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Antitrust: Per Se Illegality for Territorial Restraints

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CASE COMMENTS

ANTITRUST: PER SE ILLEGALITY FOR TERRITORIAL RESTRAINTS*

United States v. Topco Associates, Inc., 405 U.S. 596 (1972)

The defendant, a cooperative purchasing association of independent grocery chains,[1] imposed territorial limits on member sales and customer restrictions on the wholesaling of goods procured under its auspices.[2] The Government attacked both restraints as per se violations[3] of the Sherman Act, section 1.[4] The district court refused to enjoin the practices because the restraints on intra-brand competition[5] were deemed reasonable in light of their potential for augmenting inter-brand competition.[6] On appeal pursuant to the Expediting Act,[7] the Supreme Court reversed and HELD, such horizontally imposed allocations of exclusive territories as well as the customer restrictions on member wholesaling were per se violations of the Sherman Act.[8]

Unaltered from its 1890 form, section 1 of the Sherman Act declares "every [agreement] . . . in restraint of trade . . . is . . . illegal."[9] Recognizing from the earliest cases arising under the statute that a literal interpretation of this language would cause a more pervasive effect than Congress had en-

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1. The association was formed in 1944 to develop a private-label line of grocery products, the initial costs of which were prohibitive for individual members. The higher profit margins on these products and the economic benefits inherent in cooperative purchasing of other name-brand merchandise were the primary benefits of membership. Wholly-owned by its members but performing no market development functions, the association endeavored to protect the advertising investments and profit margins of member-chains by imposing restraints. Brief for Appellee at 3-10, United States v. Topco Associates, Inc., 405 U.S. 596 (1972).

2. The territorial limitations applied only to the sale of Topco-controlled brands, 405 U.S. at 602.

3. Brief for Appellant at 15.

4. 15 U.S.C. §1 (1970).

5. "Intra-brand" denotes competition in the consumer market between retailers of identical products bearing the same trademark. "Inter-brand" signifies that competition between retailers of identical or functionally similar products bearing different trademarks. Since product-differentiation advertising schemes are capable of developing definite consumer preferences for identical products bearing separate trademarks, the purer intrabrand competition may be the only area in which price competition will play a significant role. *See* Comanor, *Vertical Territorial and Customer Restrictions:* White Motor *and Its Aftermath*, 81 HARV. L. REV. 1419, 1422 (1968).

6. United States v. Topco Associates, Inc., 319 F. Supp. 1031 (N.D. Ill. 1970).

7. 15 U.S.C. §29 (1970). The Act provides for a direct appeal from the district court to the Supreme Court in any antitrust case in which the United States is the complainant.

8. 405 U.S. at 608-12.

9. 15 U.S.C. §1 (1970).

Florida Law Review, Vol. 25, Iss. 1 [1972], Art. 9

visioned,[10] the Supreme Court adopted a "rule of reason" standard to govern the Act's application.[11] Essentially this rule requires an economic evaluation of the restraints alleged in each case to determine if their over-all purpose or effect is to substantially lessen competition in any significant portion of the market.[12] Application of the rule inevitably engages the courts in balancing differing concepts of competition, the results of which are not always consistent.[13]

To counter this inconsistency and to relieve courts of the inordinate burden of in-depth analysis in every case, the Court subsequently added to the rule a corollary category of per se offenses.[14] The category included those restraints historically found to be inherently anticompetitive; such restraints were to be treated with a presumption of illegality.[15] Unfortunately, the respective spheres of the rule and the corollary were ill-defined[16] and inconsistencies became prevalent in the application of both.[17]

Despite this confusion both the rule of reason and the per se corollary continue to be governing standards in all Sherman Act cases.[18] Consequently, in a trial the prosecution often moves for summary judgment on the ground that the restraint is within the per se category and therefore presumed to be illegal.[19] The defendant may defeat this motion by showing either that the

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10. *See* J. VAN CISE, UNDERSTANDING THE ANTITRUST LAWS 31-33 (1970).

11. Standard Oil Co. v. United States, 221 U.S. 1, 60 (1911).

12. The classic statement of the rule was provided by Justice Brandeis: "[T]he legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. 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; [and] 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. . . . knowledge of intent may help the court to interpret facts and to predict consequences." Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918).

13. *See* Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division,* (pt. 1), 74 YALE L.J. 775, 811-28 (1965). *Compare* United States v. Trenton Potteries Co., 273 U.S. 392 (1927), *with* Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918).

14. Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958). Justice Black provided the following classical explanation of the per se concept: "[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." *Id.*

15. *See,e.g.,* United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 218 (1940).

16. Bork, *The Rule of Reason and the Per Se Concept: Price-Fixing and Market Division,* (pt. 2), 75 YALE L.J. 373, 378 (1966).

17. *Id. Compare* White Motor Co. v. United States, 372 U.S. 253 (1963), *with* United States v. Penn-Olin Chem. Co., 378 U.S. 158 (1964).

18. *See, e.g.,* White Motor Co. v. United States, 372 U.S. 253 (1963); Serta Associates, Inc. v. United States, 296 F. Supp. 1121 (N.D. Ill.), *aff'd per curiam,* 393 U.S. 534, *rehearing denied,* 394 U.S. 967 (1969).

19. J. VAN CISE, *supra* note 10, at 122-23. The restraints generally regarded as per se

alleged restraint is outside the ambit of the per se category or that it is reasonably ancillary to a dominant lawful purpose.[20] If he succeeds in establishing either defense, summary judgment is avoided and the court will proceed to trial on the merits to apply the rule of reason.[21]

The relationship of the parties to an allegedly restrictive agreement may also affect its legality.[22] Traditionally, agreements between parties at the same level of the production or distribution process (for example, two retailers) have been classified as horizontal,[23] while those between parties at separate levels (for example, manufacturer and distributor) have been termed vertical.[24] Economically, the horizontal agreements are more directly destructive of competition, since they involve cooperation between ostensible competitors.[25] The vertical agreement, on the other hand, involves the transfer of already existent monopoly power from one level of the market to another; total monopoly power is not necessarily increased but its effect is always rendered more pervasive.[26] Legally, the two types of classifications have been separately treated as, for example, in *White Motor Co. v. United States.*[27] There, the Supreme Court refused to regard vertical market restrictions as per se violations, but reiterated that similar restraints, if horizontally imposed, would be within the per se ambit.[28]

The issue in the instant case was the legality of horizontally imposed territorial and customer restrictions unaccompanied by price fixing.[29] From the earliest days of Sherman Act litigation, horizontal agreements allocating territories and customers have been deemed unlawful per se when used in conjunction with other illegal restraints such as price fixing.[30] However, the Court has repeatedly avoided the specific question of the separate legality of these agreements by terming violations "aggregation[s] of trade restraints"[31] or by condemning market allocations for being auxiliaries of price-fixing agreements.[32] The Court's additional failure to delineate the proper scope of the

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violations are: price fixing, boycotts, market allocations, tying arrangements, and monopolistic conduct intended to foreclose competitors from a substantial market. *Id.* at 118.

20. *Id.* at 124. *See, e.g.,* Northern Pac. Ry. v. United States, 356 U.S. 1, 7 (1958).

21. Van Cise, *The Future of Per Se in Antitrust Law,* 50 VA. L. REV. 1165, 1173 (1964).

22. *E.g.,* United States v. Sealy, Inc., 388 U.S. 350 (1967); White Motor Co. v. United States, 372 U.S. 253 (1963). *See also* Comment, *Horizontal Territorial Restraints and the Per Se Rule,* 28 WASH. & LEE L. REV. 457, 460 (1971).

23. *See, e.g.,* Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951); Addyston Pipe & Steel Co. v. United States, 175 U.S. 211 (1899).

24. *See, e.g.,* United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967); White Motor Co. v. United States, 372 U.S. 253 (1963).

25. *See* Warren, *Economics of Closed-Territory Distribution,* 2 ANTITRUST L. & ECON. REV. (No. 2), 111, 115 (1968).

26. *Id.*

27. 372 U.S. 253 (1963). *See* text accompanying notes 35-40 *infra.*

28. 372 U.S. at 263.

29. 405 U.S. at 609 n.9.

30. *E.g.,* Addyston Pipe & Steel Co. v. United States, 175 U.S. 211 (1899).

31. United States v. Sealy, Inc., 388 U.S. 350, 354 (1967); Timken Roller Bearing Co. v. United States, 341 U.S. 593, 598 (1951).

32. United States v. Bausch & Lomb Optical Co., 321 U.S. 707, 720 (1944).

ancillary restraints defense has compounded this uncertainty.[33] Prior to the instant case therefore, two questions remained: (1) whether horizontal market allocation agreements standing alone were per se unlawful and (2) if so, to what extent they might be redeemed by pro-competitive potential.

The instant Court resolved the first question unequivocally in the affirmative.[34] It refused, however, to consider defendant's proffered evidence of the pro-competitive potential for the restraints,[35] and asserted that the Sherman Act gave Topco "no authority . . . to determine the respective values of competition in various sectors of the economy."[36] In view of recent case history the decision represents a definite expansion of the per se corollary and a corresponding decline of the rule of reason.

The roots of this expansion are imbedded in *White Motor Co. v. United States*[37] where the Supreme Court reversed a district court's holding that vertically imposed market restrictions were per se violations of the Sherman Act. As a manufacturer of trucks, White Motor had attempted to allocate exclusive territories to its independent distributors and to prohibit them from selling to certain large users whom White serviced directly.[38] Although the Court reiterated the principle that similar restrictions, horizontally imposed, were clearly unlawful,[39] it refused to subject these vertical allocations to the per se presumption.[40] The absence of a demonstrable nexus between the market restrictions and the previously enjoined price-fixing scheme also precluded an initial per se application,[41] and the *White* Court felt that without such nexus it knew "too little of the actual impact of both [restrictions] . . . to reach a conclusion" on their per se character.[42]

The importance of this nexus between market restrictions and price fixing was seemingly enhanced by *United States v. Sealy, Inc.*[43] Sealy owned certain bedding trademarks that were licensed to individual manufacturers on an exclusive territorial basis. The manufacturer-licensees were the principal owners of Sealy stock.[44] The Government attacked the market allocations as well as Sealy's resale price maintenance scheme as horizontally im-

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33. *See* McLaren, *Territorial and Customer Restrictions, Consignments, Suggested Resale Prices and Refusals To Deal*, 37 ANTITRUST L.J. 137, 142 (1967).

34. 405 U.S. at 609 n.9.

35. *See* Brief for Appellee at 20-24. The evidence was presented under the doctrine of ancillary restraints, no mention of which occurs in the majority opinion. 405 U.S. at 596-611.

36. 405 U.S. at 610-11.

37. 372 U.S. 253 (1963).

38. *Id.* at 255.

39. *Id.* at 263.

40. *Id.* at 264.

41. *Id.* at 260.

42. *Id.* at 261.

43. 388 U.S. 350 (1967). The significance of a nexus between the market restrictions and a price-fixing scheme is also supported by the economic fact that territorial restrictions prevent buyers in one area from purchasing in another. As a result, retailers may "fix" prices arbitrarily with little adverse effect. Warren, *supra* note 25, at 115.

44. 388 U.S. at 352.

posed restraints subject to the per se presumption.[45] The district court found the price-fixing scheme invalid under the per se corollary, but ruled the market allocations lawful under the rule of reason.[46] The Government appealed only the market restriction issue. Recognizing that Sealy was controlled by its licensees, the Supreme Court deemed the territorial limitations horizontally imposed and thereby subject to the per se presumption.[47] The Court, however, avoided the issue of their separate legality once again by resurrecting the lower court's finding of illegal price restrictions and denominating the proscribed practice a traditional "aggregation of trade restraints."[48]

On the other hand, in *United States v. Arnold, Schwinn & Co.*,[49] decided the same day as *Sealy*, the Court squarely faced the issue of vertically imposed market restrictions and extended the per se presumption to them.[50] Defendant was a leading manufacturer of bicycles and marketed its product through direct and consignment sales to independent distributors and retailers.[51] Territorial restrictions were imposed on both. In addition, distributors were permitted to sell only to franchised retailers.[52] The Government contended that these vertically imposed market restraints were all per se violations of the Sherman Act.[53] The Supreme Court's response, however, was more limited. It held the restrictions imposed where the defendant had "parted with dominion over the goods . . . would violate the ancient rule against restraints on alienation."[54] Though this "ancient rule" was in fact instant tradition in the field of Sherman Act litigation, its adoption by the Court extended the per se presumption to naked, vertically imposed market allocations where title to the product had been relinquished.[55]

The instant Court's application of the per se corollary to Topco's restrictions was an enlargement of the per se illegality rule consistent with *Sealy* and *Schwinn*. Clearly, the restraints were horizontal, for the member-chains controlled Topco through an organization almost identical to that in Sealy.[56] The instant case differed principally from *Sealy* by its lack of any price-fixing element;[57] however, the vertical restraints in *Schwinn* were held per se invalid without any finding of such coordinate restraint.[58] Careful reading of the two decisions therefore suggests that the tie to price fixing

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45. *Id.* at 351.
46. *Id.* at 351-52.
47. *Id.* at 356-57.
48. *Id.* at 357. By relying on the presence of price fixing, the Court bolstered the theory that territorial restrictions alone were legal. *See also* text accompanying note 32 *supra*.
49. 388 U.S. 365 (1967).
50. *Id.*
51. *Id.* at 370.
52. *Id.* at 371.
53. *Id.* at 367.
54. *Id.* at 380.
55. *Id.* at 382.
56. Brief for Appellee at 11.
57. *See* text accompanying note 46 *supra*.
58. The United States did not appeal the district court's finding that no price fixing existed. 388 U.S. at 368.

in *Sealy* was resurrected for the sake of additional support for the holding rather than as the basis for the per se result. To read *Sealy* otherwise would be to find the Court treating the economically less destructive vertical restraints more stringently than their less desirable horizontal counterparts.[59] The instant Court reached the more logical result.

A significant aspect of the instant decision was the Court's disregard of Topco's rebuttal evidence that its restraints were reasonably ancillary to a lawful purpose.[60] Topco showed that its purpose, the marketing of a private-label line of products, contained proved potential for lower consumer prices and increased inter-brand competition.[61] It then maintained that these restraints on intra-brand competition were required to enable the small member-chains to assume the risk and expense of market development activities.[62] The Court, nevertheless, failed to take notice of this precedent-supported defense[63] on the ground that the Sherman Act provided no authority for increasing competition in one arena at the expense of its demise in another.[64]

Economically, this rationale is sound. The product-differentiation potential of today's advertising has drastically reduced the role of price competition in the inter-brand arena.[65] By contrast the purer intra-brand competition offers much more potential benefit to the nation's consumers.[66] The Court wisely refused to extend the scope of the ancillary restraints defense to a situation where the restrictions were conceivably as costly as the potential benefit to be derived from the lawful purpose.

The anomaly created by the instant decision is that cooperatives are prohibited from employing a competitive practice that remains available to fully integrated firms. As Topco noted, and the Government conceded, the restraints proscribed in the instant case would be completely valid if employed by one of the single large competitor chains.[67] This inconsistency does not necessarily discredit the instant holding;[68] it does, however, reveal a need for regulatory legislation with more uniform impact.

In addition, this inconsistency produces a marked conflict in present antitrust policy by creating an obvious incentive for small businesses to merge. Under the Clayton Act, section 7,[69] as well as section 1 of the Sherman Act,[70] mergers are carefully regulated in order to preserve the viability of

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59. *See* text accompanying notes 25, 26 *supra*.
60. *See* McLaren, note 33 *supra*.
61. Brief for Appellee at 6-8.
62. *Id.* at 22-23.
63. *See* McLaren, note 33 *supra*.
64. 405 U.S. at 609-10.
65. *See* Comanor, *supra* note 5, at 1422-27.
66. *Id.*
67. 319 F. Supp. 1031, 1040 (1970).
68. Economically, the restraints had sufficient anticompetitive potential to support proscription. *See* text accompanying notes 65, 66 *supra*. Certainly they should not have been tolerated solely because loopholes existed elsewhere in antitrust regulations.
69. 15 U.S.C. §18 (1970).
70. 15 U.S.C. §1 (1970).

small business.[71] Yet the holding in the instant case readily reveals that protection of small business is not a controlling element where the Sherman Act is applied to other practices. Likewise, the instant Court's refusal to consider evidence of pro-competitive potential renders its stance on market restrictions even more stringent than its approach to horizontal mergers.[72] The result is not only an incentive for small businesses to merge, but also a limited loophole through which they may reach that end.

For Topco, whose large market share precludes merger,[73] the less effective yet viable alternative of assigning areas of primary responsibility[74] still remains. Its adoption would entail designating one Topco member in each territory to assume the responsibilities of market development for the private-label products. Topco would in turn compensate him for these activities by taxing all other members operating in the area. This alternative would protect the responsible member from loss on advertising expenses; it would not, however, protect his profit margin on Topco-brand goods from the price competition of the other member firms. Likewise, evidence of such intra-brand competition would be necessary to shield the system from indictment as a de facto allocation of exclusive territories.[75]

The instant decision continues in the tradition of *Schwinn* and perhaps *Sealy* to establish uninhibited competition as the controlling principle of section 1 of the Sherman Act.[76] Despite its possible harsh effects on small businesses, the decision seems laudable for its potential development of three important goals. First, by extending the per se presumption to naked horizontal market restrictions, the instant case has created predictability that should allow business planners and consulting lawyers to function with some degree of certainty. Second, this extension of the per se corollary should produce a saving of judicial time and effort that will inure to the benefit of business through a reduction of court delays and litigation expenses. Third, and potentially most important, the Court's fidelity to the competitive tradition produces a sharper focus on the need for immediate legislative action in the antitrust field. The conflict in present antitrust policy, which the decision reveals, is indicative of the incomplete role that the single value of competition plays in our modern economy.[77] The complex nature of this

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71. *See, e.g.*, Ford Motor Co. v. United States, 405 U.S. 562 (1972); United States v. Penn-Olin Chem. Co., 378 U.S. 158 (1964).

72. *See* Brief for Appellee at 36 n.36.

73. Brief for Appellee at 38. *See also* United States v. Von's Grocery Co., 382 U.S. 270 (1966); U.S. DEP'T OF JUSTICE, MERGER GUIDELINES (May 30, 1968).

74. For a short discussion of the nature and antitrust implications of this practice *see* Note, *Selected Antitrust Problems of the Franchisor: Exclusive Arrangements, Territorial Restrictions, and Franchise Termination*, 22 U. FLA. L. REV. 260, 287-89 (1969).

75. *Cf. Id.* at 283-89.

76. 405 U.S. at 610.

77. *See, e.g.*, J. GALBRAITH, THE NEW INDUSTRIAL STATE (1967).