Closed Dealer Territories

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There are two basic types of "exclusive" territorial arrangements. The first is an exclusive franchise, which is a promise by the manufacturer not to sell to another outlet in a given area. The second is a "closed territory"—a promise from dealer to manufacturer not to sell in another dealer’s territory. The subject of this comment is the promise running from dealer to manufacturer which creates the "closed territory." Customer restrictions will not be included, but it is noteworthy that theoretically, a restriction to one type or class of customer can represent an effective territorial restriction if, within an easily accessible area (determined by freight rates or practical advertising limits, for example) there are only a limited number of the allowed class of customers. Although it is possible to have a closed territory without an exclusive franchise, this comment further assumes the existence of the latter.

There have been many consent decrees in which manufacturers agree to cease using closed territories, but there has been little case law. The problem is further complicated by the fact that while commentators commonly differentiate between exclusive selling arrangements (hereinafter referred to as exclusive franchises), restrictive territories (hereinafter referred to as closed territories) and customer restrictions, the courts have, until White Motor Co. v. United States, generally treated them together as "closed territories." In that case Justice Brennan, concurring, distinguished customer and geographic restrictions.

Both exclusive franchises and closed territories are an effort by the manufacturer to market his goods effectively. Two main reasons are commonly given

5. See, e.g., United States v. Consolidated Laundries, 1961 Trade Cas. ¶ 70,039 at 78, 179 (2d Cir.), where the court, in considering an horizontal territorial division said, "We fail to see any significant difference between an allocation of customers and an allocation of territory."
for such restrictions. First, it is necessary for the “orderly marketing of goods,” and secondly, it assures the dealer a sufficient market. The fact that a manufacturer can often obtain substantial benefit by voluntarily limiting his distributorships in any given area is a further indication that in many cases his promise to do so is forced by the dealer. That is, in order to get the best dealers, or to get the best results out of existing dealers, the manufacturer must promise them exclusive franchises. The reason for imposing closed territories then becomes one of protecting a previously granted exclusive franchise from the hazards of cross-selling. Such cross-selling is an inevitable result of both dealer and customer mobility; it is often extremely easy for a dealer to go into another territory for customers, and often even easier for a customer to buy in another territory. The dealer may be tempted because it sometimes takes less effort to “skim the cream,” i.e., sell to the best or most easily reached customers in an adjacent territory, than to expend the additional time, effort and money in making additional sales in one’s own territory.

Once the closed territory is imposed, certain benefits accrue to the manufacturer which he may not lawfully obtain by contract. As an example, the dealer, now assurred an adequate market, will be discouraged from handling competing lines, though the manufacturer might not legally be able to impose such a restriction. The closed territory also makes it easier for the manufacturer to distribute his goods, as volume is constant. It is also of aid in tracing defective goods, an important consideration, for example, in the drug industry.

8. 47 Marq. L. Rev. 389, 392 (1963). This is at best a vague and inconclusive statement. Treating only of an exclusive franchise, the manufacturer benefits because of lower selling costs (due to a restricted number of buyers); often the manufacturer is able to minimize his risk by picking only the most solvent dealers. This may confer a “prestige” benefit on him. Note, 75 Harv. L. Rev. 795, 805 (1962). See Banning, Techniques for Marketing New Products at 55 (1957); Robinson, Restraints on Trade and the Orderly Marketing of Goods, 45 Cornell L.Q. 254 (1960).


10. See note 3, supra.

11. Ibid.


13. It is hazardous because when another dealer’s territory is encroached upon, one of two things will happen: he will either be driven out of business, leaving the manufacturer with no assurance that the remaining dealers will handle the entire vacated area instead of merely the “cream” accounts, or the offended dealer will fight back, in which case effort will be expended over a customer likely to buy that brand anyway (though it may result in lower consumer prices). Id. at 812. Thus, in the lower court, White Motor argued that “To obtain the maximum number of sales of trucks in a given area, the White Motor Company has to insist that its distributors and dealers concentrate on trying to take sales away from other competing truck manufacturers in their respective territories rather than on cutting each others throats in other territories.” White Motor Co. v. United States, 194 F. Supp. 562, 578 (N.D. Ohio 1961).


17. A somewhat less praiseworthy benefit is that the closed territory also makes it easier to spot price-cutting dealers.

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Closed territories are enforced by profit passovers, under which the offending dealer must give his profit on the sale (or a percentage thereof) to the dealer in whose territory the sale was made, and by simple franchise cancellation, a rather drastic and thus little-used measure. Other enforcement methods include refusal by the manufacturer to ship to a customer outside the dealer's territory, or a curtailment of the dealer's allotment of the line of goods the dealer has been cross-selling.18

According to one commentator, it is often difficult to determine whether a given arrangement is in effect an exclusive franchise or a closed territory.19 In terms of a definite agreement, it is of course rather easy, but such situations are in reality rare.20 In many instances there is not even an oral agreement—merely an “understanding”—derived from the business circumstances.21

CURRENT LEGAL STATUS

The Exclusive Franchise Background and the Position of Exclusive Franchise under the Anti-Trust Laws

The lower court in White Motor22 distinguished closed territories from exclusive franchises "... have been upheld as reasonable when ancillary to the sale of goods for resale because they protect the vendee's property rights in his resale business from being destroyed or damaged by the actions of his vendor who is in a position to undersell, or establish a competitor of, his vendee."23 Territorial restrictions were, however, held illegal per se, since they constituted market allocation among competitors. Here the court cited horizontal market allocation cases.24 The court bridged the gap between horizontal and vertical market allocation with Dr. Miles Medical Co. v. John D. Park & Sons Co.,25 in which the court held resale price—maintenance contracts among manufacturing distributors and retailers illegal. A unilateral decision by a manufacturer to limit his outlets does not violate the antitrust laws, absent any monopoly or monopolization problem.26 This is so

19. Id. at 809.
20. White Motor Co. v. United States, 372 U.S. 253 (1963) was such an exception. See Note, 75 Harv. L. Rev. 795, 802 (1962).
even though it be at the behest of the dealer. After all, "Such decisions are not made in a vacuum."27 In this matter at least, the Federal Trade Commission has followed the courts.28 Although commonly found in conjunction with an exclusive franchise, the closed territory must be considered as a separate entity, and its cumulative effect, when found with an exclusive franchise, is not determinative of its legality.29

**Early History of Closed Territories**

The case law on closed territories is sparse. In 1917, a judge charged a jury that closed territories were illegal, whether by agreement among the dealers or imposed by the manufacturer.30 This was based on the assumption that what the dealers could not lawfully agree to do among themselves, the manufacturer could not impose on them, as the result was the same.31 The first case directly on the question32 upheld the closed territory, consistent with the common law doctrine of allowing a seller to impose a condition on a buyer that the product would not be used to compete with the seller.33


Reliable Volkswagen S & S Co. v. World-Wide Auto Corp., 182 F. Supp. 412 (D.N.J. 1960) involved uncertain relevant market definitions and monopoly allegations, and was distinguished from the *Schwing* and *Packard* cases.


27. *Schwing Motor Co. v. Hudson Sales Corp.*, 138 F. Supp. 899, 906 (D. Md. 1956), *aff'd per curiam*, 239 F.2d 176 (4th Cir. 1956), *cert. denied*, 355 U.S. 823 (1957). The trial Court went on "To say that a manufacturer may legally decide to reduce the number of its dealers in a given area if it does not discuss the matter with the dealers beforehand, but violates the anti-trust laws if it does discuss the matter with them before the new agreements are made, ignores the realities." 138 F. Supp. 899, 906 (D. Md. 1956).

28. *Columbus Coated Fabrics, 5 FTC 1500 (1959).*

29. In *Snap-On Tools v. FTC*, 321 F.2d 825 (7th Cir. 1963), the Court of Appeals in reversing the FTC held restrictive provisions of the "Dealer Agreement*" must be considered seriatim, not collectively.


31. See Commissioner McCollough dissenting in Matter of General Cigar Co., Inc., 16 FTC 537, 538 (1932): "Of course, a manufacturer has the legal right to choose his customers and to limit them in numbers, but he has not the legal right by exacted promises or by cooperative or coercive methods, to restrain his customers from making sales outside of allocated territory."


Cole Motor Car Company v. Hurst dealt with the problem of whether a principal could control an agent's territory, but the Court of Appeals did suggest that closed territories were reasonable under federal law. This decision furnished a precedent for Boro Hall Corp. v. General Motors, in which the lower court, in a Sherman Act action, ruled the closed territory valid. On appeal, a limitation was imposed by the Court of Appeals finding that defendant's uncontradicted affidavit refuted plaintiff's allegation that plaintiff could sell only in his "zone of influence." Thus this limited holding in reality affirms only the legality of "... what in effect was an exclusive selling arrangement. ... The result is that, aside from the untested district court dicta in Boro Hall, there is no definitive federal court decision on closed territories.

Within a space of 29 years the FTC considered the question of closed territories only twice, first in the General Cigar case and then in Snap-On Tools. In the former case, the complaint alleging closed territories was dismissed without opinion; in the latter case, the practice was found illegal. This was reversed on appeal. The Commission had distinguished Boro Hall, and being adverse to skeletons in the closet, buried General Cigar in a footnote, saying it had "... little precedential significance now."

Territorial restrictions have been considered within the framework of a price-fixing scheme. In United States v. Volkswagen of America, Inc. the plaintiff alleged a comprehensive price-fixing scheme between Volkswagen of America (VOA) and fourteen distributors. Dealers and the manufacturer were alleged co-conspirators, but were not made defendants. It was alleged that:

1. distributors will sell to dealers at prices fixed by VOA, manufacturer and Volkswagen United States (VUS. This was substantially the same in personnel and purpose as VOA and was formed for the importation distribution and sale of Volkswagen automobiles in the United States);
2. dealers will sell to purchasers at prices set by VOA, VUS and the manufacturer;
3. distributors will sell to franchised dealers only;
4. co-conspirator dealers will not sell to others for resale;
5. each distributor will sell only to those franchised dealers located within the distributor's assigned territory;
6. dealers will sell only to customers in his exclusive territory;
7. distributors and dealers will not sell competing cars;
8. distributors will terminate sales agreements or cut quantity of cars allocated to dealers violating these terms.

In holding that the territorialization allegations could not be dealt with on defendant's motion to dismiss, the court said the price-fixing charges precluded determination of their legal efficacy and went on to frame two issues: first, whether or not the territorialization was designed to assist price-maintenance, and secondly, if so, its utility in so doing.\textsuperscript{48} Even assuming its legality, the court refused to dismiss the territorialization charges, saying:

\begin{quote}
It does not follow that practices legal per se when considered alone, are necessarily so whatever the context in which they are found.\textsuperscript{47}
\end{quote}

Thus there is here no treatment of closed territories on their own merits. (Query whether they ever can be, since they are not usually found except in concert with circumstances similar to the above allegations.)\textsuperscript{49}

\textit{Reliable Volkswagen S & S Co. v. World Wide Auto Corp.}\textsuperscript{40} was a suit by a dealer against other dealers, distributors, VOA, VUS and the manufacturer, alleging cut-off of his promised supply of Volkswagen automobiles. Charges were brought under section 3 of the Clayton Act that dealers agreed to handle no other makes of cars. Plaintiff also urged that other distributors would not sell to him after the cut-off, as he was outside their assigned territory, and that this violated section 1 of the Sherman Act. Section 2 violations were alleged in that defendants had a monopoly on the sale of Volkswagen cars and parts.

The court said that the territorialization charges must be isolated, as there was no allegation of violation per se of the antitrust laws, and that their obvious deficiency was failure to allege a public or even a private injury.\textsuperscript{50} Thus the allegations of closed territories were dismissed on a point of pleading.

Questions of trademark protection were raised in \textit{Denison Mattress Factory}
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v. Spring-Air Co.\(^{51}\) The Spring-Air Company was composed of thirty-four small bedding manufacturers who were Spring-Air shareholders. They contributed advertising funds and were licensed by Spring-Air to use its trademark on bedding meeting Spring-Air specifications. Spring-Air sued when defendant withdrew without paying its assessment. The defense consisted of allegations of:

1. division of trade territory;
2. requirements contracts for materials;
3. price-fixing;
4. restrictions on manufacturing of competing products;
5. restraints on sale or use of products and materials after termination of the contract.\(^{52}\)

The trial court held for the plaintiff, and the Court of Appeals affirmed, saying the plaintiff had not only a right, but a duty to protect its trademark, and that where division of territories is not the central purpose of the agreement, the licensor can impose closed territories.\(^{53}\) The court did not deal with the possibility that this could be viewed as an horizontal agreement among joint venturers (as the licensees were all shareholders of plaintiff) and thus illegal under settled principles of horizontal market allocation.

White Motor v. United States.\(^{54}\) although deciding only that a per se rule was inapplicable at the time, gives indications of the Court's view of closed territories. The majority opinion mentions four instances in which they might be allowed: when used by a small company in the face of aggressive competition, where a small company must use them either to break into, or stay in business, and where the company is failing. The concurring opinion draws a distinction between dealer and manufacturer imposed restrictions, saying the former would be illegal under horizontal market allocation principles. Their effect on inter-brand competition is vital: "Surely it would be significant to the disposition of this case if . . . some such arrangement were a prerequisite for effective competition on the part of independent manufacturers of trucks."\(^{55}\)

\(^{51}\) 308 F.2d 403 (5th Cir. 1962).
\(^{52}\) Id. at 406.
\(^{55}\) Id. at 268-69.

"White Motor apparently stands for several important propositions concerning franchises: (a) restrictive provisions regarding territorial and customer division do not of themselves render a franchise program illegal; (b) the legality of vertical integration by contract, including franchise systems, can be determined only in the context of the factual background of the industry concerned; (c) insofar as a franchise system may result in horizontal price-fixing, it falls under the prohibition of Section 1 of the Sherman Act, but this does not mean that the entire program is necessarily unlawful. If a system of fixing prices, however, includes restrictive practices which are not independent of the price-fixing, such restrictive practices may be prohibited. . . ." Statement of Paul Rand Dixon, Chairman, Federal Trade Commission, Hearing Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 89th Cong., 1st Sess. 12 (1965).
Although the holding of White Motor is expressly limited to the need for a trial, there are some later cases upon which the practitioner can attempt prediction as to how territorial restrictions will fare in the courts.

The first of these is Snap-On Tools v. FTC. In upholding Snap-On's "Dealer Agreement" which included exclusive franchises, closed territories and customer restrictions, the Court of Appeals found it had no real collective anti-competitive effect. Under this holding, a simple closed territory by itself would be a fortiori valid, although seldom encountered except in concert with other restrictions similar to those found in the Snap-On "Dealer Agreement." The court reasoned that a minimal curtailment of intrabrand competition was justified if promotive of competition on the interbrand level. Although this has been interpreted as a misuse of the White Motor decision, in view of that Court's limited holding, it would not seem to be so. Admittedly, a manufacturer can more easily justify a closed territory under the Snap-On decision than under the more exhaustive scrutiny of the White Motor concurrence, but the majority opinion in White specifically limited its holding to the necessity of a trial to determine the effect and legality of territorial and customer restrictions.

Recent Cases

Three recent cases indicate the thinking of two courts on the validity of closed territories. In United States v. Sealy, a mattress licensor was charged in a civil suit with violating section 1 of the Sherman Act by allocating exclusive territories and fixing uniform retail prices. Defendant admitted its licensees were licensed to manufacture and sell Sealy products in specific geographical

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56. 321 F.2d 825 (7th Cir. 1963).
57. The "Dealer Agreement" contained, inter alia, clauses providing that:
1. dealer would sell only at price fixed by Snap-On, where legal under fair trade laws.
2. dealer would sell only within his allocated territory.
3. dealer shall not sell to certain reserved customers.
Snap-On Tools v. FTC, Brief and Appendix for Respondent, p. 3, n.3. Note however that the Dealer Agreement did not in form couple the closed territory with an exclusive dealership:
2. The Company hereby assigns to the Dealer, not as an agent, a non-exclusive franchise for the sale of its products only within the territory described below . . . .
Id. p. 46 of Appendix. It was conceded however, that the term "non-exclusive" referred only to petitioner's sales directly to certain customers in the territory, and not to sales therein by any other dealer. Id. p. 21 of Brief.
58. See notes 48, 57 supra.
59. 321 F.2d 825, 831-32 (7th Cir. 1963).
63. Sealy was found guilty of the latter charge, and because the court considered the allegations separately, discussion of this charge is omitted.
areas, but contended that the restrictions were reasonably ancillary to the proper protection and exploitation of its trademarks, patents, processes and manufacturing and merchandising techniques—in other words, a combination of business convenience and trademark protection. Sealy also noted the licensing arrangements promoted competition in the bedding industry, and that vigorous competition in the field made the restraints reasonable. Thus, it argued, the relief prayed for was contrary to the public interest. Sealy also defended on the ground that its licensees were still allowed to, and many evidently did, manufacture and sell non-Sealy bedding as long as it was not passed off as "Sealy."

The court severed the price-fixing from the territorial restriction allegations, treated them separately, and found the territorialization did not violate the antitrust laws. The court concluded that Sealy’s business conduct was not indicative of a corporation originated and operated for the purpose of dividing the United States among competing mattress manufacturers, as alleged. Additionally, the court found the executive committee had, in 1933, seriously considered and rejected a proposal that the eight Sealy licensees then in existence divide the United States among themselves. The court found the evidence established the licensing agreements were developed in the early 1920’s for legitimate business purposes, and that Sealy’s objective was not market division among licensees, but rather obtaining additional licensees and more intensive sales coverage. It concluded as a matter of law that the Government had not proven a conspiracy to allocate territories among competitors in unreasonable restraint of trade, and that the assignment of exclusive territories did not violate the antitrust laws.

Considered from the point of view of a conspiracy among licensees, this conclusion is probably correct. Sealy’s hand was heavy in changes among terri-

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65. Ibid.
66. Id. at 80,072.
67. Id. at 80,071.
68. Id. at 80,072.
69. Ibid.
70. Sealy presented testimonial and documentary evidence expressly limited to the price-fixing allegations of the complaint.
71. The court’s opinion seems to imply a distinction between an attempt to divide the territory (here the United States) among existing licensees and an attempt to cover the territory by adding licensees as necessary. Sealy continually sought new licensees to fill uncovered territory; licensees relinquished territory not within their natural trading areas and Sealy continually shifted territories amonglicensees, discontinuing some contracts. These facts, says the court, “. . . are incompatible with a finding that the Sealy licensees conspired to allocate territories among themselves.” The court also noted the restrictions were imposed by Sealy, not the licensees. Id. at 80,077.
72. Ibid.
73. Id. at 80,083. This does not really answer the question, as a company may achieve more intensive coverage by eliminating competition on the dealer (here licensee) level thru the use of restricted territories, which, it is arguable, Sealy was attempting to do.
74. Id. at 80,106-07.
tories,\textsuperscript{76} and although it appears obvious the licensees knew much about each other’s business, Sealy’s control of territorial allocation precludes a conspiracy on the part of existing licensees to divide the United States, at least as of 1933.\textsuperscript{76} Nevertheless, it seems clear the dominant theme is one of licensor-imposed territorial allocation; what Sealy undoubtedly tried to do was blanket the United States with licensees, each restricted to his territory.\textsuperscript{77}

A finding that the practice is reasonably ancillary to the exploitation of a trademark indicates the court based its opinion on the intent or purpose inherent in setting up the restrictions. In this respect the case resembles \textit{Denison v. Spring Air}; both are small businesses attempting to protect trademarks. Under the \textit{Sealy} decision, therefore, a licensor who has long practiced territorial restriction of its licensees, and who is engaged in constant addition, deletion and shifting of those licensees to obtain maximum market coverage may employ closed territories if reasonably ancillary to trademark exploitation \textit{provided} there is no intent on the part of the licensor or licensees to divide the market among a fixed group of competitors.\textsuperscript{78} In effect, it gives blanket approval to closed territorial restrictions.

\textit{United States v. Arnold Schwinn & Co.}\textsuperscript{79} involved a business whose economic position was midway between that of Sealy, a going concern, and Sandura,\textsuperscript{80} a small business struggling to survive. The government’s complaint, brought under section 1 of the Sherman Act, alleged a combination and conspiracy among Schwinn, its distributors, Schwinn Cycle Distributors Association (SCDA) and B.F. Goodrich (BFG)\textsuperscript{81} as evidenced by the following practices:

1. The number of franchised retailers in each area was limited with concurrence of a wholesaler co-conspirator who was to sell only to such franchised retailer.
2. BFG was permitted to sell Schwinn products only to BFG outlets.

\begin{footnotes}
\item[75] Id. at 80,076. See generally the court’s Findings of Fact \textit{passim}.
\item[76] Id. at 80,077. Findings of Fact IV, \textit{passim}.
\item[77] Id. at 80,076.
\item[78] Justice Brennan, concurring in \textit{White Motor} analogizes closed territories to horizontal market division among competitors, and indicates that whether the impetus for their use comes from the manufacturer or the dealers is vital:

If it were clear that the territorial restrictions involved in this case had been induced solely or even primarily by appellant’s dealers and distributors, it would make no difference to their legality that the restrictions were formally imposed by the manufacturer rather than through inter-dealer agreement. 372 \textit{U.S.} 253, 267 (1963). (Footnote omitted.)

The origin of the agreement would be difficult to prove, and in terms of economic consequences, it is irrelevant.

\item[80] See the \textit{Sandura} discussion \textit{infra}. Schwinn’s market share fell from 22.5\% in 1951 to 12.8\% in 1961. The largest bicycle manufacturer in 1961 had 21.8\% of the market. Id at 80,376.
\item[81] B. F. Goodrich did not go to trial because of a consent decree to which neither Schwinn nor SCDA was a party.

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3. BFG outlets and franchised retailers in certain states were required to adhere to Schwinn-fixed prices.

4. Price-cutting franchised retailers or price-cutting BFG outlets, or those selling to non-authorized retail dealers were to be reported to Schwinn, and henceforth not supplied by Schwinn, BFG or wholesale co-conspirators.

5. Wholesaler co-conspirators were given an exclusive area with respect to other wholesalers and were to sell only in that area.

6. Franchised retailers were required to buy only from the wholesaler co-conspirator authorized to sell in that area, and to sell only from the area specifically franchised.3

The government took the position that all aspects of the complaint, including price-fixing and boycotting, were so interwoven as to constitute one overall, vertical conspiracy among Schwinn, wholesalers, SCDA members and all franchised retailers.8 The gist of the closed territory allegations was a conspiracy existing since 1952 among these parties to allocate territories and suppress competition by a dual system, in which distributors sold only in their territory and dealers bought only from their territorial distributor. This allegedly was enforced by Schwinn.8

Schwinn's principal defense was that the challenged practices were reasonably ancillary to its main purpose of waging effective interbrand competition with the larger integrated bicycle sellers, and that its conduct must be considered in the light of conditions in the bicycle business.85 Although this is substantially the same defense Sealy presented, it is more convincing as a business necessity when raised by Schwinn86 than by Sealy where (aside from trademark exploitation) it was evidently a mere convenience. Schwinn further contended that the territories had been created by natural boundaries and available transportation, that a dealer was not compelled to buy from a specific distributor, and that some territories had more than one dealer.

After finding Schwinn not guilty of price-fixing, the court said it had a right to assign areas of primary responsibility to either Schwinn Plan agent-distributors, or independent contractor distributors. But the agreement between Schwinn and certain SCDA members, SCDA itself and certain franchised re-

82. § 71,329 at 80,376.
83. Ibid.
84. Id. at 80,385.
85. Id. at 80,377.
86. See note 80, supra.
87. The Schwinn Plan was a method devised to meet Depression-caused capitalization problems. Under it, the franchised dealer could buy either directly from the Schwinn factory or from the distributor's warehouse. If the dealer chose to buy from the factory, the distributor forwarded the order to the factory, which shipped to the dealer, billing him and extending him credit. Schwinn then paid the distributor a commission equaling the difference between the distributor's cost and the Schwinn Plan price of the bicycle. Distributors were not (and are not) compelled to use this plan, and some do not. The plan eliminates one handling of the bicycle. Usually, dealers purchase their basic inventory under the plan, and fill in orders from the distributor's warehouse stock. Id. at 80,377.
tailers, by which distributors’ sales were confined to areas of prime responsibility was really a closed territory, and a per se violation of section 1 of the Sherman Act.

A third important case dealing with the problem of closed territories is Sandura Co. v. FTC. Sandura, a floor-covering manufacturer, is a small concern, completely overshadowed by three giant, integrated companies (as well as others), to whom it is currently losing ground. Because of a product failure which nearly forced it into bankruptcy, the company was faced with dealer, distributor and customer dissatisfaction which caused sales to fall from a 1950 high of $7,000,000 to a 1954 low of $3,557,000. Confronted with the problem of persuading distributors to handle a dubious line and to bear, as well, the advertising costs (which Sandura was financially unable to meet), the company recruited new distributors. They were not so new, however, as to take Sandura’s product line without the special inducement of a closed exclusive territory. Many distributors testified that they would not have handled Sandura’s products on any other terms. According to the evidence, this is still the case, and perhaps with good reason—Sandura sales rose to a 1959 high of $24,001,523, but by 1962 had fallen to $11,023,041, with a before-tax credit loss of $200,119.

The complaint was brought under section 5 of the Federal Trade Commission Act. Based on the economic evidence, the court, reversing the Commission, found the acknowledged elimination of competition, by the use of closed territories, necessary for Sandura’s “very survival” and continued economic effectiveness, even though the court also found Sandura not to be a “failing company.” The evidence shows the minimal restraint (the only degree of restraint allowable under the antitrust laws to accomplish a purpose) in this case was the continued use of closed territories. In view of Sandura’s precarious condition, it seems difficult to quarrel with the court’s opinion without taking the rather extreme position that territorial restrictions are illegal per se, and that a business must be able to survive without them. Essentially, the FTC and the court differed on the implications of the evidence, with the latter being very im-

88. Id. at 80,391.
90. Armstrong, Congoleum-Nairn, and Pabco (now Pabco division of Fiberboard Paper Products Company). In 1958 Sandura’s sales of $19,634,000 was 4.8% of hard floor-covering industry sales. At the most it owned 1.6% of industry assets.
92. Id. at 80,397.
93. Ibid.
94. Id. at 80,398.
95. Id. at 80,399.
96. Id. at 80,397. The sales decline was in yearly steps, after the 1959 high, as follows: 1960, $16,394,061; 1961, $13,718,297.
97. Id. at 80,401.
98. Ibid.
pressed with distributor testimony to the effect that they would not have handled Sandura's products without closed territories. The FTC's position was that they were not necessary. If the use of closed territories can be justified by other than a corporation in extremis, (which presumably could be saved by invoking the "failing company" doctrine) then it would seem Sandura had that justification. This comports with the majority opinion in White Motor: "... they may be allowable protections against aggressive competitors or the only practicable means a small company has for breaking into or staying in business. ..." Under the concurring opinion, Sandura might not have fared so well.

CONTINUING PROBLEMS

Since the earlier cases on closed territories arose at a time when antitrust policy and economic conditions varied substantially from what they are today, it is safe to say that the modern law of closed territories is based on White Motor and succeeding cases. White Motor, though deciding only that summary judgment is not yet a proper procedural device for disposition of the issue, furnishes valuable guidelines for judging the legality of these restrictions. The central questions are first, do they restrain trade, and if so, is the restraint justified? Once it is concluded, as it was in White Motor, that the rule of per se illegality is inapplicable, then

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 conditions before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. (Emphasis added.)

With respect to the use of closed territories as a restriction, this inquiry will involve the factors set forth in White Motor, namely:

1. is the restriction being used to protect against aggressive competitors?

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99. Id. at 80,398-99.
101. See note 78, supra.
103. 372 U.S. 253, 261 (1963): "... we believe that the applicable rule of law should be designed after a trial."
104. Cases involving territorial restrictions can be brought under the Sherman Act § 1, as a "restraint of trade," under the Clayton Act § 3, if its effects "may be substantially to lessen competition or tend to create a monopoly," or under the Federal Trade Commission Act § 5, as an "unfair method of competition." At the present time, it would seem to make no difference as to which Act charges are brought under, in terms of relevant defense and justifications.
2. Is it the only means a small company has either to break into or to stay in business?
3. Is the company failing?
4. Was the restriction manufacturer or dealer induced?
5. Is it necessary for effective interbrand competition?
6. Is it more restrictive than necessary?
7. Are there less restrictive alternatives?
8. Is its use reasonably related to the needs which brought it into being?

In short, legality for the present will not be tested without a thorough economic analysis.

There is no question that closed territories, when used in conjunction with an exclusive franchise, restrain and may eliminate intrabrand competition. The issue then is economic justification. It seems clear that at the present time, a company in Sandura's condition will be able to use closed territories. If "the general objective of the antitrust laws is promotion of competition in open markets," then the course most promotive of that competition is to uphold closed territories where necessary to survival. However, if the emphasis is placed on the phrase "open markets," then it is arguable that such restraints may not be used, even though the result may be failure of the business. The life of a company with an inferior product or management should not be unnaturally extended by sheltering it from the antitrust laws. On balance it would seem more consonant with current antitrust policy to uphold territorial restraints in such a situation, as the present view seems to be that the existence of competition even if weak, is preferable to no competition at all.

More difficult problems arise when there is no survival issue, but where the claimed justification is product protection through, for example, necessary servicing or trademark protection. This arises in the Sealy and Schwinn cases. Factually, these two cases are distinguishable. First, the Schwinn court found an horizontal conspiracy; secondly, economic position varied; thirdly, Sealy involved royalty income to the licensor (arguably giving him a greater interest in the licensees' activities), and many concurrent activities directed primarily toward obtaining additional licensees rather than maintaining market divisions among a few existing distributors, as revealed by the evidence in Schwinn. In short, there was in Sealy no intent to divide and maintain existing closed territories for the purpose of eliminating competition on the distributor level. Of course, a good intention will not save an otherwise objectionable practice, but knowledge of intent may assist the court in interpreting facts and predicting consequences.

Assuming the *Sealy* and *Schwinn* cases are factually distinguishable, the issue then becomes whether or not the distinctions are significant, or whether, on the other hand, one of the two cases is wrongly decided. The *Schwinn* court found an horizontal conspiracy on evidence quite like that of *Sealy*, in addition to which *Schwinn* was held not guilty of price-fixing. Although there was a difference in the territorialization pattern, it can be explained on the simple ground that *Schwinn* decided as a matter of business policy that it needed fewer outlets; *Sealy* believed it needed more. Neither is any less a system of closed territories.

There is an additional factor complicating the *Sealy* case. As in *Denison*, (where stock in Spring-Air was wholly owned by the licensees), 95 per cent of *Sealy* stock is owned, in unequal amounts, by the licensees. Thus it is in reality a joint venture, with the licensees agreeing among themselves, (through the licensor *Sealy*) to allocate their own territories. In short, it is market allocation by and for competitors. The question then is whether such activity by a licensor is reasonably ancillary to waging effective competition when carried on by a profit-making corporation (as contrasted to Spring-Air, which is arguably an "umbrella" corporation, having no profit-making intent and functioning purely for convenience in advertising and marketing functions). The situation can be analogized either to a trade association or more classically, to a simple horizontal agreement not to compete. Though the trade association problem is usually one of determining when cooperation has become conspiracy, no such issue exists here, as it is admitted closed territories restrain competition. Further, their allocation goes far beyond permitted trade association activities. The analogy of classical inter-manufacturer territorial allocation is110 logically at least, inescapable.

Because closed territories are usually found in conjunction with other arrangements, they raise the problem of whether multiple charges should be considered *seriation* as the Court of Appeals held in *Snap-On Tools*, or collectively as the FTC contended. The Supreme Court favors the collective approach, at least in price-fixing cases:

In any price-fixing case restrictive practices ancillary to the price-fixing scheme are also quite properly restrained. Such was the *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707, 64 S. Ct. 805, 88 L. Ed. 1024, where price-fixing was an integral part of the whole distribution system.111

This approach is certainly sensible in the territorial restrictions field, where an exclusive franchise is usually found with the closed territory, and the economic effects of the two are apt to be inextricable. In terms of realistic and effective

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antitrust policy it seems the sound approach. There is a danger, however, that a business ordered to cease using a certain over-all distribution plan will find itself also forbidden to use practices, which although legal, are found to be "ancillary" to the forbidden plan. Such a dilemma and its concomitant lengthy litigation, could well lead to a per se approach to the question.\textsuperscript{112}

There is always the possibility of a legislative solution. A recent bill has proposed amendment of the FTCA by adding a new section providing that for purposes of the FTCA and the Sherman Act,

\begin{quote}
a contract or agreement between a purchaser and a supplier restricting the right of the purchaser to the distribution of the supplier's product within a clearly delineated territorial area shall not in and of itself be deemed to be an unfair method of competition, an unfair or deceptive act or practice in commerce, a restraint of trade or commerce or a monopoly or attempt to monopolize where the product or products which is or are the subject of such exclusive territorial franchise agreement or contract are in free and open competition with products of like grade and quality produced by persons other than the supplier, and where the purchaser under such exclusive territorial franchise agreement or contract is in free and open competition with other vendors of like or similar merchandise within the territorial area defined by such agreement or contract and is not inhibited by the terms of such agreement or contract from dealing in like or similar products of persons other than the supplier.\textsuperscript{113}
\end{quote}

The bill, introduced as being particularly for the benefit of small businesses,\textsuperscript{114} presents definitional problems. Under it, three requirements must be met before the closed territory will be allowed: product competition, purchaser competition (that is, competition among the purchaser class using the closed territory), and freedom of that purchaser to deal in the goods of another (in reality a facet of purchaser competition). The product must be in "free and open competition." The first question is, just what is "free and open competition?" Would an oligopolist be able to use closed territories, even though he may have only two competitors?

The requirement that product competition be with goods "of like grade and quality" and purchaser competition be "of like or similar merchandise" is confusing. Assuming there is a distinction, why is it made? The phrase "like grade and quality" as used in the Robinson-Patman Act refers to competition among different products of one manufacturer, whereas in the proposed bill it refers to competition among brands of different manufacturers. Does this mean that judicial construction of the Robinson-Patman Act is to be adopted with

\textsuperscript{112}"Flexible standards may then have to give way once more to rigid rules in order to deal with realities. Just as the standards of negligence, contributory negligence, and last clear chance have had to retreat in favor of rules flashed by traffic lights, so also the standard of the so-called rule of reason may have to withdraw farther to make room for more per se rules which codify experience."\textsuperscript{113} Dixon, \textit{Recent Changes in Organization and Procedure of the Federal Trade Commission}, 19 ABA Sect. of Antitrust Law 252, 259 (1961).

\textsuperscript{113}H.R. 4862, 89th Cong., 1st Sess. (1965).

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respect to "like grade and quality" product competition, but not with respect to purchaser competition?

Any closed territorial arrangement may be said to "inhibit" dealing in "like or similar products of persons other than the supplier" simply because a closed territory makes it easier to market goods. This forces a definition of "inhibit," probably in terms similar to the quantitative substantiality test of commerce foreclosed. The bill thus invites the courts to swim in the "... sink of uncertainty and error,"115 of Robinson-Patman terminology.

An adequate legislative solution would probably be most desirable, in view of the extensive use by modern business of franchises embodying contractual restrictions.116 Other remedies have been suggested; one of the foremost of these is the "area of primary responsibility." In Snap-On Tools the court dismissed the FTC's area of primary responsibility as "... a sterile exercise in language," creating more problems than it solves.117 There is much merit in this position. The term "area of primary responsibility" is a facile one whose only virtue is uncertainty. It is a comparatively simple matter for a manufacturer to set up standards of "responsibility" in terms of a closed territory.118 When geared to a quota system, under which dealers must sell a certain amount in a given area, it might conceivably become an added incentive to an aggressive, successful dealer. Viewed as an entire plan, which might easily be more restrictive than a simple closed territory, "its interpretation would only tend to promote friction


116. Contractual restrictions in franchises frequently include territorial and customer restrictions, agreements to deal only in the franchisor's merchandise, to limit purchase of supplies to firms named by the franchisor, to sell at franchisor-set prices, not to compete with the franchisor for a certain time after cancellation of the franchise. Statement of Eugene P. Foley, Administrator, Small Business Administration, Hearings Before the Subcommittee on Antitrust and Monopoly Legislation of the Senate Committee on the Judiciary, 89th Cong., 1st Sess. (1965).

Franchise growth has been very rapid, and its volume is now about $65 million a year. Newsweek, Boss Yourself: The $15 Billion Boom (Feb. 22, 1965). The growth rate is about 10% a year. The International Franchise Association estimated that in 1962 over 400 companies in eighty different fields franchised over 100,000 people, and that in 1963 there were over 338,000 franchised outlets. See generally Konopa, What Is Meant by Franchise Selling? Journal of Marketing, 35 (April 1963).

The vast majority of franchises sell highly standardized goods and/or services directly to the consumer. Statement of Eugene P. Foley, Administrator, Small Business Administration, supra at 2. Their reported failure rate is less than 1%. Id. at 5.

The Small Business Administration spokesman mentioned that franchise-imposed territorial restrictions are "... a very effective method of encouraging each franchisee to advertise in his territory, secure in the knowledge that the soil thus fertilized will not be invaded by others. Further, it serves to direct the competitive energies of all the franchisees away from each other and against rival brands." Id. at 12.

Similarly, the SBA is concerned with per se rules, saying inter-competitor agreements strengthen the position of small businesses competing against a few dominant firms, thus improving competition. Id. at 16. In particular, it is concerned with the per se approach of the FTC and Department of Justice to the allocation of closed territories to franchisees. Id. at 17.

117. Snap-On Tools v. FTC, 321 F.2d 825, 832 (7th Cir. 1963).
118. Ibid.
and misunderstanding among dealers."119 Most writers prefer an application of
the equally uncertain rule of reason, with a variety of guides centering around
the hazy notion of legitimate business practice,120 although there is some support
for per se illegality.121

Summary

Closed territories are usually found in conjunction with a franchise sys-
tem. Their use is an attempt by the manufacturer to market his goods effect-
vively. There is little case law on closed territories, although there are a number
of consent decrees forbidding their use.

The White Motor case gives valuable suggestions as to the Supreme Court's
view of this restraint, but the few available lower court decisions deal with
divergent fact situations, and generalization, at present, is difficult.122 Thus,
the Sealy case allowed the use of closed territories if reasonably ancillary to
trademark exploitation, and absent any intent on the part of competitors to
divide the market among themselves. The court in Snap-On Tools found no real
anticompetitive effect, and concluded that a minimal curtailment of intra-
brand competition was justified if it stimulated inter-brand competition. The
Schwinn court struck down closed territories on the basis of an horizontal con-
spiracy, implemented by the manufacturer. But in Sandura, the court found
the use of closed territories justified as necessary for survival.

Because of the extensive use of franchise arrangements and territorial plan-
ning,123 an adequate legislative solution is needed. Closed territories should be
illegal only if used as a means to effect an unlawful objective, or if they ma-

119. Ibid. This would not seem to be the type of misunderstanding and friction that
would be of benefit to the consumer via price-cuts or improved services. But cf. Note, 1964
Duke L.J. 408, 413.

120. See, e.g., Jordan, Exclusive And Restricted Sales Areas Under the Antitrust Laws,
9 U.C.L.A.L. Rev. 111, 154 (1962): "Where the purpose of the restraint is to foster some
legitimate business interest the restraint should be prohibited only if some restraint of
competition in the market is clearly discernible."

121. See, e.g., Stone, Closed Territorial Distribution: An Opening Question In The
distributorship appears so likely to be anticompetitive that it is difficult to conceive any but
the most problematical and burdensome proffers of some saving grace. In such circumstances,
the invocation of a rule of per se illegality seems warranted." (Footnote omitted.)

Even with respect to a failing company, the author believes ". . . the closure should be
limited in time; if the company cannot put itself back together after a period the Court
deems reasonable, the workings of competition ought not to be interfered with further."122

Ibid.

This is open to the objection that any antitrust law restricts the working of classical
unregulated competition. In the completely unregulated situation, a failing company could
use closed territories to survive. If, to "promote competition," closed territories were deemed
illegal per se, the company would be barred from using a marketing system which might,
in unregulated competition, keep it alive. Thus we have an example of the current anomaly
that imposed antitrust regulations become part of "the workings of competition."

122. "Aside from White Motor, the decided cases concerning various franchising
arrangements do not lend themselves to general propositions beyond the facts of each case."
Statement of Paul Rand Dixon, Chairman, Federal Trade Commission, Hearings Before the
Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary,
89th Cong., 1st Sess. 18 (1965).

123. See note 116, supra.
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terially reduce competition in the relevant market. The use of closed territories should not depend upon the availability of less restrictive alternatives, as those alternatives may not be available to all competitors. The “area of primary responsibility” provides no certainty for business planning, and is an open invitation to misunderstanding, confusion and litigation.

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If there is no unlawful objective (such as monopolization, price-fixing, etc.) and no material reduction of competition, it would not seem necessary for the courts to inquire into the validity of the business purpose prompting the use of the closed territory. Presumably, if it is not useful, it will be dropped, or if retained, it will have no competitive effect; this still leaves the courts with the power to strike it down if harmful.

125. “Nor do I believe that it should be incumbent on the manufacturer to prove, once economic justification for the territorial restraints is shown, that he could not have squeezed by with some lesser alternative restraint. Such a requirement would be wholly impractical both from the legal and business points of view. Suppose it appears that, in order to compete effectively against other brands, it was reasonably necessary for the manufacturer to have independent dealers who would concentrate their efforts in their assigned territories and not encroach upon their neighbors. How, as a practical matter, can the manufacturer go further and prove that if he had employed an “area of primary responsibility” clause, for example, his dealers would in fact have invaded each other’s territory to his detriment? Maybe they would have, and maybe they would not have. Maybe each would have stayed in his own backyard even without a primary responsibility obligation. But surely the manufacturer should not be forced to build a distribution system on a foundation of maybe’s. He should not be required, at the pain of incurring antitrust liability, to experiment with “less restrictive alternatives” when, if he guesses wrong, he may find himself out of the competitive race. It is all well and good to sit back and theorize about what the manufacturer might get by with. But the manufacturer who operates in a heavily competitive business world cannot afford the luxury of theorizing. He is on the firing line and should not be second-guessed after the event if his own solution to the problem is reasonable.” Handler, Recent Antitrust Developments, 112 U. Pa. L. Rev. 159, 167-68 (1963).

126. Both the Department of Justice and the FTC, with perhaps pardonable adversary zeal, consider territorial restrictions illegal per se. Recently, the Department of Justice has begun to cast a suspicious eye upon “areas of primary responsibility,” perhaps in anticipation of the confusion they would engender. Note, 75 Harv. L. Rev. 795, 797 (1962).

Although the Department of Justice prevented White Motor from putting a primary responsibility clause in the District Court’s final decree, it later told the Supreme Court that White Motor could have used an area of primary responsibility limitation as a less restrictive alternative! Brief for Appellee, pp. 25-26, Reply Brief for Appellant, p. 2, n.3. White Motor Co. v. United States, 372 U.S. 253 (1963).