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Vertical Territorial Restraints and the Per Se Concept

Kenneth D. Weiss

COMMENTS

VERTICAL TERRITORIAL RESTRAINTS AND THE PER SE CONCEPT

I. Introduction

A. *Vertical Territorial and Customer Restraints*

Present antitrust treatment of agreements contemplating vertical territorial and customer restraints has been the subject of continuing controversy among legal scholars. Vertical territorial and customer restraints are limitations of the area within which, and, the customers to whom, distributors and retailers may sell the manufacturer's product.

In explanation of the ramifications of such a restraint and the terminology that is commonly employed in cases and commentaries on this subject, consider the following hypothetical situation:

X manufactures widgets. His distribution system is vertically integrated by ownership, that is to say, that X owns all of the outlets that are used to market his product. Y manufactures didgets, a product similar in function and use to widgets. Y uses a franchise system of distribution. He does not own the outlets which distribute and sell his product. Y is related to his distributors and retailers by contract arrangements.

Assume from the outset that widgets and didgets are reasonable substitutes for one another. Therefore, X and Y are competitors. X's outlets have an advantage over those of Y. Y's dealers must compete against each other as well as against X's dealers. Using more formalistic terminology, Y's dealers must meet *intra-brand* competition among fellow sellers of Y's product. X's dealers need only be concerned with *inter-brand* competition with Y's dealers. Y decides to impose vertical territorial limitations, or in other words, to divide his sales areas and to grant an exclusive franchise to one dealer in each area. His ostensible motive for taking such action is to improve his position vis-a-vis X. Note that by revising his marketing network Y is destroying *intra-brand* competition—an anti-competitive effect. If, as is assumed, widgets and didgets are reasonably interchangeable, and, by virtue of increased efficiency resulting from market division Y can afford to charge a lower price for didgets,[1] X may be stimulated to respond by reducing the price of Widgets. Therefore, *inter-brand* price competition has been enhanced—a pro-competitive effect. The term "pro-competitive effect" as hereinafter used, means an effect which resembles a result that would follow from actual competition. One critic will assert that Y's busi-

1. It is asserted that a manufacturer can distribute his product less expensively when he has only one outlet in each sales area. He can avoid duplication of expenses and effort. He can properly plan for the future. Consequently, the manufacturer can lower his prices and still obtain the same profit as he did before market division. For a more detailed explanation, see the text accompanying footnotes 102-108.

ness conduct is always more harmful than beneficial to competition.[2] Others maintain that Y's actions are justified by business necessity, and that the effect on competition may be good or bad depending on the circumstances in each case.[3] The former advocates believe that market division should be *illegal per se*, that is, unlawful without elaborate inquiry into business justification. The opposing position is that business justification should be weighed against any undesirable effects to determine whether the restraint is *reasonable* in terms of antitrust goals. Another authority argues that all such vertical restraints are innocuous, and should almost always be treated as lawful.[4] At present, the law is such that Y's conduct is "per se" unlawful when Y's outlets are independent dealers, and unlawful in many instances when they are agents of Y.[5]

Perhaps the only point of agreement among those who have spoken on the subject is that the law, as it now exists, fails to achieve the ends sought by antitrust law, and fails to provide realistic regulation of business conduct.[6] In defense of the present law, it has been stated that the goals of antitrust are nebulous;[7] economic theories of competition are too abstract to shape pragmatic anitrust policy;[8] and the judiciary lacks the time and expertise to effectively extract and resolve complex issues presented in voluminous records.[9] In view of the foregoing circumstances, the need for a more easily workable rubric for deciding cases of vertical territorial and customer restraints is compelling. The purpose of this comment is to relate in substance the competing positions of several commentators, and to suggest areas susceptible of compromise, in the hope that a more successful approach to this type of antitrust problem might be realized.

B. *The Background and Present Legal Treatment of Vertical Territorial and Customer Restraints*

Prior to 1964, courts generally upheld vertical territorial and customer restraints which had the purpose and effect of facilitating legitimate business

2. *See* Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath*, 81 Harv. L. Rev. 1419 (1968).

3. *See, e.g.*, von Kalinowski, *The Per Se Doctrine as an Emerging Philosophy of Antitrust Law*, 11 U.C.L.A. Law Rev. 569 (1964); Zimmerman, *Distribution Restrictions After Sealy and Schwinn*, 12 A.T. Bull. 1181 (1967).

4. *See* Bork, *The Rule of Reason and The Per Se Concept: Price Fixing and Market Division*, 75 Yale L.J. 373 (1966).

5. *See* United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967) for the present law. *See also* Bork, *supra* note 4. Elman, *"Petrified Opinions" and Competitive Realities*, 66 Colum. L. Rev. 625 (1966); P. Areeda, *Antitrust Analysis*, 236-40 (1967).

6. *See, e.g.*, Comanor, *supra* note 2; Zeidman, *The Growth and Importance of Franchising—Its Impact on Small Business*, 12 A.T. Bull. 1191 (1967).

7. *See* P. Areeda, *supra* note 5 at 240.

8. *See* Markham, *Current Decisions in Antitrust*, 12 A.T. Bull. 851, 855-56 (1967).

9. *See* McLaren, *Marketing Limitations on Independent Distributors and Dealers—Prices, Territories, Customers and Handling of Competitive Products*, 13 A.T. Bull. 164, 168-69 (1968).

ends.[10] The dicta of *United States v. Addyston Pipe & Steel Co.*[11] deterred Sherman Act prosecutions,[12] so long as restrictive covenants were found to be ancillary to justifiable business goals.[13] The relevant inquiry was whether the restraint was such that it merely afforded fair protection to the interests of the party in favor of whom it was given, without prejudice to the public interest.[14] In 1963, the Supreme Court was, for the first time, presented with the opportunity to hold vertical territorial and customer restraints illegal per se, without inquiry into business justifications.[15] The Court refused to affirm the lower court's summary judgment of per se illegality, on the ground that sufficient understanding of the economic and "business stuff" of these agreements, as well as their actual impact on competition, was lacking.[16] Whether such agreements have the requisite pernicious effect on competition and the lack of any redeeming virtue to be fairly classified as illegal per se, could not at that time be determined. In 1967, however, the Supreme Court apparently believed that it had acquired sufficient knowledge of the "business stuff" of vertical territorial and customer restraints to warrant a holding of per se illegality. In *United States v. Arnold, Schwinn & Co.*, the Supreme Court held that where the manufacturer fails to retain title, dominion, and risk with respect to his product, the imposition of vertical territorial and customer restraints upon distributors or retailers is illegal per se.[17] If the dealer's position and function are indistinguishable from that of agent or salesman, the legality of the restraint may be determined by reference to the *rule of reason*,[18] which comprehends business excuse as a defense. In addition to the agency requirement, the restraint may not exceed limits reasonably necessary to achieve a pro-competitive business end.[19] There must be vigorous inter-brand competition and a demonstrated need to employ exclusive franchising to meet such competition.[20] Also, it is probably necessary that the franchisee sells rival brands, and that there is sufficient interchangeability among the competing products to assure a satisfactory supply for other dealers in the market.[21] Furthermore, the manufacturer is obliged to demonstrate

10. *See, e.g.*, Boro Hall Corp. v. General Motors Corp., 124 F.2d 822 (2d Cir. 1942), *cert. denied* 317 U.S. 695 (1943); Chicago Sugar Co. v. American Sugar Refining Co., 176 F.2d 1 (7th Cir. 1949), *cert. denied* 383 U.S. 948 (1950).
11. 175 U.S. 211 (1899).
12. 26 Stat. 209 (1890), *as amended*, 15 U.S.C. § 1 (1955).
13. An example of a justifiable ancillary restraint is a partnership. In the context of of territorial division, a justifiable business goal would be lower prices through efficient distribution.
14. Addyston Pipe and Steel Co. v. United States, 175 U.S. 211 (1899).
15. White Motor Co. v. United States, 372 U.S. 253 (1963).
16. *Id.*
17. 388 U.S. 365 (1967).
18. *Id.* 381. *See also* text accompanying notes 40-46 for an explanation of the "per se rule." It should be noted that there need not be a formal agency as well as an arrangement which in essence resembles an agency relationship.
19. 388 U.S. 380-81.
20. *Id.* at 381.
21. *Id.*

that the net effect of the restraint will preserve or enhance overall competition in the relevant product market.[22] In summary, it may be stated that a manufacturer may select and franchise those to whom, alone, he will sell his product, if there is sufficient inter-brand competition, and the restraint stops at that point.[23] Beyond this, it is clear only that territorial and customer restraints are unlawful *per se* in the context of sale for resale marketing.[24] If the distribution arrangement is in substance an agency, however, it is difficult to predict whether the agreement will escape prohibition through the narrow, ill-defined, and difficult to prove *rule of reason* exception.[25]

C. *Business and Economics Background*

One of the infirmities of the law as it now stands is the lack of clarity in the guidelines prescribed in *Schwinn* for lawful territorial and customer restraints. How strong must interbrand competition be? How severe may the impact on competition be before the restraint becomes unreasonable? How is that impact measured? How is necessity for the restraint determined? These questions, and others can be responded to only with conjecture and speculation, leaving the legal position of franchise operators unsettled. The Supreme Court regards franchising and confinement of distribution as an "unusual method which may be permissible in an appropriate and impelling competitive setting, since most merchandise is distributed by means of purchase and sale."[26] It can therefore be assumed that only rare, narrow, and exigent circumstances, such as those in *Schwinn*,[27] where "competitive giants" posed difficult competitive problems to their smaller rival, will justify territorial and customer limitations. But the scope of this exception may be greater than it would appear to be at first glance. Franchising is the fastest growing distributional vehicle in our economy.[28] It has been estimated that there are more than 750 franchising operations, encompassing 450,000 outlets, generating gross income of 70 billion dollars, or 10% of our gross national product.[29] The promise of growth of franchising is clouded by its dubious legal status, since the great majority of franchises employ territorial restraints.[30] If, as it appears from the *Schwinn* opinion,[31] the Supreme Court will uphold territorial and customer restraints

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22. *Id.* at 380-82.
23. United States v. Colgate & Co., 250 U.S. 300 (1919).
24. United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).
25. *Id.* It should also be noted that price fixing is unlawful even though an agency arrangement is being used. Simpson v. Union Oil Co., 377 U.S. 13 (1964).
26. United States v. Arnold, Schwinn & Co., 388 U.S. 365, 379 (1967).
27. *Id.* at 376.
28. *See* Zeidman, *supra* note 6 at 1196-97.
29. New York Times, Sec. 3, p. 1, July 9, 1967.
30. In a recent survey 57 of 69 respondents stated that they use territorial restraints. *Partners For Profit, A Study of Franchising*, 51 (American Management Assoc., Inc., New York 1966). But note that not all franchises use a consignment arrangement. Sometimes the francisee merely has bought the right to use the manufacturer's name.
31. United States v. Arnold, Schwinn & Co., 388 U.S. 356, 379 (1967).

only in extraordinary circumstances, the Court may well be undermining antitrust goals in mistaken reliance upon economic theory.

Economic models are characteristically employed by the judiciary to demonstrate the desirability of vigorous competition as the best market economy.[32] But perfect competition is not a social actuality. Once it is conceded that markets are imperfect, conclusions as to the relative desirability or competitiveness of market structures are difficult to formulate.[33] Simplifying assumptions render economic analysis less useful as a guide for antitrust policy, because the workings of the actual market mechanism are poorly understood. Further difficulty arises when legality turns on phrases such as "lessening of competition," which in neither law nor economics has a clear definition.[34] The result is that men lacking expertise endeavor to apply abstract and often inappropriate economic theory to little understood competitive realities. Beyond the vague aspiration to "maximum social and economic welfare" it is difficult to say exactly which goals antitrust policy seeks to achieve. Efficiency in production and distribution; proper allocation of resources, output and wealth; development, innovation and progress are in some combination the accepted ends of antitrust.[35] Economists disagree as to the relative importance of these goals, and as to the best way to realize them.[36] It is no wonder that judges have misconceptions as to what "competition" should be, and as to how antitrust policy can be implemented.[37] On the other hand, although the fact that competition is impeded may or may not dispose of the question of a given practice's desirability, it is often asserted that ordinary notions of competition are the closest we can come to a comprehensible standard for ordering the conduct of business.[38] It is also conceded that the issues revolving about the impact on competition of territorial and customer restraints are too complex for the courts to grapple with. Does this mean that "per se illegality" upon a finding of restraint of competition is the only workable formula available to the courts? The answer is clearly no. Antitrust law is replete with examples of lawful restraints of competition.[39] Every contract in some way restrains competition. Yet most contracts are not condemned by the Sherman Act. A brief examination of the Sherman Act, and the vehicles used for its application, the "rule of reason," and the "per se rule," may provide some insight into the problems that assail a court hearing a vertical territorial and customer restraint case.

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32. *See* Markham, *supra* note 8.
33. *Id.* at 857-58.
34. *See* Bernhard, *Competition in Law and in Economics*, 12 A.T. Bull. 1099 (1967).
35. *Id.*, 1100.
36. *See* P. Samuelson, *Monopolistic Competition Theory: Studies in Impact*, 107-8 (New York, 1967).
37. *See* Bernhard, *supra* note 34 at 1099-1116.
38. *See* Blake & Jones, *In Defense of Antitrust*, 65 Colum. L. Rev. 377 (1965).
39. *See, e.g.*, Addyston Pipe and Steel Co. v. United States, 175 U.S. 211 (1899); United States v. Colgate and Co., 250 U.S. 300 (1919).

D. *The Sherman Act: The Rule of Reason and the Per Se Rule*

The purpose of the Sherman Act is the preservation of free competition as the rule of trade.[40] It is presupposed that unfettered interplay of market forces will result in optimum allocation of resources, economic progress and development, low prices and high quality, while insuring the preservation of societal institutions.[41] To assure free competition, the policy of limiting undue aggrandizement of economic power in private hands is pursued.[42] Monopolization is proscribed because it creates inordinate power over price, production, quality and to whom the product is sold.[43]

Beyond the proscription of activities which are obviously socially undesirable,[44] the Sherman Act has been interpreted as prohibiting only unreasonable restraints of trade.[45] At common law, agreements that achieved socially commendable ends were upheld, notwithstanding provisions for necessary incidental restraints.[46] One criterion for decision has been whether the agreement led to unreasonably excessive power over price or production.[47] Agreements creating such power are unlawful. Those not within this common law prohibition can be justified by reason.[48] The relevant inquiry has been whether the agreement diminished existing competition, threatened monopoly, or used means unnecessarily restrictive in view of the ends sought.[49] A classic interpretation of the Sherman Act and the "rule of reason" as a device for its administration was offered by Mr. Justice Brandeis in *Chicago Board of Trade v. United States:*

> Every agreement concerning trade, every regulation of trade restrains . . . . The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. . . . The reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts . . . because knowledge of intent may help the court to interpret facts and to predict consequences.[50]

It is clear from the preceding statement that promotion of self interest alone will not suffice to invoke the rule of reason. Conduct must be found to be compatible with the statutory concern for preservation and enhancement of compe-

40. Northern Pacific Railway Co. v. United States, 356 U.S. 1, 4, 5 (1958).
41. *See* von Kalinowski, *supra* note 3.
42. *See* Bernhard, *supra* note 34.
43. *See* United States v. Grinnel Corp., 384 U.S. 563 (1966).
44. Such activities include price fixing, group boycotts, tying agreements, various horizontal restraints and monopolization.
45. *See* Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918).
46. Addyston Pipe and Steel Co. v. United States, 175 U.S. 211 (1899).
47. Standard Oil Co. v. United States, 221 U.S. 1 (1911).
48. *Id.*
49. *Id.*
50. Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918).

tition. Demonstration of downward pressure on prices, cheaper and more efficient production, and any other factor that might lead to greater satisfaction of economic and social needs, would apparently place the disputed restraint within the rule of reason, and consequently without the per se rule.

The per se rule, the antithesis of the rule of reason, applies to agreements or practices which because of their adverse effect on competition and lack of any redeeming qualities are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry into the precise harm they caused or the business justification for their use.[51] Among the practices held to be illegal per se are vertical and horizontal price fixing,[52] tying arrangements,[53] group boycotts,[54] horizontal territorial restraints,[55] and most recently vertical territorial restraints in other than an agency context.[56] One cogent interpretation of the per se rule, is that the proper judicial inquiry is with regard to the purpose and effect of the challenged restraint.[57] The fact that the general conduct within which the specific challenged restraint falls, has on the basis of experience proven to be anti-competitive in most cases, allows for a fair presumption of illegality in the particular case. But where a defendant can demonstrate that the purpose and effect of the restraint are innocuous or pro-competitive, he should be able to escape from the per se rule.[58]

The foregoing interpretation of the per se rule is not the only way to characterize its operation. In practice, it is very difficult if not impossible to vitiate the presumption of illegality.[59] The "lacking any redeeming virtue" element of the per se formula is apparently overlooked.[60] This is not surprising in view of some of the purposes underlying the per se rule. Courts are not well equipped to deal with long, complex records which are common in antitrust cases.[61] In the attempt to simplify, shorten, and eliminate where practicable, antitrust litigation, the Supreme Court is defining an increasing variety of

51. Northern Pacific Railway Co. v. United States, 356 U.S. 1, 4, 5 (1958).

52. *See* Simpson v. Union Oil Co., 377 U.S. 13 (1964); Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211 (1951).

53. *See* Northern Pacific Railway Co. v. United States, 356 U.S. 1 (1958); Susser v. Carvel Corp., 332 F.2d 505 (2d Cir. 1964).

54. *See* Radiant Burners, Inc., v. Peoples Gas, Light & Coke Co., 364 U.S. 656 (1961).

55. *See* Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951).

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

57. *See* von Kalinowski *supra* note 3. A case authority for this position is United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 223 (1940).

58. *See* United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 223 (1940).

59. *See* United States v. Loew's Inc., 371 U.S. 38 (1962) where the Supreme Court made the dubious economic judgment that a typing contract was per se unlawful, finding the requisite leverage in the product's uniqueness rather than examining the manufacturer's share of the market. *See also*, Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951), another much criticized decision.

60. *See* von Kalinowski, *supra* note 3 at 582.

61. The record in United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967), was composed of 23 volumes, and filed 60 days before oral arguments were heard. *See* McLaren, *supra* note 9 at 161, who notes that the Court lacks the physical abilities to handle antitrust cases.

restraints as per se violations of the Sherman Act.[62] This also decreases the cost of investigating factual circumstances which are difficult to prove. Another virtue of the per se rule is that it provides a measure of clarity and certainty in a field where it is much needed. Businessmen need a clear and reliable guide for their conduct. They must necessarily speculate at what is "reasonable." They can understand, predict and act upon a clear per se boundary. For the same reason of clarity, the per se rule is a more effective deterrent than the rule of reason. Antitrust suits take so long, involve so many people and have such drastic consequences, that it may well be fair and reasonable to sweep in some innocuous or beneficial conduct to obtain certainty, and brevity of results.[63]

Notwithstanding the pragmatic advantages of the per se rule, a very real danger inheres in the recent trend toward extending its scope. The economic judgment that underlies a finding that a general business practice is usually anti-competitive and lacks redeeming qualities should be an informed decision. The consequences of such a judgment are severe and far reaching. Several antitrust experts believe that per se decisions are too often grounded on dubious judicial economic judgments.[64] In deciding whether to apply the per se rule to a given practice, the court should be well acquainted with actual business circumstances, and the predictable impact on competition in the relevant market. The court should demonstrate that experience has shown that the practice is so harmful that the gains to be derived from its outright prohibition clearly outweigh the losses, based not upon abstract theory, but upon business realities.[65]

II. Some General Criticism of the Present Legal Treatment of Vertical Territorial and Customer Restraints

A. *The Agency—Resale Dichotomy*

The Supreme Court, in *White Motor Co. v. United States* refused to hold territorial and customer restrictions illegal per se.[66] The rationale for this decision was that the court lacked sufficient understanding of business circumstances, and the likely impact on competition surrounding such restraints.[67] But four years later, in *United States v. Arnold Schwinn & Co.* the Court did hold territorial and customer restrictions illegal per se.[68] There was no evidence adduced that Schwinn's franchise program injured any dealer, distributor, com-

62. *See* Elman, *supra* note 5.

63. It would seem to be unfair to award treble damages against a manufacturer who, because of nebulous guidelines provided by the *rule of reason*, run slightly afoul of the Sherman Act. On the other hand, it is also inequitable to punish a manufacturer whose business conduct appears undesirable upon superficial examination, when such conduct is in fact socially and economically desirable.

64. *See, e.g.*, Bork, *supra* note 4; Elman, *supra* note 5.

65. *See* von Kalinowski, *supra* note 3.

66. 372 U.S. 253 (1963).

67. *Id.*

68. 388 U.S. 365 (1967).

petition in the bicycle market or any other relevant interest.[69] In fact, there are several economic arguments, indicating that in many instances territorial and customer restraints are actually pro-competitive, or at least not clearly anti-competitive in effect.[70] Unfortunately, the focus of the Supreme Court's reasoning in the *Schwinn* case, is apparently not upon the effect of territorial limitations on competition as reflected in price and output, but upon their interference with the freedom of distributors and retailers. In raising the agency-resale dichotomy for deciding when the per se rule becomes operational, the Court draws distinctions that do not serve to deter pernicious practices and leave commendable ones unaffected. There is no basis in logic or experience to conclude that social detriment is less onerous when accomplished in the form of agency, rather than resale arrangements.[71] To extend the per se rule to reach distribution arrangements such as Schwinn's by saying that it limits the freedom of dealers is to beg the question. All contracts have a limiting effect on competition. The fact that a dealer's freedom of action is impeded after title has passed does not at all bear on the questions of whether competition has been unduly restricted, whether the purpose and effect of the restraint are anti-competitive, and whether the restraint lacks any redeeming virtue.[72] The answers to these questions must determine the propriety and the legal status of suspect business conduct.

In addition to the foregoing criticism of the agency-resale dichotomy based on the rationale of the per se rule, another practical consideration should be noted. There may in some instances be difficulty in determining whether the arrangement is actually an agency. The issue is whether two parties are more like independent businessmen, or like parts of a single economic entity.[73] Although the Supreme Court threatens to look past form to business realities when dealers no longer resemble agents,[74] there can be confusing differences between legally and economically recognized business units, which may give both courts and businessmen difficulty.[75] It has been held that a proprietor of a small hardware store carrying a variety of items is the agent of General Electric when he sells its bulbs.[76] A more recent case, however, held that a

69. *See* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 382-88 (1967) (Mr. Justice Stewart concurring in part and dissenting in part demonstrates that Schwinn had ample business excuse for its distribution policies).

70. *See, e.g.*, Bork, *supra* note 4; Lewis & Handcock, *The Franchise System of Distribution* (1963) (A study prepared for the Small Business Administration); Zimmerman, *supra* note 3.

71. In fact, the Supreme Court stated in Simpson v. Union Oil Co., 377 U.S. 13 (1964) that it would not allow vertical price fixing through consignment systems, since this would mean that the legality of a distribution arrangement would turn on form or clever draftsmanship, rather than substance.

72. *See* Elman, *supra* note 5; von Kalinowski, *supra* note 3.

73. *E.g.*, Dealings between a parent corporation and its subsidiary are sometimes held unlawful combinations under section one of the Sherman Act, but some sign of independence such as separate incorporation is probably necessary.

74. United States v. Arnold, Schwinn & Co., 388 U.S. 365, 381 (1967).

75. *See, e.g.*, P. Areeda, *supra* note 5; Note 81 Harv. L. Rev. 235 (1967).

76. United States v. General Electric Co., 272 U.S. 476 (1926).

filling station operator is not the agent of the oil company whose gas is his principal stock in trade.[77] In *United States v. Arnold, Schwinn & Co.*,[78] it appears that a wholesale distributor is an agent when he receives goods on consignment—as did the aforementioned filling station operator. Generally, concerted action by persons within a single business enterprise is not a contract, combination, or conspiracy within section one of the Sherman Act.[79] The business enterprise is regarded as a unit. It cannot combine with its officers or employees, who are its only means for acting. The problem is defining "business enterprise," and rationalizing the language of the cases to determine whether in a given instance the agreeing parties are part of a single economic entity. The *Schwinn* case fails to provide guidelines for deciding when a distributor or dealer is legally categorized as an agent of the manufacturer.

It is also questionable whether the policy judgments underlying the agency-resale dichotomy are valid. Proponents of the *Schwinn* decision might argue that the Supreme Court is reasonably endeavoring to apply the per se rule wherever practicable and fair. Exceptions to antitrust theories requiring pure competition are, however, obviously necessary to allow for cooperation among those working within the same economic unit.[80] So the Court limits lawful territorial and customer restraints to the clearly identifiable area of consignment distribution. The argument is that reasonable restrictions imposed by the manufacturer on his consignee are justifiable to the extent that the manufacturer is responsible for his product. The manufacturer has an interest in maintaining good will. Service and repairs are integral elements of good will. The manufacturer is also responsible for the product's condition, insofar as he may be liable in tort for damages. But it is unrealistic to assume that a manufacturer does not have these same interests after title has passed to a distributor or dealer. He still must make good on advertising promises and warranties. His marginal revenue or maximum profit will still depend on the quantity that retailers of his product can sell. So it would seem that a manufacturer is justified in exercising some direction over the marketing of his product regardless of whether title has passed.[81]

In terms of the freedom of distributors and dealers, the *Schwinn* court's reasoning is apparently that the dealer if he chooses can remain free so long as there are enough competing products to supply him. If he wants to agree to a consignment arrangement he may choose to do so knowing that he is subject to reasonable restriction by his principal. But, as predicted by Mr. Justice

77. Simpson v. Union Oil Co., 377 U.S. 13 (1964). Note that he was not the agent of the oil company for purposes of price fixing, but he might be an agent for purposes of territorial division.

78. 388 U.S. 365 (1967).

79. *See* P. Areeda, *supra* note 5 at 236 for an in depth analysis.

80. Alpha Distributing Co. v. Jack Daniel's Distillery 207 F. Supp. 136 (N.D. Cal. 1961), *aff'd*, 304 F.2d 451 (9th Cir. 1962).

81. United States v. Arnold, Schwinn & Co., 388 U.S. 365, 392-93 (1967) (Mr. Justice Stewart concurring in part and dissenting in part).

Stewart in his dissent in *Schwinn,* one result has been the destruction of many distributorships and dealerships.[82] The agency-resale dichotomy has injured small business more than it has benefitted it.[83] Individuals, heretofore independent dealers, may now find themselves agents, employees or unemployed. The rule in *Schwinn* thus destroys small business by encouraging vertical integration by ownership; hurts middlesized manufacturers who cannot afford to integrate; and hurts the consumer by depriving him of the added competition that would obtain by allowing marketing restrictions after title passes, where warranted by business necessities.[84]

B. *Some Justification of Vertical Territorial Restraints*

Since the agency-resale formula of *Schwinn* appears to lack justification it becomes apparent that the proper inquiry might be whether per se treatment of all vertical, territorial and customer restraints is warranted. Other possible alternatives are per se treatment with several clearly defined exceptions, or an exclusive rule of reason approach.

In deciding the proper procedural framework for evaluating territorial and customer restrictions it is necessary to start with basic assumptions as to antitrust policy. The objectives of competition, more than merely competition itself, should circumscribe the lawful boundaries of business conduct.[85] Therefore, the emphasis should be on the effect of the restraint upon price; production and distribution efficiency; output; and allocation of resources, output and wealth.[86] The tendency of a restraint to promote innovation and development, and to satisfy consumer wants, is also not insignificant.[87] One further assumption is that economic models of pure competition are so far divorced from reality that they confuse rather than simplify appraisal of business practices. Each seller has some degree of power to dominate the market due to location, product differentiation, and reputation.[88] This is not undesirable to the extent that concentration of economic power generates greater efficiency, whose benefits may be passed to the consumer in the form of lower prices.[89] The same may be said with regard to innovation and economic development and its attendant satisfaction of societal needs.[90] Yet empirical studies indicate that in many industries

82. *Id.* at 394. It may be argued contra, that franchising hurts small unfranchised businesses. One response is that antitrust has no interest in saving inefficient businesses to the detriment of the consuming public unless the challenged restraint is found to be anti-competitive in overall effect.

83. *See* Keck, *Alternative Distribution Techniques—Franchising, Consignment, Agency, and Licensing,* 12 A.T. Bull. 177 (1968).

84. The business circumstances in United States v. Arnold, Schwinn & Co., 388 U.S. 365, 382-85, 392-94 (1967), exemplify this assertion.

85. *See* Standard Oil Co. v. United States, 337 U.S. 293, 320 (1949) (separate opinion of Mr. Justice Douglas).

86. *See* Markham, *supra* note 8.

87. *See* J. Schumpeter, *Capitalism, Socialism, and Democracy* (1950).

88. *See* Samuelson, *supra* note 36.

89. *See* J. Schumpter, *supra* note 87.

90. *See* J. Galbraith, *The New Industrial State* (1967).

concentration is greater than that necessary for the achievement of commendable goals.[91] Consequently, it is impossible to avoid the arduous task of balancing pro- and anti-competitive effects, if the objective is to reconcile each decision with antitrust policy. Courts are not well equipped to perform this function. Perhaps then, the *Schwinn* decision is justifiable in terms of common if not economic sense.[92] But it would seem that logic and fairness demand that the rationale of facility of judicial administration give way to persuasive economic justification for territorial and customer restraints, that can actually be demonstrated.

The great majority of franchising operations use territorial and customer restraints.[93] Perhaps many can rearrange the legal terminology of their distributional agreements to comport with the requirements of *Schwinn.* But it is difficult to rationalize its inevitably disruptive effect on franchising, a socially desirable method of marketing.[94] In justification of territorial and customer restraints it has been argued that where inter-brand competition is vigorous, restriction of intra-band competition is excusable, especially where competitors are stronger integrated companies which enjoy freedom from intra-band competition, and therefore higher profit margins.[95] To many manufacturers, the franchise system is the only economically practicable substitute to vertical integration.[96] Franchising is a legal concept which facilitates the pooling of the capital and experience of a large organization with the zeal and the knowhow of local operation.[97] While providing the advantages of bigness, franchising allows the small businessman to retain ownership rather than employee status.[98] The consumer benefits by receiving quality, service, and prices competitive with those of chain or vertically integrated operation. The manufacturer derives the benefit of the retailer's peculiar knowledge of local conditions, expertise in servicing the product, and local good will. Manufacturer owned outlets take longer and cost more to establish.[99] The dealer also benefits, by obtaining the franchiser's capital, managerial acumen, modern techniques, economy of large scale purchasing, advertising and prestige.[100] Therefore, it appears that franchising has many

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91. *See* J. Bain, *Barriers to New Competition*, p. 111 (1956).
92. *See* Markham, *supra* note 8.
93. *See supra* note 30.
94. *See* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 382 (1967) (Mr. Justice Stewart concurring in part and dissenting in part).
95. *See, e.g.*, Lewis & Handcock, *supra* note 70.
96. *See* Zeidman, *supra* note 6. Chain operations have greater competitive power than their smaller rivals. With the advent in the 1950's and 1960's of large shopping centers, small independents could no longer effectively compete with their larger adversaries. To survive, they had to stress quality, competitive prices, and sophisticated marketing techniques. The answer for these small independents was franchising, which provided at once the requisite capital and marketing system.
97. *See Rowe, Introduction: The Significance of Franchising in 1967*, 12 A.T. Bull. 1167 (1967).
98. See Lewis & Handcock, *supra* note 70.
99. *See* Zeidman, *supra* note 6 at 1192-94.
100. *Id.*

social and business advantages over alternative methods of marketing.[101] Nevertheless, the future of franchises using territorial restrictions is clouded by the dubious legal status of such restraints.

Assuming that franchising is a commendable business practice the relevant inquiry in terms of antitrust goals is whether territorial division is necessary for successful franchising, and whether its effect on competition is so harmful that it must, nonetheless, be prohibited. In this regard it should be noted that vertical territorial restrictions may actually create conditions which are ordinarily expected to flow only from vigorous competition.[102] They enable a manufacturer to derive the benefits of a stable, reliable relationship with his retailers. This in turn results in marketing efficiency.[103] Market division, it is argued, facilitates planning, and consequently efficiency, by allowing the manufacturer to accurately estimate how much he must produce to meet demand and to avoid waste; to reduce the cost of promotion and distribution by averting duplication of effort and expenses; and to more easily control the quality and goodwill of his product.[104] Furthermore, it assures optimal sales effort and market coverage;[105] obviates the "free ride problem;"[106] encourages exchanges of information;[107] and minimizes the cost and likelihood of dissatisfaction with service.[108] All of the preceding efficiencies mean that the marginal cost of producing and distributing the manufacturer's product is decreased. If any part of this saving is passed on to the consumer, the effect is pro-competitive. Another desirable outgrowth of territorial division is the freeing of dealers of relatively weak manufacturers to concentrate on competition with their inter-brand rivals. If this increases inter-brand competition, and the resulting impact on the market price outweighs the deleterious effect on intra-brand competition, the consuming pub-

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101. *See* Jones, *The Growth and Importance of Franchising and the Role of Law*, 12 A.T. Bull. 717 (1967).

102. *See* Markham, *supra* note 8.

103. *See* Zimmerman, *supra* note 3 at 1181-83.

104. *See* Bork, *supra* note 4 at 429-35.

105. Territorial division frees the dealer from the burden of meeting intra-brand competition, and therefore allows him to concentrate on maximum exploitation of his sales area. The dealer is assured of sufficient supply at a given price, and an ample market to cover, assuring the success of an investment. The dealer knows that he will recapture, through sales, all of the money and sales effort (which includes advertising, promotion, service, information, goodwill, and training of personnel) that he has expended. This attracts dealers to weak manufacturers, a pro-competitive effect.

106. Absent territorial limitation, there is nothing to prevent one dealer from taking advantage of the sales effort of his intra-brand rivals. It is doubly unfair since the "free rider" has saved money on selling costs, and therefore can underprice his competitors.

107. When a dealer obtains information valuable to the manufacturer and to other resellers, he will not be reluctant to relate it if he knows that it can't result in competitive detriment. Antitrust policy should facilitate mobility of information which may lead to efficiency or innovation.

108. Market division prevents distant dealers from taking a "free ride" with regard to the service of a local dealer. Also, the customer is more likely to receive good service when one dealer is responsible, and eager to retain his clientele. Furthermore, the likelihood of selling defective products is lessened when a dealer knows that he will have to fix it. For a more thorough analysis which complements notes 105-8, *see* Bork, *supra* note 4 at 429-35.

lic benefits, and the courts err in preventing the public from having these benefits.[109]

One of the most persuasive proponents of the lawfulness of vertical territorial limitations is Robert H. Bork,[110] who asserts that most vertical restraints should be lawful. His theory is based on the ultimate values underlying the Sherman Act, preservation of competition and satisfaction of consumer wants as they may be promoted by increased efficiency and output, and decreased prices.[111] The law, he maintains, is aimed not at precluding efficient combination, but only those which adversely affect price, output or quality.[112] Manufacturers will try to maximize profits by equating marginal revenue with marginal cost. Market division will be employed to distribute products more efficiently. The resulting reduction in cost and increase in efficiency of distribution will generate lower prices, increased output and better service.[113] There is no reason to believe that market division will deflect manufacturers from equating marginal cost and marginal revenue, because profit maximization depends on it. Since it is to the detriment of manufacturers to divide markets to protect inefficient retailers, it is fair to assume that the purpose of these agreements is to enhance marketing efficiency.[114] The economic judgments of manufacturers are probably more often correct than those of the judiciary. Therefore, Bork concludes, vertical restraints which do not affect price or output should not be within the purview of antitrust regulation.[115]

Opponents of territorial restrictions have also offered persuasive arguments to support their position. They argue that manufacturers imposing territorial restraints are not primarily concerned wth marketing efficiency, but rather acting to eliminate disruptive price competition.[116] Manufacturers are emphasizing the image of their products by enhancing the prestige of their dealers, the object being an artificially high price.[117] One of the most persuasive advocates of per se illegality for territorial restraints is William S. Comanor who agrees with Bork, that the sale-agency dichotomy in *Schwinn* is unwarranted. They seem to agree on nothing else. Comanor takes the polar position to that of Bork, assert-

109. *See* Zimmerman, *supra* note 3, whose inquiry is in terms of whether the decrease in intra-brand competition is overborne by the increase in inter-brand competition. On the basis of different considerations, he concludes that justifications of territorial restrictions are generally spurious.

110. *See* Bork, *supra* note 4.

111. *Id.* at 375.

112. Bork concentrates his inquiry on the restraint's impact on output, assuming that price is a function of output, and quality is merely how much is put into the product—another aspect of output.

113. *Id.* at 398-416.

114. *Id.* at 381-85.

115. *Id.* at 403-5.

116. *See* Zimmerman, *supra* note 3.

117. *Id.* at 1185. For example, it is not unusual for an item sold at Saks Fifth Avenue and at Alexander's to cost substantially more at the former outlet. Part of this difference is payment for the Saks Fifth Avenue image. Thus, the price of the product is somewhat inflated.

ing that all territorial restrictions should be per se violations of the Sherman Act.[118] He argues that market division not only eliminates intra-brand competition, but also deletes inter-brand price competition. Market power depends not only on the number and relative sizes of the firms in the industry, but also on the extent to which purchasers are willing to substitute among the competing products. Producers try to differentiate their products in order to insulate themselves somewhat from price competition.[119] Where product differentiation is based on the substantial peculiarity of the product, the overall effect may not be entirely undesirable, since decreased price competition will be attended by increased satisfaction of consumer wants. But where product differentiation is a function of prestige, advertising, and other largely illusory distinctions, it is clearly anti-competitive.[120] Dealers can contribute to the manufacturer's attempt to differentiate his produce by pursuing commercial policies directed toward that end.[121] Once freed from intra-brand competition, the dealer uses a higher markup and obtains a greater than competitive price. Comanor argues that manufacturers will not prevent their dealers from doing this, because that extra-competitive profit is used to create consumer preferences for his product.[122] Manufacturers and dealers are therefore acting concertedly to raise prices, and direct the resulting extra-competitive revenues into product differentiation, the incentive being increased sales.[123] As product differentiation increases and substitutability of products decreases, inter-brand competition becomes style rather than price oriented. Thus, to the extent that vertical territorial restraints facilitate product differentiation they are socially and economically undesirable. Comanor further maintains that market coverage is better and resource allocation superior through the ordinary competitive market mechanism.[124] He also discounts the danger of vertical integration as a substitute for market division, noting the diseconomies in such a switch.

C. *Analysis of and Response To Extreme Approaches To Vertical Territorial and Customer Restraints*

Having examined the opposing economic arguments it is easy to see the reasons for the existence of anomalies in the present law governing vertical ter-

118. *See* Comanor, *supra* note 2.
119. *Id.* at 1426.
120. *Id.* at 1425.
121. *E.g.*, Through local advertising, promotion, good service, attractive showrooms, etc., dealers can enhance a product's image.
122. *See* Comanor, *supra* note 2.
123. *Id.* at 1425.
124. *Id.* at 1430. Comanor also notes that vertical market limitations can be used to charge different profit maximizing prices, depending on the elasticity of demand in the given markets. But price discrimination is difficult to identify. In the economic sense it occurs, not when there are price differentials, but when there are greater profits from some sales than others. Since observation of visible prices is not a good enforcement technique, and no one has the machinery to investigate and prove cost justification, it is difficult to draw inferences one way or the other.

ritorial and customer restraints. Strong arguments can be offered for both per se illegality, and per se lawfulness. It is suggested that somewhere between the polarity of approaches, a workable rubric can be devised. Any formula for determining the legality of vertical territorial and customer restraints should take into account three major variables. Antitrust goals, the purpose and actual effect of the restraint, and ease of judicial administration are the factors that should be dispositive of the legal treatment of business conduct.[125]

With regard to the particular arguments of Bork and Comanor,[126] it would seem that both positions taken to their logical extreme, as they are, break down somewhat under scrutiny. Comanor asserts that per se illegality is the proper legal treatment for vertical territorial restraints, because they may be used to effect product differentiation, which in turn deletes inter-brand competition.[127] There is no doubt that this argument has some merit, but it is, nevertheless, dubious support for per se treatment of market division. Product differentiation may be desirable insofar as it leads to satisfaction of real consumer needs.[128] If product differentiation results in price differentials it is in most instances a consequence of consumer preference for different products, rather than similar products at uniform lower prices.[129] In terms of antitrust policy, it is difficult to say whether low prices are more desirable than variety in competing products. It is also unclear whether manufacturers generally employ territorial limitation to decrease distribution costs, pass the savings on to consumers in the form of decreased prices, and thereby augment sales, or as Comanor maintains charge extra-competitive prices, and direct the increased profit margin revenues into product differentiation, resulting in the similar effect of larger sales.[130] If, as it may well be, the purpose and effect of territorial division is some combination of these two alternatives, the restriction does not lack any redeeming virtues, and may well be a lawful ancillary restraint.[131] Another problem with Comanor's reasoning is the concept that product differentiation, based not upon substantial peculiarity of the product, but upon image, effectively destroys inter-brand competition and therefore should be "illegal per se." If consumers prefer products that are widely advertised, sold in fancy showrooms, and properly serviced they are theoretically making a reasoned choice. There is nothing, except evidence of consumer preferences, to prevent manufacturers from increasing sales by offering less prestigious products at lower prices. The evil is not market division, but irrational consumer behavior. The remedy is consumer education, not elimination

125. It may be assumed that the goal of clarifying the law for businessmen will follow from the three elements mentioned, to the extent that the law will comport with business realities.
126. *See infra* text accompanying notes 110-124.
127. *See* Commanor, *supra* note 2.
128. *Id.* at 1423-25.
129. *See* Bork *supra* note 4.
130. *See* Comanor *supra* note 2.
131. *See, e.g.*, Northern Pacific Railway Co. v. United States, 356 U.S. 1 (1958); Addyston Pipe and Steel Co. v. United States, 175 U.S. 211 (1899); Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918).

of efficient distributional networks. Market limitation clearly has potential pro-competitive, or redeeming qualities, and therefore is not properly within the purview of an unconditional per se rule.[132]

It is more difficult to respond to the opposite position to that of Comanor's, that vertical territorial restraints should be per se lawful, because Bork's economic argument seems technically correct.[133] He assumes that manufacturers will seek to maximize profits by equating marginal revenue with marginal cost.[134] Since market division does not affect the profit formula, it does not affect output, price or quality, except to the extent that resulting efficiency has its favorable impact. It would seem, however, that since marginal revenue is a function of demand, at least one of the variables in the profit formula is affected by territorial division. On the other hand it is also apparent that marginal cost is similarly influenced, to the extent of efficiencies resulting from market division. Therefore, territorial restraints do affect the point where marginal revenue meets marginal cost, and consequently affect output and price. The practical manifestation of this effect is difficult to predict. In a given area with a high demand, the manufacturer may increase price, or output, or both. One factor in his decision will be elasticity of demand. If there is low substitutability of his product with others, a manufacturer would be able to raise his price and thereby obtain greater profits. Therefore, product differentiation that is made possible by territorial restraints would appear to affect pricing. If, on the other hand, there is a high elasticity of demand, a manufacturer would be able to decrease price, (because of the efficiencies of market division), resulting in a pro-competitive effect. Thus, in some instances, antitrust policy demands prohibition, in other instances, acceptance of vertical territorial restraints, which rules out Bork's per se lawfulness approach.[135]

In a less technical vein, one knows on the basis of experience, that there are industries in which intra-brand competition is vitally important. If all dealers were to charge the same price, there would be almost no price competition whatsoever in the automobile industry. No business excuse could justify territorial restraints in this field. But in the *Schwinn* situation, there were com-

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132. The *Schwinn* Court acknowledged that the "per se" rule was not necessary to prevent product differentiation. The Court explicitly required product interchangeability as a prerequisite for fitting within the "rule of reason." The measure of interchangeability is cross elasticity of demand. *See* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 380-81.

It is also difficult to understand why Comanor apparently would allow already integrated firms, which do not face intra-brand competition, to use their extra-competitive product margins to differentiate their products, but would not allow Schwinn to do the same thing. Once again, the dichotomy is one of form, rather than substance.

133. *See infra* text accompanying notes 10-15.

134. *See* Bork, *supra* note 4 at 398-416.

135. If there is no price competition due to monopoly or oligopoly on the manufacturing level, and there had been intra-brand price competition prior to the imposition of the restraint, common sense requires a finding of illegality, notwithstanding technical economic arguments to the contrary. *But see* Bork, *supra* note 4 at 398-405 for such an economic argument.

pelling business reasons for dividing markets.[136] Since no concrete evidence of anti-competitive impact was demonstrated, the decision seems indefensible.[137] Perhaps the explanation for *Schwinn* is that the Court, believing that territorial restraints are irreconcilable with the concept of competition stressed in the Sherman Act, deliberately selected a weak case for imposing per se illegality. The Court might have reasoned that anyone interested in franchising will conclude *a fortiori* from *Schwinn* that territorial restraints will be allowed only in very rare circumstances. They will then presumably turn to other alternatives to achieve similar ends.[138]

III. A Suggested Approach to Determining the Legal Status of Vertical Territorial Restraints

Although there are some obviously undesirable aspects to vertical territorial restraints, there are also some commendable features. To hold per se illegality in the *Schwinn* case is to ignore the language and policy underlying the per se rule. Condemnation of conduct, based upon formal doctrine in lieu of empirical evidence demonstrating anti-competitive purpose and effect leads to perverse results.[139] The weight of expert opinion is that territorial division is a practice which ordinarily does not lack any redeeming qualities. The inflexible per se rule for territorial restraints as formulated in *Schwinn* is unsatisfactory, in terms of the rationale for per se illegality. The rationale for a per se rule is that based on empirical evidence, experience, and logic, the likelihood of harm is so great and of justification so slight that inquiry into the reasonableness of a practice based on the facts in each case may fairly be forborne. The primary reason for disdaining examination of reasonableness in each case is the Supreme Court's inability to cope with complex, unwieldly antitrust case records.[140]

One possible vehicle for mitigating the difficulty of judicial regulation of business is revision of the Expediting Act to allow for review by the Court of Appeals before the Supreme Court hears the case.[141] In this way, the issues will be shaped, findings of fact verified, and excess verbiage pared away by the time the Supreme Court hears the case. Another possibility is the creation of a special antitrust tribunal, similar in function and operation to tax courts. Such a court might be composed of judges having a background in economics, experience with actual recurring fact situations in the business world, and some facility with antitrust problems. The preceding suggestions are not offered as an exclusive approach to the problem of implementing and interpreting antitrust legisla-

136. *See* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 382-84 (1967) (Mr. Justice Stewart concurring in part and dissenting in part).
137. *Id.* at 392-94.
138. Vertical integration by ownership, and areas of primary rather than absolute responsibility are two such alternatives.
139. *See* von Kalinowski, *supra* note 3.
140. *See* McLaren, *supra* note 9 at 168-69.
141. 32 Stat. 823 (1903), *as amended,* 15 U.S.C. § 29 (1958); *see also,* Mr. Justice Fortas, 30 ABA Antitrust Sec. 131 (1966).

tion. They are merely meant to point out one way of avoiding the use of an inflexible per se rule where business conduct requires differing regulatory treatment.

Another suggested improvement on the present procedural approach to the legal status of territorial restraints envisages a conditional "per se" rule, similar to that in force in the European Common Market. Article 85, paragraph 1 of the Treaty Establishing the European Economic Community stipulates that all agreements that are liable to affect trade between Member States, and that are designed to prevent, restrict, or distort competition within the Common Market or which have this effect are incompatible with the Common Market.[142] But Article 85, paragraph 3 excepts certain restraints from the ambit of paragraph 1, where the challenged practice helps to improve the production or distribution of goods, or to promote technical progress, while allowing consumers a fair share of the resulting profit.[143] The restrictions used must be indispensable to the achievement of the above objectives. Such restrictions also may not eliminate competition in respect of a substantial part of goods concerned.[144]

A formula, similar to the Common Market standard above, might better satisfy competing interests with regard to territorial restraints that are the subject of Sherman Act prosecutions.[145] The procedure would call for a rebuttable presumption of illegality. The burden of rebuttal would rest on the defendant until he can demonstrate:

A) that the challenged practice is indispensable in achieving a socially or economically beneficial end,[146] and

B) that the ultimate effect of such practice preserves or enhances both inter-brand competition and overall competition, and

C) that a substantial share of the resulting profits are shared by the consumer.

The courts under this procedure would inquire preliminarily into the necessity of the restraint. The defendant would be obliged to prove that market division is the only way that he can meet the competition of a more powerful rival. Therefore, a firm which controls a large share of the relevant market would receive per se treatment summarily. In a highly competitive industry, where no enterprise enjoys a strong advantage, a firm resorting to territorial restraints would in most cases be unable to demonstrate business necessity, and likewise fall within the per se rule.

142. *See* Treaty Establishing the European Economic Community, *adopted* March 25, 1957, 298 U.N.T.S. 14.

143. See art. 85(c) Treaty Establishing the European Economic Community, *adopted* March 25, 1957, 298 U.N.T.S. 47.

144. For an insight into the actual operation of this provision, *see e.g.*, Hahn Exclusive Distributorship agreements in the Common Market: Antitrust Laws on the Move. 16 Am. U. L. Rev. 367 (1967).

145. 26 Stat. 209 (1890), *as amended*, 15 U.S.C. § 1 (1955).

146. *See, e.g., supra* text accompanying notes 96-100, 113, 143.

Requisites B, and C, which necessitate proof that competition, in general, has not been injured, and that the consumer benefits from the restraint can be demonstrated objectively. The easiest way for a defendant to meet the above requirements, would be to show that his product is substantially interchangeable with rival products. By showing that his sales are highly sensitive to changes in price of competing products, the defendant can reasonably assert that inter-brand price competition will be enhanced as a consequence of market division. It can be presumed that the efficiency derived from territorial division will enable the defendant to charge lower prices. He will be encouraged to decrease prices in order to increase sales. Since his product is reasonably interchangeable with others, inter-brand rivals will have to meet his lower price to avoid losing sales. Thus, the effect on inter-brand competition is salutary.[147] Since product substitutability can be measured by cross elasticity of demand, an objective test of how consumers respond to price changes, it would seem that the foregoing approach would be workable.

One difficult obstacle would then remain for the defendant, that is, to prove that the *overall* effect of the restraint is pro-competitive. This calls for a showing that despite the destruction of pre-existing intra-brand competition, the increase in inter-brand price competition renders the total effect beneficial in terms of antitrust goals. If hitherto intense intra-brand competition is eliminated, the restraint is probably unlawful. If only token intra-brand competition is destroyed, the restraint is probably lawful. In close cases, the defendant, having the burden of proof, would usually fail, unless he could show a substantial increase in inter-brand competition.[148] In the case of a new product, the overall effect of territorial limitation on competition would almost always be favorable. Although a more exact test is highly desirable, it is probably impracticable to further delimit the inquiry into the overall effect on competition.

Where the defendant carries the burden of proof, the plaintiff can then offer to prove that the business practice used was unreasonable, not being the least restrictive method of achieving the desired ends. The plaintiff could also prove that there is a trend toward concentration in the relevant market, indicating that the long run effect on inter-brand competition is actually depressive.

147. *But see* FTC v. Brown Shoe Co., 384 U.S. 316 (1966).

148. It is easier to demonstrate the magnitude of decrease in intra-brand competition than to demonstrate the degree of increase in inter-brand competition. In proving the former, one need only point out that there was so much pre-existing competition that was nullified. Where there used to be a number of competitors, there is now no competition at all. In proving the latter, however, there are no visible indicators of the change in the level of competition after the restraint. Therefore, although a defendant can prove that theoretically inter-brand price competition should be stimulated (as a result of efficiencies derived from market division which allows him to decrease his prices) he probably cannot prove how much inter-brand competition has increased. Consequently, in proving that overall competition has been enhanced, the likelihood of a defendant's success would vary inversely with the amount of intra-brand competition that has been eliminated. In other words, since the degree of increase in inter-brand competition is difficult to ascertain, the inquiry into the impact on total competition would focus primarily on the amount of intra-brand competition that was nullified.

In other words, the inquiry would shift to the rule of reason rubric, with the burden of proof of unreasonableness on the plaintiff, as it ordinarily would be.

IV. Conclusion

It is submitted that by means of the foregoing *conditional per se* approach, the determination of the legal status of territorial restraints would be more logical, workable and equitable than the present procedure explained in the *Schwinn* case.[149] Where it is fair to do so, the courts would be able to forego elaborate examination of business circumstances surrounding the restraint. But where the purpose and effect of a restraint allow for an inference that the restraint may further the ends of antitrust, common sense and fairness militates for a thorough inquiry into the actual effects on competition. Businessmen would favor such a procedure, knowing that necessary business conduct toward an acceptable end would not be arbitrarily prohibited under an inflexible per se rule. Consumers would benefit from enhanced competition, that is presently precluded, in those instances where territorial limitations have beneficial overall effects. And as suggested previously, the burden on the Supreme Court of deciding complicated antitrust cases could be mitigated by revision of the Expediting Act, or some similar change of procedure. It is therefore suggested that a conditional per se approach to the legal status of vertical territorial and customer restraints is an improvement upon the existing law and a fair compromise among the competing interests of manufacturers, dealers, plaintiffs, courts, and consumers.

Kenneth D. Weiss

THE NEED FOR PROTECTION OF THE CONSUMER OF SERVICES

Introduction

A legal distinction has been made for hundreds of years between sales and service contracts. For example, the original English Statute of Frauds,[1] passed in 1677, declared itself applicable to any contract for the sale of goods worth more than ten pounds,[2] but not applicable to service contracts if the work could be performed within one year.[3] Today there exists a whole body of law dealing with the sales contract as separate from other types of contracts. This

149. United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

1. 29 Chas. 11.
2. Fuller, L., and Braucher, R., Basic Contract Law (1963) at 796.
3. *Id.*