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VERTICAL DISTRIBUTIONAL RESTRAINTS UNDER *SCHWINN AND SYLVANIA*: AN ARGUMENT FOR THE CONTINUING USE OF A PARTIAL PER SE APPROACH

*Martin B. Louis**

For more than fifteen years a critically important debate has raged over the proper antitrust treatment of vertical territorial restraints on distribution. The debate began with the district court decision in *United States v. White Motor Co.*,¹ exploded over the Supreme Court's decision in *United States v. Arnold, Schwinn & Co.*,² which established a partial per se rule in this area,³ and was renewed recently as lower courts have begun to extend or apply *Schwinn*.⁴ The latest round of cases and commentary reveals that *Schwinn's* detractors are in the ascendency.⁵ Almost all commentators deplore

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1. 194 F. Supp. 562 (N.D. Ohio 1961), *revd.*, 372 U.S. 253 (1963).

2. 388 U.S. 365 (1967).

3. The decision prohibited the imposition of territorial restraints, which designate the area to which the resales of a distributor are confined, and customer restraints, which designate certain classes of persons to whom a dealer can or cannot sell purchased goods. 388 U.S. at 377-78. For a more comprehensive definition of these restraints, see notes 33-34 *infra*. Nothing was said about other vertical territorial restraints, which presumably remained subject to the rule of reason.

4. The Ninth Circuit sitting en banc reversed the initial panel decision and held that location clauses are not per se unlawful. *GTE Sylvania Inc. v. Continental T.V., Inc.*, 1974-1 Trade Cas. 96,792 (9th Cir. 1974), *revd. en banc*, 537 F.2d 980 (9th Cir.), *cert. granted*, 97 S. Ct. 252 (1976).

Other courts have divided over whether the per se rule should give way when resale is reasonably restricted to protect the health or safety of the user, or the quality of the product. Compare *Adolph Coors Co. v. FTC*, 497 F.2d 1178, 1187 (10th Cir. 1974) (product quality justification), and *United States v. Glaxo Group, Ltd.*, 302 F. Supp. 1 (D.D.C. 1969) (health and safety justification), with *Tripoli Co. v. Wella Corp.*, 425 F.2d 932 (3d Cir.), *cert. denied*, 400 U.S. 831 (1970) (health and safety justification); and *United States v. First Prods. Corp.*, 1972 Trade Cas. 93,025 (S.D.N.Y. 1972) (safety justification); and *LaFortune v. Ebbe*, 26 Cal. App. 3d 72, 102 Cal. Rptr. 588 (1972) (product quality justification). A few courts, in apparent dissatisfaction with *Schwinn*, have sought to avoid its effect through spurious refinements and distinctions. See, e.g., *Janel Sales Corp. v. Lanvin Parfums, Inc.*, 396 F.2d 398, 406 (2d Cir.), *cert. denied*, 393 U.S. 938 (1968), in which the court noted that, unlike *Schwinn*, the defendant in *Janel* had not been "firm and resolute" in enforcing territorial restraints. However, this distinction is false, because *Schwinn* had employed it to find an agreement in the face of unwritten restraints, whereas the *Janel* restraints were in writing. For criticism of this and similar cases, see Robinson, *Recent Antitrust Developments: 1974*, 75 COLUM. L. REV. 243, 273-74 (1975).

5. Some of the recent commentary includes Robinson, *supra* note 4; Note, *The Per Se Rule As Applied To Vertical Territorial Restraints: An Improper Standard*,

the opinion as unforgivably bad.⁶ A few critics demonstrate that the entire line of cases, of which *Schwinn* is a critical part, lacks a consistent theoretical basis,⁷ and many more argue that, because vertical restraints have mixed competitive effects that are the subject of con-

1975 DUKE L.J. 935; Comment, *Schwinn Re-cycled—Enforced Restrictions on Location of Franchised Retail Outlets Held a Per Se Violation of Section 1 of the Sherman Act*, 49 N.Y.U.L. REV. 957 (1974); 88 HARV. L. REV. 636 (1974). Earlier commentary is cited in Note, *Territorial Restrictions and Per Se Rules—A Reevaluation of the Schwinn and Sealy Doctrines*, 70 MICH. L. REV. 616, 626 n.83 (1972).

6. See, e.g., 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).

There are three basic criticisms of *Schwinn*. First, the Court is accused of reneging, for no articulated reason, on an earlier promise to eschew per se rules until it understood more of "the economic and business stuff out of which these arrangements emerge." *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963). One commentator has suggested, somewhat cynically, that the extensive 23-volume record compiled by the lower court in *Schwinn* more than satisfied the Court's desire for knowledge and explains its hasty change of mind. See McLaren, *Territorial and Customer Restrictions, Consignments, Suggested Resale Prices and Refusals to Deal*, 37 ANTITRUST L.J. 137, 144 (1967).

Second, the Court has been chastised for almost totally ignoring the merits and relying instead on the essentially irrelevant "ancient rule against restraints on alienation." 388 U.S. at 380. Although this common-law rule was invoked in an early decision holding vertical price fixing per se unlawful, *Dr. Miles Medical Co. v. John D. Parke & Sons*, 220 U.S. 373, 404-05 (1911), it was thereafter ignored until its resurrection in *Schwinn*. Furthermore, it was never absolute and would not necessarily have outlawed all such vertical territorial restraints. See Handler, *The Twentieth Annual Antitrust Review—1967*, 53 VA. L. REV. 1667, 1684-86 (1967). However, it turns out that the rule is a convenient description of the most dangerous restraints, which arguably should be per se unlawful anyway, and that therefore it may be less arbitrary than heretofore believed.

Third, the Court has been criticized for establishing what has been called an anomalous exception to its per se rule for territorial and customer restraints imposed in agency or consignment relationships, and for sustaining under the rule of reason *Schwinn*'s use of restraints in this context because it faced strong competition from mass merchandisers. See 388 U.S. at 380-81. No effort was made to explain why such competitive pressures should not also excuse price-fixing clauses in consignment arrangements, which the Court had condemned in *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964). Of course, there can be no restraint on alienation when title to goods does not pass. Furthermore, the Court stressed that the person to whom goods have been consigned must be "indistinguishable in function from agents or salesmen." 388 U.S. at 381. While *Schwinn*'s wholesalers satisfied this test, its retailers, who normally purchased most of their inventory, did not. Thus, this exception for consignment relationships should be limited to intermediate distributors who function like and could easily be replaced by company salespersons. See Zimmerman, *Distribution Restrictions After Sealy and Schwinn*, 12 THE ANTITRUST BULL. 1181, 1188-89 (1967). This distinction may indicate the Court's partial acceptance of the much advanced but generally rejected contention that a manufacturer should be permitted to achieve by contract what it could achieve by vertical integration. See, e.g., *Standard Oil Co. v. United States*, 337 U.S. 293, 315-21 (1949) (Douglas, J., dissenting). Acceptance of this contention may make sense here, however, because of the ease with which *Schwinn* might have made the substitution.

7. See, e.g., Posner, *supra* note 6.

tinuing debate and inquiry,⁸ their per se condemnation is for the moment totally inappropriate.⁹

It is possible, however, to accept most of these criticisms and yet still to conclude that some use of the per se rule for vertical restraints is well-advised. A restraint is traditionally not to be condemned as per se unlawful unless its anticipated harm is great and its alleged redeeming virtues are few, random in occurrence, and unlikely.¹⁰ Not all distributional restraints, whether used alone or in certain combinations, can now be definitely so characterized. Although this may therefore rule out the use of the per se approach for *all* vertical restraints, it does not necessarily preclude the use of such an approach for *some* of them, which is all that *Schwinn* requires. Many vertical restraints are at least partially interchangeable. Consequently, the business needs that would be served by those restraints that are now per se unlawful can be satisfied in whole, or at least in substantial part, by those that are not.¹¹ Thus, the present outright condemnation of the most dangerous restraints does not necessarily impose great burdens on business. This partial per se approach is hardly novel: How else can we logically explain the generally accepted prohibition against resale price fixing,¹² which is merely one of the most restrictive vertical restraints?¹³

A partial per se approach is not necessarily acceptable, however, simply because it is less mischievous than a general one. Positive justifications are needed, and one in particular can be identified. Adoption of a rule of reason standard for popular business practices must necessarily generate a substantial volume of protracted litigation that will consume substantial prosecutorial and judicial resources,¹⁴ and that frequently cannot yield results that are "accurate,"

8. Compare Zimmerman, *supra* note 6, and Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath*, 81 HARV. L. REV. 1419 (1968) (attacking the widespread use of such restraints), with Bork, *The Rule of Reason and Per Se Concept: Price Fixing and Market Division*, 75 YALE L.J. 375 (1966) (generally exonerating the use of such restraints).

9. See Robinson, *supra* note 4.

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

11. See generally Note, *Restricted Channels of Distribution Under the Sherman Act*, 75 HARV. L. REV. 795 (1962).

12. Vertical price fixing was prohibited long ago in *Dr. Miles Medical Co. v. John D. Parke & Sons*, 220 U.S. 373 (1911). In 1975, Congress repealed the Maguire Act, which had exempted from the Sherman Act state fair trade laws permitting vertical price fixing. Pub. L. 94-145 § 2, 89 Stat. 801 (1975).

13. See Posner, *supra* note 6.

14. The volume of litigation since *Schwinn's* per se rule was announced is itself impressive evidence of that which a more inviting rule of reason approach might generate. See note 4 *supra*. Furthermore, *Schwinn's* extensive record is suggestive of the size and complexity of cases tried under such an approach. See note 6 *supra*.

"consistent," or "predictable."¹⁵ Consequently, as the administrative burdens become apparent, and as the decisions reached seem increasingly to turn on the unarticulated values and attitudes of the courts rather than on the reasons set forth in their opinions, there is not surprisingly a growing temptation to adopt some type of bright-line test like the per se rule to achieve more predictable results more easily, if less "accurately."

This phenomenon has been manifested in the vertical distribution cases, which seem to cry out for a departure from the rule of reason approach for several reasons. First, as section I of this article will show, vertical cases frequently involve a package of restraints—a characteristic that compounds all of the difficulties of evaluation mentioned above. Second, vertical restraints reduce intrabrand competition in order, supposedly, to promote interbrand competition. Thus, even if we could identify and measure both the procompetitive and anticompetitive effects of a particular restraint, we cannot assume a one-to-one equivalency, and we lack a workable process by which we can compare the net effect each way. Thus, all we can presently do under the rule of reason is muddle through. Finally, under a rule of reason standard an avalanche of vertical restraint cases would be a real possibility. The extreme reaction to *Schwinn* from the antitrust bar implies more than dissatisfaction with the decision's rationale: It suggests thwarted desires to employ vertical restraints widely and, if necessary, the will to litigate their legality under the rule of reason. The delay and uncertainty that would inevitably result from such a volume of litigation would surely invite questionable uses of restraints and even more litigation. Thus, a rule of reason approach to such cases would cause great uncertainty, delay, and waste, could not yield predictable or consistent results,

15. See Posner, *supra* note 6, at 298. No one to my knowledge contends that economists, let alone judges, can provide consistent, predictable results in such cases, even if the necessary time and resource commitment were made. For this reason, perhaps, application of the rule of reason is being cut back in other areas governed by section 1 of the Sherman Act. Compare *United States v. Container Corp. of America*, 393 U.S. 333 (1969), with *Maple Flooring Mfrs. Assn. v. United States*, 268 U.S. 563 (1925). Furthermore, one recalls the confident assertion of the Federal Trade Commission that it was willing and able, as an expert administrative tribunal, to make rule of reason determinations in exclusive dealing cases, see *Maico Co.*, 50 F.T.C. 485, 488 (1953), despite the Supreme Court's conclusion in *Standard Oil Co. v. United States*, 337 U.S. 293, 309-14 (1949), that the courts could not. Hindsight suggests that the Commission's success in this effort was less than conspicuous. See generally Bok, *The Tampa Electric Case and the Problem of Exclusive Arrangements Under the Clayton Act*, 1961 SUP. CT. REV. 267.

and would have only the hollow satisfaction of theoretical purity to commend it.¹⁶

There is no known escape from this problem other than some kind of bright-line test or approach. One such approach is the "structural" rule of reason test presently used in exclusive dealing¹⁷ and merger¹⁸ cases, whereby certain readily ascertainable market factors are identified and weighed to predict market effects, but no effort is made to measure actual market effects, upon which volumes of relevant information might be produced.¹⁹ The other available bright-line standard is *Schwinn's* partial per se test, whereby the most restrictive practices are outlawed and other, less restrictive substitutes, which, as section II will show, are readily available to replace the prohibited restraints, are accepted as presumptively lawful under the rule of reason. Most of *Schwinn's* antitrust bar critics would probably also reject the structural approach, which was hardly applauded in its Clayton Act debut.²⁰ However, the full rule of reason approach these critics advocate as an alternative would throw the problem into the proverbial briar patch, in which only they would feel at home. Consequently, there is a temptation to disregard further consideration of their position, supported as it is by so obviously interested advocacy, until they acknowledge and deal with its obvious difficulties. In any case, it is the position of this article that the partial per se rule represents the best available balance between business needs and the imperatives of antitrust enforcement.

16. Professor Turner has recently articulated the nature of this problem in a different area of antitrust law as follows:

It would impose great and probably unmeetable demands on the capacity of the enforcement process to define exclusionary conduct accurately and precisely, and to reach appropriate results in a burgeoning variety and number of individual cases. It would greatly increase the risk that enforcement costs would considerably exceed welfare gains.

Turner, *The Scope of "Attempts to Monopolize,"* 30 REC. OF N.Y.C.B.A. 487, 498 (1975).

17. *E.g.*, *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 329 (1961); *Standard Oil Co. v. United States*, 337 U.S. 293 (1949). See Bok, *supra* note 15.

18. *E.g.*, *United States v. Philadelphia Natl. Bank*, 374 U.S. 321 (1963); *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962). See Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226 (1960).

19. For commentary in support of a structural or "truncated" approach for vertical distribution cases, see Note, 49 N.Y.U.L. REV. 957, *supra* note 5, at 969; Note, *supra* note 11, at 823-34.

20. One good reason is a growing awareness that structural factors are generally not accurate predictors of market performance, especially when only a few factors are examined, and that at best they are useful in identifying markets for which more extensive analysis may be productive. See generally H. GOLDSCHMID, H. MANN & J. WESTON, *INDUSTRIAL CONCENTRATION: THE NEW LEARNING* (1974).

I. THE USES AND EFFECTS OF VERTICAL DISTRIBUTIONAL RESTRAINTS

Vertical restraints are designed principally to reduce or eliminate competition in the distribution of a product.²¹ However, they may also strengthen the product's competitive stance, enhance interbrand competition, and effect a net competitive gain.²² It is necessary to determine, therefore, which end was sought or achieved, and then punish or commend accordingly. That inquiry, however, is difficult and complicated,²³ especially in the real world of mixed motives and effects.

Only one short cut has traditionally been accepted. If dealers coerce a reluctant manufacturer into imposing vertical restraints, they are regarded as acting horizontally and, ordinarily, illegally.²⁴ If, however, the restraints are unilaterally imposed by the manufacturer, the result is a series of vertical agreements in restraint of trade.²⁵ Whether these agreements are unlawful is the troublesome question. According to one line of reasoning, vertical agreements cannot ipso facto enhance the horizontal market power of a manufacturer,²⁶ and, to its partial detriment, such restraints will ordinarily reduce the level of dealer competition.²⁷ Consequently, if a manufacturer elects to employ them, it presumably anticipates countervailing, beneficial effects upon the marketing of its products. Therefore, it is argued,

21. See Comanor, *supra* note 8, at 1422-23.

22. *Id.*

23. See text at notes 14-16 *supra*.

24. This is the so-called masked horizontal restraint which is tantamount to illegal horizontal market division. *E.g.*, *United States v. General Motors Corp.*, 384 U.S. 127, 140-48 (1966); *White Motor Co. v. United States*, 372 U.S. 253, 267 (1963) (Brennan, J., concurring).

25. In theory, a vertical "agreement" need not exist since a manufacturer could unilaterally impose its will by threatening not to deal with those dealers who do not accede to its wishes. The line between a refusal to deal and an implied agreement is very fine, however. See *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960). In fact, *Schwinn* holds that a manufacturer's "firm and resolute" enforcement of its wishes will itself constitute an agreement under section 1 of the Sherman Act. 388 U.S. at 372.

26. See Bork, *Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception*, 22 U. CHI. L. REV. 157, 197-200 (1954).

27. It was once generally argued that since any distributional restraint might enhance dealer markups, it would also reduce retail sales to the manufacturer's detriment. While this is generally true for a single-firm monopoly, it does not follow for an oligopoly if the profits resulting from the inflated markups are used by dealers to create consumer preferences for the product, since product differentiation to some extent isolates a manufacturer, to its advantage, from price competition. See Comanor, *supra* note 8, at 1425.

such agreements should presumptively be regarded as reasonable, procompetitive measures, and certainly not as per se unlawful.²⁸

Despite its superficial appeal, there is a major flaw in this argument. Vertical restraints are ineffective in the face of interbrand competition unless the product already possesses market power, or the acquisition of such power is anticipated. The purpose or effect of vertical restraints, furthermore, may be to create, enhance, or preserve market power, ordinarily through common promotional efforts of the manufacturer and its distributors to differentiate the product.²⁹ In fact, since most vertical cases involve branded products susceptible to promotional differentiation, such a purpose or effect is likely, rather than merely speculative. Three conclusions seem to follow. First, if both a manufacturer and its dealers believe that the use of distributional restraints will create or preserve promotional differentiated market power, they will ordinarily concur in their imposition.³⁰ Consequently, inquiries into the source of the restraints—that is, whether the manufacturer truly acted unilaterally or was forced by its dealers to adopt vertical restrictions—rather than into their effects will often be unhelpful, irrelevant, or misleading.³¹ Second, if the principal purpose or effect of such restraints is the creation of market power, their existence obviously need not be tolerated, regardless of who imposed them. Third, if reasoned inquiry into such purpose or effect is, as suggested above, burdensome and generally unproductive, the use of a partial per se test to overcome these difficulties is still a potentially reasonable solution to the problem. Thus,

28. See Bork, *supra* note 8; Posner, *supra* note 6, at 298.

29. Comanor, *supra* note 8. Needless to say, not all product differentiation is to be condemned. Product differentiation and the associated market power that results from having a truly better product or distribution scheme, or from advertising and promotion that inform consumers of these merits, are desirable. Some promotional efforts, however, seek a measure of differentiation beyond that attributable to the relative superiority of the product, or in spite of its relative inferiority. I shall hereafter refer to these efforts as promotional product differentiation. It is obviously difficult to draw the line between legitimate promotion and promotional product differentiation. Nevertheless, a line does exist and we may legitimately make policy to discourage firms from crossing it, even though the available techniques are at present somewhat crude. And, of course, we can certainly forbid or refuse to exempt under the antitrust law restraints apparently having this goal as their principal purpose.

30. See P. AREEDA, *ANTITRUST ANALYSIS* 500-04 (2d ed. 1974).

31. See Posner, *supra* note 6, at 298. Although a manufacturer and its dealers might concur in the desirability of imposing restraints, they might disagree over the appropriate level of restraints. A rational manufacturer should never prefer a higher level than the dealers, who may desire more than "efficiency." See P. AREEDA, *supra* note 30, at 500 n.4. Thus, evidence of the source of the restraints might arguably be relevant in predicting their effects. Unfortunately, the line between coercion and cooperation is so hard to discern, and the measure of effects is so elusive, that some might tend to give evidence of the source of the restraints disproportionate weight.

while Professor Posner is correct in arguing that the crucial inquiry should focus on the effect rather than the source of the restraints, and that price and nonprice vertical restraints should be approached in the same fashion, both he and Professor Bork are far less persuasive in suggesting that unilaterally imposed restraints are necessarily or presumptively unharmed,³² and that none are appropriate for per se treatment. Before a standard can be devised for vertical restraints, however, it is necessary to examine their interrelated usage and effects.

A. *The Interrelationships of Vertical Restraints*

Vertical restraints vary significantly in anticompetitive impact. At one end of an imaginary scale there are territorial restrictions³³ and customer limitations,³⁴ which like resale price fixing generally bar competition, or some crucial aspect of it, absolutely; moving along the scale, there are the exclusive franchises³⁵ and location clauses,³⁶ which create significant territorial barriers to competition but do not explicitly prohibit it; finally, there are clauses providing for profit passovers³⁷ and areas of primary responsibility,³⁸ which do

32. See Posner, *supra* note 6, at 298; Bork, *supra* note 26. As Professor Areeda has pointed out, a manufacturer's strategy is to maximize profits, not sales, and it may succeed through a higher price per unit with reduced output, a result that "does not necessarily reflect more efficient resource use for society." P. AREEDA, *supra* note 30, at 504 n.12.

33. A territorial restriction "is a promise by the buyer that he will not sell the goods outside a specified area or to customers who reside or have their place of business outside of that area." Note, *supra* note 11, at 796.

34. Customer limitations embrace promises by the buyer not to sell to certain customers or classes of customers who are identified other than by their location. Included in this category are promises not to sell to governmental units or to other large customers whose business is reserved for the manufacturer; promises by wholesalers to sell only to retailers who have been approved by the manufacturer, by retailers to sell only for use and not for further resale, and by consumers not to sell at all; promises not to sell to a particular customer within a specified period of time after another dealer or distributor has made contact with him; and promises to sell only to a certain class of customers—drug stores but not hospitals, for instance.

Id.

35. The exclusive franchise or sole outlet provision "denotes a promise by the seller of the goods to the buyer not to sell to other outlets within the buyer's 'exclusive territory' and not to sell directly to consumers within that area." *Id.*

36. A location clause prohibits dealers from opening other outlets, especially in another's exclusive territory, without the approval of the manufacturer.

37. A profit-passover clause requires a dealer who sells in another's territory to pay over to the latter all or some portion of the former's profit on the sale. Note, *supra* note 11, at 814.

38. A primary responsibility clause requires a dealer to concentrate sales efforts in a particular territory or at a particular location. See generally Note, *Area of Primary Responsibility Clauses and the Antitrust Laws*, 35 U. PITT. L. REV. 671 (1974).

not prohibit intrabrand competition in the first instance, but only seek to "discourage" it to one degree or another. Not surprisingly, perhaps, the "bars" are now per se illegal,³⁹ and impediments like location clauses may be,⁴⁰ but the rest are presumptively lawful under the rule of reason.⁴¹

Restraints also vary in effectiveness and desirability depending on the type or level of distribution affected. This may be illustrated by several common examples. First, wholesalers that locate volume buyers through salespersons and ship to them are obviously more adversely restrained by territorial prohibitions than by location clauses.⁴² The opposite is true for most retailers, whose customers generally come to them. Thus, in order to obtain a territory closed to other authorized distributors, a wholesaler generally requires an exclusive franchise coupled with a territorial restraint, whereas a retailer generally requires an exclusive franchise coupled with a location clause.⁴³

Second, the effective marketing of some products at retail, especially low-priced, convenience goods like cigarettes and gasoline, ordinarily requires too many closely spaced outlets to permit the effective use of territorial restraints.⁴⁴ Sometimes so many dealers handle a product that inefficient sales volumes, discounting, price wars, and bankruptcy become everyday problems.⁴⁵ In such situations resale price control or limitations on the advertising of discount prices is the only potentially effective way to limit intrabrand competition.⁴⁶

39. *Schwinn* itself made territorial restrictions and customer limitations per se unlawful. Resale price fixing was barred long ago in *Dr. Miles Medical Co. v. John D. Parke & Sons*, 220 U.S. 373 (1911).

40. See note 4 *supra*.

41. Exclusive dealership or sole outlet agreements have generally been upheld, except where the grantor had monopoly power. *Packard Motor Car Co. v. Webster Motor Car Co.*, 243 F.2d 418 (D.C. Cir.), *cert. denied*, 355 U.S. 822 (1957); *P. AREEDA*, *supra* note 30, at 529 n.33. Area of primary responsibility clauses have routinely been approved by courts, see, e.g., *Colorado Pump & Supply Co. v. Febco, Inc.*, 472 F.2d 637 (10th Cir.), *cert. denied*, 411 U.S. 987 (1973), and inserted in consent decrees, see *Robinson*, *supra* note 4, at 279 n.216. In fact, such a clause appears in the final decree in *Schwinn* itself. 1968 Trade Cas. 85,568 (N.D. Ill. 1968). Courts have similarly approved the use of profit-passover clauses. See, e.g., *Superior Bedding Co. v. Serta Assoc.*, 353 F. Supp. 1143 (N.D. Ill. 1972).

42. See Note, *supra* note 11, at 811.

43. *Id.* at 796.

44. *Id.* at 795.

45. These events once occurred with regularity in the retail marketing of gasoline. See generally *FTC v. Sun Oil Co.*, 371 U.S. 505 (1963); *American Oil Co. v. FTC*, 325 F.2d 101 (7th Cir. 1963), *cert. denied*, 377 U.S. 954 (1964).

46. See *Simpson v. Union Oil Co.*, 377 U.S. 13, 19 n.5 (1964) (resale price control).

Third, in the marketing of expensive, durable consumer items, such as major appliances and automobiles, manufacturers can readily limit the number of their retail outlets and control intraband competition through distributional restraints.⁴⁷ In recent years, however, urban sprawl and suburbanization have often increased the number of outlets needed in metropolitan markets at a time when increasing consumer mobility, the growth of discounting, and the increasing geographic reach of some forms of advertising often require wider spacing of dealers to make geographic restraints effective.⁴⁸ Until recently, as noted in the second illustration, the most effective restraint was often resale price control, or, if that was not possible, limitations on the advertising of discount prices.⁴⁹ With the recent repeal of the Maguire Act,⁵⁰ however, all direct resale price maintenance is now per se unlawful, and manufacturers must attempt to deal only with dealers who either will not discount or will not advertise that fact, or refuse to deal with those who do.⁵¹

Fourth, some wholesalers may attempt to maximize their short-run sales volume by eschewing proper dealer spacing or selection.⁵² To prevent this, manufacturers have sometimes compiled lists of "approved" retailers, or have attempted to prevent wholesalers from selling to certain undesirable retailers, such as discount stores.⁵³ Such customer limitation clauses were also used to prevent wholesalers or retailers from selling excess or unwanted inventory at bargain prices to unauthorized retail outlets.⁵⁴ Such clauses are now

47. Note, *supra* note 11, at 795.

48. *Id.* at 804. For example, a television advertisement seen within a 50-mile radius, which is estimated to be the distance for which consumers will shop for automobiles, *id.* at 810, covers an area of approximately 7,850-square miles. If the advertiser's place of business is near the center of the circle, it can be reached by most viewers by automobile within an hour. Within that area, especially if it is a major metropolitan area with suburbs, a manufacturer of expensive, durable consumer goods must obviously have many authorized dealers.

49. Some manufacturers have sought to place limitations on discount price advertising within the context of their cooperative advertising plans. The Federal Trade Commission has, however, announced an intention to challenge such limitations. 74 F.T.C. 1681 (1968).

50. Pub. L. 94-145 § 2, 89 Stat. 801 (1975).

51. It is well known, of course, that the line between refusal to deal except on a stipulated condition and agreement is very indistinct and that one who seeks to walk it virtually courts a lawsuit. The risk is probably even greater when a manufacturer distributes through wholesalers and must use them to control the retailers. See *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); P. AREEDA, *supra* note 30, at 599-60.

52. Note, *supra* note 11, at 821.

53. See, e.g., *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967).

54. In *United States v. General Motors Corp.*, 384 U.S. 127 (1966), Chevrolet dealers were supplying automobiles to unauthorized discount houses. Because of the

per se unlawful under *Schwinn*,⁵⁵ and, therefore, a manufacturer who wishes to limit intraband competition must rely on lawful persuasion, dealer selection, or threats of termination.

Finally, clauses designating areas of primary responsibility or providing for profit passovers are essentially the less restrictive alternatives to territorial prohibitions,⁵⁶ but, as a practical matter, they are probably more effective generally in restraining cross-selling by wholesalers.⁵⁷ A primary responsibility clause in effect urges a distributor to cultivate its own fields; a profit-passover provision taxes it for harvesting another's. Of course, the former may be a cover for an illegal territorial division⁵⁸ and the latter may have that effect if the tax is high enough.⁵⁹ But absent such illegal purpose or effect, both are presumptively lawful today under the rule of reason.⁶⁰

B. Particular Restraints

1. The Exclusive Franchise

The foregoing discussion suggests that the linchpin of many distributional restraints is the exclusive franchise, which stakes out the territory for a particular dealer and excludes the manufacturer and its future appointees. It is reasonable to believe, therefore, that this restraint would be most susceptible to antitrust challenge. Experience has shown otherwise, however, and an inquiry reveals several,

continuing relationships between some dealers and the discounters, General Motors sought to curtail the practice by enforcing location clauses contained in the dealers' franchise agreements. Such relationships may also be barred by clauses requiring retailers to sell only for use and not for further resale. See Note, *supra* note 11, at 821.

55. 388 U.S. 365 (1967). Although some special exceptions to this rule have been announced by lower courts, see note 4 *supra*, none offer hope to manufacturers seeking primarily to prevent sales to unauthorized or undesirable outlets.

56. The profit-passover clause is, in fact, often the principal device by which manufacturers enforce violations of territorial clauses, because the alternative of terminating the franchise is often so onerous. See Note, *supra* note 11, at 814.

57. The retail price of some goods may include allowances for installation or warranty services. If the customer purchases from a distant dealer, he may call upon a local dealer for these services. *Id.* at 812. To compensate the local dealer, manufacturers often impose a profit-passover clause in their retail franchise agreement. *Id.* at 812, 814-15.

58. See, e.g., *Hobart Bros. v. Malcolm T. Gilliland, Inc.*, 471 F.2d 894 (5th Cir.), *cert. denied*, 412 U.S. 923 (1973); *Interphoto Corp. v. Minolta Corp.*, 295 F. Supp. 711 (S.D.N.Y.) *affd. per curiam*, 417 F.2d 621 (2d Cir. 1969). Cf. *Fontana Aviation, Inc. v. Beech Aircraft Corp.*, 432 F.2d 1080 (7th Cir. 1970), *cert. denied*, 401 U.S. 923 (1971).

59. See *Sharp Elec. Corp.*, 3 TRADE REG. REP. (CCH) ¶ 20,638 (1974).

60. See *White Motor Co. v. United States*, 372 U.S. 253, 271-72 (1963) (Brennan, J., concurring).

closely related, extremely technical reasons for its general antitrust immunity.

Virtually all restraints limit the conduct of distributors who purchase from the manufacturer; the exclusive franchise is an exception, however, since it limits the conduct of the manufacturer, who is the seller, and, consequently, it is not technically a restraint on alienation.⁶¹ Moreover, although the manufacturer needs promises from distributors to control their conduct, it obviously needs none to control its own. Therefore, it could always unilaterally implement a lawful program of de facto exclusive franchising even if the promise thereof were unlawful. Furthermore, a manufacturer could also conceal or deny oral promises by representing that its conduct was unilateral, and its refusal to franchise new dealers would not be evidence to the contrary. Finally, the exclusive franchise confers an individual benefit upon a dealer, who would bargain for it independently. Other restraints entail detriments for individual dealers that become benefits only when other dealers are similarly bound, and these are bargained for accordingly. The interdependent conduct of the dealers in the latter situation smacks of illegal horizontal group action,⁶² whereas their independent conduct in the former situation does not.⁶³

These distinctions, however, are formalistic and ignore the fact that a de jure exclusive franchise is still an agreement in restraint of trade⁶⁴ that dealers would seek to obtain, since it may dampen intrabrand competition to a greater degree than any other restraint.⁶⁵ Thus, a curious anomaly is presented: the territorial restraint most threatening to competition is virtually per se legal. An obvious ex-

61. *GTE Sylvania Inc. v. Continental T.V., Inc.*, 1974-1 Trade Cas. 96,792 (9th Cir. 1974), *revd. en banc*, 537 F.2d 980 (9th Cir.), *cert. granted*, 97 S. Ct. 252 (1976). In effect, the manufacturer that grants an exclusive franchise accepts a restraint upon its future sales. Traditionally, however, the doctrine has only protected purchasers. See *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911); Robinson, *supra* note 4, at 277 n.213.

62. See generally Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusal to Deal*, 75 HARV. L. REV. 655 (1962). Professor Turner argues that such conscious parallelism by dealers in accepting even interdependent restraints should not itself be prima facie evidence of horizontal agreement by them. Otherwise any unilateral program of such vertical restraints could then be found to be per se unlawful. *Id.* at 695-700. I do not mean to question that argument here. Nevertheless, that which is not itself prima facie evidence of agreement may still be considered probative of that fact in the light of other evidence.

63. See *Albrecht v. Herald Co.*, 390 U.S. 145, 161 (1968) (Harlan, J., dissenting).

64. 88 HARV. L. REV. 636, *supra* note 5, at 643 n.42.

65. Note, *supra* note 11, at 805-09, 824 (1962).

planation for this development is that some form of territorial protection is often necessary to recruit and retain dealers, who must invest substantial time, money, and effort in the development of their territories.⁶⁶ This is a concession that some distributional restraints are probably procompetitive and that not all of them should be declared per se unlawful. It does not follow, however, that none should be. Nor does it follow that the exclusive franchise should be virtually exempt from the rule of reason.⁶⁷ Some grants of exclusive franchise are unlimited in duration, or are extended routinely⁶⁸ beyond the time needed to attract new dealers.⁶⁹ Surely it is arguable that these are unreasonable and unlawful, and there is no reason why courts cannot so find. There is a good reason, however, why they have not and perhaps should not: Although the exclusive franchise is not challenged, even when it is arguably unreasonable, other restraints are condemned under *Schwinn*, even when they are arguably reasonable. In other words, a bright-line trade off has evolved whereby some restraints are conclusively unreasonable and others are presumptively reasonable in order to avoid the hard question of reasonableness in most cases.⁷⁰ Those who want *Schwinn* overruled have never acknowledged the existence of this compromise. They should understand that success in their endeavor may mean a closer scrutiny for other practices, the legality of which they now take for granted.

2. The Location Clause

As indicated above, the territorial restriction and the location clause are employed at the wholesale and retail levels respectively to confine distributors within specified sales areas.⁷¹ Since these restraints ordinarily are not complementary and, therefore, are rarely

66. *Id.*

67. The only apparent exception is when the manufacturer's market power becomes prohibitively great. P. AREEDA, *supra* note 30, at 529 n.33.

68. This may be the exception rather than the rule, especially at the retail level, where multiple outlets can better serve the convenience of retail customers. See Note, *supra* note 11, at 825-27. Nevertheless, in leading cases like *White Motor, Schwinn*, *United States v. Sealy, Inc.*, 388 U.S. 350 (1967) and *United States v. Topco Assoc., Inc.*, 1973 Trade Cas. 93,797 (N.D. Ill.), *affd.*, 414 U.S. 801 (1973), the exclusive franchises were all apparently unlimited in duration or were extended routinely.

69. The time period for new dealers would vary, of course, depending on the time, investment and effort required to create a successful dealership and the time needed to recover a sufficient return thereon to justify it.

70. See note 41 *supra*.

71. See text at notes 42-43 *supra*.

used together,⁷² the prohibition of the former in *Schwinn* is no reason, as some have argued, to exempt the latter. In fact the opposite conclusion is logically more compelling; otherwise territorial confinement and perhaps closed sales areas⁷³ would be barred at wholesale but permitted at retail.⁷⁴ Furthermore, if a limitation on where or to whom purchased goods may be resold is an illegal restraint on alienation, arguably so is a limitation on the location from which they may be resold.⁷⁵ Curiously, however, few commentators suggested after *Schwinn* that the location clause was implicated,⁷⁶ and many seemed to be genuinely shocked by the first decision to that effect.

These commentators argue that if the location clause were condemned, a manufacturer would lose all control over retail distribution and "would exhaust his right of dealer selection . . . once he appointed a single dealer"⁷⁷ since a dealer once "franchised anywhere . . . is franchised everywhere."⁷⁸ This conclusion is essentially correct, yet it did not deter the *Schwinn* Court from prohibiting the imposition of territorial restraints on wholesalers, to whom the same rationale applies.⁷⁹ There is no reason why retailers should not also come within the prohibition. Furthermore, in neither situation is the loss of control absolute. A dealer selling in another's exclusive territory will suffer increasing transportation costs unless the manufacturer is willing to ship directly to the dealer's customers or

72. I know of no case in which these two restraints were jointly employed. A likely situation, however, was that in *White Motor Co. v. United States*, 372 U.S. 253 (1963), where dealers enjoyed a locational advantage with respect to some customers, but were also able to compete for substantial nonlocal business.

73. An exclusive territory protected by territorial restraints or location clauses is a closed territory. 88 HARV. L. REV. 636, *supra* note 5, at 639.

74. It does not necessarily follow that an exclusive franchise can be lawfully used with a location clause just because neither is per se unlawful. Yet it has been argued that the combination is a natural one whose legality can be implied from the legality of the exclusive franchise. See, e.g., *GTE Sylvania Inc. v. Continental T.V., Inc.*, 537 F.2d 980 (9th Cir.) (en banc), *cert. granted*, 97 S. Ct. 252 (1976).

75. See *GTE Sylvania Inc. v. Continental T.V., Inc.*, 537 F.2d 980, 1009 (9th Cir.) (en banc), *cert. granted*, 97 S. Ct. 252 (1976) (Kilkenny, J., dissenting).

76. See, e.g., McLaren, *supra* note 6, at 144-45; Pollock, *Alternative Distribution Methods After Schwinn*, 63 NW. U.L. REV. 595, 603-04 (1968). One reason, perhaps, was the Supreme Court's refusal a year earlier to rule on the legality of such clauses, see *United States v. General Motors Corp.*, 384 U.S. 127, 139-40 (1968), which had theretofore been upheld, see *Boro Hall Corp. v. General Motors Corp.*, 124 F.2d 822 (2d Cir. 1942), *cert. denied*, 317 U.S. 695 (1943).

77. McLaren, *supra* note 6, at 145.

78. *GTE Sylvania Inc. v. Continental T.V., Inc.*, 537 F.2d 980, 998 (9th Cir.) (en banc), *cert. granted*, 97 S. Ct. 252 (1976) (emphasis omitted).

79. A wholesaler free of territorial clauses is as much franchised everywhere, once franchised anywhere, as is a retailer whose location cannot be fixed.

to any location it establishes there. Such direct shipments into the territory would, however, arguably violate the manufacturer's promise of exclusivity⁸⁰ and justify its refusal so to deal; such a refusal could, of course, be regarded as evidence of the "firm and resolute" enforcement of a territorial policy.⁸¹ But if it is lawfully implied in the grant of the exclusive franchise, as I think it is,⁸² a distributor's ability to operate anywhere at wholesale or retail is significantly limited by the cost of transshipping merchandise from its nearest authorized location.⁸³ Finally, a manufacturer's ability to control

80. There is some evidence that manufacturers have refused to make such direct shipments in order to discourage territorial invasions. Apparently some have also refused to supply all or part of the merchandise needed. Note, *supra* note 11, at 816-17. The legality of these tactics is discussed in note 82 *infra*.

81. See note 24 *supra*.

82. A seller that grants an exclusive franchise promises not to sell to anyone within the territory. See note 35 *supra*. Thus, it seems lawful for that seller to refuse to deal directly with another dealer's location within that exclusive territory or, arguably, to refuse to ship to customers within that territory at the order of an invading wholesaler, since to do otherwise would appear to be a breach of contract. A more difficult question concerns the legality of a refusal to supply to an authorized location all or part of the inventory that the dealer intends to ship to or sell in another's exclusive territory. The manufacturer does not seem to be violating the other's exclusive franchise, and since it would otherwise willingly fill the order, its refusal to do so would be tantamount to an imposition of a territorial condition on resale.

Similar analysis presumably applies if a manufacturer has promised not to enfranchise more than a certain number of dealers within a territory or has simply promised the existing dealers not to enfranchise anyone else. But what if no such exclusive promises have been made? Perhaps a manufacturer's right to choose dealers with such territorial considerations in mind itself includes the right to such partial refusals to deal. Thus, if a manufacturer could lawfully refuse a new franchise in city X because the distributor there, though not protected by a promise of exclusivity, is thought to be adequate, why should it be compelled to deal directly with a new location there owned by a dealer franchised elsewhere?

83. Such partial refusals to deal are not as readily available to a manufacturer who sells to wholesalers. According to *Schwinn*, a manufacturer may not limit or select retail customers of wholesalers. Consequently, it presumably may not grant to a retailer an exclusive franchise that would be enforceable upon a nonassenting wholesaler, who, as a practical matter, must make the grant itself and would thereafter be bound like a manufacturer dealing directly.

The real question, then, is whether a manufacturer can compel or contractually bind reluctant wholesalers to make such grants or otherwise to restrain their retail customers. This question has not been discussed widely. The Court in *United States v. Parke, Davis & Co.*, 362 U.S. 29, 45-46 (1960), suggests that a manufacturer's threatened refusal to deal with a wholesaler who continues to deal with an offending dealer named by the manufacturer exceeds the exception in *United States v. Colgate*, 250 U.S. 300 (1919). *Parke, Davis* does not hold, however, that a manufacturer cannot convey in advance to a wholesaler a desire for a policy of restricted retail distribution and simply refuse to deal with one who fails to honor it. Furthermore, no case prohibits a manufacturer from binding a wholesaler by contract to any such program that the manufacturer could itself lawfully impose upon retailers with whom it deals, or might have dealt, directly. Arguably, there is no restraint upon alienation if, in satisfaction thereof, the wholesaler then grants exclusive franchises that prevent it from dealing with others. The promise to make such grants could of course be

locations and protect territories at retail has already been substantially impaired by the per se illegality of customer limitation clauses, which were used to prevent distributors from "enfranchising" unauthorized persons within another's territory.⁸⁴ It does not follow, of course, that because a manufacturer's control over retail locations has been limited, it must be eliminated. On the other hand, new locations by authorized retail dealers will often be more potent competitors than unauthorized bootleg dealers.⁸⁵ Consequently, if a manufacturer can no longer use customer clauses to bar the latter, it should a fortiori also be unable to use the more restrictive location clause to bar the former.⁸⁶

It follows from this analysis that the location clause is directly implicated by the result in *Schwinn*, and not merely by a mindless application of its restraint on alienation rationale. Consequently, if it is not to be declared per se illegal, it must be otherwise differentiated from the territorial clause or shown to fulfill a need peculiar to retail distribution. Some commentators claim the two clauses are distinguishable in their effect: the location clause, it is argued, only hinders competition whereas the territorial clause bars it absolutely.⁸⁷ This claim is exaggerated on both ends. At the retail end a dealer with a fixed location may, of course, freely solicit distant customers. Such efforts, however, lose effectiveness and eventually become insignificant as the distance from the potential customer increases, and the price of the goods and therefore the customer's potential saving decreases.⁸⁸ At the point where the retailer must relocate to make the distant sale, however, the location clause insidiously bars the way. On the wholesale end, in contrast, a territorial restraint is an absolute bar to intrabrand competition only if the manufacturer

condemned as unreasonable under section 1 of the Sherman Act, but there is no obvious reason why it should be illegal if what it requires of the wholesaler is permissible. *Parke, Davis* is not to the contrary because there the manufacturer sought to compel wholesalers to enforce an otherwise illegal scheme of resale price maintenance. Still, some might argue that a manufacturer must take the bitter with the sweet if it does not choose to assume the wholesaling function. But often the choice is mandated by what is financially or economically feasible. What reason is there to reward those who can make it or to punish those who cannot?

84. See text at note 54-55 *supra*.

85. See *GTE Sylvania Inc. v. Continental T.V., Inc.*, 537 F.2d 980, 997 (9th Cir.) (en banc), cert. granted, 97 S. Ct. 252 (1976).

86. See 88 HARV. L. REV. 636, *supra* note 5, at 645 n.51.

87. See *GTE Sylvania Inc. v. Continental T.V., Inc.*, 537 F.2d 980, 990 (9th Cir.) (en banc), cert. granted, 97 S. Ct. 252 (1976).

88. Note, *supra* note 11, at 810. Furthermore, the expensive products that might attract distant customers may require service that local dealers are often reluctant to give at all or on equal terms with those who purchased from it. To overcome the fear of second-class local service or inconvenient distant service, the potential price saving may have to be even greater.

is prepared to stop dealing with offenders. Many manufacturers apparently were reluctant to do so, and instead merely ordered offenders to pay over a portion of their profits.⁸⁹ Thus, as a practical matter the territorial restraint is not always an absolute bar to competition, and the location clause often is; efforts to distinguish the two restraints on this basis should fail.

In one sense, however, the location clause may fulfill more compelling business needs than does the territorial restraint. Wholesalers who raid the territories of neighboring dealers are generally readily subject to retaliation in kind, since wholesalers as a class are mobile. Consequently many of them, in recognition of their mutual interdependence, will strive to keep the problem of cross-selling within manageable limits, in which effort the manufacturer may assist through the imposition of certain, generally lawful, restraints.⁹⁰ Such constraints are generally also effective in dampening retail competition through cross-advertising.⁹¹ They are ineffective, however, in preventing or controlling the effects of new locations. Retaliation in kind by invaded dealers is slow and often beyond the means of many, who are, therefore, the most likely victims; other available distributional restraints are not particularly effective in deterring the effort or in ameliorating its effect.⁹² The real constraint upon new locations is the cost and risk involved, but that is neither solace to the dealer who has in fact been attacked, nor assurance to the prospective dealer who sees strong, expansion-minded dealers nearby. In this situation, therefore, the location clause may be more important to retail distribution than the territorial limitation is to wholesale distribution, and the former, therefore, arguably should not be condemned as per se unlawful,

89. *Id.* at 814-15, 827.

90. The grant of exclusive franchises, refusals to drop-ship into another's territory, and the use of reasonable profit passover or area of primary responsibility clauses will discourage cross-selling by wholesalers.

91. The retailer who aggressively advertises in nearby localities is generally subject to ready retaliation in kind. Furthermore, it may be financing the effort in part with cooperative advertising funds, which the manufacturer may then limit. Finally, to the extent that one dealer is compelled to give service to those who purchase from another, the manufacturer can compensate him fully or provide for a profit passover in the case of prepaid service. Note, *supra* note 11, at 816.

92. 88 HARV. L. REV. 636, *supra* note 5, 644 n.49. The *Topco* decree, however, approved a provision that required the invading dealer to compensate the other through a fixed-sum payment or profit passover for the goodwill for the product that the latter had cultivated. *United States v. Topco Assoc., Inc.*, 1973 Trade Cas. 93,797 (N.D. Ill.), *affd.*, 414 U.S. 801 (1973). Such compensation arrangements must be reasonable. If they are based on sales by the new location, it must render an accounting. Of course, if the manufacturer supplies the new location directly, it could credit the account of the invaded dealer directly for each item shipped. See Note, *supra* note 11, at 814-15 n.74.

especially when used alone, just because the latter is. Otherwise, a manufacturer that requires new, nonexclusive⁹³ retailers would be unable to promise them any significant territorial protection.

If these distinctions suggest that the location clause should not be per se unlawful, they also suggest its use should be significantly limited only to new dealers, or perhaps only to nonexclusive new dealers,⁹⁴ for a limited time.⁹⁵ The anticompetitive effects are

93. In marketing situations in which locational convenience is important to retail customers, the retailers might rationally be denied exclusive franchises even though such franchises were given to wholesalers serving them. Note, *supra* note 11, at 803. A retailer might then request a location clause in substitution for an exclusive franchise and plausibly contend that the choice between them should not face different legal consequences. Respondent's Brief for Certiorari at 14-15, *Continental T.V., Inc. v. GTE Sylvania Inc.*, 537 F.2d 980 (9th Cir.) (en banc), *cert. granted*, 97 S. Ct. 252 (1976). There are two reasons why this argument should not be accepted. First, an analogous argument that could be made with respect to the choice between territorial restraints and exclusive franchises was effectively rejected by *Schwinn*. The obvious reason is that the exclusive franchise is technically not a restraint on alienation, whereas the alternatives are. See note 61 *supra*. Second, a manufacturer lawfully permitted to employ territorial restraints or location clauses alone might also grant de facto exclusive franchises and, therefore, de facto closed territories. See note 94 *infra*. The converse is, of course, not possible.

94. Allowing the temporary use of the location clause in nonexclusive new-entry situations would actually be a minor concession. By definition some degree of intrabrand competition would exist. Furthermore, during that period the new entrant would presumably provide the area with sufficient additional capacity or locational convenience to discourage other dealers from locating there anyway, unless they undertook to drive it out of business. Barring such a possibility, the temporary use of location clauses may give the potential new entrant the assurance to undertake the dealership without significantly harming competition.

A harder question is whether to permit a location clause to operate in favor of a new dealer who has no promise of exclusivity but who in fact enjoys it. A negative answer invites litigation over whether a territory is actually exclusive. Cf. *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500 (1959) (analogous antitrust litigation over whether one theatre was in competition with another and could, therefore, enjoy clearance over it). An affirmative answer means that de facto closed territories may exist temporarily at the retail level and invites manufacturers to conceal promises of exclusivity in order to offer them. It also invites litigation alleging such concealment by dealers barred from opening new locations. Although litigation either way will usually last longer than the temporary location clause that provokes it, it offers a treble damage payoff to any dealer who successfully undertakes it. Most such litigation could be eliminated if the manufacturer were permitted to couple an exclusive franchise with a location clause and offer the new dealer a temporary closed territory. But such a concession appears to be inconsistent with *Schwinn*. Of course *Schwinn* never specifically ruled out the temporary use of territorial prohibitions, alone or in combination with an exclusive franchise in the new entry or failing company situations. See Zimmerman, *supra* note 6, at 1181. There is some reason to believe that eventually the Court will make this exception. Cf. *United States v. Jerrold Elec. Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *affd. per curiam*, 365 U.S. 567 (1961) (similar exception for tie-in sales). See generally note 4 *supra*. To the extent the Court does make this exception, it will presumably create a similar exemption for location clauses. To the extent it does not, however, the refusal need not apply equally to the location clause, which, I have argued, is partially distinguishable. See text at notes 90-96 *supra*.

95. There are other problems of retail distribution for which the location clause

reduced since new entrants must still face interbrand competition. If eventually they cannot survive without protection from intrabrand competition, their departure from the market is not a significant loss; nor is it a serious social loss if, as a result, the manufacturer or a line of products is forced out of the market.⁹⁶

There is a second important reason to prohibit the unrestricted use of location clauses. It is generally assumed that distributional restraints deter only intrabrand competition, but this may not be true for location clauses. Because of changing distributional patterns and antitrust constraints on exclusive dealing, retailers today are far less likely to be single-brand outlets.⁹⁷ Nevertheless, those retailers subject to a location clause with respect to some brands will undoubtedly consider that fact in choosing new locations. For example, in *United States v. Topco Assoc., Inc.*,⁹⁸ a large number of supermarket chains jointly established a private-label purchasing company, and each chain effectively agreed not to sell the private-label brand from new locations in the territory of the others. To the extent that this prohibition affected each chain's choice of new locations, potential competition among them with respect to the other brands they carried, obviously the major part of their business, was also restrained or eliminated. Indeed, because of the importance of the private-label brand, the location clauses there may have amounted to a noncompetition pact.⁹⁹

Obviously, we should not permit one manufacturer to accomplish that which would ordinarily require the combined illegal efforts of a number of competing manufacturers or dealers. However, to evaluate such effects of location clauses as these on a case-by-case, rule of reason basis, we must consider such factors as the importance of the brand subject to the location clause, the number of dealers of that brand within the territory, the number of other brands carried by the affected dealer, the number of these brands also affected by location clauses or other territorial restraints, and the duration of and

would be an effective solution. I shall, however, suggest below that there are other, less restrictive means of achieving these ends. See text at notes 146-51.

96. See Zimmerman, *supra* note 6, at 1186.

97. The large number of American automobile dealers who now also sell one or more makes of foreign cars is perhaps the best illustration of this trend.

98. 405 U.S. 596 (1972).

99. Such a result was not unlikely, although the participants claimed otherwise, because of testimony that private-label sales were profitable, popular, and needed to compete with the largest chains, which were able to undertake efficient private-label programs individually. 405 U.S. at 599 n.3, 600.

justification for the location clause in question. To describe the scope of the inquiry is to show its impossibility.¹⁰⁰ Furthermore, legality could then vary from one retailer to another,¹⁰¹ as well as from one brand to another. The game would not be worth the candle; consequently, location clauses should be generally outlawed, subject to some exception for new entrants.

The preceeding discussion is clearly at odds with the recent en banc opinion of the Ninth Circuit in *GTE Sylvania Inc. v. Continental T.V., Inc.*¹⁰² Although the opinion holds only that location clauses are not per se unlawful, it places no significant limitations on their use, posits no criteria for measuring their reasonableness, and in effect suggests that they are, like exclusive franchises, per se reasonable.¹⁰³ Furthermore, although the court's opinion recog-

100. The Supreme Court has said, with regard to the use of the per se rule in other contexts, that it "avoids the necessity for an incredibly complicated and prolonged economic investigation . . . an inquiry so often wholly fruitless when undertaken." *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958).

101. The suggestion that location clauses be permitted to operate only in favor of new dealers obviously also means that their legality will vary from one dealer to another. In that case, however, the manufacturer would presumably employ some uniform time period for all new entrants, and after some initial litigation as to what is reasonable, the standards developed should be sufficiently clear to discourage prolonged litigation.

102. 537 F.2d 980 (9th Cir.) (en banc), cert. granted, 97 S. Ct. 252 (1976).

103. The majority makes much of the fact that in 1962, when Sylvania undertook restricted distribution, its market share had fallen and it had reached or was approaching the point where it might have to abandon the market altogether. See 537 F.2d at 991. Consequently its status as a "failing" company entitled it, like a new entrant, to use the restraints for a reasonable period. See *Sandura Co. v. FTC*, 339 F.2d 847, 850-53 (6th Cir. 1964). However, such a period should last no longer than the emergency that gives rise to it. See *United States v. Jerrold Elec. Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), affd. per curiam, 365 U.S. 567 (1961). The majority, like the Sixth Circuit in *Sandura*, makes no inquiry into whether the emergency continued in 1965, does not suggest that the burden is on the company to show its continuance, and ignores substantial evidence that it had indeed ended. In fact, when Sylvania's dispute with plaintiff began in 1965, its market share had risen to five per cent, and in the majority's own words, it "had emerged as a vigorous competitor ranking as the nation's eighth largest manufacturer and seller of color television sets." 537 F.2d at 984. Arguably the emergency was over then, as some of the dissenters had argued in the initial majority panel discussion. See 1974-1 Trade Cas. 96,796. See generally Note, 1975 DUKE L.J. 935, supra note 5, at 949 n.88.

As an answer to this argument, some would note that it is obviously very difficult to determine when an emergency has ended and that courts, therefore, should hesitate to find that once-lawful restraints were terminated a few months or a year too late, if the consequence is liability for huge treble damages. This answer, while essentially persuasive, must be qualified. First, even if damages were awarded in this situation, they should arguably only cover the excess time period. Second, if Sylvania had been relying on the existence of such an emergency to justify its restraints, then it should have been aware of the possibility that the emergency had ended when it deliberately terminated its relationship with plaintiff. Finally, when the trial court's injunction against further enforcement by Sylvania of its location clauses was issued almost a decade later, the emergency or the dispensation had surely ended. Thus in

nizes that Sylvania was not also granting exclusive franchises,¹⁰⁴ it states that a combination of the two restraints is natural and reasonable.¹⁰⁵ Thus, it would apparently allow closed territories at retail, even though they are prohibited by *Schwinn* at wholesale, and it effectively gives back to many retailers what Congress the same year took away by scuttling the fair trade laws.¹⁰⁶

These anomalous results occur in *Sylvania* without acknowledgement, let alone explanation. This is perhaps understandable because the opinion is largely drawn from the published criticisms of *Schwinn* and the initial decision in *Sylvania*, and, like its precursors, it is apparently not anxious to spell out the full implications of its holding. Since the opinion adds nothing new to the argument of *Schwinn*'s critics, which I have sought to challenge at length here, I shall otherwise leave it to the tender mercies of the law reviews, which to date have unfortunately also tended to follow without question the prevailing critical orthodoxy.

its failure in 1976 to limit, or to discuss limits upon, a giant conglomerate corporation that arguably had special needs in 1962, the majority suggests a policy of virtually no limits on per se reasonableness. Furthermore, in its failure to make any inquiry into the needs or the competitive situation of the dealer Sylvania sought to protect, it suggests that Sylvania could protect all dealers, including powerful, well-established chains.

104. 537 F.2d at 983. The dissent, however, notes that the invaded dealer accounted for all of the sales of Sylvania color television sets (and most of the black and white ones) in Sacramento in 1965. 537 F.2d at 1010. One wonders how many more large cities like Sacramento effectively had only one Sylvania dealer. For a discussion of the legality of combining de facto exclusive franchises with location clauses, see note 94 *supra*.

105. The majority argues strenuously that [i]f it is legal for a manufacturer to promise one dealer that he will have the exclusive right to sell the manufacturer's products within a designated territory, then obviously it is legal for that manufacturer to keep his promise of exclusivity by denying other dealers like Continental the power to sell from retail outlets at unauthorized locations within the first dealer's exclusive territory. 537 F.2d at 997. This conclusion is not compelled by the usual language of contracts granting exclusive franchises nor by inescapable logic. A standard, exclusive-franchise contract, it must be remembered, does not require a manufacturer to intervene should the exclusive franchisee's territory be invaded, nor does it include any provision that restricts other dealers. See note 35 *supra*. Thus, so long as the manufacturer does not directly sell to other purchasers in the exclusive franchisee's territory, it is not in violation of its contract. Further, it can be argued that, in some instances, it may be unlawful for the manufacturer to refuse to provide an invading dealer located elsewhere with goods it would sell in the exclusive franchisee's territory. See note 82 *supra*. However, a court adopting the assertion of the majority in *Sylvania* will generally accept as lawful the use of both location and exclusive franchise clauses, and, therefore, permit closed territories.

106. See generally Comanor, *supra* note 8, at 1427. Closed territories may have more serious effects than resale price fixing because they also prevent nonprice intrabrand competition. Furthermore, the price chosen by a retailer protected from competition by a closed territory will often exceed but should never fall short of the price the manufacturer would choose under a fair trade or price fixing arrangement. P. AREEDA, *supra* note 30, at 500-01.

II. THE JUSTIFICATIONS FOR DISTRIBUTIONAL RESTRAINTS

The nonrestrictive purposes of, or justifications for, distributional restraints have already been examined extensively in the literature¹⁰⁷ and do not require lengthy explication here. Essentially, vertical restraints are useful in facilitating three basic goals of successful distribution: the recruitment of new dealers, the provision of dealer services thought necessary to market the product effectively, and the proper exploitation of each dealer's sales territory.¹⁰⁸ In considering each goal separately, this section will show that a variety of restraints, with varying degrees of anticompetitive effect, are available to the manufacturer seeking to attain a particular goal.

A. *The Recruitment of New Dealers*

Economic theory suggests that new investment should occur whenever the prospective rate of return exceeds the opportunity cost of capital, which is presumed to include a premium for risk and uncertainty.¹⁰⁹ Since distributional restraints are designed to raise the prospective return or to reduce the risk of investment, they should attract an even higher level of investment in distribution than otherwise.¹¹⁰ Such artificial stimulation of capital investment in excess of the socially optimal level, however, is hardly a customary goal of antitrust policy. One reason for the tender regard for it in the vertical context is that distributional restraints are most effective in the marketing of differentiable goods through franchises.¹¹¹ Such factors, however, tend to raise entry barriers and to concentrate such markets at the manufacturing level.¹¹² To enter them, a manufacturer must recruit good dealers quickly in order to increase sales and thereby lower its unit costs of production and of advertising and promotion.¹¹³ In addition, the dealers' efforts to promote the

107. See, e.g., Comanor, *supra* note 8; Zimmerman, *supra* note 6; Note, *supra* note 11.

108. Comanor notes as additional justification the "free ride" and price discrimination problems. See Comanor, *supra* note 8, at 1432-33. The former problem will be discussed in the section on provision of dealer services. See text at notes 129-37 *infra*. The latter is not discussed because it raises concerns peripheral to this article.

109. Comanor, *supra* note 8, at 1428.

110. *Id.* at 1429.

111. *Id.* at 1428.

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

113. *Id.* A manufacturer that erects a plant of optimal size will presumably not achieve the lowest possible unit costs at substantially less than full capacity operations. *Id.* at 53. Meanwhile, it must pay the debt service costs attributable to the unused capacity.

product and develop goodwill for it should help to overcome any product differentiation barrier.

Thus, the use of distributional restraints to facilitate new entry into concentrated manufacturing markets, even at the temporary expense of intrabrand competition in the new product, may represent a reasonable tradeoff.¹¹⁴ In effect, however, each new entrant employing vertical restraints is being permitted to fight fire with fire, and care must be taken lest one prematurely burns the bridges for subsequent entrants.¹¹⁵ Furthermore, manufacturers that build the proverbial better mousetrap will presumably attract dealers even without such added inducements, whereas those that obviously have not will presumably fail in any case. The majority of entrants fall between these two extremes, and they should be able to succeed if they can temporarily give new dealers some reasonable level of protection. A larger dispensation should be necessary only for those entrants whose prospects are otherwise unpromising, and whose exit from the market represents no societal loss.

There are no simple solutions, however, to the problem of determining who may claim the exemption and for what time period. It is accurate but not very helpful to say that those able to demonstrate legitimate, temporary needs will be permitted to use an otherwise unlawful restraint or package of them for a limited period of time. Fortunately, more specificity can be obtained by examining some typical situations. One such situation involves true new entry by a dealer or distributor, which may make a substantial investment in plant, equipment, and inventory, and incur considerable advertising and promotional expenses. There are two crucial determinants here: The first is the length of time this new entrant should require to show a profit or to achieve normal profits; and the second is the additional time it needs to recover enough of its startup costs to make the initial investment attractive.¹¹⁶ These considerations should suggest some reasonable time period, roughly approximated in years or substantial fractions thereof, during which a manufacturer can lawfully impose restraints uniformly on all such new dealers, and to

114. Zimmerman, *supra* note 6, at 1186. *Schwinn* noted the possibility of an exception for new entrants or failing companies, but declined to rule on it. 388 U.S. at 374.

115. A new entrant is being assisted in the creation of product differentiation and a dealer network, the very things that those already in the market used to create the entry barriers that necessitate this assistance. Thus, there is the danger that the new entrant will surmount these barriers, join those already behind them, and in the process raise entry barriers even higher.

116. See note 135 *infra*.

which the courts should accord some latitude in reviewing its reasonableness.

Other factors will of course affect the calculation of the period or our perception of its reasonableness. The intensity of interbrand competition¹¹⁷ and the anticipated intensity of intrabrand competition after the exemption terminates¹¹⁸ are two obvious considerations. Another is the situation of the manufacturer. If it is a new entrant into manufacturing, it must recruit many dealers rapidly, for which need some allowance should perhaps be made. If, however, it is entering a new product or geographic market, or is merely adding new dealers in existing markets, its need for haste may be less and its bargaining position with dealers may be stronger. In addition, the dealer's risk and attendant needs may be reduced.¹¹⁹ On the other hand, a single new dealer may be justifiably apprehensive of intrabrand competition from established neighboring dealers and may require a longer period of insulation.

Another typical situation involves the recruitment of established dealers to handle a new product or product line. Their capital outlays should be smaller, and often so should their outlays for advertising and promotion.¹²⁰ Indeed, they may well be satisfied with exclusive franchises and some protection against "free riding" by neighboring dealers.¹²¹ If they must invest substantial time, effort, and money in developing the territory, however, they understandably wish to enjoy alone the first fruits of their efforts and are fearful that intrabrand competition might drive down markups before the profit corner has been turned and some portion of the initial invest-

117. Intensive interbrand competition should hold down the price of competing or substitute products, which should in turn limit the price of the product in question despite the use of vertical restraints. This might not be true if the product in question enjoys substantial differentiated market power, the existence of which would, of course, limit or negate any claimed exemption.

118. If vigorous intrabrand competition is not anticipated at the termination of the exemption period, either because of natural factors such as high transportation costs, or because of the manufacturer's selection of nonaggressive dealers, its award of exclusive franchises, or its wide geographical spacing of dealers, the exemption should perhaps be limited. Conversely, when vigorous postexemption competition is anticipated, the exemption could be appropriately extended.

119. A dealer taking on a brand established in other markets may still have to make extensive capital outlays, for which some protection may properly be sought. But its prospects for success are greater and the need for advertising and promotion may be less.

120. On the one hand, illustratively, a wholesale supply house may be able simply to feature the new product in its catalog or showroom. On the other hand, a new or different kind of product may require, among other things, extensive advertising and promotion, outlays for inventory and spare parts, and the training of service personnel.

121. See text at notes 129-30 *infra*.

ment has been recovered. Thus, the nature of the calculation of any reasonable exemption period here is similar to that in the first example, but its duration should, in most cases, be shorter.

The last and most difficult situation is one in which an established manufacturer finds that its competitive position is declining or failing. That fact alone may not justify an exemption, but together with other factors, it might. Two cases are instructive here. In *Sandura Co. v. FTC*,¹²² the record showed that the company had almost been forced into bankruptcy by product failures. After solving this problem, *Sandura* had to undertake a substantial advertising campaign, which it could not alone afford, to regain its market image and position. It therefore offered closed territories to dealers willing to help finance the campaign. The Federal Trade Commission and the Sixth Circuit both concluded that such dealer efforts, which seem indistinguishable from those discussed above, properly earned an exemption.¹²³ The Sixth Circuit, however, reversed the Commission's finding that the exemption period had expired, concluding that it should run indefinitely because substantial dealer advertising would otherwise terminate. That conclusion was, in my opinion, both factually and legally erroneous.¹²⁴

The second illustrative case is *G.T.E. Sylvania Inc. v. Continental T.V., Inc.*¹²⁵ There the company's market position had declined, but reasons for it were not given, and the cure apparently did not involve either dealer expenditures or recruitment. Indeed, to implement the company's "elbow room policy," some dealerships may have been terminated in order to give the remaining ones ample territorial separation. Location clauses were then imposed upon the remaining dealers in return, apparently, for their promises not to discontinue handling the company's television sets and perhaps for promises to push them. There is a serious doubt whether this situa-

122. 339 F.2d 847 (6th Cir. 1964).

123. See 339 F.2d at 855-59.

124. Continuing advertising and promotional outlays are marginal costs, which dealers will rationally include in price determinations made even in situations of intense price rivalry. See note 135 *infra*. No facts were offered to show that *Sandura* dealers were unable to recover such costs. If the problem was "free riding" by some dealers who did not advertise widely, *Sandura* could have required minimum advertising outlays or levels proportionate to sales. Once the success of its improved product was assured, it presumably could have done this without suffering large-scale dealer defections. If it could not, its comeback clearly must have failed, and it lacked any excuse for further immunity.

125. *GTE Sylvania Inc. v. Continental T.V., Inc.*, 537 F.2d 980 (9th Cir.) (en banc), cert. granted, 97 S. Ct. 252 (1976). For a more detailed discussion of the relevant facts, see note 103 *supra*.

tion justifies an exemption,¹²⁶ for the dealers apparently made no substantial new investment, outlays, or efforts. Furthermore, this type of situation does not seem to offer the guidelines that would permit calculation of a reasonable exemption period. Finally, defendant apparently did not lack other options;¹²⁷ it appears that Sylvania simply chose the cheapest and easiest one—vertical restraints in return for dealer commitment. If a large conglomerate corporation could make this choice in the face of adversity, who could not? Arguably more concern should be shown for a small, struggling firm in a concentrated market where entry is difficult, and perhaps enforcement agencies should briefly look the other way while it tries. Thereafter, it might even be preferable if the company left the market or were forced to sell out to others better able to run it.¹²⁸

B. *The Provision of Services*

A manufacturer may believe that the provision by dealers of certain services, some of which are expensive, is essential to the effective marketing of its products.¹²⁹ Each dealer, however, would presumably choose to provide only those services its market would profitably support. Some dealers, knowing that others nearby are providing expensive services like showrooms or repair facilities that are available to everyone's customers, might not provide these services, and might instead pass on the savings in the form of lower prices that attract sales away from dealers providing services. As a result, these dealers might eventually be forced to lower the level of services they provide.¹³⁰ Such "free-rider" problems¹³¹ can be

126. Needless to say, this conclusion would not affect the result in the case unless Sylvania's use of location clauses was otherwise unlawful.

127. For example, Sylvania might have begun a new advertising or promotional campaign, which presumably it was financially able to undertake.

128. Obviously, the temporary loss of intrabrand competition is preferable to the company's failure or its acquisition as a failing company by a competitor if no other purchaser can be found. But there is no guarantee that the loss will be temporary and no justification for accepting it indefinitely. Furthermore, in the face of the difficulty of rationalizing and defining such an exemption, it seems wiser to reject it officially and to rely on prosecutorial discretion for partial implementation.

129. The manufacturer may desire that dealers have expensive showrooms or display facilities, carry a full line of inventory, advertise or otherwise promote the product, or provide service or installation facilities and carry the necessary parts. Note, *supra* note 11, at 806-08. For example, it was estimated in 1962 that the cost of opening a metropolitan automobile dealership supplying such services was between \$600,000 and \$1,000,000. *Id.*

130. Some services like repair facilities, which charge customers separately, may not raise the dealer's prices and are not, therefore, necessarily vulnerable to free riding, as are other services like elaborate showrooms.

131. See Comanor, *supra* note 8, at 1432; Posner, *supra* note 6, at 285.

eliminated if all dealers provide a uniform level of services. If they cannot be persuaded by the manufacturer to do so, a service requirement could be made a condition to obtaining the franchise,¹³² or, alternatively, the manufacturer could provide the services itself.¹³³ Often, however, a manufacturer cannot afford to provide all of them itself,¹³⁴ and although many dealers could make up the difference, they will be reluctant to do so without protection from intrabrand competition necessary to secure the high markups required to permit recovery of the substantial fixed costs of some of these services.¹³⁵ Thus, such protection is often the quid pro quo for mandatory dealer services,¹³⁶ or the necessary incentive for those provided voluntarily.¹³⁷

It may initially seem surprising that a manufacturer would seek to compel the provision of expensive services in excess of what the market will support, and that its products can compete at the resulting higher prices against other brands not so burdened.¹³⁸ The only

132. See Note, *supra* note 11, at 806-08.

133. For example, an increasing number of appliance manufacturers now provide their own repair facilities. See *id.* at 807-08 n.52.

134. See, e.g., *Sandura Co. v. FTC*, 339 F.2d 847 (6th Cir. 1964).

135. To the extent that the market will not support the level of services demanded by the manufacturer, the dealers obviously will not supply them unless the manufacturer pays the difference or the restraints permit supracompetitive returns. But a problem exists even when competitive returns will support the services. Some services, like expensive showrooms or repair facilities, involve fixed costs; others, like advertising, involve variable costs. In the short run, a dealer can profitably sell at any price above marginal cost, which is affected by variable costs but not by fixed costs. To recover the latter, the long-run price must equal the average or fully distributed cost. An intrabrand price war that reduces price below average cost may then prevent dealers from recovering fixed costs, even though all have uniformly incurred them. Consequently, dealers may refuse to provide such services unless their markups are protected long enough to recover all or most of the associated fixed costs. This is, however, primarily an entry problem, and it should presumably be a consideration in the determination of the extent and duration of the restraints needed to encourage it.

136. Note, *supra* note 11, at 808-09.

137. Professor Posner has demonstrated that dealers subject to resale price maintenance would automatically engage in nonprice competition and spend any excess profits for the provision of services. Posner, *supra* note 6, at 284-85. This would not necessarily be true for dealers protected by territorial restraints, who could either pocket the excess profits or employ them in interbrand competition to finance services or engage in price wars. These dealers must be required by the manufacturer to provide the services in return for the protection provided.

138. Of this result, Professor Comanor has written:

Vertical restrictions, which encourage dealers to provide customer services jointly with the manufacturer's product at a single price, are thus likely to result in the provision of more of these services than would be the case if consumers were free to purchase them separately from the manufactured products. This arrangement is likely also to lead to a joint price which is higher than the sum of the two prices which would be set were the commodities priced separately.

Comanor, *supra* note 8, at 1430.

answer is that the services will help to differentiate the product sufficiently to insulate it from the lower prices of others.¹³⁹ The acquisition of such market power is a benefit to the manufacturer and its dealers, who will normally join voluntarily in efforts to achieve it¹⁴⁰ so long as free-rider problems are minimized. It is not necessarily in the public interest, however, and, therefore, hardly a reason to excuse the restraints that make it possible.

Established manufacturers, admittedly, can themselves provide enough services to create promotional product differentiation.¹⁴¹ The inevitability of some such differentiation, however, does not justify its general encouragement. In any event, even small manufacturers can and do provide some services themselves and demand or encourage the provision of others by their dealers. Manufacturers can, furthermore, employ various lawful devices and restraints to minimize the possibility that some dealers will try to gain a free ride on the services provided by others, yet not substantially reduce intra-brand competition.¹⁴² Finally, manufacturers can facilitate the recovery of the fixed cost of certain expensive services by the temporary use of additional restraints during the entry period.¹⁴³ Beyond this, high fixed costs have generally not caused ruinous competition in other markets.¹⁴⁴ So there is no reason to expect that result in distribution. Indeed, this excuse for restraints has elsewhere been uniformly rejected.¹⁴⁵

The manufacturer's desire here to induce or compel dealers to provide services is obviously complicated by the per se illegality of

139. See *id.*; Zimmerman, *supra* note 6, at 1184-85.

140. See *id.* at 1183-85.

141. Some commentators argue that established manufacturers can and might integrate forward into distribution in order to accomplish lawfully that which the antitrust laws otherwise do not permit. That argument has been generally rejected for good reasons. See *Standard Oil Co. v. United States*, 337 U.S. 293, 315-21 (1949) (Douglas, J., dissenting). Distribution has many characteristics that make such activity unattractive to manufacturers. *Comanor, supra* note 8, at 1435-36. Consequently, few have integrated forward as a response to antitrust prohibitions. See Zimmerman, *supra* note 6, at 1186-87.

142. See note 131 *supra*. For example, competing dealers of disparate size could be required to advertise at levels proportionate to their sales. Zimmerman, *supra* note 6, at 1184-85. To avoid the problem of prepaid services for installation or warranty repair, these costs could be charged separately or the dealer performing the work could be compensated through a profit passover arrangement. In fact, one court decree allowed a profit passover arrangement that would generally compensate a dealer for the goodwill shared with another's new location. *United States v. Topco Assoc., Inc.*, 1973 Trade Cas. 93,797 (N.D. Ill.), *affd. per curiam*, 414 U.S. 801 (1973).

143. See note 135 *supra*.

144. See *P. AREEDA, supra* note 30, at 270.

145. See, e.g., *United States v. Joint-Traffic Assn.*, 171 U.S. 505 (1898).

customer clauses and perhaps of location clauses, because it cannot influence or control new dealers or locations established without its approval. It can circumvent the customer clause problem by assuming the wholesaling function itself or perhaps by transforming the wholesalers into agents or consignees under the *Schwinn* exception.¹⁴⁶ Alternatively, it might be able to prohibit wholesalers from dealing with any retailer that refuses to provide certain minimum services.¹⁴⁷ It could circumvent both the customer and location clause problems by accepting such new outlets or locations as authorized dealers and bringing them within its influence. These tactics will not be helpful with respect to new locations with which the manufacturer cannot deal directly¹⁴⁸ or with unfranchised retail outlets that occasionally acquire inventory, often excess or dated, from dealers or distributors.¹⁴⁹ The latter, though annoying to authorized dealers, are usually not serious competitive factors. The former may be, but as branches of authorized dealers with established goodwill, they should ordinarily meet minimal requirements voluntarily. Admittedly, the manufacturer might be forced to change certain practices¹⁵⁰ or to assume additional services itself to prevent "free riding," but such changes should not be so difficult or oppressive as to cast doubt upon a decision to outlaw customer and location clauses in the first place.¹⁵¹

146. See note 6 *supra*.

147. This could be considered a restraint on alienation, but if a manufacturer dealing directly with retailers can impose and enforce such requirements, it should be able to require wholesalers to do the same thing. *But see* United States v. Parke, Davis & Co., 362 U.S. 29 (1960). The only difference is a technical one. The manufacturer chooses not to deal, whereas the wholesaler is compelled by agreement not to deal, which constitutes in effect a restraint on alienation.

148. Direct dealing with a new location in a territory to which the manufacturer has granted an exclusive franchise may constitute a breach of the exclusive contract. See note 82 *supra*.

149. See note 54 *supra*.

150. Sometimes retail prices include the cost of installation or warranty service. Manufacturers may then use a profit-passover arrangement to compensate a dealer, other than the seller, which performs such services. In other situations, manufacturers sometimes do not fully compensate dealers for performing such services. These problems are exacerbated when some sellers are not authorized dealers. The manufacturer accordingly may be compelled to permit dealers to charge for all such services separately or may have to compensate them fully. See generally Note, *supra* note 11, at 812.

151. For a discussion of the reasons for outlawing the location clause, see text at notes 71-106 *supra*. The reasons for condemning customer clauses have been summed up by Zimmerman:

On the issue of the utility of restrictions in encouraging the dealers to provide special promotion and service, or the importance of customer restrictions in enabling the manufacturer to preserve the integrity of its own promotional efforts to stress the distinctive quality of the product, at least two observations are pertinent. Often the nature of the manufacturer's interest in avoidance of

C. *Assuring the Proper Exploitation of a Territory*

A manufacturer's sales can be maximized only if dealers seek out and serve every potential customer. The dealers, however, will presumably only make sales where marginal revenue equals or exceeds marginal cost. Thus, they will not serve some high-cost customers. On the other hand, the cost of attracting or serving other customers will be low; theoretically, these customers should receive a lower price reflecting these savings, but often they do not.¹⁵² These high-margin customers may eventually become the target of other dealers, who seek to "skim" this "cream" from their neighbor's business.¹⁵³ In a competitive model, such warfare should eventually eliminate these high margins. It may also, however, upset dealer harmony and involve the manufacturer, who would prefer that dealers devote their excess energies to interbrand competition and to the obtaining of new customers in their immediate sales areas. For these reasons, manufacturers often seek ways to compel dealers to sow their own fields in preference to reaping fields sown by neighboring dealers.

One way to accomplish this is through the imposition of territorial restraints to insulate high-margin sales in return for each dealer's promise to serve high-cost customers within its territory. Unfortunately, such objectives are not cost free. In effect, the manufacturer is seeking to create or to perpetrate, through the elimination or restriction of intrabrand competition, a system of economic price discrimination whereby monopoly profits realized on sales to some customers are used to subsidize sales to new, otherwise unprofitable, customers.¹⁵⁴ Although the manufacturer benefits, it does so at the

resale by non-prestigious outlets is cloaked in ambiguity; it may correspond closely to little other than an effort to avoid the outbreak of "disruptive" price competition. Certainly most discount houses are reputable, if not elegant, these days, and the asserted damage to the image of a product from sales by such establishments may be no more than a puncturing of an inflated claim to an inflated price. Moreover, to the extent that dealer or producer efforts to distinguish the brand by intensive sales and servicing efforts do enhance the brand's competitive stance, the nature of this particular type of competitive enhancement must be reckoned with. The elimination of intrabrand competition results in a diminution in price competition, interbrand as well as intrabrand. If, as is too often the case, the manufacturing segment of the industry is concentrated, the further product differentiation which may be encouraged by the restrictions—the alleged benefit—serves largely to help transfer oligopolistic behavior to the distribution level and to encourage interbrand "product" competition at the expense of price competition. And while genuine product competition is not to be scorned, the very need for restrictions to secure it here suggests that it is to be provided in quantity and intensity that the market, left untrammelled, does not want.

Zimmerman, *supra* note 6, at 1185.

152. Comanor, *supra* note 8, at 1430.

153. Note, *supra* note 11, at 811.

154. Comanor, *supra* note 8, at 1431.

expense of the public interest through price discrimination and resource misallocation.¹⁵⁵

Needless to say, a manufacturer has a legitimate interest in the reasonable exploitation of each assigned territory. It may, however, promote this interest by contractually assigning each dealer an area of primary responsibility, and, if necessary, by requiring territorial sales quotas.¹⁵⁶ There is, further, no legitimate interest in preventing most "cream skimming," which is only a manifestation of competition. In some instances it may seem unfair that, after one dealer has made a significant effort to sell to a high-cost customer, another dealer free rides on the former's preselling effort and expense.¹⁵⁷ If all dealers are required to provide the same essential services and efforts, however, these instances should tend to offset each other. In special situations, the manufacturer could employ a profit-passover arrangement.¹⁵⁸

D. *An Overview of the Justifications*

Having considered these justifications separately, let us now examine them collectively. Vertical restraints are often legitimately directed at problems inherent in the distribution process, but as a general matter, as this section has shown, the less restrictive restraints are adequate to deal with them. Although vertical restraints can strengthen the competitive stance of those using them, too often this strengthening comes principally from the acquisition or retention of promotional differentiated market power that will contribute to interbrand competition primarily in the sense that another firm participates in a shared monopoly.¹⁵⁹ Thus, there is no necessarily direct correspondence here between benefits to particular brands and consumer welfare.

These are not simply theoretical observations. In leading cases like *White Motor*, *Schwinn* and *GTE Sylvania*, the apparent purpose of the restraints, which were essentially permanent, was the acquisition or preservation of promotional differentiated market power. Each company, to be sure, faced significant competitive pressures to which these tactics were presumably a response. None could justify the extraordinary measures allegedly required for its survival,

155. *Id.*

156. See Zimmerman, *supra* note 6, at 1181, 1185.

157. Note, *supra* note 11, at 811.

158. *Id.* at 815-16.

159. The theory and potential consequences of shared monopoly are discussed in P. AREEDA, *supra* note 30, at 1186.

however, except in terms of the potential loss of a competitor in an already concentrated market. Although this is the very reason for the new entry or failing company exception, it cannot justify the indefinite protection of those who have had their chance and cannot otherwise make it,¹⁶⁰ unless we incorporate into the antitrust laws a rather bizarre notion of free enterprise.

Curiously, although these points were carefully made by others a decade ago,¹⁶¹ their merits have largely been ignored by *Schwinn's* critics, who merely acknowledge the existence of an opposite point of view and continue to recite the familiar litany of justifications. Apparently they believe that empirical or theoretical refutation of the anticompetitive effects of vertical restraints is unnecessary, and that as long as there is an apparent difference of opinion among experts over the need for and the net effect of such practices, it cannot be concluded that they are, on the whole, overwhelmingly bad or only sporadically good, which is supposedly the sine qua non of per se illegality.¹⁶²

It is this conclusion to which I demur. Since the restrictive aspects of these practices are inferrable, the burden should be on those who use them to establish the countervailing competitive gains. If the courts cannot realistically measure their net effects or even muster the resources to attempt such a measurement, then they may surely adopt, under the general language of the Sherman Act, bright-line tests that give a decent measure of respect to the interests of both sides. This is in fact the lesson of *Schwinn*, regardless of the language of the opinion, and it should not be abandoned as a solution unless the balance struck was unfair or a superior approach is possible.

III. CONCLUSION

The preceding discussion of the effects of and justifications for vertical restraints should confirm the judgment that a full rule of reason approach to their legality would frequently require an expensive, prolonged exercise in futility. Furthermore, it is not unlikely that judges regularly faced with such impossible tasks would begin to decide cases on the basis of various unarticulated preferences, prejudices, or rules of thumb. The simplest of these would be to resolve doubts against the government as the party with the burden

160. Zimmerman, *supra* note 6, at 1186.

161. See note 107 *supra*.

162. See, e.g., Robinson, *supra* note 4, at 279-80.

of proof, or, conversely, against the defendant as the party with the burden of justification.¹⁶³ If these simple approaches failed to yield a result, the courts presumably would then have to examine structural market factors such as concentration and size distribution, the degree of product differentiation, and the prevalence of such restraints among the largest firms.¹⁶⁴ The final question that merits discussion, then, is whether such a structural or "truncated" rule of reason approach,¹⁶⁵ which others have recommended,¹⁶⁶ would be superior to the partial per se test that *Schwinn* mandates.

At first glance, a structural approach has the two obvious advantages of being less arbitrary than a per se standard and yet not requiring the involved inquiry of the rule of reason. There are potential disadvantages to such an approach, however. It will not yield predictable results unless it is limited to a small number of factors or variables, which, in turn, means that it will normally reveal very little about the actual performance of specific markets,¹⁶⁷ and at best can only identify those deserving more attention.¹⁶⁸ Indeed, it may be fair to characterize such an approach as a coverup for the implementation of rather crude, result-oriented biases, which seems to make it less satisfactory than a straight forward, albeit arbitrary, rule. Of course, the number of variables to be considered, and it is hoped, the accuracy of the analysis, could be expanded considerably. At some stage, however, the scope of the inquiry and the un-

163. This approach is recommended in Note, *supra* note 11, at 823-32, which carefully measures the manufacturer's legitimate needs and accepts only the least restrictive restraint that will effectuate them.

164. *See id.* at 832-34.

165. Such an approach is associated primarily with merger and exclusive dealing cases under the Clayton Act. *See* notes 17-18 *supra*. However, there is no barrier to its use under the Sherman Act. Otherwise the validity of more drastic tests like the per se rule, especially in its application to tie-in arrangements not governed by the Clayton Act, would also be drawn into question. *Cf.* *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958).

166. *See* note 19 *supra*.

167. There is increasing empirical evidence suggesting that even in cross-sectional industry studies, it is difficult to find significant correlations between selected market structure and market performance variables. *See* N. COLLINS & L. PRESTON, *CONCENTRATION AND PRICE-COST MARGINS IN MANUFACTURING INDUSTRIES* 1-5 (1968). The likelihood of correlation, let alone accurate predictions about market performance, for a particular market, is far less.

168. Kaysen, *Comment to Scitovsky, Economic Theory and the Measurement of Concentration*, in NATIONAL BUREAU OF ECONOMIC RESEARCH, *BUSINESS CONCENTRATION AND PRICE POLICY* 117 (1955). Indeed, there is growing doubt in general that structural analysis will yield accurate predictions about the performance of specific markets or the results of specific practices. *See generally* H. GOLDSCHMID, H. MANN & J. WESTON, *supra* note 20.

predictability of its outcome will resemble a full rule of reason approach.¹⁶⁹

Some compromise between these two formulations of the structural approach must obviously be found and articulated with sufficient clarity to provide predictable, consistent results, and not ad hoc responses. This can be accomplished if the standard contains a built-in bias against the government or the defendant as the party with the burden of proof or justification, respectively.¹⁷⁰ A presumption against the government, however, would invite the use of vertical restraints, thereby overtaxing enforcement resources; a presumption against defendants, alternatively, would probably produce results similar to those required by *Schwinn's* partial per se approach.¹⁷¹ Consequently, a compromise acceptable to both sides would require a neutral standard flexible enough for accuracy, but limited enough for economy and predictability.

In my opinion, there are two principal reasons why no compromise structural standard can be articulated for distributional restraints to match the results achieved with this approach in merger cases or under the merger guidelines promulgated by the Department of Justice.¹⁷² First, although guidelines for the use of each restraint individually could presumably be drafted, they would also have to deal with the use of these restraints in various combinations. The introduction of this variable, not present in merger cases, would obviously complicate the formulation of guidelines enormously, just as it would undermine the precedential value of factually dissimilar cases decided under such standards. Indeed, it is possible to contemplate with horror the necessity for relitigation simply because a restraint has been added to or subtracted from a previous package of restraints.

Second, the merger cases and guidelines seem to reflect or incorporate a theory of oligopolistic behavior that was widely accepted at the time, whereas no such theory is available or is as helpful in dealing with distributional restraints. For example, the horizontal merger cases and guidelines seem to incorporate the premise that, in a market sufficiently concentrated to produce recognized price interdependence, any merger likely to intensify it or transmute it

169. See, e.g., *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 176-77 (1964) (suggesting an impossibly long list of structural factors for consideration on remand).

170. See text at note 163 *supra*.

171. For an example of such an approach, see Note, *supra* note 11, at 823-32. Nevertheless that approach would still produce more litigation than would *Schwinn's* partial per se approach.

172. 1 TRADE REG. REP. (CCH) ¶ 4510 (1975).

from hostile awareness to friendly cooperation is *prima facie* illegal.¹⁷³ They probably also embrace the more restrictive premise that a less concentrated market approaching such interdependence cannot be transformed by mergers into one possessing it, and, therefore, that any merger between substantial firms in the market is *prima facie* illegal if other similar mergers, which would produce the forbidden result, might, or are likely to, follow.¹⁷⁴ The vertical merger cases and guidelines, and the analogous exclusive dealing cases, clearly involve different considerations, but can still be similarly related to a general theory by such structural factors as the market shares of the acquiring firm, of the acquired company, and of those manufacturers following, or likely to follow, its lead.¹⁷⁵

By contrast, there are no general propositions or theories that will enable us to draw the line in distribution cases. Clearly, we should prevent all of the leading firms in a concentrated market from employing similar restraints and transferring their oligopoly downwards. We might also object if a single, nondominant firm with differentiated market power did this because the net effect is direct horizontal restraint among its dealers. For example, assume that a certain manufacturer of television sets is believed by many to have developed a superior color system that others do not or cannot employ. Do we wish to permit that company to fix retail prices on these desirable, expensive products, even though it does not dominate market sales? If not, should we allow it to accomplish an equivalent result through other distributional restraints? And after others eventually match it technologically and its price falls, should we then permit that manufacturer to stabilize its market position through such restraints? Each of us may hold strong views on the proper answers to these questions, but how can we relate them to some helpful, widely held theory? I do not know how to do this or even how to begin. It is difficult enough to draw lines when a single restraint is used by a manufacturer whose market position is changing in a changing market. It is next to impossible when a varying package of restraints is used.

173. See *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

174. Cf. *United States v. Von's Grocery Co.*, 384 U.S. 270, 280-81 (1966) (White, J., concurring).

175. The vertical integration cases are, of course, vastly more complicated than this and in fact the results therein cannot be related as directly to general theory as with horizontal merger cases. Compare Bok, *supra* note 15, with Bok, *supra* note 18. For this reason, the percentages chosen for the vertical merger guidelines are arguably more arbitrary or debatable than those chosen for the horizontal ones. But such choices would be even more arbitrary and debatable in distribution cases because of greater concern there with the activities of a single firm.

The obvious way out is to outlaw the use of certain restraints while generally allowing the use of others. This was done long ago with price fixing and exclusive dealerships. *Schwinn* merely advanced this process of trading off the presumed legality of some restraints for the per se illegality of others, and *GTE Sylvania* will essentially complete it, regardless of how the location clause finally fares. Moreover, it is possible that the results yielded by these cases coincide closely with those that would have been reached if business and government had been forced to settle the matter over the bargaining table.¹⁷⁶ There is, furthermore, no evidence at the moment that business is unable to satisfy its legitimate needs through the use of those restraints that are still available. Thus, although this trade-off process may represent a unique antitrust solution, it was responsive to the almost unique problem of a series of interrelated restraints. Indeed, this unique problem, upon which the more traditional approaches foundered, proves to be at once the source and strength of the partial per se solution, in that the multiplicity that defied reasoned analysis lent itself nicely to bargaining and tradeoff.

176. Some evidence of this assertion is supplied by the consent decrees entered into by defendants in these cases. See, e.g., *United States v. White Motor Co.*, 1964 Trade Cas. 79,762 (N.D. Ohio 1964).