at 998.

The adoption of a per se rule might diminish the capacity of the small, independent franchisee to compete with the large vertically integrated giants. For example, if a single franchisee expanded and sold everywhere in violation of a contract provision, it would be impossible for other single outlet franchises of the same manufacturer to compete effectively. *Id.* at 999.

the dissent saw a distinction between a manufacturer's restricting his own behavior through the use of exclusive dealerships and restricting an independent franchisee through the use of a locations clause.[76] Concededly, a distinction between the two practices exists, but in order to insure that an exclusive dealership has its intended effect, a manufacturer must have the power to deny other dealers the right to sell within an existing exclusive territory.

The Ninth Circuit also argued that locations clauses had never been struck down for illegality.[77] For example, prior to *Schwinn*, in *Boro Hall Corp. v. General Motors Corp.*,[78] a clause which fixed the location for the sale of used cars by a dealer "at such a place as would not unduly prejudice other dealers" was held a reasonable restraint of trade.[79] Moreover, after *Schwinn*, in *Salco Corp. v. General Motors Corp.*,[80] the Tenth Circuit held that a location clause was valid as a matter of law.[81] Similarly, the Third Circuit affirmed a summary judgment in favor of an auto manufacturer against an allegation of an illegal location clause.[82]

Vertical restraints, such as "area of primary responsibility"[83] and "profit pass over"[84] clauses, are far more burdensome than location clauses.[85] Nevertheless, these restraints have been upheld under the rule of reason. Thus, lower courts have demonstrated a willingness

76. *Id.* at 1013-14 (Kilkenny, J., dissenting).

77. *Id.* at 992.

78. 124 F.2d 822 (2d Cir. 1942), *cert. denied*, 317 U.S. 695 (1943).

79. 124 F.2d at 823.

80. 517 F.2d 567 (10th Cir. 1975).

81. *Id.* at 576.

82. Kaiser v. General Motors Corp., 530 F.2d 964 (3d Cir. 1976), *aff'g without opinion* 396 F. Supp. 33 (E.D. Pa. 1975).

83. An "area of primary responsibility" is created when a dealer is responsible for a "best effort" within prescribed boundaries and the manufacturer may discontinue the franchise if the "area of primary responsibility" is not covered adequately. *See* Plastic Packaging Materials, Inc. v. Dow Chemical Co., 327 F. Supp. 213 (E.D. Pa. 1971). However, such an arrangement is not permitted if it is in substance a restraint upon alienation. *See* Hobart Brothers Co. v. Malcolm T. Gilliland, Inc., 471 F.2d 894 (5th Cir.), *cert. denied*, 412 U.S. 923 (1973) (silent understanding translated a "primary responsibility" clause into a per se illegal restriction).

84. A "profit pass over" clause requires a dealer to turn over part of the profit made on a sale outside his "area of primary responsibility" to the dealer designated for that area. *See* Superior Bedding Co. v. Serta Associates, Inc., 353 F. Supp. 1143 (N.D. Ill. 1972). *See also* White Motor Co. v. United States, 372 U.S. 253 (1963) (Brennan, J., concurring).

85. GTE Sylvania, Inc. v. Continental T.V., Inc., 537 F.2d 980, 995-96 (9th Cir. 1976), *cert. granted*, 45 U.S.L.W. 3299 (U.S. Oct. 19, 1976) (No. 76-15).

to abandon the *Schwinn* per se rule for these less than complete restraints on alienation. These courts have also evidenced a desire to look to the effect of such restraints on competition.

B. Outright Restraints on Alienation

By utilizing the specific language of *Schwinn*,[86] some courts have circumvented its broad proscriptions, even for the more onerous restraints of trade.

1. *The requirement of "firm and resolute" enforcement*

The *Schwinn* Court found that the manufacturer enforced its territorial and customer restrictions with threats that the franchise would be terminated.[87] As a result, some courts[88] have interpreted *Schwinn* to mean that enforcement of the restraints by the manufacturer is necessary to a finding of a per se illegality. Such decisions are both logical and consistent with the purposes of section 1 of the Sherman Act.[89]

In *Janel Sales Corp. v. Lanvin Parfums, Inc.*,[90] the Second Circuit held that a customer restriction[91] was not a per se violation since there was conflicting evidence as to whether the manufacturer had been "firm and resolute" in insisting on compliance with the restric-

86. It is interesting to note that the first cases to use this reasoning involved absolute customer restraints, as in *Schwinn*. *See* notes 89-90, 97 *infra* and accompanying text. However, subsequent application of the rationale of these decisions has encompassed many of the less burdensome restraints of trade. *See* notes 92, 101-102 *infra* and accompanying text.

87. The Court stated:

> It is clear and entirely consistent with the District Court's findings that Schwinn has been "firm and resolute" in insisting upon observance of territorial and customer limitations by its bicyle distributors and upon confining sales by franchised retailers to consumers, and that Schwinn's "firmness" in these reports was grounded upon the communicated danger of termination.

388 U.S. at 372.

88. *See, e.g.*, Good Investments Promotions, Inc. v. Corning Glass Works, 493 F.2d 891 (6th Cir. 1974); Colorado Pump & Supply Co. v. Febco, Inc., 472 F.2d 637 (10th. Cir.), *cert. denied*, 411 U.S. 987 (1973); Janel Sales Corp. v. Lanvin Parfums, Inc., 396 F.2d 398 (2d Cir.), *cert. denied*, 393 U.S. 938 (1968); Knutson v. Daily Review, Inc., 383 F. Supp. 1346 (N.D. Cal. 1974), *modified*, 401 F. Supp. 1374 (N.D. Cal. 1975). *See also* Reed Bros., Inc. v. Monsanto Co., 525 F.2d 486 (8th Cir. 1975), *cert. denied*, 423 U.S. 1055 (1976) (manufacturer had "firmly and resolutely" enforced its territorial restrictions).

89. *See* note 2 *supra* and accompanying text.

90. 396 F.2d 398 (2d Cir.), *cert. denied*, 393 U.S. 938 (1968).

91. The pertinent clause provided: " 'Retailer' will not, where statute or law permits such restriction, sell any of the 'Commodities' except to consumers for use." 396 F.2d at 400.

tion.[92] Similarly, in *Colorado Pump & Supply Co. v. Febco, Inc.*,[93] a manufacturer authorized a distributor to sell within a defined area. In concluding that there was no per se violation, the Tenth Circuit pointed out that there was no "firm and resolute" insistence upon the observance of the restriction.[94]

2. Dangerous products—"without more"

The *Schwinn* court stated:[95]

> Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it.

In *Tripoli Co. v. Wella Corp.*,[96] a manufacturer prohibited the resale of beauty and barber supplies to nonprofessional users. The Third Circuit reached for the "without more" language of *Schwinn*, found that "there [was] more"[97] due to the potential danger of the product to uneducated consumers,[98] and held that the restriction was to be treated under the rule of reason.[99] In a similar case, the Court of Claims citing *Tripoli* held that the rule of reason must be applied to vertical restraints on the resale of drugs.[100] At least one state court has extended this concept and judged vertical restraints, used to maintain quality control, under the rule of reason.[101]

C. New or Failing Company Defense

Schwinn itself made specific reference to two exceptions to the per se rule (*i.e.*, the new or failing company exceptions).[102] Although not

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92. *Id.* at 406.

93. 472 F.2d 637 (10th Cir.), *cert. denied*, 411 U.S. 987 (1973).

94. *Id.* at 639. The court went on to hold that the territorial provision was nothing more than a "description of a primary marketing territory" and therefore, was not a per se violation. *Id.*

95. 388 U.S. at 379.

96. 425 F.2d 932 (3d Cir.), *cert. denied*, 400 U.S. 831 (1970).

97. 425 F.2d at 936.

98. *Id.*

99. *Id.*

100. Carter-Wallace, Inc. v. United States, 449 F.2d 1374, 1380 (Ct. Cl. 1971). *Contra*, United States v. Glaxo Group Ltd., 302 F. Supp. 1 (D.D.C. 1969), *rev'd on other grounds*, 410 U.S. 52 (1973).

101. La Fortune v. Ebie, 26 Cal. App. 3d 72, 102 Cal. Rptr. 588 (2d Dist. 1972).

102. Generally, the failing company defense has been applied to mergers or acquisitions which would otherwise violate section 7 of the Clayton Act. *See* 537 F.2d at 1004 n.41. It is basically a "lesser of two evils" approach, in which the possible anticompetitive effects of the

applicable to the *Schwinn* facts, proof that a company is new or failing is relevant to a showing that a vertical restraint is not anti-competitive and is accordingly sheltered by the rule of reason.[103]

In *Sylvania*, the manufacturer sought a failing company instruction, arguing that it would be forced to abandon its business if it were not allowed to increase its share of the market through the imposition of the dealer-location clauses.[104] The court noted the existence of the failing company defense,[105] but concluded there was no need for a jury instruction incorporating the defense, because a new trial had been ordered under the rule of reason.[106] By looking to the procompetitive effect of the location clause,[107] however, the majority silently adopted the reasoning of the failing company exception.[108] Thus, even though Sylvania's actions led to a restraint of trade, the court permitted them in order to avoid the loss of a competitor. Therefore, the court preserved competition in the industry.[109]

IV. Interpreting the Per Se Rule

Controversy abounds as to the application of the per se rule. While some jurists attempt to avoid the effects of such a rule,[110] others strictly construe *Schwinn* to mean that all post-sale vertical

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merger are deemed preferable to the potential adverse impact on competition, if the company failed. United States v. General Dynamics, 415 U.S. 486, 507 (1974). The Clayton Act test for a failing company is, first, that its resources be "so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure," International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930), and second, that there was no other prospective purchaser for it. Citizen Publishing Co. v. United States, 394 U.S. 131, 138 (1969). Thus, a merger between a financially stable corporation and a failing one which is no longer a competitive factor can be upheld under the Clayton Act. *See* Brown Shoe Co. v. United States, 370 U.S. 294, 319 (1962).

103. 388 U.S. at 374.

104. 537 F.2d at 1017 (Kilkenny, J., dissenting).

105. *Id.* at 1004 n.41.

106. *Id.*

107. *See* notes 67-71 *supra* and accompanying text.

108. *See* note 103 *supra*.

109. It should be noted that this argument parallels similar concerns expressed under section 7 of the Clayton Act. Thus, the primary goal of the Clayton Act is the preservation of *competition* and not necessarily *competitors*. Accordingly, although a merger leads to one less competitor, it would be prevented only if it tended to lessen competition. Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962). Note however, in cases like *Sylvania* the continued existence of the competitor necessarily insures the preservation of competition due to the oligopolistic nature of the industry.

110. *See* text accompanying notes 42-109 *supra*.

restraints are prohibited.[111] Judge Kilkenny, in his *Sylvania* dissent, argued that *United States v. Topco Associates, Inc.*,[112] a case involving horizontal restraints, "strengthened and extended the *Schwinn* per se rule against territorial restrictions."[113] He took issue with the procompetitive policy argument[114] of the *Sylvania* majority and stated:[115]

> . . . [T]opco stands for the rule that restricted intrabrand competition cannot be justified by alleged interbrand competitive gain . . . [and that] the preservation and encouragement of intrabrand competition, [is] a desirable end in itself.

Topco was an association of supermarkets engaged in procuring and distributing food items under brand names owned by Topco, in order to compete more effectively with larger national and regional chains.[116] Each member agreed with Topco to the designation of a territory in which that member could sell Topco brand products.[117] Although striking down the territorial restrictions, the Court emphasized that a per se violation existed because the restraint was essentially horizontal and not vertical.[118] Horizontal restraints have traditionally been per se violations[119] and thus the case is easily distinguished from both *Schwinn* and *Sylvania*.

In his *Sylvania* dissent, Judge Kilkenny also stated that *Cooper Liquors, Inc. v. Adolph Coors Co.*,[120] ". . . reaffirms the *Schwinn* dogma that the Supreme Court has 'set its face against both horizontal and vertical territorial restrictions' . . . ."[121] However, the Fifth Circuit found that Coors' system of exclusive regional distributorships had the effect of maintaining control over the wholesale and retail prices of its beer.[122] Price fixing is another traditional per se violation.[123] Therefore, any restraint accompanied by price fixing is

111. *See* text accompanying notes 113-123 *infra*.
112. 405 U.S. 596 (1972).
113. 537 F.2d at 1012 (Kilkenny, J., dissenting) (citation omitted).
114. *See* notes 67-71 *supra* and accompanying text.
115. 537 F.2d at 1015 (Kilkenny, J., dissenting).
116. 405 U.S. at 599.
117. *Id.* at 602.
118. *Id.* at 608.
119. *See* note 2 *supra* and accompanying text.
120. 506 F.2d 934 (5th Cir. 1975).
121. 537 F.2d at 1013 (Kilkenny, J., dissenting).
122. 506 F.2d at 944.
123. *See* note 8 *supra*. *See also* Bowen v. New York News, Inc., 366 F. Supp. 651 (S.D.N.Y. 1973), *modified*, 522 F.2d 1242 (2d Cir. 1975), *cert. denied*, 44 U.S.L.W. 3593 (U.S. Apr. 20, 1976) (No. 76-41).

illegal regardless of its reasonableness. Accordingly, *Coors* is factually and legally distinguishable from both *Schwinn* and *Sylvania*.

V. Conclusion

The creation and application of an absolute per se rule with regard to all post-sale vertical restraints is not justified. Instead, restraints affecting trade require the weighing of the procompetitive and anticompetitive effects of the restraint, in order to determine what result is best for a particular industry and for society as a whole.

Enlightened decisions[124] dealing with less offensive restraints of trade, and decisions[125] which look to the specific language of *Schwinn* to reach a contrary result are part of a trend to abandon the per se rule for a more result-oriented approach. These cases indicate an awareness of the "economic and business stuff"[126] which governs the business world. Such an analysis benefits the business giants, the single proprietorships, and ultimately the consumers.[127] Thus, the Supreme Court should reexamine the *Schwinn* per se rule and end its broad proscriptions.

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124. *See, e.g.*, GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980 (9th Cir. 1976), *cert. granted*, 45 U.S.L.W. 3299 (U.S. Oct. 19, 1976) (No. 76-15).

125. *See, e.g.*, Tripoli Co. v. Wella Corp., 425 F.2d 932 (3d Cir.), *cert. denied*, 400 U.S. 831 (1970); Janel Sales Corp. v. Lanvin Parfums, Inc., 396 F.2d 398 (2d Cir.), *cert. denied*, 393 U.S. 938 (1968).

126. *See* note 11 *supra*.

127. *See* text accompanying notes 62-71, 110 *supra*.