Michigan Law Review

Volume 76 | Issue 2

1977

Vertical Distribution Restraints After *Sylvania*: A Postscript and Comment

Martin B. Louis
University of North Carolina

Recommended Citation
Martin B. Louis, *Vertical Distribution Restraints After Sylvania: A Postscript and Comment*, 76 MICH. L. REV. 265 (1977).
Available at: https://repository.law.umich.edu/mlr/vol76/iss2/3

VERTICAL DISTRIBUTION RESTRAINTS AFTER *SYLVANIA*: A POSTSCRIPT AND COMMENT

*Martin B. Louis**

The Supreme Court's decision last term in *Continental T.V., Inc. v. GTE Sylvania Inc.*[1] demonstrates once again the difficult antitrust problem posed by vertical distribution restraints and the Court's continuing inability to resolve it satisfactorily.[2] Vertical distribution restraints consist of terms imposed by a manufacturer on its distributors limiting their freedom to redistribute goods. Such restraints vary widely in their details, but the basic forms involve restraints on the prices at which goods are distributed, the customers to whom they can be distributed, and the locations from which or territories in which they can be distributed. These restraints assist a manufacturer, especially a new entrant, in establishing and maintaining an effective distribution system. Unfortunately, they do so by suppressing intrabrand competition among the manufacturer's dealers and distributors.[3]

The effect of this interference with intrabrand competition will be minimized, some say, by the presence of interbrand competition and by the seller's own interest in preserving some intrabrand competition.[4] Yet, these countervailing pressures do not arise whenever vertical restraints are used. Interbrand competition is not invariably strong enough to impose a competitive equilibrium on the affected market—if it were, vertical restraints would be meaningless. In ad-

* Professor of Law, University of North Carolina. A.B. 1956, Princeton University; LL.B. 1959, LL.M. 1965, Harvard University.—Ed.

1. 433 U.S. 36 (1977).

2. Before the decision in *Sylvania* was announced, the *Michigan Law Review* published an Article by me arguing that the case was controlled by the Court's earlier decision in United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967), and that *Schwinn* had been correctly decided despite its unforgivably bad opinion. Louis, *Vertical Distributional Restraints Under Schwinn and Sylvania: An Argument for the Continuing Use of a Partial Per Se Approach*, 75 MICH. L. REV. 275 (1976). In *Sylvania* the Court agreed with the former contention, but it rejected the latter and overruled *Schwinn*. Although I believe that the Court's action was a mistake, I come to bury *Schwinn* and not to praise it, and thus I will attempt to focus here on the *Sylvania* decision and its future impact.

Many of the ideas set forth in the first Article are relevant here and have been reasserted, usually in summary fashion with citation to their earlier, fuller explications. I have undoubtedly sometimes exceeded these limits. It is much easier to adopt high purposes than to adhere to them religiously.

3. 433 U.S. at 54-55.

4. 433 U.S. at 56.

dition, the seller and its distributors often have shared an interest in reducing intrabrand competition,[5] since restricted distribution helps create or enhance promotional product differentiation, which in turn may shield the brand from interbrand competition or enable it to share in the resulting partial monopoly with other similarly differentiated brands.[6] Thus, it is no surprise that *Sylvania* and most of its predecessors involved branded consumer goods susceptible to such differentiation.

The traditional antitrust approach to practices resulting in such mixed blessings is the rule of reason, which promises particularized solutions responsive to both the needs of business and the interests of the public. Unfortunately, the rule of reason is a heavy burden upon the enforcement process. Antitrust proceedings conducted under that test are usually bulky and protracted.[7] Moreover, common business practices like these vertical distributional restraints may produce too many such proceedings for the federal courts and enforcement agencies to handle well, if at all. Furthermore, judges and trade commissioners presented with the huge records these cases ordinarily generate clearly cannot render decisions that are " 'accurate,' 'consistent,' or 'predictable,' "[8] and consequently they often fall back upon their relevant passions or economic prejudices.[9] These difficulties are magnified in the case of distribution restraints because of the many types and combinations available and of the wide variety of circumstances in which they are used.[10] As a result, precedents are more easily distinguished, guidelines and rules are harder to formulate, trial records are potentially larger, rational de-

---

5. P. Areeda, Antitrust Analysis 500-04 (2d ed. 1974). The *Sylvania* opinion sweeps these qualifications aside with the inaccurate statement that "the view that the manufacturer's interest necessarily corresponds with that of the public is not universally shared." 433 U.S. at 56. It is probably correct to say that few share this view because it is necessarily accurate only when the manufacturer is a monopolist. Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath*, 81 Harv. L. Rev. 1419, 1425 (1968). When the manufacturer is an oligopolist, its interest will generally fall somewhere between that of its dealers and distributors and that of the public, and it is as likely to approach one as the other. The adoption by the manufacturer of a program of distribution restraints, however, hardly suggests that the public interest is the one in the ascendency.

6. Comanor, *supra* note 5, at 1425.

7. The record in *Schwinn*, which was tried under the rule of reason, filled 23 volumes. McLaren, *Territorial and Customer Restrictions, Consignments, Suggested Resale Prices and Refusals To Deal*, 37 Antitrust L.J. 137, 144 (1967).

8. Louis, *supra* note 2, at 277-78 (citing Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 Colum. L. Rev. 282 (1975)).

9. Louis, *supra* note 2, at 277-78.

10. *Id.* at 282-85.

cisionmaking becomes more difficult, and defendants are more inclined to litigate than to negotiate.

There are two escapes from this dilemma. One is the use of per se rules, which sacrifice accuracy in particular cases for predictability and consistency in most of them. Another is the structural rule-of-reason approach widely used in Clayton Act cases,[11] under which market structure factors are examined to predict anticompetitive effects but evidence of actual effects, which could fill many volumes, is largely ignored. A decade ago the Supreme Court, after a hesitant flirtation with the rule of reason,[12] adopted a modified per se approach to the vertical restraint problem in *United States v. Arnold, Schwinn & Co.*[13] In that case the Court held, in effect, that the most restrictive practices were per se unlawful and that the less restrictive ones were presumptively lawful, a result whose predictability could obviate much litigation while leaving business some—perhaps even enough—capability to satisfy its legitimate needs. Unfortunately, *Schwinn* made no mention of this practical rationale, but instead invoked a common-law catchphrase—restraints on alienation when the seller parts with title—as its ratio decidendi.[14] In consequence, the opinion was widely criticized, especially by those who opposed its practical result or did not understand it,[15] and the weight of this criticism bore heavily upon the federal courts.[16] Finally, in *Sylvania*[17] the Supreme Court overruled *Schwinn* and reinstated the rule-of-reason approach adopted in *United States v. White Motor Co.*,[18] a case which *Schwinn* had itself rather hastily overruled.

The question actually presented in *Sylvania* was whether *Schwinn*'s per se rule condemning territorial and customer restraints applied to location clauses. The trial court had answered in the affirmative, but the Ninth Circuit reversed en banc,[19] holding that location clauses were distinguishable from customer clauses. The Su-

---

11. Such an approach is presently employed in merger and exclusive dealing cases. *Id.* at 279. The merger guidelines announced by the Department of Justice embrace such an approach. 1 TRADE REG. REP. (CCH) ¶ 4510 (1977).

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

13. 388 U.S. 365 (1967).

14. *See* 388 U.S. at 378-80.

15. For an examination of the deficiencies of the *Schwinn* opinion, see Louis, *supra* note 2, at 276 n.6.

16. *See Sylvania*, 433 U.S. at 48 n.14.

17. 433 U.S. at 59.

18. 372 U.S. 253 (1963).

19. GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980 (9th Cir. 1976) (en banc).

preme Court agreed with the trial court that location clauses and customer clauses are essentially indistinguishable under *Schwinn.*[20] Consequently, the Court confronted the broader issue of whether *Schwinn* was correctly decided.

In *Schwinn,* the Court couched its per se rule in terms of a doctrine providing that the seller cannot restrict distribution of goods over which it no longer has title. Accordingly, goods sold on consignment or by an agent were not subject to the per se rule.[21] This technically necessary but essentially anomalous exception was not available to most manufacturers,[22] and might readily have been narrowed even further.[23] Nevertheless, in *Sylvania* the Court alleged that this quaint qualification of the per se rule manifested an analytical irresoluteness in *Schwinn* that could be remedied only by either eliminating the exception or by overruling *Schwinn.*[24] Spurning the former alternative—the adoption of which would have displeased almost no one—the Court triumphantly chose the latter.

Unfortunately, the reasons given for rejecting *Schwinn,* with or without its anomalous exception, are neither illuminating nor persuasive. Mr. Justice Powell's opinion for the Court in *Sylvania* merely reiterates the accepted fact that these restraints are both

---

20. 433 U.S. at 46. The Court disregarded the additional argument that the location clause and the territorial restriction, which are similarly used to confine distributors and dealers within their specified sales areas (generally at the retail and wholesale levels respectively), are also indistinguishable for all practical purposes. For a lengthy evaluation of the question, see Louis, *supra* note 2, at 287-94.

21. *Schwinn,* 388 U.S. at 380-81.

22. Relatively few manufacturers presently use consignment or agency arrangements in the distribution of branded consumer products, especially at the retail level, perhaps because of the ease with which security interests in inventory can be secured under the Uniform Commercial Code and the resulting willingness of various credit institutions to provide inventory financing. For a review of those uses of consignment that remain, see Handler, *The Seventeenth Annual Review of Antitrust Developments—1964,* 19 REC. N.Y.C. BAR ASSN. 379, 381 (1964). In fact, in none of the many reported cases after *Schwinn* was the exemption even raised. Furthermore, it is very unlikely that a manufacturer would have been permitted to change its distribution system to agency or consignment in order to qualify for the exception, especially if there were no independent commercial reason to justify the practice. *Cf.* Simpson v. Union Oil Co., 377 U.S. 13 (1964).

23. *Schwinn* emphasized that the agents or consignees had to be "indistinguishable in function from agents or salesmen." 388 U.S. at 381. This qualification eliminates most retailers and those wholesalers that serve customers substantially from their own inventory. *See* Louis, *supra* note 2, at 276 n.6.

24. 433 U.S. at 57. The Court argued that this exception was *Schwinn*'s inapt concession to the fact that there is some redeeming social virtue in vertical distribution restraints. It seems to me, *see* text at note 21 *supra,* and to Justice White in his concurring opinion, 433 U.S. at 59, that the exception was otherwise justified and that the presumptive legality of the less dangerous restraints was the real concession. *See* text at notes 26-27 *infra.*

widely used and have some redeeming social virtue.[25] But that is why *Schwinn's* per se approach was only partial and specifically exempted all of the less restrictive partially substitutable restraints.[26] The question in *Sylvania* really was whether in the generality of cases the use of these substitutes could meet enough of business' legitimate needs. Many have suggested that they could,[27] no one has yet even attempted to show they could not, and surely some data or experience deserving the Court's attention had accumulated during the *Schwinn* decade. The Court ignored this question, however, except to suggest that the differences among the most frequently used restraints are merely "of degree and form" and that it was "unable to perceive significant social gain from channeling transactions into one form or another."[28]

The social gains from that channeling are, in my opinion, rather obvious. For one, the *Schwinn* approach tends to minimize the inhibiting effect of vertical restraints on intrabrand competition. That is, the limited per se rule allows those less restrictive practices that preserve a significant level of intrabrand competition and forbids the more restrictive devices that leave room for little, if any, such competition.[29] For example, resale price fixing severely curtails intrabrand competition, and although it differs from other vertical restraints only in "degree and form," it is per se invalid under longstanding authority. Even *Sylvania* did not disturb this individual per se rule,[30] although the Court there offered no satisfactory explanation for retaining this "anomalous" exception to its own rationale.[31]

Society also benefits from an antitrust policy discouraging use of the more restrictive vertical restraints insofar as these restraints

25. 433 U.S. at 57-58.

26. Louis, *supra* note 2, at 277.

27. *See, e.g., id.*; Zimmerman, *Distribution Restrictions After Sealy and Schwinn*, 12 ANTITRUST BULL. 1181 (1967); Note, *Restricted Channels of Distribution Under the Sherman Act*, 75 HARV. L. REV. 795 (1962).

28. 433 U.S. at 58 n.29.

29. On the different uses and effects of the various restraints, see generally Louis, *supra* note 2, at 282-85; Note, *supra* note 27.

30. 433 U.S. at 51 n.18.

31. In his concurring opinion, Justice White forcefully demonstrated the anomalous nature of this distinction and showed that the majority, in drawing it, rejected the position of those commentators on which it most heavily relied. 433 U.S. at 70. Justice White might also have noted that some of those commentators who supported the *Schwinn* result would also regard such a distinction as illogical. *E.g.*, Comanor, *supra* note 5, at 1427; Louis, *supra* note 2, at 282. Indeed, substantial academic support for it cannot be found. If the distinction is to remain, it may eventually provide doctrinal precedent for the adoption of additional per se rules, a possibility the Court specifically left open. 433 U.S. at 58.

create and preserve promotional product differentiation. As Professor Bain discovered in his pioneering study of entry barriers, in many areas of the economy product differentiation often accounts for high barriers to entry[32] and, therefore, for the creation or persistence of oligopoly and the high profit levels that often attend it.[33] This insight strongly suggests that the height of the barrier varies with the severity of the restraint. Consequently, by regulating the degree and form of permitted vertical restraints, the courts can curb this source of entry barriers.

The Court's feeble response to this analysis is contained in a footnote suggesting that the argument is logically flawed and that in any event a per se rule merely forces business to employ less effective means to achieve product differentiation.[34] The first assertion is inaccurate, and the second, although probably correct, cuts against the Court's position. Compelling a company to use less efficient means of product differentiation will raise its costs, and, since the incentive to pursue differentiation depends on the relationship between marginal cost and marginal return, will reduce the optimal level of product differentiation. Furthermore, even if the company could achieve a comparable level of differentiation for its products without restricting distribution, it would still confront the countervailing pressure of intrabrand competition in marketing them.

Schwinn's channeling process also benefited society by substantially increasing the predictability of antitrust regulation, thereby

32. J. BAIN, BARRIERS TO NEW COMPETITION 114-43 (1956).

33. *See, e.g.*, N. COLLINS & L. PRESTON, CONCENTRATION AND PRICE-COST MARGINS IN MANUFACTURING INDUSTRIES 116 (1968); H. GOLDSCHMID, H. MANN & J. WESTON, INDUSTRIAL CONCENTRATION: THE NEW LEARNING 168-245 (1974).

34. 433 U.S. at 56 n.25. The footnote states: "This argument is flawed by its necessary assumption that a large part of the promotional efforts resulting from vertical restrictions will not convey socially desirable information about product availability, price, quality and services." Unfortunately, the "argument" demands no such "necessary assumption." Although vertical restrictions are often designed to produce excess profits in order to pay for additional advertising and promotion, they can also contribute to product differentiation in such ways as the elimination of discount outlets, the control of price rivalry, and the requirement or stimulation of dealer services in excess of what the market would provide. *See generally* P. AREEDA, *supra* note 5, at 22; J. BAIN, *supra* note 32, at 142; Comanor, *supra* note 5; Louis, *supra* note 2, at 301-02. In any event, it also seems clear that these assumptions that some part of product differentiation "merely exploits consumer ignorance" and that "many oligopolists advertise more extensively than would be useful for the industry viewed collectively," P. AREEDA, *supra* note 5, at 21-22, although not necessary to the argument, are too often correct. The undesirable contributions of vertical restraints to such differentiation may be offset, as many argue, by their procompetitive contributions to the distribution process and by the high cost of regulating them. That, at least, is the nub of present academic disagreement. The Court, however, sophomorically assumed away the entire controversy with a single, partially incorrect, conclusory sentence in a footnote.

diminishing enforcement costs. The Court in *Sylvania* completely ignored this feature of *Schwinn*, even though it is the most compelling reason for adopting any bright-line approach,[35] and was the controlling consideration in another antitrust decision which the Court handed down only a few weeks before *Sylvania*.[36] The Court's silence on this consideration dramatically underscores the impact of its decision. Since *Sylvania* gave no indication of the bounds of reasonableness[37] aside from implying that the location clauses used by *Sylvania* were reasonable under the circumstances of the case, we will lack clear guidelines in this area until an accumulation of decisions sketches in the contours of the Sherman Act's tolerance of vertical distribution restraints. For the foreseeable future, then, the cost of enforcing limits, should the federal government again take up the gauntlet, will be staggering. Surely many sellers will undoubtedly accept *Sylvania*'s tacit invitation to do as they please. Furthermore, given the inequality of litigation resources between the government and business, can anyone doubt upon which side of the scales the Court has placed its thumb or whether renewed governmental litigation in this area will, for the foreseeable future, constitute much more than a gesture of defiance?

In summary, the ultimate question before the Court in *Sylvania* was whether the less restrictive restraints permitted by *Schwinn* fell so consistenly short of the legitimate needs of business that the cost of hampering business outweighed the enormous enforcement costs of the rule of reason. *Sylvania*, like *Schwinn*, failed to address this question, dwelling instead on the spurious problem supposedly created by the distinction between sale and nonsale transactions. Neither decision is an exemplar of judicial reasoning;[38] both suffer

35. *See* Louis, *supra* note 2, at 278-79, 310.

36. Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).

37. *Sylvania*, aside from its direct or implied overruling of most recent decisions favoring the government, merely returned the law to the year 1963 and the decision in *White Motor*, where the Court said it did "not know enough of the economic and business stuff out of which these arrangements emerge to be certain." 372 U.S. at 263. Fourteen years and many cases later, when some knowledge and experience should have accumulated, the Court has retreated to that position without a hint about where the lines should now be drawn, 433 U.S. at 59, except for two citations to Justice Brandeis' hoary explication of the rule of reason, 433 U.S. at 49 n.15 & 53 n.21 (citing Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918)), which is totally unilluminating and contains deviant overtones rejected by later cases. *See* Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 74 YALE L.J. 775, 817-20 (1965).

38. I have already mentioned *Sylvania*'s heavy reliance upon the false dilemma supposedly created by Schwinn's agency and consignment exception, *see* text at notes 21-24 *supra*, the inappropriate characterization of that exception as an inadequate sop to the legitimate needs of business, *see* note 24 *supra*, and the failure simply to

from what they said as well as from what they ignored. And, for these reasons, *Sylvania* may not be the Court's last word on the subject of vertical distribution restraints.

* * *

The effect of *Sylvania* is less debatable than its merits: the Court simply wiped the slate clean and commanded a fresh start. No one can foresee precisely where the courts will go; the best we can do is catalog the factors that they are likely to examine in cases involving vertical distribution restraints. Presumably they will consider the restrictive effect of the package of restraints employed, based upon their number and kind;[39] the market structure and performance of the industry affected;[40] the position of the seller employing the restraints within that industry;[41] the frequency and magnitude with which these restraints are used by its competitors;[42] any special needs or problems peculiar to the seller;[43] and how well other, less restrictive practices or restraints can meet its legitimate needs.[44]

---

eliminate the exception, *see* text at notes 25-28 *supra*. Also deserving note is Justice Powell's new school of ecumenical economics, which conveniently borrows from friend and foe alike whatever is useful and rejects whatever is not.

39. Lengthy discussions of how the various restraints are employed, how they interrelate, and how they fulfill particular needs at various distribution levels can be found in Louis, *supra* note 2; Note, *supra* note 27.

40. The assumption here is that exclusive dealing cases like Standard Oil Co. v. United States (Standard Stations), 337 U.S. 293 (1949), and FTC v. Motion Picture Advertising Serv. Co., 344 U.S. 392 (1953), which both emphasize the presence of concentration in the affected markets, will be considered the most relevant precedents. This assumption exists though they are Clayton Act decisions and the entry barrier effects of exclusive dealing are more direct and immediate. These cases, particularly *Standard Stations*, attempted to ignore actual market performance and effects, which are presumably relevant under the rule of reason. *Cf.* Maple Flooring Mfrs. Assn. v. United States, 268 U.S. 563 (1925).

41. *Cf.* Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 334 (1961) (exclusive dealing case emphasizing the absence of "a seller with a dominant position in the market" or "myriad outlets with substantial sales volume, coupled with an industry wide practice").

42. *Cf.* Bok, *The Tampa Electric Case and the Problem of Exclusive Arrangements Under the Clayton Act*, 1961 SUP. CT. REV. 267, 300 ("the proportion of goods in the relevant market that are sold subject to restrictive arrangements" should be considered in a Clayton Act § 3 proceeding). In addition, see the sources in note 40 *supra*.

43. Such special factors include restrictions designed to protect the health and safety of the user or the quality of the product, Louis, *supra* note 2, at 275 n.4, or the special problems of a seller who is a new entrant, a declining company, or a failing company, *id.* at 297-300.

44. The availability of less restrictive alternatives has always been a basic consideration under the rule of reason, as Justice Brennan carefully noted in his concurring opinion in *White Motor*, 372 U.S. at 271-72. Ironically, then, considerations of degree and form, which *Sylvania* rejected as determinants of per se unlawfulness, *see* text at notes 28-31 *supra*, are still relevant as determinants of reasonableness.

Obviously, the allocation of the burdens of proof on these questions will also be crucial.[45]

Although these are the most likely factors, the list could obviously be expanded beyond the point of manageability.[46] Indeed, I doubt that any reasonably inclusive list would be manageable or particularly helpful. What are needed are predictions on how the courts and enforcement agencies will react to various combinations of the crucial factors. Perhaps a few such predictions can be tentatively advanced. All sellers, I assume, can confidently continue to employ in any legitimate fashion all those less restrictive practices that were presumptively lawful under *Schwinn*,[47] even though it is now arguable that they are unreasonable in some circumstances.[48] On the other hand, sellers assigning closed territories to their distributors or dealers will, I suspect, still be courting trouble[49] unless the sellers are new entrants, failing companies, or are otherwise specially situated.[50] A safe course would be to use de facto exclusive or limited franchising in combination with territorial or locational protection.[51]

It is more difficult to predict in what situations it will be unreason-

45. Clearly the plaintiff must show that the restraints exist and that they have, or are likely to have, anticompetitive effects. Whether the plaintiff must also show prima facie that any justifications for the restraints are insufficient and that they are, therefore, unreasonable is the question. Although the Court might eventually place the entire burden of justification upon the defendant, who is clearly in a better position than the plaintiff to discharge it, *Sylvania* is hardly good authority for that result.

46. *See* Bok, *supra* note 42, at 297-300. An example of such an impossibly long list—which was predictably ignored—is found in United States v. Penn-Olin Chem. Co., 378 U.S. 158, 176-77 (1964).

47. These restraints include exclusive franchises, profit-passover clauses, and area of primary responsibility clauses. Louis, *supra* note 2, at 282-83.

48. The unlimited use of exclusive franchises is often arguably unreasonable, Louis, *supra* note 2, at 286-87, but traditionally their use has been virtually immune to antitrust attack. One possible reason for this development is that this immunity was a tradeoff for the designation of per se illegality of other restraints, the use of which would occasionally have been reasonable. *Id.* This rationale has been undercut by *Sylvania*, under which only vertical price fixing is still per se unlawful.

49. *See* note 69 *infra*.

50. *See* note 43 *supra*.

51. Manufacturers that take this course are still courting problems, however. Many dealers or distributors set such a high premium on obtaining an enforceable exclusive franchise that they may not be willing to settle for a de facto one. *See* Note, *supra* note 27, at 805-09. Thus they may demand, at the minimum, oral assurances that, if disclosed, might subject the manufacturer to antitrust prosecution for using and concealing closed territories. *See generally* Louis, *supra* note 2, at 292 n.94. Furthermore, as courts become aware of this problem, they may take a tougher stance toward the grant of locational or territorial protection to dealers enjoying de facto exclusive or limited franchising. *See generally* United States v. Topco Assocs., Inc., 405 U.S. 596, 602 (1972).

able to use individually any of the three restraints that were per se unlawful under *Schwinn*—the territorial limitation, the location clause, and the customer clause. Although it can be argued that these three should be treated alike,[52] historical and functional differences among them presage dissimilar results.[53] Of the three, location clauses are the least likely to arouse judicial reproach. The automotive companies historically have successfully met all legal challenges to their use of location clauses,[54] and there is no reason to expect a contrary result in the future. Thus, location clauses are presumably legitimate in all other industries as well.[55] On the other

52. *Sylvania*, of course, holds that the three are equivalent, 433 U.S. at 45-46, although the purpose of this holding was to include all of them within either the per se rule or the rule of reason, and not necessarily to preclude differing results under the latter. Since all three have similar functions, arguably they should be treated alike. The territorial restraint and the location clause are both employed to keep distributors and dealers within their assigned sales territories, usually with the former affecting the wholesale level and the latter affecting the retail level of distribution. Louis, *supra* note 2, at 283. Furthermore, the customer restraint is often used as a supplement or alternative to the location clause in preventing unauthorized or bootleg retail sales outlets. *Id.* at 284, 289-90. Thus, any significant legal distinctions among these three restraints would discriminate between the intermediate and final levels of distribution or among roughly equivalent means to the same end.

53. Historically, the location clause has survived all challenges to its legality, *see* note 54 *infra*, whereas the other two obviously have not. One reason for this result is that the location clause merely hinders intrabrand competition, while the other two forbid it completely. Louis, *supra* note 2, at 290. Although that difference was not sufficient under *Schwinn* and *Sylvania* to distinguish the location clause from the other two restraints, it may portend differing results under the rule of reason. Furthermore, the location clause may be more important to retail distribution than the territorial limitation is to wholesale distribution because manufacturers are less inclined to grant exclusive franchises at the retail than at the wholesale level. *Id.* at 291-92. In that situation a manufacturer recruiting retail dealers can offer them no significant territorial protection other than the location clause.

54. *E.g.*, Salco Corp. v. General Motors Corp., 517 F.2d 567 (10th Cir. 1975); Boro Hall Corp. v. General Motors Corp., 124 F.2d 822 (2d Cir. 1942), *cert. denied*, 317 U.S. 695 (1943). In United States v. General Motors Corp., 384 U.S. 127, 139-40 (1966), the Supreme Court refused to consider the question.

55. There are two acceptable rationalizations for protecting an automobile dealer's location: inducing the initial substantial investment, which arguably demands only temporary protection, Louis, *supra* note 2, at 292-93, 296-98, and inducing the continuing provision of services thought essential to the marketing of the product, which arguably justifies continuing protection. In *Sylvania*, however, the dealers apparently neither invested more money nor promised additional services. *See id.* at 294 n.103. The only apparent justification there was the manufacturer's small, declining market share. Thus it is hard to see why any manufacturer should hesitate to use location clauses today unless it is dominant, its dealers have exclusive franchises, they made their investments long ago, and they presently provide almost no services. Eventually, however, the enforcement agencies and the courts may look more closely at these factors and require a showing that such protection is truly necessary and reasonable. Moreover, the imposition of location clauses by a manufacturer upon multi-brand dealers may also restrain interbrand competition. *Id.* at 293. Whether the legality of using location clauses would be affected by a showing of such interbrand effects is unclear, but certainly not unlikely.

hand, territorial limitations on distributors may well remain unavailable to the leading firms in highly concentrated industries, especially if they are combined with de jure or de facto exclusive franchises.[56] Consequently, even the first such firm to contemplate the use of territorial restraints must proceed with caution, especially if it suspects others will follow.[57] Finally, the prospective judicial attitude toward customer restraints is perhaps the most difficult to predict. I expect that the courts will permit customer clauses designed to protect the quality of the product or the health and safety of the user.[58] A harder question is whether substantial, thriving sellers of differentiated products can now use customer clauses simply to eliminate bootleg sales and dealers, to facilitate price discrimination, or to reserve business for themselves.[59] For example, the reimposition by Schwinn of customer restraints in order to eliminate bootleg sales might now survive judicial scrutiny because the company apparently still faces strong interbrand competition.[60] Similar efforts by General Motors, however, would be much riskier.[61]

Obviously, using two of these three restraints in tandem increases the risk of illegality, especially if they are imposed upon or affect the same level of distribution. For example, the combined imposition of location clauses upon retailers and of customer restraints upon wholesalers or retailers in order to eliminate bootleg sales or dealers entirely might be unreasonable, even though the use of

56. *See* note 51 *supra*. Most of the cases dealing with territorial restraints involved manufacturers with relatively small market shares facing the competition of dominant firms, *e.g.*, *White Motor*, 372 U.S. 253 (1963), with some of the smaller firms having suffered serious market declines, *e.g.*, Sandura Co. v. FTC, 339 F.2d 847 (6th Cir. 1964). In *Schwinn*, 388 U.S. 365 (1967), the defendant, although the largest name-brand seller, had suffered a serious loss of its market share because of strong competition from mass merchants and imports. Even Sylvania's principal excuse for employing analogous location clauses was a declining market share. 433 U.S. at 38. Thus there is very little case law suggesting that a strong, dominant manufacturer can employ territorial restraints, even under the rule of reason. Indeed, a strong argument to the contrary is found in Justice White's concurring opinion in *Sylvania*. 433 U.S. at 63-64. Furthermore, the availability of less restrictive practices to substitute for territorial restraints should obviously still be a factor in assessing reasonableness.

57. *See* note 42 *supra* and accompanying text.

58. *See* P. AREEDA, *supra* note 5, at 552; note 43 *supra*.

59. *See generally* P. AREEDA, *supra* note 5, at 550-52.

60. From 1971 to 1976 Schwinn's market share declined from 12.8% to 11.8%, even though it took over the wholesaling function in order to avoid the effects of the decree. [1977] ANTITRUST & TRADE REG. REP. (BNA) No. 844, at A-8. Schwinn may still be the largest selling name brand in the domestic market.

61. *Cf.* United States v. General Motors Corp., 384 U.S. 127 (1966) (question raised by enforcement of analogous location clause left unanswered because of a finding of conspiracy between General Motors and some of its dealers).

either restraint alone would not be unreasonable and the combination merely completes the task either alone lawfully attempts.[62] Thus the automobile companies would arguably invite litigation if they augment their location clauses[63] with customer restraints.

On the other hand, territorial limitations and location clauses are ordinarily imposed upon different levels of the distribution network. Thus, if a seller could lawfully impose the former upon its intermediate distributors or could lawfully compel them to impose the latter upon the retailers to which they sell,[64] should it hesitate to require both? The seller would argue that since the two reasonable restraints basically do not reinforce each other, the combination is also reasonable. The government or a private plaintiff, however, might contend that the public should not be totally denied the benefits of intrabrand competition at both levels and, therefore, that distribution at one level must be left relatively unrestrained.[65] Neither side is clearly right, although *Sylvania* appears to preclude a rule making the combination per se unlawful.[66] Nevertheless, the use of the combination by a prosperous, oligopolistic seller presents the government with an ideal test case that the seller might prefer to avoid.

Fortunately the combined use of one of these three restraints with one of those traditionally measured by the rule of reason—*i.e.*, exclusive franchises and areas of primary responsibility or profit-passover clauses—presents fewer difficult problems than a combination

---

62. *See* note 52 *supra*.

63. *See* note 54 *supra*.

64. In theory, a manufacturer has no direct control over where or to whom a retailer who purchases from a wholesaler may resell. *See* Louis, *supra* note 2, at 289 n.83. With *Schwinn* overruled, however, possibly the manufacturer may now appoint authorized retailers, condition that appointment accordingly, and prohibit the wholesalers from selling to anyone else. In any event, no good reason exists why a manufacturer cannot lawfully compel a wholesaler to impose location clauses upon retailers if the manufacturer, dealing directly with the retailers, could lawfully impose them. *Id.*

65. In other words, the seller could grant exclusive franchises or impose a profit-passover arrangement on one of the two levels. The reply here is that the level of restraint would not be very different, that the *Sylvania* opinion opposed such distinctions between degree and form, *see* text at note 28 *supra*, and that the manufacturer could overcome such limitations by assuming the wholesale function and dealing directly. In rejoinder the government would argue that some intrabrand competition is preferable to none, *see* Louis, *supra* note 2, at 297, 300 n.128, that *Sylvania* was not addressing distinctions under the rule of reason, and that the risk of vertical integration is not great. *Id.* at 302 n.141.

66. Although Sylvania left open the possibility that some restraints might still be found per se unlawful, 433 U.S. at 58, it probably did not mean to include this situation, for the reasons presented in note 65 *supra* and accompanying text.

of two restraints that were covered by *Schwinn*'s per se rule. As I mentioned before, a closed territory—produced by coupling an exclusive franchise with either a location clause or a territorial limitation—is a risky venture.[67] Indeed, a prohibition of closed territories is a leading candidate for one of the narrow per se rules that *Sylvania* would allow.[68] A per se prohibition of closed territories seems desirable since they often restrict intrabrand competition even more than vertical price fixing,[69] which remains per se unlawful under *Sylvania.*[70]

Sellers will probably possess considerably more freedom in the use of areas of primary responsibility and profit-passover clauses. In most cases an area of primary responsibility would not significantly enhance the anticompetitive effect of a lawful territorial restraint affecting the same level of distribution.[71] Similarly, firms should ordinarily be free to combine a reasonable profit-passover clause with either a location clause or a territorial limitation affecting the same level of distribution, since the former often serves merely as a means of enforcing the other two that is less drastic than the anticipated refusal to deal.[72] Courts might even tolerate such combinations affecting two different levels of distribution on the ground that they are a less restrictive alternative to the equivalent combination of a location clause and a territorial limitation.[73] Finally, the combination of a reasonable profit-passover clause with a customer restraint affecting the same level of distribution would often represent a less restrictive—and therefore presumably a lawful—alternative to the combination of the latter with either a location clause or a territorial limitation. Of course, some profit-passover clauses are rea-

67. *See* text at notes 49-51 *supra.*

68. *See* note 31 *supra.*

69. Closed territories can bar every form of intrabrand competition. Resale price maintenance still permits nonprice competition over services and promotions, which will often amount to indirect price competition. Furthermore, one reason for the Court's refusal to exempt price maintenance from the per se rule was that Congress recently repealed those provisions of the McGuire Act, 15 U.S.C. § 45 (1976), and the Miller-Tydings Act, 15 U.S.C. § 1 (1976), which exempted state fair trade laws from the Sherman Act. Consumer Goods Pricing Act of 1975, Pub. L. 94-145, 89 Stat. 801 (noted in 433 U.S. at 51 n.18). It would be anomalous if *Sylvania* gave back to business through closed territories as much as or more than what Congress has so recently taken away.

70. 433 U.S. at 51 n.18.

71. Louis, *supra* note 2, at 282-83. Sellers would have little interest in combining an area of primary responsibility clause with either a territorial limitation or a location clause, since the former is basically a milder alternative to either of the other two.

72. *See* Note, *supra* note 27, at 814-15, 827.

73. *See* note 65 *supra.*

sonably limited to special situations involving prepaid installation or warranty costs and are not generally aimed at discouraging intrabrand competition.[74] Their combination with other lawful restraints should pose no additional risk.

Although these predictions are not difficult to toss off and, on the whole, are probably not far off the mark, one should not rely on any individual prediction. This uncertainty will hardly help the Department of Justice, which now has almost no basis on which to seek summary judgment or to impose a consent decree, and, consequently, must expect to try almost every new case it brings. Furthermore, because of the variety and the various possible combinations of restraints, the Department will have to win a number of cases before it has the precedential authority to back up its bargaining position. It cannot accomplish this in less than a decade, even if it has the inclination and the resources to begin immediately.[75] Meanwhile, potential defendants should spring up like weeds in an untended garden, and the government, with its limited resources, can be expected to challenge only the most egregious uses. And even in these cases the defendants may resist vigorously in the hope of prevailing ultimately on the merits or of obtaining a generous consent decree. Admittedly, private plaintiffs should somewhat check those who might otherwise throw caution to the winds. But because of the high cost, delay, and low success rate of private litigation, as so recently illustrated by *Sylvania* and *Fortner*,[76] and the special difficulties of making new law in this area under the rule of reason, the private plaintiff is not, in my opinion, a substantial deterrent to those who proceed prudently.[77]

As an alternative or supplement to an ambitious litigation program, the Department of Justice could announce guidelines for these practices similar to those adopted in the merger field.[78] Such guidelines would probably have more influence upon sellers than the tenuous threat of litigation and should receive some deference from federal judges seeking direction in the wilderness *Sylvania* has created.

---

74. *See* Note, *supra* note 27, at 812.

75. In remarks made at Duke Law School, Durham, North Carolina, on December 2, 1977, Assistant Attorney General John H. Shenefield indicated that he does not now set a high priority on the bringing of such suits.

76. United States Steel Corp. v. Fortner Enterprises, Inc., 429 U.S. 610 (1977).

77. *Accord,* [1977] ANTITRUST & TRADE REG. REP. No. 843, at B-1, B-5, suggesting that antitrust attorneys representing private plaintiffs strongly prefer cases involving per se offenses anyway, and would probably especially avoid this area of the rule of reason because of the present uncertainty.

78. 1 TRADE REG. REP. (CCH) ¶ 4510 (1977). Such guidelines could alterna-

Unfortunately, vertical distribution restraints are less susceptible to such control than mergers because of the variety and possible combinations of the restraints involved[79] and because of the absence of a widely accepted economic theory to guide the drafters.[80] In addition, such a scheme would have to follow a narrow path between too much detail and flexibility, which would result in proceedings that resemble those under the rule of reason,[81] and too much rigidity, which would achieve results similar to those under *Schwinn*'s partial per se approach. These difficulties, which are inherent in the use of such guidelines and of the structural rule-of-reason approach they embrace,[82] raise grave questions about the desirability of constructing a structural regulatory framework in this area.[83] Nevertheless, structural analysis is the middle ground be-

---

tively be promulgated as substantive regulations by the Federal Trade Commission, acting under its new statutory power, FTC Improvement Act, § 202(a), 88 Stat. 2193 (1975) (codified at 15 U.S.C. § 57a(a)(1) (1976)), or under § 6(g) of the FTC Act, 15 U.S.C. § 46(g) (1976), as interpreted in National Petroleum Ref. Assn. v. FTC, 482 F.2d 672 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 951 (1974). The power under the FTC Improvement Act, however, by its terms applies only to "unfair or deceptive acts or practices," and not to "unfair methods of competition," which is the traditional source of the Commission's concurrent jurisdiction over antitrust violations. The latter power is of undefined scope, and it may never have been intended to reach substantive anticompetitive conduct. Even if it had been so intended by the court in *National Petroleum*, it may have been impliedly limited or excised by Congress, which rejected its codification in the FTC Improvement Act. Note, *The State Action Exemption and Antitrust Enforcement Under the Federal Trade Commission Act*, 89 HARV. L. REV. 715, 740 n.155 (1976). Needless to say, the FTC could also issue guidelines or launch an enforcement program under § 5's condemnation of unfair methods of competition, which supposedly include incipient Sherman Act violations. If certain cases are taken at face value, the FTC could condemn, in a blaze of expertise and expletives, practices that violate not the letter of the Sherman Act as interpreted in *Sylvania*, but the Act's spirit and central policy. *Cf.* FTC v. Sperry & Hutchinson Co., 405 U.S. 233 (1912) (FTC has authorization to determine whether actions are unfair methods of competition or unfair or deceptive practices though the actions pose no threat to competition within the letter or spirit of antitrust laws); FTC v. Brown Shoe Co., 384 U.S. 316 (1966) (under FTC Act § 5, FTC has power to arrest restraints of trade in their incipiency without proof that the restraints are outright violations of other antitrust laws).

79. Louis, *supra* note 2, at 308.

80. *Id.* at 308-09.

81. Justice White's concurring opinion in *Sylvania*, 433 U.S. at 59, although purporting to be a full rule of reason analysis, could readily be mistaken for a structural analysis.

82. *See* note 11 *supra.*

83. I stated these doubts at length in my earlier Article. Louis, *supra* note 2, at 307-09. A reading of Justice White's concurring opinion in *Sylvania*, 433 U.S. at 59, discussed in note 56 *supra*, confirms and enlarges them. That opinion purports to apply a rule of reason analysis to distinguish *Sylvania* from *Schwinn*, but in the process omits discussion of many facts that I, at least, regard as crucial. *See* Louis, *supra* note 2, at 294 n.103. It is unimportant whether these facts should control in *Sylvania.* It is important if facts like them are generally present in such cases

tween the rule of reason and *Schwinn*'s partial per se approach. Since the restoration of *Schwinn* in the foreseeable future is highly unlikely, the Department of Justice, and eventually the courts, will probably begin to move toward structural rules once the difficulty and futility of proceeding under the rule of reason becomes apparent to them. Until then, the government and the courts will find themselves in the briar patch, in which only defendants with their generally unlimited litigation resources will, like Brer Rabbit, feel at home.

---

in sufficient numbers to obscure the "correct"—or even the likely—result, and to permit any factfinder, by judicious selection, to choose and justify plausibly whatever result he prefers. This danger, always a possibility under the rule of reason, may be an expensive, time-consuming probability in the context of vertical distribution restraints.