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The Sherman Antitrust Act\(^1\) was passed at a time when giant trusts were monopolizing major portions of the United States economy.\(^2\) The passage of the Act reflected a social decision that competitive market processes should operate freely and without restraint to achieve the desired goals of the consuming public.\(^3\) Although the original thrust of the Act was aimed at obvious monopolizing practices, anti-competitive techniques in today's society have become much more subtle and more difficult to define. Not only have antitrust laws continued to direct their attention toward monopolies and attempts to monopolize, they have also attempted to prohibit a wide range of restraints placed upon competition through agreements or contractual arrangements which are inconsistent with modern social values. Recently, challenges to the effects of vertical restrictions\(^4\) placed by manufacturers upon their distribution processes in attempts to stimulate the sale of their products have embroiled the practicing attorney and the economist alike in a continuing controversy over the effects that such restraints have upon competition,\(^5\) and over the judi-

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3. The ultimate aims of antitrust policy can be broken down into four broad classes: the attainment of desirable economic performances; the achievement and maintenance of competitive process in the marketplace; the prescription of a standard of business conduct, that is, a code of fair competition; and the prevention of undue growth of big business. C. Kayser & D. Turner, *Antitrust Policy* 11-20 (1959). "The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions." Northern Pacific Ry. v. United States, 356 U.S. 1, 4-5 (1958). "[W]e cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision." Brown Shoe Co. v. United States, 370 U.S. 294 (1962).
4. Vertical restrictions are those imposed upon or by persons at different levels of the market. These must be distinguished from horizontal restrictions that operate among competitors at the same level of the market. ABA Antitrust Section, *Monograph No. 2, Vertical Restrictions Limiting Intrabrand Competition* 2 (1977).
5. The major controversy surrounds the effects such restraints have upon *intrabrand*
cial rules for analyzing these restraints. The purpose of this comment will be to review vertical restrictions and their effects upon competition, the changes that recent decisions will have upon the method of analysis and the areas within which practitioners should be knowledgeable in order to analyze business decisions that could result in antitrust violations.

Economic Background

Antitrust laws and economic analysis are inextricably tied together, not only in examining the particular restraint in question, but also in evaluating how well the antitrust laws have served society's perceived goals. One major social goal advanced by antitrust law is the maintenance of a competitive economy. To understand the forces that affect the economy, economists have developed various models to reflect what they believe happens in the marketplace. Although the theories developed from these models are useful as a starting point, the practitioner should remember that economic realities rarely involve such easy determinations as the ideal models portray. However, the attorney must be able to understand and apply these basic economic theories.

Economists believe that the unfettered operation of the market system will decide what goods will be produced, how scarce resources will be allocated among those goods, and for whom the various goods will be produced. The underlying proposition of the market system is that the consumer will decide what and how much will be produced, and that competition among manufacturers will determine who will produce it.

6. The two major methods of analysis developed by the courts are the per se and rule of reason tests. For a further discussion of these methods, see notes 47-57, infra, and accompanying text.


8. Competition operates to keep private markets working in ways which are socially acceptable. Under ideal conditions, private markets would encourage efficient resource allocation, stimulate the use of efficient methods of production and distribution, and encourage a progressive technology and high productivity. L. Sullivan, supra note 7, at 21. See note 3, supra.

9. The models are analyzed under ideal conditions by making certain basic assumptions and by holding all variables constant except the ones to be tested. P. Samuelson, supra note 7, at 68-70.

10. See generally E. Gellhorn, Antitrust Law and Economics 41 (1976); P. Samuelson, supra note 7, at 15-16.

11. E. Gellhorn, supra note 10, at 41.
Assumptions involving the concepts of scarcity\(^1\) and basic price theory\(^2\) reflect that resources are not unlimited, that they must be allocated among the various production possibilities, and that prices are the coordinating mechanism for the market, because every good, resource, or service, has a price.\(^3\) The price of an individual product is determined by the interaction of supply and demand: how much will be demanded\(^4\) and how much will be willingly supplied\(^5\) at a given price. If all other factors remain constant, an equilibrium price\(^6\) can be established. If the price is too low or too high, forces within the market will bring it back to the equilibrium point.\(^7\) In this sense, supply and demand in the marketplace determine the price of the product.

The behavior of markets cannot properly be analyzed without an explanation of the behavior of consumers and business firms within the market, because their behavior is important in understanding the

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\(^1\) The law of scarcity recognizes the fact that there are not enough resources to produce everything in unlimited amounts. Therefore, a decision must be made as to what kind and what amounts of goods will be produced, and what will not be produced. E. GELLHORN, supra note 10, at 44; P. SAMUELSON, supra note 7, at 16.

\(^2\) Price theory is the concept that the pricing mechanism, working through supply and demand in the competitive market, will answer the questions of what kinds of, how many and for whom products will be developed, produced, and distributed. E. GELLHORN, supra note 10, at 45; P. SAMUELSON, supra note 7, at 42.

\(^3\) P. SAMUELSON, supra note 7, at 42.

\(^4\) The demand schedule reflects the relationship between the market price of a good, and the quantity demanded of that good by consumers. The quantity demanded varies inversely with the price. With other variables held constant, this would mean that the higher the price charged for a good, the less quantity people will be willing to buy. E. GELLHORN, supra note 10, at 59; P. SAMUELSON, supra note 7, at 59-60.

\(^5\) The supply schedule reflects the relationship between the market price of a good, and the amounts of that good that producers are willing to supply. The quantity supplied varies directly with the price. Again holding other variables constant, the higher the price of a good, the more goods producers will be willing to supply. E. GELLHORN, supra note 10, at 60; P. SAMUELSON, supra note 7, at 61.

\(^6\) See note 18, infra.

\(^7\) When the supply and demand schedules are combined, an equilibrium price is reached. This is the only price where the amount willingly supplied equals the amount willingly demanded. If the price is above the equilibrium price, more will be supplied than demanded. As stocks of merchandise build up, some sellers will be willing to undercut the going price, thus the price will fall, but it will not be reduced to zero. If the price of the product falls below the equilibrium price, more will be demanded than supplied. The consumers will bid more for the amount available, thus the price will rise. At any price other than the equilibrium point, forces within the market (assuming that consumers and suppliers will act according to the underlying assumptions) will bring the price back to the equilibrium point. E. GELLHORN, supra note 10, at 63; P. SAMUELSON, supra note 7, at 62-63.
problems of resource allocation. Basic to this analysis is that each consumer has many tastes and desires for a wide variety of services and products. Economists proceed under the assumption that the consumer will attempt to maximize his needs and desires in terms of his available income. As a function of the total dollar amount available, the consumer will buy a mixture of goods and services that maximizes his marginal utility. This does not mean that if a particular product increases in price, the consumer will do without it, for he may be willing to have less of one type of good to obtain more of another. However, as the price of that good continues to rise, at some point the consumer will demand less of that good or will substitute a comparable item for it.

On the suppliers/producers side, economists proceed under the assumption that a firm will usually seek to maximize its profits. Normally, profits are determined through the interaction of the firm's costs of production and the price at which the finished product can be sold. Here, costs of production include not only the raw materials, overhead and administration costs, and costs of distribution, but also a normal return of profit. The more efficiently the firm produces the product, the better profit margin it can expect.

19. Here, the objective of antitrust law in assuring a competitive economy is based upon the belief that through competition, consumer wants will be satisfied at the lowest price with the sacrifice of the least amount of scarce resources. E. Gellhorn, supra note 10, at 41-51.

20. Various concepts have been developed to explain the law of downward-sloping demand. Marginal utility is the amount of additional utility provided by an additional unit of economic good or service. The concept of diminishing marginal utility demonstrates the consumer's tendency to maximize his total utility for all goods where there is equality of each and every good's marginal utility per dollar. Total utility rises with each new marginal addition of a good but at a decreasing rate of growth. With equal additions to a good's quantity, its marginal utility tends to decrease. To get the most total utility, the consumer must achieve a fundamental marginal condition for demand equilibrium: A consumer has not maximized his well-being until he has succeeded in making equal the respective marginal utilities per dollar spent on each and every good. P. Samuelson, supra note 7, at 417-24, 427-28.

21. The explanation of the downward-sloping demand curve can also be broken down into its substitution-effect and income-effect components without resorting to the marginal utility concept. The substitution effect occurs when the price of the good rises while other prices of goods remain the same. At some point, the consumer will substitute relatively cheaper products. The income effect takes place when a consumer has a fixed income and the price of a good increases. If the consumer continues to buy the good, this results in a decrease in his real income. With a lower real income, he will now want to buy less of that good. Id.

22. P. Samuelson, supra note 7, at 517-22.

23. Such factors are explained by the economic theory of production. Producers want to have efficient production because this will usually mean higher profits. With the price
will continue to produce as long as the last item produced will increase the firm’s profits.

In addition to analyzing the process of establishing the market price, economists further extend their examinations into the areas of performance, conduct, and structure of the overall marketplace to explain the interaction of these basic elements within the market and the orderly market behavior brought about by competition. This type of analysis provides useful concepts and analytical techniques for determining whether competition is present and whether certain kinds of market structures or conduct are consistent with the overall objective of maintaining competition. Perhaps the most important area for the practitioner to understand is the market structure, which encompasses market characteristics and organization. The more common models include pure competition, oligopoly, monopolistic competition, and stable at the equilibrium point in the supply and demand schedules, greater efficiency means less costs. The gap between costs and price will widen as long as the firm keeps becoming more efficient. The firm will make profits as long as its marginal revenue exceeds its marginal cost. This result exists where the last item of production brings in more funds than it cost to be made. Id.

24. Micro-economics deals with these terms in a subdivision called industrial organization. Market performance deals with such questions as the relationship between costs and prices, price elasticities of demand and supply, whether there are adequate resources available for production, and whether technology is efficient and progressive. How the firm responds to various stimuli in the marketplace, is called the firm’s market conduct. Market structure describes the way the market is organized and the basic characteristics each type of market possesses. L. Sullivan, supra note 7, at 22.

25. E. Gellhorn, supra note 10, at 76.
27. L. Sullivan, supra note 7, at 24.
28. Pure competition is characterized by a large number of buyers and sellers, none of whom can affect the market price of the product by varying the quantity demanded or supplied. Other characteristics include a homogeneous product; perfect information about the prices and nature of the goods sold; and complete freedom of entry into the market. Since no single firm can affect the price, all are price takers and can control only their output and efficiency of operation to increase their profits. The firm will produce until its marginal cost equals the market price. This maximizes consumer satisfaction by using resources in the most efficient manner. See generally E. Gellhorn, supra note 10, at 79-87; P. Samuelson, supra note 7, at 467; L. Sullivan, supra note 7, at 25.

29. The oligopoly market structure is characterized by a few sellers with a somewhat differentiated product. Rather than acting alone and not being able to affect the market price, each firm considers the reaction of the others in the market before making its own output and pricing decisions. With just a few firms, if one firm raised its prices and the others retained the old price, consumers would switch to a comparable, but lower priced good. Therefore, the firm would have to lower its prices to regain its relative position. Although a firm which lowered its prices might sell more for a short term, the others would also lower their prices and the relative market shares would remain the same. Oligopolists
monopoly. Under the assumption that firms will seek to maximize their profits, the ideal situation from the firm’s viewpoint would be the monopoly position, for this structure produces supra-normal profits. However, the most socially desirable position is that of pure competition, which permits only normal profits. This basic conflict between the goals of businessmen and society in general was the motivating cause in the development of antitrust laws, for society quickly learned that businessmen, left unsupervised, would not be content to let the free operation of the marketplace determine their profit margins. The antitrust laws themselves are legislative acknowledgements that competition within the marketplace was not working because of the restraints placed upon it.

Antitrust Law

The fundamental premise underlying antitrust law is that “competition,” which the antitrust laws are designed to promote and protect, is realize that they are interdependent upon each other and that only through concerted action can they receive higher than normal profits. See generally E. Gellhorn, supra note 10, at 102-08; P. Samuelson, supra note 7, at 469; L. Sullivan, supra note 7, at 26.

30. The monopolistic competition model is an attempt to reconcile the difference between the two extremes of competition and monopoly. Whereas in the pure competition model there is a homogenous product, and in the monopoly model there is a unique product, monopolistic competition is based upon each firm having a similar product, but each product being differentiated through various sales techniques. The many sellers do not engage in price competition, but compete vigorously in non-price competition. While such efforts eliminate the supra-normal profits of each firm, the price remains the same to consumers. See generally E. Gellhorn, supra note 10, at 98-102; P. Samuelson, supra note 7 at 469.

31. The monopoly market structure is characterized by a single seller; a unique product; substantial barriers to entry; and imperfect market knowledge. Whereas the firm in the pure competition situation takes the price as given, the monopolist considers the market price in determining his output, because he can set the market price. The pure competition firm will produce until its marginal cost equals the market price; the monopolist will produce until his marginal cost equals his marginal revenue. The price at such output will be above that in a competitive situation, producing supra-normal profits for the monopolist. See generally E. Gellhorn, supra note 10, at 87-93; P. Samuelson, supra note 7, at 468-69; L. Sullivan, supra note 7, at 25-26.

32. See note 23, supra, and accompanying text.

33. To be able to demand higher prices, the firm must have some amount of market power. Whether a seller possesses such power depends upon the reaction of buyers to price changes. Buyer reaction, in turn, will depend upon the availability of substitutes. Monopoly power not only allows the firm to control prices in the market, but also includes the ability to exclude competition by creating barriers to entry. L. Sullivan, supra note 7, at 30-33.

34. See note 3, supra.
equivalent to the “free market”—the unrestrained rivalry of independent business concerns.\textsuperscript{35} Competition “without restraint” implies the absence not only of anti-competitive actions by firms, whether acting alone or in concert, but also of intrusive actions by government agencies. Maintaining an economy capable of functioning effectively without creating an abundance of supervisory political control is therefore the goal.\textsuperscript{36} A properly operating market would thus achieve both social\textsuperscript{37} and political objectives.\textsuperscript{38} While pure competition would \textit{seem} to be the ideal structure for the attainment of these goals, competition in a pure form rarely, if ever, exists. The question thus becomes to what extent the market can deviate from the ideal and still achieve the desired objectives.

In response to public dissatisfaction with the economic power attained by certain firms and combinations of firms in the late 1880’s, Congress enacted the Sherman Antitrust Act.\textsuperscript{39} Although the Act was aimed at the obvious anti-competitive effects of monopolies and attempts to monopolize\textsuperscript{40} prevalent at that time, it also contained a broad provision that made a wide variety of activities to restrain competition illegal. Section 1 of the Sherman Antitrust Act of 1890 provides:

\begin{quote}
Every contract, combination, . . . or conspiracy, in restraint of trade or commerce; . . . is hereby declared to be illegal . . . .
\end{quote}

From such relatively simple language has sprouted a multitude of legal and doctrinal opinions concerning the meaning and the proper scope of review that should be applied in determining which action is a “restraint


\textsuperscript{36} \textit{Id.} The purpose of the Sherman Act is to insure the “unrestrained interaction of competitive forces” which will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress while at the same time providing 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).

\textsuperscript{37} The major social objectives include efficient allocation of resources, maximum consumer satisfaction and minimum maldistribution of wealth. Blake & Jones, \textit{supra} note 35, at 381-84. See note 3, \textit{supra}.

\textsuperscript{38} The major political objectives include avoiding governmental management of privately owned enterprises; avoiding concentration of economic power in the hands of a few; and enlargement of individual liberty. Blake & Jones, \textit{supra} note 35, at 381-84.


\textsuperscript{40} Section 2 of the Sherman Act provides:

\begin{quote}
Every person who shall monopolize, or attempt to monopolize . . . any part of the trade or commerce . . . . shall be deemed guilty.
\end{quote}

\textsuperscript{41} 15 U.S.C. § 1 (1970). This language of the Sherman Act has been interpreted as establishing the “rule of reason as the prevailing standard of analysis.” Continental T.V., Inc. v. GTE Sylvania Inc., 97 S. Ct. 2549, 2557 (1977).
Justice Peckham in *United States v. Trans-Missouri Freight Ass'n* read the statute literally and insisted that the Act outlawed every restraint, regardless of its reasonableness. On the other hand, Justice White, writing for the majority in *Standard Oil Co. of New Jersey v. United States* and *United States v. American Tobacco Co.*, advocated the position that only such restraints which unreasonably affected commerce were unlawful. Under this view even a significant restraint of trade would not violate the Act if it could be shown to have redeeming features that would outweigh the injury to competition. The prevailing position today, one generally developed along the lines of Justice White's viewpoint, is that the Sherman Act bans all concerted arrangements which are adopted for the purpose of reducing competition, or which, regardless of purpose, have a significant tendency to reduce competition, but that arrangements which are adopted for and tend to achieve other purposes do not fall within the condemnation of the Act merely because of some incidental and inconsequential restraining effect on competition.

In evaluating a restraint upon competition, two basic methods of analysis have developed. The rule of reason test, generally attributed to Justice White, in essence provides that only those restraints which are unreasonably anti-competitive or which significantly restrict competition are illegal under the Sherman Act. The rule of reason and the factors to be considered in using this method were perhaps best explained by

42. The Supreme Court in *Standard Oil Co. v. United States*, 221 U.S. 1, 52 (1911), has indicated three principal concerns that the court should look to in determining whether a particular restraint impairs competition. These are: "(1) The power . . . to fix the price and thereby to injure the public; (2) [The power to impose some] . . . limitation on production; and (3) The danger of deterioration in quality . . . which . . . [is] the inevitable resultant of the monopolistic control over . . . [an article's] production and sale." See generally MONOGRAPH, supra note 4, at 26.

43. 166 U.S. 290 (1897).

44. 221 U.S. 1 (1911).

45. 221 U.S. 106 (1911).

46. For a good review of the historical basis of this area, see generally Bork, The Rule of Reason and the Per Se Concept: Price Fixing and Market Division (pt. 1), 74 YALE L.J. 775, 785-805 (1965) [hereinafter cited as Bork I].

47. L. SULLIVAN, supra note 7, at 166.

48. But see Bork I, supra note 46, at 785. Professor Bork believes that a careful reading of Justice Peckham's opinions would reveal that the honor of establishing the rule of reason belongs to him.

49. L. SULLIVAN, supra note 7, at 186-87. Under this rule, the fact-finder weighs all the circumstances of a case to decide whether a restrictive practice should be prohibited for
Justice Brandeis in *Chicago Board of Trade v. United States*:

[T]he legality of an agreement or regulation cannot be determined by so simple a test, as whether it restraints competition. Every agreement concerning trade, every regulation of trade, restraints. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.

This statement of the rule is exceedingly general and does not afford the practitioner any degree of certainty about the objective factors to be considered in determining the "purpose" of the restraint, the "facts peculiar to the business," the "effects" of the restraint, or the competing "conditions" of the industry. However, *Chicago Board of Trade* does provide a general framework which includes such inquiries as:

1. Identify specifically the practice involved.
2. Determine the purpose of the restraint.
3. Identify the effects of the practice.
4. Determine whether, on balance, the restriction imposed substantially impedes competition.

As a result of the complexity and uncertainty in analyzing massive amounts of economic data, and as an attempt to balance the competitive and anti-competitive effects of the restraints, a second rule of analysis was developed. The per se rule recognizes that some restraints, because of their proven anti-competitive effect, are unlawful as a matter of law. As classically stated by Justice Black in *United States v. Northern Pacific Railway*:

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50. 246 U.S. 231 (1918).
51. *Id.* at 238.
[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of per se unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable—an inquiry so often wholly fruitless when undertaken.\textsuperscript{54}

The per se rule would thus foreclose any further inquiry into the reasonableness of the restraint or practice once it is established that:

1. The practice if effective is likely in the great generality of cases to cause substantial injury to competition; and

2. An inquiry into whether the practice in this instance is injurious to competition would be complex, time consuming, costly and, in the end, uncertain.\textsuperscript{55}

Basically, the per se method represents a value judgment by the courts that the anti-competitive effects of the particular practice in question outweigh its purported justifications.\textsuperscript{56} Due to the severity of attaching a per se label to a particular restriction, "[i]t is only after considerable experience with certain business relationships that courts classify them as per se violations of the Sherman Act."\textsuperscript{57} While over the years the courts have declared a number of practices between competitors to be per se violations,\textsuperscript{58} the area of vertical restrictions in the distri-

\textsuperscript{54} Id. at 5.

\textsuperscript{55} L. SULLIVAN, supra note 7, at 193.

\textsuperscript{56} Comanor, \textit{Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath}, 81 H\textsc{arv}. L. \textsc{R}e\textsc{v}. 1419, 1420 (1968). Recently the Court noted that, "Per se rules thus require the Court to make broad generalizations about the social utility of particular commercial practices. The probability that anti-competitive consequences will result from a practice and the severity of those consequences must be balanced against its pro-competitive consequences. Cases that do not fit the generalization may arise, but a \textit{per se} rule reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them. Once established, \textit{per se} rules tend to provide guidance to the business community and to minimize the burdens on litigants and the judicial system of the more complex rule of reason trial." Continental T.V., Inc. v. GTE Sylvania Inc., 97 S. Ct. 2549, 2558 n.16 (1977).


\textsuperscript{58} Horizontal Price Fixing Arrangements: Kiefer-Stewart Co. v. Joseph E. Seagram \& Sons Inc., 340 U.S. 211 (1951); United States v. Socony-Vacuum Oil Co., 310 U.S. 150
Distribution Arrangements

When the production processes are completed, the finished product is ready for distribution to the consuming public. Distribution systems, in addition to performing other economic functions, provide the delivery mechanism for effecting the physical transportation of the product from the manufacturer to the purchaser, and to be successful, necessarily involve certain basic requirements. The distribution systems available to the manufacturer range from dealings with independent distributors to the manufacturer's personal operation of the entire marketing process. However, not all options are open to every manufacturer. Since every system will incur costs in the performance of its functions, the availability of capital, managerial control, cost efficiencies, and the product's basic character interact to determine the best distribution system for each manufacturer.

The basic character of the product, whether it is deemed a convenience or shopping good, will determine whether the manufacturer

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59. Professor Strasser has identified the economic functions of a distribution system as including: (1) Delivery—includes the buying, selling, transporting, and other logistical operations; (2) Sorting—the matching of consumer preferences to a particular quality-product mix; (3) Services—includes pre-sale and post-sale repair; (4) Risk Taking and Insurance—risk that the products won't be sold and insuring the goods while moving through the system; and (5) Management Information—information for those in authority to make price and other marketing decisions. Strasser, Vertical Territorial Restraints After Sylvania: A Policy Analysis and Proposed New Rule, 1977 Duke L.J. 775, 785-86.

60. The most important requirement is that it function as a coordinated system rather than as a group of independent businesses. Other requirements include the ability to solve intra-channel conflicts, the necessity of some sort of channel leadership, and the retention of flexibility to meet dynamic market situations. Id. at 786-88.


62. Convenience goods are usually relatively low-priced impulse goods and are generally sufficiently standardized for the customer to accept another brand if the one he prefers is not in stock. Therefore, greater exposure of the product increases the likelihood of more numerous sales. Id.

63. Shopping goods are relatively expensive items and the purchaser is usually willing to shop around and compare prices and brands. He will sometimes travel a considerable distance before making his decision. Id.
wants an intensive or selective distribution. Given the type of good, the method best suited for that good, and the relative market, the distribution system chosen by the manufacturer depends upon a comparison of the relative operating costs of such a self-operated system with the cost of using independent distributors.

Another important consideration in the selection process is that of control. Until the product is ready for distribution, the manufacturer exercises exclusive control over every decision affecting it. The degree of control he retains also depends upon the distribution method. This ingredient must be viewed against the background of the economic processes for determining price, because the degree of control the manufacturer retains increases the expenses of the distribution system. To maintain absolute control over the price and the number of resale sales outlets, the manufacturer would have to operate a complete vertically integrated system for merchandising the product. At the other extreme, a manufacturer may exercise no control by selling to independent distributors, thus allowing them to set prices and locations for resale. Restrictive distribution arrangements are intermediate forms of vertical market control which allow manufacturers to maintain some control over certain managerial decisions affecting the product while relinquishing control over others. Through a wide variety of contractually ar-

64. Intensive distribution involves attempting to place the product in as many retail outlets as possible. However, the cost of distribution increases with the number of outlets. Id.

65. A manufacturer who uses selective distribution limits the number of outlets for his product which in turn decreases the costs of distribution. The most extreme form of selective distribution involves the use of exclusive territories. Although selective distribution tends to lower costs of distribution, it normally tends to restrict or eliminate competition among the various sellers of the manufacturer's products. This reduction of intrabrand competition is one of the major areas of concern for the opponents of vertical restrictions under the antitrust laws. Id.


67. See notes 13-18, supra, and accompanying text.


69. One commentator in discussing why a supplier would prefer a restrictive arrangement to the complete control of a distribution outlet through vertical integration, found three characteristics of distribution arrangements of paramount importance: (1) that distribution is a relatively low-profit activity; (2) that distribution is typically a multiproduct activity, with the product mix of distributors substantially different from that of any one supplier; and (3) that the local managerial problems and personal service content of distribution discourage suppliers from integrating forward when other alternatives are available. Preston, supra note 68, at 512.
ranged vertical restrictions and the business relationships\textsuperscript{70} within which they are used, manufacturers have sought the advantages of vertical integration without the accompanying disadvantages of the capital expenditure and costs associated with operating the vertical system.

**Vertical Restrictions**

Although the antitrust laws have not often been applied to extreme arrangements of independent dealings and vertical integration,\textsuperscript{71} they have been concerned with vertically restrictive distribution arrangements and the possible adverse effects such restrictions could have upon competition. The economic justifications for a particular type of restraint in such a vertical situation and the economic effect that restraint has upon \textit{intra}brand\textsuperscript{72} and \textit{inter}brand\textsuperscript{73} competition are varied. Although economists and commentators alike have extensively analyzed and debated the reasons and effects of the restraints and the applicable standard for evaluating them, very little agreement has resulted.\textsuperscript{74}

\textsuperscript{70} Many of the business relationships in which such restrictions are used are frequently referred to by the term "franchise." The Ad Hoc Committee on Franchising identified three distinct types of franchises: (1) Those that are primarily concerned with an effective method of distributing the franchisor's products, \textit{i.e.}, automobiles, bicycles; (2) Those that establish retail outlets where the franchisor is principally selling a name and method or format of doing business, \textit{i.e.}, restaurants, motels, and serving organizations; and (3) Those that establish manufacturing or processing plants, \textit{i.e.}, soft drink field, mattress manufacturing. MONOGRAPH, \textit{supra} note 4, at 1 n.2. Although franchising may take many different forms, most franchise arrangements share four characteristics: (1) the franchisee is an economically dependent but legally independent member of the system; (2) the franchise business is operated with the name and standardization advantages extended by the franchisor; (3) the franchisee's business came into being to sell the franchisor's product or service; and (4) there is typically a formal agreement and continuing relationship between the parties. Strasser, \textit{supra} note 59 at 790. \textit{See generally} L. SULLIVAN, \textit{supra} note 7, at 399-401.

\textsuperscript{71} This is assuming that the independent dealings are a result of arms length bargaining. If otherwise, then there would be a concern. Also, if the manufacturer had a monopoly, it would be subject to antitrust scrutiny.

\textsuperscript{72} \textit{Intrabrand} competition occurs between different manufacturers or sellers of the same brand of product.

\textsuperscript{73} \textit{Interbrand} competition exists among different manufacturers or sellers of different brands of products.

General explanations for the manufacturer's behavior in restricting competition among his distributors include his desire to increase the amount of nonprice competition to stimulate the provision of point-of-sales services, and his belief that the restraint will increase net revenues by increasing efficiency. Frequently cited justifications for the restrictions include the desire to obtain market access/dealer investment, to eliminate the "free-rider" problem, to increase distributors' sales efforts, and to determine quality and character of dealer services. Professor Posner, supra note 74, at 283. Professor Posner explains that point-of-sales services can be stimulated by setting a minimum retail price but not restraining nonprice competition. Dealers will then increase nonprice competition in an effort to engross as much as possible between the retail price and the cost of distribution, i.e., their profit margin. Dealers will continue spending more on nonprice competition until the marginal cost of distribution has risen to meet the resale price. When that point is reached, the retailers will not be receiving any monopoly profits; instead they will be furnishing the level of services desired by the manufacturer. As an alternative to retail price fixing, granting exclusive sales territories while enacting a dealer commitment to provide the desired point-of-sales service would reach the same result. Id. at 283-85. It must be noted that this method only eliminates the monopoly profits among the dealers. It does not help the consumer because he is still paying for the product at the monopoly price.

With certain restrictions, the manufacturer might obtain access to markets that would otherwise be closed to him. This argument proceeds under the theory that distributors would be unwilling to handle a manufacturer's product unless they were afforded some protection against ruinous intrabrand competition. Dealers could justifiably believe that in the absence of vertical restrictions, "cutthroat" intrabrand competition from other dealers would drive down prices, render their operations unprofitable, and thus endanger their capital investment. GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 1003 n.37 (9th Cir. 1976) (en banc).

Under the "free rider" theory, vertical restrictions are necessary to prevent dealers from invading the territories of other dealers by choosing to rely on the promotional efforts of those other dealers rather than undertaking costly selling activities themselves. It is argued that without such restrictions, dealers will not provide advertising or repair facilities as extensively as they would if assured that invading dealers will not pirate the benefits of these promotional activities. GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 1003 n.37 (9th Cir. 1976) (en banc).

It is argued that vertical restrictions encourage total sales effort on a dealer's part by facilitating more concentrated and intense coverage of each geographic market, thus leading to increased sales of the manufacturer's products. Sales to large customers located close to the dealer cost less than sales to smaller, more distant customers. The manufacturer benefits if all customers are charged an identical
ponents of vertical restrictions also argue that they actually increase overall competition by promoting interbrand competition more than they reduce intrabrand competition. Opponents counter with the argument that restraints on the freedom of distributors to sell their products are on their face violations of the antitrust laws. Vertical restrictions are criticized not only for eliminating intrabrand competition but also, through their effect upon product differentiation, for limiting interbrand competition. Moreover, some commentators consider the economic effects of vertical territorial and customer restraints to be similar to those of horizontal market division and vertical price fixing.

As a result of this debate over the effects that such vertical restrictions have upon competition, two different schools of economic thought have developed. On the one side, Professor Comanor argues that vertical restrictions lead to a serious misallocation of resources and that consumers should be the ones to decide what goods will be sold and what services will be provided by dealers. On the other side, Professor Bork argues that the manufacturer should decide how his product is distributed and that vertical restrictions are a source of efficiency themselves and do not misallocate resources.

price and the dealer's savings from sales to the choice customers offset the higher costs incurred in sales to others. Vertical territorial restrictions are thus often designed to motivate dealers to increase their depth of coverage in narrowly defined areas rather than "skimming" choice customers over a wider area. GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 1003 n.37 (9th Cir. 1976) (en banc).

81. The fourth justification for the legality of vertical restrictions is that they are necessary incentives to motivate dealers to provide a high quality and character of dealer services such as consumer credit, prompt and efficient repairs, and other post-sale services. The theory is that dealers can be persuaded, and are willing, to provide these better services in exchange for some insulation from ruinous intrabrand competition. GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 1003 n.37 (9th Cir. 1976) (en banc).

82. MONOGRAPH, supra note 4, at 40. Vertical restrictions reduce intrabrand competition by limiting the number of sellers of a particular product competing for the business of a given group of buyers. The ability of retailers to exploit this market may be limited by the ability of the consumer to travel to other locations, and to purchase competing products. However, these factors are not affected by the form of the transaction between the manufacturer and the retailer. Continental T.V., Inc. v. GTE Sylvania Inc., 97 S. Ct. 2549, 2560 (1977).

83. MONOGRAPH, supra note 4, at 35.
84. Comanor, supra note 56, at 1427.
85. MONOGRAPH, supra note 4, at 43-47.
87. Comanor, supra note 56, at 1427-32.
88. Id. at 1423-25.
89. Bork II, supra note 74, at 403.
Although abstract conjecture and debate over the issues can be useful in pointing out the problem areas, the effect that any particular arrangement has in a given context cannot be assessed in advance. Undoubtedly some vertical restrictions increase a firm's efficiency while others enhance a firm's market power. Although each situation is different, vertically imposed restraints have generally been considered to fall within three broad categories: territorial and customer sales restrictions; location restrictions; and vertical price fixing. While it can be shown that all of these restraints can affect intrabrand and interbrand competition, the effects are distinguishable. Location restrictions,
including location clauses, areas of primary responsibility, and profit pass-over arrangements, restrict intrabrand competition, but do not theoretically foreclose such competition, while territorial and customer sales restrictions intend to foreclose intrabrand competition entirely. Both location and territorial/customer restraints to some extent limit intrabrand price and nonprice competition. However, price fixing, commonly known as resale price maintenance, not only eliminates intrabrand price competition, but also prevents distributors from responding to interbrand price competition.

In the past, restrictions involving price fixing, whether vertical or horizontal, have been consistently recognized as having obvious anticompetitive effects and have uniformly been held to be per se violations of the Sherman Act. However, other types of vertical restraints have not been viewed so consistently. As with most allegations brought under the Sherman Act, vertical restraints were initially viewed under a rule of reason approach. The application of this rule by the courts has not been satisfactory, for with few exceptions, the courts have not identified adequate economic criteria for evaluating the restraints. Most cases have cited Justice Brandeis' expression of the rule of reason, reviewed the purpose of the restraint and the general economic facts of the industry, and then drawn conclusions about the relative effects of the restrictions in dampening intrabrand competition while promoting inter-

98. See note 96, supra.

99. A distributor given a primary responsibility area promises to devote its best efforts to promote and market the manufacturer's product within a designated area. Under this type of clause, a distributor can sell outside its area, and other sellers can sell inside its area. L. SULLIVAN, supra note 7, at 496-97; MONOGRAPH, supra note 4, at 3 n.6.

100. Distributors involved in profit pass-over agreements who make sales to customers outside their assigned area must provide certain compensation to the distributor in whose territory the customer was located. The compensation is to reimburse the other distributor for its promotion and sales efforts, and for providing servicing, for otherwise the distributor would obtain a "free ride." MONOGRAPH, supra note 4, at 4 n.7.

101. Id. at 4.

102. Id.

103. Id.

104. Id.

105. "The aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves power to control the market and to fix arbitrary and unreasonable prices. . . . Agreements which create such potential power may well be held to be in themselves unreasonable or unlawful restraints, without the necessity of minute inquiry." United States v. Trenton Potteries Co., 273 U.S. 392, 397 (1927). See authorities cited in note 58, supra.

106. MONOGRAPH, supra note 4, at 54.

107. See text at note 51, supra.
brand competition. The courts have not usually considered such factors as market power, product differentiation, or structural and behavioral characteristics which indicate the presence or absence of competition.

Although specific criteria have not been sufficiently developed in vertical situations, parameters have been placed upon the scope of the rule of reason inquiry by the doctrine of ancillary restraints. Here, courts must "consider whether the restraint is such only as to afford a fair protection to the interests of the party in favor of whom it is given, and not so large as to interfere with the interests of the public." More often than not, antitrust cases in this area have not focused upon the economic effects of such restrictions under either test, but have judged the legality of vertical restraints under rules governing similar conditions in a horizontal context. Since most of the same restrictions would be per se violations if imposed by competitors in the same level of the marketplace, there is a definite tendency to view the restrictions in a vertical context in the same manner. This should not be the controlling factor, however, because an assessment of vertical restrictions must in-

108. MONOGRAPH, supra note 4, at 54.
109. Market power is the power of a firm to affect the price which will prevail on the market. L. SULLIVAN, supra note 7, at 30-33.
110. The attempt by the manufacturer to create a real or fancied difference between similar products through styling, packaging, advertising, service or other nonprice competition is termed product differentiation. A correlation clearly exists between the extent to which the product has been differentiated, and the extent a firm can raise its prices above that of its competitors and still retain a substantial share of the market. The greater the product differentiation, the smaller the degree to which interbrand competition will be effective. See generally Comanor, supra note 56, at 1423-25; Note, Restricted Channels of Distribution Under the Sherman Act, 75 HARV. L. REV. 795, 832-33 (1962); MONOGRAPH, supra note 4, at 64-67.
111. See notes 27-31, supra, and accompanying text.
112. Behavioral indicators are used to measure product differentiation. Perhaps the most important guide to the extent of product differentiation is the cross-elasticity of demand. This is the degree of responsiveness in the sales of one product to price changes of other similar products. MONOGRAPH, supra note 4, at 65.
113. "The doctrine of ancillary restraints . . . permits, as reasonable, a restraint which (1) is reasonably necessary to the legitimate primary purpose of the arrangement, and of no broader scope than reasonably necessary; (2) does not unreasonably affect competition in the market place; and (3) is not imposed by a party or parties with monopoly power." United States v. Columbia Pictures Corp., 189 F. Supp. 153, 178 (S.D.N.Y. 1960). See generally Bork II, supra note 74, at 377-90.
116. See authorities cited in note 58, supra.
volve an economic analysis of their effects in respect to intrabrand versus interbrand competition. Evaluating the same restraint in a horizontal context would only involve the determination of its effects in relation to competitors, or interbrand competition. When economists cannot agree on the effects of vertical restrictions, it is hard to understand how such restraints are deemed to have the requisite "pernicious effect"\(^ {117}\) and complete "lack of any redeeming virtue"\(^ {118}\) to be declared per se illegal if courts classify a particular practice as a per se violation of the antitrust laws "only after considerable experience."\(^ {119}\) As will be seen from the development of the case law, the Supreme Court has been laboring under a similar confusion concerning the proper manner for reviewing vertical restraints.

**Development of the Law**

From the time the Sherman Act was passed until the early 1940's, vertically restrictive distribution arrangements were not seriously challenged and were uniformly upheld.\(^ {120}\) However, in 1948 the Department of Justice, relying primarily upon the Supreme Court's decision in *United States v. Bausch & Lomb Optical Co.*,\(^ {121}\) took the position that vertical territorial and customer restrictions which totally foreclosed intrabrand competition were per se illegal.\(^ {122}\) A dearth of higher court adjudications continued to plague this area for the next fifteen years. Although the government did bring a number of cases attacking such restrictions, the cases all ended in consent decrees and provided little guidance.\(^ {123}\) This implies that businessmen, at least during this period of time, believed that the per se test applied to vertical restrictions.

**A. White Motor**

It was not until 1961 that a firm refused to accept the government's contentions that its vertical restrictions were per se illegal and chose to litigate the case. The government, in *United States v. White Motor Co.*,\(^ {124}\) contended that White Motor's method of franchising its distribu-

\(^{117}\) See note 54, *supra*, and accompanying text.

\(^{118}\) *Id.*

\(^{119}\) See note 57, *supra*, and accompanying text.

\(^{120}\) *MONOGRAPH*, *supra* note 4, at 6-7.

\(^{121}\) 321 U.S. 707, 721 (1944) (vertical territorial restrictions were unlawful per se if they were accompanied by, or an integral part of, an agreement to fix prices).

\(^{122}\) *MONOGRAPH*, *supra* note 4, at 7.

\(^{123}\) For a list of the citations to the 16 consent decrees, see Stewart, *Franchise or Protected Territory Distribution*, 8 *ANTITRUST BULL.* 447, 470 n.51 (1963).

\(^{124}\) 372 U.S. 253 (1962).
tors and dealers constituted per se violations of sections 1 and 3 of the Sherman Antitrust Act. White's franchise contracts restricted resales by both distributors and dealers to designated geographic areas, restricted resale customers, and fixed resale prices for trucks and parts. At that time White Motor was the leading manufacturer of trucks and truck parts, but it was neither the dominant firm in the automotive industry, nor was it a newcomer. Rejecting the contentions of White that it should be allowed to present evidence at trial concerning the reasonableness of its franchise contracts, the district court granted summary judgment for the government.

The Supreme Court reversed, finding that summary judgment was inappropriate for vertical restrictions. The Court specifically rejected the invitation to apply a per se test, citing a lack of knowledge of the impact of such restrictions upon competition, but did not, on the other hand, specifically adopt a rule of reason approach. The Court simply stated that it did "not know enough of the economic and business stuff out of which these arrangements emerge to be certain" of their effects. In addition, the Court refused to express an opinion upon the legality of territorial and customer restrictions until after a trial upon the merits, saying:

"[t]his is the first case involving a territorial restriction in a vertical arrangement; and we know too little of the actual impact of both"

125. White, in arguing for a trial of the case on the merits, alleged that the territorial clause was necessary for its distributors to compete with other competitors; that it could theoretically have its own retail outlets but that method was not feasible; that the only feasible method was a distributor or dealer system; for that system to be effective a distributor must make vigorous and intensive efforts and that if he was to be held responsible for such performance, it was fair and reasonable to protect him against invasion of his territory by other distributors; and that in order to obtain maximum sales, White had to ensure that its distributors concentrate on taking sales away from other competing truck manufacturers, rather than from each other. 372 U.S. at 256.

126. At that time White Motor was among the 100 largest industrial firms in the United States. Although it was the leading firm in truck production with its principal competitors being Mack Truck and International Harvester, it also competed with and was substantially smaller than General Motors, Ford, and Chrysler. Preston, supra note 68, at 524.


129. The court accepted the contention that summary judgment was appropriate for price fixing. Id. at 264.

130. Id. at 263. The majority did not distinguish between vertical "territorial" and "customer" restrictions. However, a concurring opinion of Justice Brennan did attempt such an analysis. Id. at 264-75.

131. Id. at 263.

132. Id. at 264.
that restriction and the one respecting customers to reach a conclusion on the bare bones of the documentary evidence before us.\textsuperscript{133}

Further guidance from the case is nonexistent, for upon remand a consent decree\textsuperscript{134} was entered. While the Court did not express a definite preference for either test, both the majority opinion and Justice Brennan's concurrence can be read to imply a rule of reason approach.\textsuperscript{135} Apparently the lower federal courts read the opinion as adopting that view, for during the next four years, in the two cases concerning the legality of vertical restrictions,\textsuperscript{136} the courts of appeals rejected the per se rule against vertical restrictions and applied the rule of reason test.\textsuperscript{137}

\textbf{B. Schwinn}

The second case concerning the legality of vertical sales restrictions to reach the Supreme Court was \textit{United States v. Arnold, Schwinn & Co.}\textsuperscript{138} Schwinn was a family-owned business which for many years had manufactured and sold bicycles. While in 1951 Schwinn had the largest single share (22.5\%) of the bicycle market, by 1961 its share had declined to 12.8\%. During this period, in an attempt to reduce its costs of distribution, to avoid haphazard methods of selling, and to streamline its advertising and marketing efforts, Schwinn elected to implement a method of selective distribution by franchising its distributors and retailers.\textsuperscript{139} Schwinn's principal methods of selling its bicycles were through sales to distributors, sales to retailers through consignment or agency arrangements with distributors, and sales to retailers under the "Schwinn-Plan."\textsuperscript{140} As an integral part of the franchise agreements, Schwinn assigned distributors a specific geographic area in which they had the ex-

\textsuperscript{133} Id. at 261.


\textsuperscript{135} The majority noted that the restrictions might be allowable against aggressive competitors or if they were the only practicable means a small company had for breaking into or staying in business. Justice Brennan specifically noted several justifications for vertical restrictions. Both opinions imply a rule of reason approach since allowing justifications is inconsistent with the per se test. 372 U.S. at 263, 268-72.

\textsuperscript{136} Sandura Co. v. F.T.C., 339 F.2d 847 (6th Cir. 1964); Snap-on Tools Corp. v. F.T.C., 321 F.2d 825 (7th Cir. 1963).

\textsuperscript{137} Sandura Co. v. F.T.C., 339 F.2d 847, 858 (6th Cir. 1964); Snap-on Tools Corp. v. F.T.C., 321 F.2d 825, 831-33 (7th Cir. 1963).

\textsuperscript{138} 388 U.S. 365 (1967).

\textsuperscript{139} For an excellent review of the reasons and manner in which Schwinn selected its distribution system, see Keck, \textit{The Schwinn Case}, 23 Bus. Lawyer 669 (1968).

\textsuperscript{140} The Schwinn Plan involved direct shipment by Schwinn to the retailer with Schwinn invoicing the dealers, extending credit and paying a commission to the distributor taking the order. 388 U.S. at 370.
exclusive right to supply franchised retailers. Sales to the public were made only through franchised retailers who were authorized to sell only from specified locations. Franchised distributors were limited to sales only to franchised retailers in their territory and franchised retailers could only sell to customers not to unfranchised retailers.\textsuperscript{141}

In the district court,\textsuperscript{142} the government contended that Schwinn's franchise agreements amounted to an overall conspiracy to fix prices, to allocate exclusive territories, and to limit sales to selected customers. Relying upon \textit{United States v. Bausch & Lomb Co.},\textsuperscript{143} the government alleged that such nonprice restrictions constituted per se violations under section 1 of the Sherman Act since they were a part of a scheme for fixing retail prices. After a lengthy trial of seventy days in which the restrictions' economic effects upon the market, interbrand competition, and the distribution programs and practices were extensively presented, the district court rejected the charge of price-fixing, but held that territorial restrictions were unlawful per se in products sold by Schwinn to its distributors.

Upon appeal,\textsuperscript{144} the government urged that the district court's injunction should not be confined to sale transactions, but should also include consignments, agency, and Schwinn-Plan transactions. The government also urged that restrictions limiting the customers to whom the distributors and retailers could supply and resell should also be enjoined. Before the Supreme Court, the government abandoned its contentions that vertical territorial and customer restrictions were per se illegal and instead urged that a rule of reason be applied.\textsuperscript{145} The Supreme Court did not completely agree with the government, although it did modify the district court's decree. Generally, the Court agreed with the district court that a distinction had to be made between sales and consignment/agency situations. The Court applied a rule of reason approach to those vertical territorial and customer restrictions where Schwinn retained all indicia of ownership and the distributors/retailers acted as Schwinn's agents or consignees. On the other hand, the Court found illegal those territorial and customer restrictions imposed by

\textsuperscript{141} Id. at 370-71.
\textsuperscript{143} 321 U.S. 707 (1944).
\textsuperscript{144} Schwinn did not appeal the order prohibiting restraints on resale by distributors who purchased products from Schwinn. The United States did not appeal the court's rejection of its price-fixing charge. 388 U.S. at 368. Since the issue of the lawfulness of vertical sale restrictions was not appealed, it was not before the Court and any reference to it was technically dictum.
\textsuperscript{145} 388 U.S. at 368.
Schwinn upon its distributors/retailers for those products purchased from Schwinn. Justice Fortas, writing for the majority, based this decision upon the "ancient rule against restraints on alienation." He stated that "once the manufacturer had parted with title and risk . . . his effort thereafter to restrict territory or persons to whom the product may be transferred . . . is a per se violation of § 1 of the Sherman Act."

_Schwinn_ has become one of the most highly criticized antitrust cases in recent times. Criticism has generally revolved around the use of the per se test developed from a small portion of the language of the opinion, and its primary reliance upon the "ancient rule against restraints on alienation." Another criticism is that the Court had before it all the necessary ingredients to analyze and establish economic criteria for evaluating such restrictions, something it had lacked in _White Motor_. The government had even cooperated by inviting the Court to confine its attention to the intrabrand effects of the restrictions, conceding that the restrictions did not place any restraints upon interbrand competition. Nevertheless, for unstated reasons the Court failed to discuss or to distinguish the economic effects although the opinion began in a manner greatly reminiscent of a rule of reason approach. The Court initially acknowledged the government's abandonment of its per se contention and stated it "must look to the specifics of the challenged practices and their impact upon the marketplace in order to make a judgment as to whether the restraint is or is not 'reasonable' in the special sense in which § 1 of the Sherman Act must be read for purposes of this inquiry."

The shift to a per se test was abrupt and was essentially without explanation other than references to and agreement with the district

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146. _Id._ at 380.
147. _Id._ at 382.
148. For a collection of articles both pro and con of _Schwinn_, see GTE Sylvania, Inc. v. Continental T.V., Inc., 537 F.2d 980, 988 n.13 (9th Cir. 1976) (en banc).
149. _But see_ L. _SULLIVAN_, _supra_ note 4, at 405.
150. See notes 128-30, _supra_, and accompanying text.
151. The Court did not distinguish among the challenged restrictions on the basis of their individual potential for intrabrand harm or interbrand benefit. Instead, the pivotal factor in the Court's decision was the passage of title. Continental T.V., Inc. v. GTE Sylvania Inc., 97 S. Ct. 2549, 2556 (1977).
152. 388 U.S. at 368. The government's abandonment of the per se allegations could be read as being influenced by the _Snap-on Tools_ and _Sandura cases' determinations that vertical restrictions should be analyzed under a rule of reason approach.
153. _Id._ at 374.
154. As the Court in _Sylvania_ noted, the Court in _Schwinn_ announced its sweeping per se rule without even a reference to _Northern Pac. Ry._ and with no explanation of its sudden
court's ruling and the government's contentions. In what was later referred to as the "bright line" per se rule of illegality for vertical restrictions, Justice Fortas stated that "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." Although this approach would seem fairly straightforward, ambiguity was created when the court used the phrase "without more" and preceded the promulgation of the rule with an extensive discussion that resembled a rule of reason approach. If the Court had intended to apply a strict per se test, both the phrase and the discussion would have been irrelevant to such analysis.

The equivocal language of the opinion created a considerable difference of opinion in the lower courts over whether Schwinn established a broad per se rule invalidating all territorial and customer restrictions in sale, as opposed to consignment, transactions. Although Justice Fortas clearly stated that the Court was not considering all vertically imposed territorial restrictions as coming within the rule, he did not provide any guidance for future determinations other than the distinction between sales and consignments. Since future applications of the Schwinn rule were not resolved, a number of exceptions and justifications have been claimed. These claims have been based upon the "firm and resolute" language in the district court's findings, the "new entrant" or "failing company" exception, health and safety justifica-

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155. 388 U.S. at 374-79.
157. 388 U.S. at 379 (emphasis added).
158. See text accompanying notes 53-57, supra.
159. MONOGRAPH, supra note 4, at 13-14.
160. The Court stated that they were "not prepared to introduce the inflexibility which a per se rule might bring if it were applied to prohibit all vertical restrictions of territory and all franchising." 388 U.S. at 379.
161. The Supreme Court noted that the district court had found that Schwinn had been "firm and resolute" in the enforcement of the restrictions. Id. at 372. Some lower courts have required this to be proven before applying a per se test. See, e.g., Reed Bros. v. Monsanto Co., 525 F.2d 486 (8th Cir. 1975), cert. denied, 433 U.S. 1055 (1976); World of Sleep, Inc. v. Stearns & Foster Co., 525 F.2d 40 (10th Cir. 1975); Good Inv. Promotions, Inc. v. Corning Glass Works, 493 F.2d 891, 893 (6th Cir. 1974); cf. Copper Liquor, Inc. v. Adolph Coors Co., 506 F.2d 934 (5th Cir. 1975).
162. Justice Fortas noted that Schwinn was neither a newcomer nor a failing company. 388 U.S. at 374. Although no case since Schwinn has sustained such a defense, it has been noted by lower courts. See GTE Sylvania, Inc. v. Continental T.V., Inc., 537 F.2d 980, 1004
tions,163 and the claim that the manufacturer has retained all indicia of ownership.164 Another area not resolved was that of vertical restrictions employed in patent, trademark, and know-how licensing in which the licensee engages in the manufacture of the product rather than the mere resale of the product.165 While Schwinn addressed itself to vertical territorial and customer sales restrictions, it did not discuss less restrictive alternatives166 that also limit intrabrand competition to certain extents. Lower courts have continued to recognize their validity and have normally applied a rule of reason approach in their analysis.167

C. Syvania

The latest case concerning vertical restrictions to reach the United States Supreme Court is Continental T.V., Inc. v. GTE Syvania Inc.168 Syvania, a manufacturer and seller of television sets, was prompted in 1962 by a steep decline of its market share of national television sales to adopt a franchise system of distribution. Chosen with the acknowledged purpose of attracting more aggressive and competent retailers, Syvania’s franchise agreement included a location restriction169 which in effect protected the retailers by ensuring that their competitive efforts would be expended against interbrand rather than intrabrand competitors. Although the franchise system spaced the dealers to allow them some “elbow room,” the arrangement was not an exclusive territory and Syvania reserved the right to increase the number of retailers in any given area as it saw fit. No other territorial or customer limitations were imposed upon the retailers.170

n.41 (9th Cir. 1976) (en banc); Copper Liquor, Inc. v. Adolph Coors Co., 506 F.2d 934, 943-45 (5th Cir. 1975).


164. See American Oil Co. v. McMullin, 508 F.2d 1345 (10th Cir. 1975).

165. See generally MONOGRAPH, supra note 4, at 17-20. The Court in Schwinn specifically noted that it did not have the case of a patentee before it to make such a decision. 388 U.S. at 379 n.6.

166. Such less restrictive alternatives include exclusive distributorships, location clauses, areas of primary responsibility, and profit pass-over arrangements. See notes 96, 98-100, supra. See generally MONOGRAPH, supra note 4, at 20-25.

167. See, e.g., Salco Corp. v. General Motors Corp., 517 F.2d 567 (10th Cir. 1975).


169. A location clause requires that the franchisee only sell the manufacturer’s products from a specified location or locations. A franchisee can sell to whomever he wants wherever that customer is located as long as the retailer sells from the franchised location. See notes 96, 98-100, supra, and accompanying text.

170. The revised plan appeared to have worked, for by 1965 Syvania’s market share
The original Sylvania case was the result of a rupture of one of these franchise agreements. Antitrust laws were invoked when the legality of the location restrictions was challenged during cross-claims in that litigation. The present controversy, concerning the proper standard for evaluating the vertical restriction’s legality, arose when the district judge refused to instruct the jury that the location restrictions were illegal only if they unreasonably restrained competition. Instead, the court, apparently in reliance upon a literal interpretation of the Schwinn rule, gave an instruction that amounted to a per se test, whereby the jury found that Sylvania had engaged in a “restraint of trade in violation of the antitrust laws with respect to location restrictions alone.” On appeal, the court of appeals reversed, concluding that Schwinn was distinguishable upon several grounds and that an instruction incorporating the rule of reason should have been given to the jury.

The Supreme Court, although affirming the decision of the court had increased from 1-2% to approximately 5% and Sylvania was ranked as the eighth largest manufacturer of television sets. GTE Sylvania Inc. v. Continental T.V., Inc., 1974 Trade Cas. No. 75,072 (9th Cir. 1974).

177. The court reviewed the nature and form of the restrictions, their competitive effects, and the market shares of Schwinn and Sylvania to conclude that location restrictions should be viewed under a rule of reason approach since such restrictions could produce desirable, pro-competitive effects wholly different from those restrictions sought to be prohibited by Schwinn. Id. at 990-92.

178. Id. at 1002.

of appeals, differed drastically in its reasoning. The Court noted that "[i]n intent and competitive impact, the retail customer restriction in Schwinn is indistinguishable from the location restriction"\(^{180}\) in Sylvania and that in looking to substance rather than form, "the fact that one restriction was addressed to territory and the other to customers is irrelevant to functional anti-trust analysis."\(^{181}\) Although the majority found that Schwinn could not be distinguished, they noted that there was a sufficient need for clarification of the law surrounding vertical restrictions to reconsider Schwinn in spite of the principle of stare decisis.\(^{182}\) After reviewing the Schwinn rule in light of the traditional meaning of the per se rule and rule of reason tests,\(^{183}\) and in terms of economic analysis of vertical restrictions, the Court found that applying different rules to sale and nonsale transactions was unwarranted. From this, the Court was left with the alternative either to expand Schwinn to include nonsale transactions, or to abandon it in favor of a rule of reason approach to all vertical restrictions. Unable to find any persuasive support for expanding Schwinn, and finding that location restrictions did not have such a "pernicious effect on competition" and did not "lack . . . any redeeming virtue," the Court concluded that the per se rule of Schwinn must be overruled.\(^{184}\)

**Future Implications of Sylvania**

Initially it must be noted that with one exception practitioners are basically back to where they started before the trilogy of White Motor, Schwinn and Sylvania. Whereas before White Motor the government had taken the position that vertical restrictions were per se illegal,\(^{185}\) now the applicable standard will be the rule of reason. Little judicial direction has been provided by these cases concerning the economic criteria to be used in deciding whether a restriction poses an unreasonable restraint on competition.\(^{186}\) While White Motor could not be decided

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180. Id. at 2556.

181. Id.

182. The Court acknowledged the great weight of scholarly opinion critical of Schwinn and that a number of federal courts had consistently sought to limit Schwinn's reach. Id. As one commentator has observed, the courts "have struggled to distinguish or limit Schwinn in ways that are a tribute to judicial ingenuity." Robinson, Recent Antitrust Development; 1974, 75 Colum. L. Rev. 243, 272 (1975).

183. See text at notes 51 and 53, supra.

184. 97 S. Ct. at 2562.

185. See note 123, supra, and accompanying text.

186. See notes 48-52, supra, and accompanying text.
due to lack of economic analysis of vertical restrictions, the Court in *Schwinn* had before it an elaborately developed analysis but ignored it to choose a sweeping per se rule based upon the "ancient rule against restraints on alienation." *Sylvania* presented a situation that was clearly within the *Schwinn* prohibition, but the Court there chose to overrule *Schwinn* because vertical restrictions did not meet the per se standard. Although *Sylvania* did not make vertical restrictions legal, it did establish the rule of reason as the standard to be applied in future cases. Furthermore, while the Court did "not foreclose the possibility that particular applications of vertical restrictions might justify per se prohibition," the majority opinion made it "clear that departure from the rule of reason standard must be based upon demonstrable economic effect." The practitioner now knows what standard will be applied, but very little of the content of that standard.

In analyzing the *Sylvania* opinion, one has the impression that the majority went out of its way to overrule *Schwinn* and to reestablish the rule of reason approach in testing vertical restrictions. As Justice White noted in his concurring opinion, the Court could have just as easily adopted the lower court's distinction between the effects of the restrictions in *Schwinn* and *Sylvania* without overruling *Schwinn* entirely. Apparently swayed by the great weight of scholarly authority critical of *Schwinn* and repeated attempts by lower federal courts to limit *Schwinn*, the Court was convinced that there was a sufficient need for clarification of the entire area of vertical restrictions to justify reconsideration.

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187. See notes 130-33, *supra*, and accompanying text.
188. See text at note 143, *supra*.
189. 388 U.S. at 380.
190. *Sylvania* did not dispute the fact that title to the televisions passed to Continental.
191. See text at note 54, *supra*.
192. 97 S. Ct. at 2562.
193. *Id.*
194. *Id.* at 2563-66.
195. It was argued that *Schwinn* involved a restriction on the locations and types of permissible vendees, while *Sylvania* only imposed restrictions on the permissible locations of vendors. In *Schwinn*, the restrictions wholly destroyed intrabrand competition by foreclosing the distributor from selling to any purchaser located outside his exclusive territory. However, in *Sylvania* intrabrand competition was preserved since *Sylvania* franchised at least two dealers in the area and each dealer was free to sell to any buyer he chose. Another distinction argued was that Schwinn had an extremely large market share and could use its market power to impose restraints whereas Sylvania's market share was so small that it was threatened with expulsion from the market. 537 F.2d at 990-92.
196. 97 S. Ct. at 2557 n.13.
197. *Id.*
rather than differentiating Schwinn. While recognizing the importance of the principle of stare decisis, the Court easily dismissed it by quoting Justice Frankfurter's statement in Helvering v. Hallock that "stare decisis is a principle of policy and not a mechanical formula of adherence to the latest decision, however recent and questionable, when such adherence involves collision with a prior doctrine more embracing in its scope, intrinsically sounder, and verified by experience." Although this justification would suffice at times, it is hard to apply to the Court's conclusion "that the appropriate decision is to return to the rule of reason that governed vertical restrictions prior to Schwinn."

The rule of reason referred to is either one developed through its application in conjunction with vertical restrictions, or a general rule of reason developed from the overall antitrust body of law. Prior to Schwinn, the only case dealing with vertical restrictions to reach the Supreme Court had been White Motor. However, that case did not clearly advocate one particular test, much less define the limits of the rule of reason. In addition, very little guidance can be gleaned from private antitrust litigation during that period because most cases ended in consent decrees. Even these decrees are of little help since the government was insisting that vertical restrictions were to be tested under the per se standard. Therefore, at least in regard to the realm of vertical restrictions, it is difficult to believe that this was the "prior doctrine more embracing in its scope, intrinsically sounder and verified by experience" that the Court looked to in overcoming stare decisis.

The standard to be applied must therefore have come from the general rule of reason probably best articulated by Justice Brandeis in Chicago Board of Trade. However, while this formulation of the rule may be more "embracing," it is questionable whether it can be termed "intrinsically sounder" or "verified by experience." Rather than providing specific criteria, the Chicago Board of Trade test speaks in generalities of the "purposes" and "effects" of the restraint, industry

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198. Id. at 2556.
199. Id. at 2562 n.30.
201. Id. at 119, quoted in Continental T.V., Inc. v. GTE Sylvania Inc., 97 S. Ct. 2562 n.30 (1977).
202. 97 S. Ct. at 2562 (emphasis added).
203. See text at notes 130-33, supra.
204. See note 123, supra.
205. 309 U.S. at 119.
206. See text at note 51, supra.
"conditions," and "facts peculiar to the business." With such open-ended and nebulous limits, such a standard could scarcely be "verified by experience." In general, as one commentator has recently stated: "The content of the Rule of Reason is largely unknown; in practice, it is little more than a euphemism for nonliability." 

Despite the difficulty in understanding this formulation of the standard, the Court in *Sylvania* has firmly established the rule of reason as the correct standard to be applied. Therefore, the criteria used in this expression of the rule as well as other economic criteria must be reviewed to determine possible avenues for future expansion.

Although published prior to the Supreme Court decision in *Sylvania*, a recent American Bar Association Monograph has attempted to discuss how Justice Brandeis' formulation of the rule of reason might be applied to vertical distribution cases. The Monograph lists the relevant question concerning the purpose of the restraint as whether the restraint was ancillary to a legitimate business purpose or was anti-competitive in purpose. In evaluating whether a restraint was reasonably necessary to accomplish the legitimate purpose, the publication notes that such factors as "[t]he degree of consumer acceptance of the product, the physical characteristics of the product and any unique marketing problems involved, the duration and scope of the intrabrand restraint, the strength of interbrand competition, and the acceptability of less restrictive alternatives might all be relevant" to the inquiry. In measuring the significance of the effects of an intrabrand restraint upon overall competition, the market power, as a function of the market share and product differentiation, must be assessed. These factors, in turn, would directly relate to the effectiveness of interbrand competition by minimizing the effects of the restraint on intrabrand competition. The major pro-competitive effects and justifications noted are maximizing market penetration; stimulating distributor service and other activity; obtaining a market presence; facilitating entry by other products; and strengthening economic concentration and the small business defense.

Recently, two possible approaches to make the rule of reason a more workable standard in cases involving restrictions on distribution

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207. *Id.*


210. *Id.* at 55-71.

211. *Id.* at 57.

212. *Id.* at 62-67.

213. *Id.* at 67-70.
have been suggested\(^\text{214}\) to the courts. The first, also developed from the Chicago Board of Trade formulation, requires the court to balance the restriction's effects on the reduction in intrabrand competition against the increase in interbrand competition. Although this balancing approach directs the focus of the court to the competitiveness\(^\text{215}\) of the alleged restrictions and eliminates unrelated criteria, the opposition argues that competition should not be the exclusive determinant because it eliminates inquiries into the efficiency increasing aspects of some restraints.\(^\text{216}\) In addition, this approach would not alleviate the complexity of the analysis nor the lengthy evaluation which would be required to qualify the impact of the restraint on all aspects of competition.

The second approach would have the courts focus on the question "whether the restriction is intended to cartelize distribution or, on the contrary, to promote the manufacturer's own interests."\(^\text{217}\) The goal of this approach would be to condemn and to impose liability automatically for those restrictions desired for monopolistic purposes.\(^\text{218}\) However, this approach would preclude liability if the manufacturer did not have a large share or was not acting in conjunction with others to form a cartel. A three-stage inquiry\(^\text{219}\) into the legality of the restrictions has been developed by Professor Posner:

1. Does the restriction embrace a sufficiently large enough portion of the market to make cartelization a plausible motive? If not, the restriction should be lawful.
2. If the answer to question 1 is yes, do dealers in the product provide any presale services? If not, the restriction should be deemed unlawful.\(^\text{220}\)
3. If both answers to questions 1 and 2 are yes, did the manufacturer's output increase or decrease after imposing the restric-

\(^{214}\) Posner, supra note 208.
\(^{215}\) The decisional process the court would have to go through would require great skill in economic facts and theories, and would at least, be a difficult prospect. However, it would include: (1) determining what difference product differentiation, market concentration, exclusive dealing arrangements, entry barriers and other structures and conduct make, and then looking for particular anti-competitive effects in the market; (2) determining what justifications are possible for the practice; (3) applying the facts of the case to determine if theoretical justifications apply; and (4) balancing the justifications against the potential for competitive harm. Strasser, supra note 59, at 832.
\(^{216}\) Posner, supra note 208, at 14-17.
\(^{217}\) According to Professor Posner, this would be the superior approach. Id. at 17.
\(^{218}\) Id.
\(^{219}\) Id. at 19.
\(^{220}\) At this stage, Professor Posner suggested an alternative might be to shift the burden of justification to the defendant. Id.
tion? If it increased, the burden would shift to the government to show that it increased for reasons unrelated to the restriction. If output decreased, the restriction should be unlawful, unless the defendant can prove that he intended to increase his output by adopting the restriction.221

A third possible approach,222 referred to as a “more structured”223 rule of reason, attempts to provide the court with criteria that the court could use in evaluating the restraints according to the legitimate needs of the distribution system, their justifications, and their entry barring and interdependent pricing potential.224 The factors to be considered in this approach include the existence of effective interbrand competition,225 the industry concentration level, the existence of product differentiation,226 the existence of barriers to entry, promotion of newcomers and new products, and the existence of exclusive dealing requirements.227 As with any adequately definable set of criteria, the advantage would be in relieving the judiciary from becoming economic theorists whenever they had a case dealing with vertical restriction. When most economists cannot agree upon one set of criteria that would address every aspect of the problem, it will be interesting to see how the judiciary can provide one.

Another possible rule that the courts could use in making this area more manageable, one that straddles the rule of reason and the per se test, is the rule of presumptive illegality.228 Under this rule, certain restraints, because of their greater likelihood of producing anti-competitive effects, would be presumed illegal. However, this presumption would not be irrebuttable as in a per se analysis, but would only shift the burden to the manufacturer to justify the restraint. Certain defenses would be allowed, but unless the presumption was rebutted the restraint would be illegal regardless of its method of imposition.229 However, if manufacturers can defend such restraints by alleging that they create efficien-

221. Id.
222. Strasser, supra note 59, at 830-40.
223. Id. at 834.
224. Id. at 838.
225. To determine if interbrand competition exists, the court should focus on such factors as the cross elasticity of demand, profit ratios, the innovation and progress in the industry, and the presence or absence of overall efficiencies in the industry. Id. at 834-35.
226. The issue here would be whether product differentiation is based on image advertising, or on product quality, function, service, or price. Id. at 836-37.
227. The existence of exclusive dealing arrangements in combination with the vertical territorial restraints would make the system suspect. Id. at 838.
228. See generally Monograph, supra note 4, at 51-52; Strasser, supra note 59, at 833-34.
229. Strasser, supra note 59, at 833.
cies or other similar pro-competitive effects, the goal of judicial economy is not advanced because a full trial of those issues would still be required involving all the complexities discussed above. Whether this remains a useful alternative is doubtful; the presumptive illegality rule would probably be of greater use if used in conjunction with one of the other approaches.

As can be seen from the above approaches and as emphasized in *Sylvania*, economic analysis will be increasingly important in future cases. As stated by the Court in *Sylvania*, "competitive economics have social and political as well as economic advantages, but an antitrust policy divorced from market considerations would lack any objective benchmarks" and any "departure from the rule of reason must be based upon demonstrable economic effect." Exactly what economic approach the lower federal courts will take in analyzing "market considerations" to provide "objective benchmarks" remains to be seen. One possible direction for the court to take comes from Professor Posner, who, as pointed out in Justice White's concurring opinion, was cited five times by the majority when analyzing vertical restrictions. Posner would read the two above quoted statements as "implying that antitrust prohibitions must have an economic rationale and that the aesthetic delights of smallness and the yearning to resurrect a nation of sturdy Jeffersonian yeomen will not be permitted to decide antitrust cases." Whether the court will eventually agree with Professor Posner and the other members of the "Chicago School" of economic thought who argue that economic efficiency is the only goal of antitrust law, or whether the court will advocate a different approach is difficult to predict.

**Conclusion**

With the decision in *Sylvania*, the rule of reason has been firmly established as the proper approach to take in analyzing vertical distribution arrangements. Economics should assume a prominent role in future determinations because of the emphasis placed on it by the Supreme Court in *Sylvania*. At present, the major drawback in this area is the lack of agreement among economists and jurists over which economic

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230. MONOGRAPH, supra note 4, at 52. This approach was rejected in Schwinn. Id. at 51.
231. 97 S. Ct. at 2559-60 n.21.
232. Id. at 2562.
233. Id. at 2568.
235. Id.
criteria to use. After only a brief review of the area, it is easy to see how difficult and complex the questions become with even the most minor restraint. Before addressing any issue in the area of vertical restrictions, the practitioner should be thoroughly familiar with the basic concepts and terminology used in this area. As long as the practitioner understands those concepts, he should be able to address distribution problems adequately.

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