NOTES

SYLVANIA AND VERTICAL RESTRAINTS ON DISTRIBUTION

In 1962 GTE Sylvania reorganized its distribution system in an attempt to restore its declining share of the national television market. By eliminating its wholesale level of distribution and sharply reducing the number of retail outlets selling its products,[1] Sylvania sought to attract the "more aggressive and competent retailers thought necessary to the improvement of the company's market position."[2] To this end, Sylvania also provided its dealers with the advantages of reduced intrabrand competition[3] by contractually restricting its franchisees to resell only at authorized locations.[4] When Sylvania initiated this distribution system in 1962 its market share was less than two percent in an industry with over one hundred competitors, but dominated by one large manufacturer.[5] By 1965 Sylvania had become the eighth largest television manufacturer in the country, with a market share of five percent.[6]

Continental T.V., Inc., owned a chain of retail stores and was franchised to sell Sylvania products at several locations in California.[7] Although bound by Sylvania's standard location restriction, in 1965 Continental made available for sale at an unauthorized Sacramento location merchandise which it had purchased from Sylvania.[8] In response to this breach of Continental's location clause, Sylvania terminated Continental's franchises, and Sylvania's finance company filed suit against Continental in federal district court for money owed.[9]

The antitrust issues in *Continental T.V., Inc. v. GTE Sylvania Inc.*[10] arose in the form of a cross-claim brought by Continental against Sylvania alleging that Sylvania's location restriction violated section one of the Sherman Act.[11] Invoking the per se rule against nonprice vertical re-

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[1] Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 38 (1977). Prior to 1962 Sylvania sold its products to wholesale distributors who in turn resold to an unrestricted group of retailers. *Id.*

[2] *Id.*

[3] Intrabrand competition is competition between sellers of the product of the same manufacturer. Interbrand competition is competition betwen sellers of the same generic product produced by different manufacturers. *Id.* at 52 n. 19.

[4] *Id.* at 38. Although Sylvania imposed a location restriction on its franchisees, it reserved the right to alter the number of retailers in an area without the consent of existing dealers. *Id.*

[5] *Id.* RCA possessed a market share of between 60 and 70 percent of national television sales. *Id.* at 38 n.1.

[6] *Id.* at 38-39.

[7] *Id.* at 39.

[8] *Id.* Prior to Continental's unauthorized movement of goods to Sacramento, Sylvania had authorized a new dealer location near Continental's San Francisco outlet. *Id.* Continental had objected strongly to the creation of a new franchise at this location, and Sylvania attributed Continental's breach of its location clause, at least in part, to Continental's dissatisfaction over the new San Francisco franchise. GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 984-85 (9th Cir. 1976) (en banc), *aff'd*, 433 U.S. 36 (1977).

[9] 433 U.S. at 40.

[10] 433 U.S. 36 (1977).

[11] 15 U.S.C. § 1 (1976). Section one provides that, "[e]very contract, combination . . . or conspiracy, in restraint of trade or commerce among the several states . . . is declared to be illegal."

straints[12] established in *United States v. Arnold, Schwinn & Co.*,[13] the trial judge instructed the jury that any attempt by Sylvania to restrict the locations from which Continental resold Sylvania merchandise, once Sylvania had parted with title and risk to the products, was illegal regardless of the reasonableness of the restriction.[14] The jury returned a verdict for Continental, finding that Sylvania's resale restrictions constituted a contract, combination or conspiracy in restraint of trade in violation of section one of the Sherman Act and that Continental had sustained damages as a proximate result.[15]

On appeal, the United States Court of Appeals for the Ninth Circuit, sitting en banc, reversed the district court's judgment.[16] Finding the location restraints at issue in *Sylvania* to be outside the scope of the *Schwinn* per se rule, the court held that the legality of Sylvania's location practice was to be determined under the rule of reason.[17] Sylvania's location restrictions were distinguished from those in *Schwinn* on two grounds. First, the court observed that whereas the territorial[18] and customer[19] restraints in *Schwinn* had completely eliminated intrabrand competition, Sylvania's location restraints preserved some degree of intrabrand competition.[20] Second, the court found that Sylvania's relatively small market share enabled it to use

[12] Vertical restraints are restrictions on distribution imposed by a seller operating at one level of an industry upon buyers at a lower level of that industry. Horizontal restraints are restrictions on distribution among sellers competing at the same level of distribution. *See* United States v. Topco Assoc., Inc., 405 U.S. 596, 608 (1972).

[13] 288 U.S. 365 (1967). In *Schwinn* the Supreme Court established a rule of per se illegality applicable to nonprice vertical restraints where the seller "parts with title, dominion or risk with respect to the article . . . ." *Id.* at 379. See text at notes 40-60 *infra* for further discussion of the case.

[14] 433 U.S. at 40-41.

[15] *Id.* at 41. The jury awarded Continental $591,505 damages, which were trebled pursuant to 15 U.S.C. § 15 (1976), resulting in a judgment against Sylvania of $1,774,515. *Id.*

[16] GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980 (9th Cir. 1976) (en banc), *aff'd*, 433 U.S. 36 (1977). The district court was initially affirmed by a three-judge panel in the court of appeals. 1974-1 Trade Cas. ¶ 75,072 (9th Cir.), *petition for rehearing en banc granted and opinion withdrawn*, 1974-2 Trade Cas. ¶ 75,935 (9th Cir. 1974).

[17] 537 F.2d at 988. Under the rule of reason, a restraint of trade is upheld if the effect of the restraint can be shown to tend toward the achievement of social goals which counterbalance or outweigh its injury to competition. The classic articulation of the rule of reason was provided by Justice Brandeis in Chicago Board of Trade v. United States, 246 U.S. 231 (1918):

> [T]he true test of legality is whether the restraint 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 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.

Id. at 238.

[18] A territorial restraint is "a promise by the buyer that he will not sell the goods outside a specified area or to customers who reside or have their place of business outside of that area." Note, *Restricted Channels of Distribution Under the Sherman Act*, 75 HARV. L. REV. 795, 796 (1962).

[19] A customer restraint involves "promises by the buyer not to sell to certain customers or classes of customers who are identified other than by their location." *Id.*

[20] 537 F.2d at 990.

distributional restrictions without the resulting anticompetitive impact which was present in *Schwinn*.[21]

The Supreme Court granted certiorari,[22] and in a six to two decision affirmed the judgment of the Ninth Circuit on different grounds.[23] With Justice Powell writing for the majority, the Court overruled *Schwinn* and held that the legality of nonprice vertical restraints is to be determined under the rule of reason.[24] The Court found that in failing to recognize the benefits to society which often could be derived from the use of vertical restraints, the *Schwinn* Court had wrongly classified vertical restrictions as illegal per se.[25] The *Sylvania* Court did not foreclose the possibility, however, that based upon a showing of "demonstrable economic effect" particular applications of vertical restraints might justify a rule of per se illegality.[26] Concurring in the result, Justice White concluded that the Court should have distinguished Sylvania's location practice from the customer restrictions in *Schwinn* on the grounds relied upon by the Ninth Circuit majority.[27] By unnecessarily overruling *Schwinn*, Justice White contended, the Court had incorrectly displaced *Schwinn's* social policy goal of allowing businessmen "the freedom to dispose of the goods they own as they see fit"[28] with an unwarranted concern for the "new economics of vertical relationships."[29]

As the third Supreme Court pronouncement on the legality of nonprice vertical restraints in the last fifteen years, *Sylvania* is important in that it represents the Court's first attempt to examine the economic implications of vertical restraints. On the basis of this inquiry, the Court has concluded that the per se rule established in *Schwinn* is unjustified and that vertical restraints hold sufficient economic utility to require a case by case analysis under the rule of reason. In exploring the significance and probable impact of *Sylvania*, this note will first review the development of the judicial

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[21] *Id.* at 991. Schwinn's market share was twenty-two percent at the time it instituted its restrictive distribution program, and thirteen percent in 1961 when the program was challenged by the government. 388 U.S. at 368. In contrast, Sylvania's market share was between one and two percent in 1962 when it began its location practice, 537 F.2d at 982, and had climbed to five percent by 1965. *Id.* at 991.

The Ninth Circuit majority opinion in *Sylvania* was met with lengthy dissenting opinions by Judges Kilkenny and Browning. Judge Kilkenny argued that the majority's efforts to distinguish location restraints as being outside the scope of *Schwinn* were specious in that *Schwinn* clearly encompassed Sylvania's location practice. *Id.* at 1004 (Kilkenny, J., dissenting). Agreeing with Judge Kilkenny's interpretation of *Schwinn*, Judge Browning addressed his dissent to a justification of *Schwinn* as a means of "protect[ing] the . . . right of independent business entities to make their own competitive decisions free of coercion, collusion, or exclusionary practices." *Id.* at 1018 (Browning, J., dissenting).

[22] 429 U.S. 893 (1976).

[23] 433 U.S. at 59. Justice Powell wrote the majority opinion, joined by Chief Justice Burger and Justices Stewart, Blackmun and Stevens. Justice White concurred in the judgment. *Id.* (White, J., concurring). Justice Brennan, joined by Justice Marshall, dissented, indicating only his disagreement with the Court's overruling of *Schwinn* and voting for reversal of the Ninth Circuit's decision. *Id.* at 71 (Brennan, J., dissenting). Justice Rehnquist did not take part in the decision.

[24] *Id.* at 57.

[25] *Id.* at 47-54.

[26] *Id.* at 59.

[27] *Id.* at 59-66 (White, J., concurring). See text at notes 16-21 *supra*.

[28] *Id.* at 67.

[29] *Id.* at 69.

treatment of nonprice vertical restraints. A discussion of *Sylvania* will follow in which Justice White's criticism of the Court's refusal to distinguish Sylvania's location restraints as falling outside the *Schwinn* rule will be examined. Next, the role which a manufacturer's market power and economic justifications will play in determining the legality of vertical restraints under the rule of reason will be analyzed. Finally, this note will consider *Sylvania's* implications for a continued per se rule against resale price maintenance.

I. NONPRICE VERTICAL RESTRAINTS: FROM *WHITE MOTOR* TO *SCHWINN*

Although the development of judicial attitudes toward vertical market division is only fifteen years old, the dramatic changes which have occurred during this period mark nonprice vertical restraints as one of the most controversial and judicially troublesome areas of antitrust law. Prior to its 1963 decision in *White Motor Co. v. United States*[30] the Supreme Court had never considered the legality of purely vertically imposed territorial or customer restraints.[31] In contrast, horizontal market division had long been established as an illegal restraint of trade subject to a per se rule of illegality under section one of the Sherman Act.[32]

In its initial exposure to nonprice vertical restraints in *White Motor*, the Court was confronted with a case in which the nation's largest truck manufacturer had imposed a system of territorial and customer restrictions on its distributors and dealers.[33] The United States had argued that White Motor's vertical restrictions were illegal per se, and the District Court for the Northern District of Ohio had agreed, granting summary judgment for the United States.[34] On direct appeal,[35] the Supreme Court, with Justice Fortas writing for the majority, reversed the summary judgment, holding that a trial on the merits was necessary to determine the legality of the territorial and customer restraints.[36] In remanding *White Motor* to trial, the Court, despite a vigorous concurrence and dissent,[37] declined to catagorize

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[30] 372 U.S. 253 (1962).

[31] Despite the fact that the Supreme Court had never dealt specifically with nonprice vertical restraints, it was generally believed, on the basis of dicta in United States v. Bausch & Lomb Co., 321 U.S. 707, 721 (1944), that *vertical* division of territories was illegal per se. Accordingly, the Justice Department was able to obtain a number of consent decrees from companies engaging in such practices without ever fully litigating a case. *See* Stewart, *Franchise or Protected Territory Distribution*, 8 ANTITRUST BULL. 447, 470 n.51 (1963). However, *Bausch & Lomb* was distinguished by the Court in *White Motor* as a case "where price fixing was 'an integral part of the whole distributor system.'" 372 U.S. at 260, *quoting* United States v. Bausch & Lomb Co., 321 U.S. 707, 720 (1944).

[32] *See, e.g.*, United States v. Topco Assoc., Inc., 405 U.S. 596 (1972); Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951).

[33] 372 U.S. at 255-56. White Motor's distributors and dealers were restricted to selling within specified territories. Distributors and dealers also were franchised subject to a customer restriction reserving sales to any federal or state government to the White Motor Co. *Id.*

[34] United States v. White Motor Co., 194 F. Supp. 562 (N.D. Ohio 1961), *rev'd*, 372 U.S. 253 (1962).

[35] Direct appeal was authorized under 15 U.S.C. § 29 (1976).

[36] *Id.* at 264.

[37] Concurring in the Court's decision not to hold vertical restraints illegal per se, Justice Brennan sharply distinguished the effects of territorial and customer restraints. Territorial restraints, observed Justice Brennan, although restricting intrabrand competition, could "foster a vigorous inter-brand competition which might otherwise be absent." *Id.* at 268 (Brennan, J., concurring). In contrast, Justice Brennan regarded customer restrictions as "lack[ing] any of

vertical restraints as per se illegal. Rather, the Court stated that it would

> intimate no view one way or the other on the legality of such an arrangement . . . . This is the first case involving a territorial restriction in a *vertical* arrangement; and we know too little of the actual impact of both that restriction and the one respecting customers to reach a conclusion on the bare bones of the documentary evidence before us.[38]

Although *White Motor* purported to leave the status of nonprice vertical restraints unresolved, the lower courts regarded *White Motor* as establishing a rule of reason standard for vertical restraints. In the five years between *White Motor* and the Supreme Court's reconsideration of vertical restraints in *Schwinn,* two cases involving vertical territorial restraints reached the courts of appeals. In both cases the legality of the restraints was upheld under the rule of reason. Based on an analysis of market structure and the justifications for the restraints, the courts found that the vertical distribution systems involved, although restricting intrabrand competition, resulted in an overall benefit to interbrand competition.[39]

Despite the findings of reasonableness in these cases, the Justice Department continued to seek a restrictive ruling on the legality of nonprice vertical restraints. In *Schwinn,* just five years after the Court had declined to rule on vertical restraints in *White Motor,* the Justice Department presented the Supreme Court with a full trial record in a case involving territorial and customer restraints. The distribution plan under attack had been adopted by the defendant in 1952, when it was the nation's largest bicycle manufacturer.[40] Schwinn's distribution system involved three distinct marketing methods, each varying the function of the middle-tier distributors who marketed Schwinn bicycles to retailers. The first method, termed the "Schwinn Plan," allowed distributors to obtain from retailers orders which would be relayed to Schwinn. Schwinn would then ship directly to the retailers, and pay a commission to the distributor taking the order.[41] Under the second distribution plan, distributors would pass merchandise through their warehouses to retailers under a consignment or agency transaction with Schwinn.[42] As a third sales option, distributors would purchase merchandise from Schwinn for resale to authorized dealers.[43] Under all three methods, the distributor was assigned a specific territory and limited to dealing with franchised dealers within that territory.[44]

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the countervailing tendencies to foster competition between brands which may accompany the territorial limitations." *Id.* at 272. By preventing distributors from competing with manufacturers for reserved accounts, Justice Brennan contended, customer restrictions enabled manufacturers to protect a noncompetitive pricing structure. *Id.* at 275.

Justice Clark, joined by Justice Black, dissented in *White Motor, id.* at 275 (Clark, J., dissenting), contending that "the existence of interbrand competition has never been a justification for an explicit agreement to eliminate competition." *Id.* at 278. Justice Clark therefore would have held nonprice vertical restraints to be illegal per se.

[38] *Id.* at 261 (emphasis in original).

[39] Sandura Co. v. FTC, 339 F.2d 847, 858 (6th Cir. 1964) (territorial restraints imposed on distributors of floor tiles); Snap-On Tools Corp. v. FTC, 321 F.2d 825, 831-32 (7th Cir. 1963) (territorial and customer restraints imposed on distributors of mechanics' handtools).

[40] 388 U.S. at 368.

[41] *Id.* at 370.

[42] *Id.*

[43] *Id.*

[44] *Id.* at 371.

In turn, retail franchisees were subject to a customer restriction prohibiting them from selling to nonfranchised retailers.[45]

The district court in *Schwinn* found Schwinn's territorial restrictions to be reasonable when exercised under the "Schwinn Plan" and consignment sales, but ruled that when the goods had been sold to the distributor, territorial restrictions on sales were a per se violation of the Sherman Act.[46] However, the district court found Schwinn's use of customer restrictions to be reasonable under all three methods of distribution.[47] On appeal the Supreme Court, Justice Fortas again writing for the majority, held that Schwinn's vertically imposed restrictions, both territorial and customer, were justified when exercised under the "Schwinn Plan" and the consignment distribution plan, but were illegal per se when the product had been sold to the distributors.[48] Drawing a sharp distinction "between the situation where the manufacturer parts with title, dominion or risk with respect to the article, and where he completely retains ownership and risk of loss,"[49] the court held it to be "unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it."[50] To allow the manufacturer to exercise post-sale control over goods, Justice Fortas further stated, would violate the "ancient rule against restraints on alienation."[51]

Justice Stewart, joined by Justice Harlan, wrote a separate opinion in *Schwinn*.[52] Although concurring with the majority's holding that Schwinn's market plan was reasonable when Schwinn retained title to its products, Justice Stewart questioned the creation of a per se rule in the absence of evidence demonstrating the anticompetitive impact of vertical restraints.[53] Criticizing the Court's reliance upon the "ancient rule against restraints on alienation," Justice Stewart contended that this rule was irrelevant in assessing the impact of vertical restraints upon competition in the American marketplace.[54] Justice Stewart observed that draftsmen would easily be able to avoid the per se rule by fitting business transactions into the consignment-agency exception created by the Court.[55] Such transactions would "operate identically in terms of economic function and competitive impact,"[56] and in instances where this could not be achieved, Justice Stewart argued, the elimination of small competitors through vertical integration would be likely to follow.[57]

[45] *Id.* at 370-71. Retailers were also franchised only to designated locations. *Id.* at 371. This practice, which was at issue in *Sylvania*, was neither presented on appeal nor addressed by the Court in *Schwinn*. 433 U.S. at 46.

[46] United States v. Arnold, Schwinn & Co., 237 F. Supp. 323, 343 (N.D. Ill. 1965), *rev'd in part*, 388 U.S. 365 (1967).

[47] *Id.* at 334.

[48] 388 U.S. at 379.

[49] *Id.* at 378-79.

[50] *Id.* at 379.

[51] *Id.* at 380.

[52] *Id.* at 382 (Stewart, J., concurring).

[53] *Id.* at 389.

[54] *Id.* at 392.

[55] *Id.* at 393.

[56] *Id.*

[57] *Id.* at 394.

The per se doctrine announced in *Schwinn* was regarded by most courts as creating a generally unqualified per se rule against all post-sale vertical restraints.[58] However, a number of lower courts sought to preserve the perceived benefits of vertical restraints by construing *Schwinn* narrowly.[59] Coinciding with this uneasy judicial acceptance of *Schwinn's* broad per se doctrine was extensive scholarly criticism of the opinion.[60] Thus, by the time *Sylvania* reached the Supreme Court, strong pressures militated in favor of *Schwinn's* modification or its complete reversal.

II. THE REDEEMING VIRTUES OF VERTICAL RESTRAINTS: *SCHWINN* RECONSIDERED

A. *Continental T.V., Inc. v. GTE Sylvania Inc.*

Against this background, the Supreme Court in *Sylvania* considered the antitrust consequences of nonprice vertical restraints for a third time. The threshhold question faced by the Court was whether Sylvania's practice of imposing location restrictions on its franchisees fell within the scope of the *Schwinn* per se rule. Rejecting the narrow construction which the Ninth Circuit majority had given to *Schwinn*,[61] Justice Powell noted that Schwinn also had imposed a location restriction on its retailers.[62] Therefore, the

[58] *See, e.g.*, Copper Liquor Inc. v. Adolph Coors Co., 506 F.2d 934, 945 (5th Cir. 1975); Eastex Aviation Inc. v. Sperry and Hutchison Co., 522 F.2d 1299, 1308 (5th Cir. 1975); Noble v. McClatchy Newspapers, 533 F.2d 1081, 1086-87 (9th Cir. 1975); Interphoto Corp. v. Minalta Corp. 295 F. Supp. 711, 720 (S.D.N.Y.), *aff'd*, 417 F.2d 621 (2d Cir. 1969); United States v. Glaxo Group, Ltd., 302 F. Supp. 1, 10-11 (D.D.C. 1969), *rev'd on other grounds*, 410 U.S. 52 (1973).

[59] *See, e.g.*, Tripoli Co., Inc. v. Wella Corp., 425 F.2d 932, 936 (3d Cir.) (exception to *Schwinn* recognized for restrictions on the sale of dangerous products to certain classes of customers), *cert. denied*, 400 U.S. 831 (1970); Janel Sales Corp. v. Lanvin Parfums, Inc., 396 F.2d 398, 406 (2d Cir.) (application of per se rule rejected for lack of firm enforcement of contractual restriction), *cert. denied*, 393 U.S. 938 (1968); Carter-Wallace, Inc. v. United States, 449 F.2d 1374, 1380 (Ct.Cl. 1971) (post-sale restrictions allowed where dual price structure allowed reduced prices for restricted buyer). *See generally*, ABA ANTITRUST SECTION, MONOGRAPH NO. 2, VERTICAL RESTRICTIONS LIMITING INTRABRAND COMPETITION 13-16 (1977) [hereinafter MONOGRAPH]; Comment, *Exceptions to* Schwinn's *Per Se Rule: Their Validity and Implications for the Future*, 31 WASH. & LEE L. REV. 643 (1974).

[60] *See, e.g.*, Handler, *The Twentieth Annual Antitrust Review–1967*, 53 VA. L. REV. 1667, 1680-86 (1967); Phillips, Schwinn *Rules and the "New Economics" of Vertical Relations*, 44 ANTITRUST L.J. 573 (1975); Pollock, *The* Schwinn *Per Se Rule: The Case for Reconsideration*, 44 ANTITRUST L.J. 557 (1975); Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282 (1975); Robinson, *Recent Antitrust Developments: 1974*, 75 COLUM. L. REV. 243, 270-81 (1975); Note, *The Per Se Rule As Applied To Vertical Territorial Restraints: An Improper Standard*, 1975 DUKE L.J. 935 (1975). *Contra*, Blecher, Schwinn —*An Example of a Genuine Commitment to Antitrust Law*, 44 ANTITRUST L.J. 550 (1975); Comanor, *Vertical Territorial and Customer Restrictions:* White Motor *and its Aftermath*, 81 HARV. L. REV. 1419 (1968); Louis, *Vertical Distributional Restraints Under* Schwinn *and* Sylvania: *An Argument for the Continuing Use of a Partial Per Se Approach*, 75 MICH. L. REV. 275 (1976); Zimmerman, *Distributional Restrictions After* Sealy *and* Schwinn, 12 ANTITRUST BULL. 1181 (1967).

[61] 433 U.S. at 46 n. 12.

[62] *Id.* at 46. Although the Court in *Schwinn* observed that Schwinn's dealers were franchised subject to a location restriction, 388 U.S. at 370, the legality of the restriction was not challenged in the district court or on appeal. Ironically, on remand the district court permitted Schwinn to use a location clause in its franchise agreements. United States v. Arnold, Schwinn & Co., 291 F. Supp. 564, 565-66 (N.D.Ill. 1968).

only element which distinguished Schwinn's franchise plan at the retail level from Sylvania's was the added presence of a customer restraint, prohibiting Schwinn retailers from selling Schwinn products to nonfranchised dealers. Although it engaged in no economic analysis of either franchise plan, the Court found that "[i]n intent and competitive impact, the retail customer restriction in *Schwinn* is indistinguishable from the location restriction in the present case."[63]

Having found that the legality of Sylvania's location practice was governed by *Schwinn,* the Court refused to apply directly that case's per se holding, but chose instead to reconsider the analysis of its 1967 opinion. Characterizing the *Schwinn* decision as an "abrupt and largely unexplained departure from" *White Motor,*[64] Justice Powell stated that a restraint of trade must " 'lack . . . any redeeming virtue' "[65] before it could be regarded as per se illegal. Under this standard, Justice Powell found that the *Schwinn* per se rule failed on several grounds. First, the per se rule in *Schwinn* had been drawn too broadly, failing to distinguish restrictions which limited intrabrand competition from those which eliminated it completely.[66] Second, passage of title, the crucial factor in *Schwinn,* was seen as irrelevant to what Justice Powell termed "the Court's effort [in *Schwinn*] to accommodate the perceived intrabrand harm and interbrand benefit of vertical restrictions."[67] Third, the *Sylvania* Court also rejected the relevancy of the "ancient rule against restraints on alienation" to the issue of whether vertical restrictions should fall under a per se prohibition.[68] In light of these considerations, the Court concluded that *Schwinn's* sale-nonsale distinction was an invalid criteria for application of a per se rule.[69]

The Court then turned to an examination of the competitive impact of vertical restrictions. While acknowledging that vertical restraints tend to reduce *intra*brand competition, the Court observed that such restraints may also promote *inter*brand competition by allowing manufacturers to achieve distributional efficiencies.[70] The efficiencies recognized by the Court were twofold: first, vertical restraints enabled manufacturers to induce retailers to make investments in capital and labor necessary to allow manufacturers to enter new markets;[71] and second, such restrictions could encourage retailers to engage in promotional activities and provide point-of-sale service and repair facilities.[72] More specifically, the Court found that vertically im-

[63] 433 U.S. at 46.

[64] *Id.* at 47.

[65] *Id.* at 50, *quoting* Northern Pac. R. Co. v. United States, 356 U.S. 1, 5 (1958).

[66] 433 U.S. at 52.

[67] *Id.*

[68] *Id.* at 53 n. 21. The Court adopted by reference Justice Stewart's criticism in *Schwinn* that the rule against restraints on alienation is "irrelevant to . . . the effect of the antitrust laws upon vertical distributional restraints in the American economy today." 388 U.S. at 392 (Stewart, J., concurring).

[69] 433 U.S. at 57.

[70] *Id.* at 54.

[71] *Id.* at 55. The Supreme Court previously had recognized the possible validity of such a "newcomer" justification, applicable to new manufacturers and manufacturers entering new markets. *See* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 374 (1967); White Motor Co. v. United States, 372 U.S. 253, 263 (1963). For further discussion of this justification, see text at notes 114-17 *infra.*

[72] *Id.* at 55. For further discussion of this justification, see text at notes 118-24 *infra.*

posed restrictions facilitate minimization of "free-rider" distributors,[73] thereby promoting aggressive marketing. In addition, the Court recognized the valid concern which manufacturers may have in the distribution of their products due to the possible strict tort and statutory liability of a remote seller.[74]

On the basis of this economic reasoning, the Court concluded that the per se rule in *Schwinn* should be overruled, and ordered a "return to the rule of reason that governed vertical restraints prior to *Schwinn*."[75] In affirming the Ninth Circuit decision, the Court declined to draw any distinctions among the forms which such restrictions might take.[76] However, the Court did not eliminate the "possibility that particular applications of vertical restrictions might justify per se prohibition," but warned that "departure from the rule of reason standard must be based upon demonstrable economic effect rather than—as in *Schwinn*—upon formalistic line drawing."[77]

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[73] The "free-rider" effect has been regarded by the courts and by commentators as a major justification for allowing the use of vertical restraints. *See, e.g.*, Copper Liquor, Inc. v. Adolph Coors., 506 F.2d 934, 941 n. 5 (5th Cir. 1975); Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 YALE L.J. 373, 430-38 (1966) [hereinafter cited as Bork II]; Posner, *supra* note 60, at 285. The free-rider effect occurs when one dealer provides point-of-sale consumer services, such as showroom facilities or a large inventory. Other dealers, rather than provide similar services, encourage customers to utilize the competing dealers facility, while soliciting buyers to make their purchases from them at a lower price. The "discount" dealer is, in effect, taking a "free-ride" on the competing dealers overhead expenditures. The result of this effect may be that no dealer will provide the extra services, despite the fact that all dealers might be better off if each provided them. *See* R. POSNER, ANTITRUST CASES, ECONOMIC NOTES AND OTHER MATERIALS 225-26 (1974).

The free-rider effect also may frustrate the manufacturer's desire to induce dealer advertising efforts. Dealers may be reluctant to provide local product promotion if intrabrand competition allows nonadvertising dealers to benefit from the advertising. *See, e.g.*, Sandura Co. v. FTC, 339 F.2d 847, 857 (6th Cir. 1964) (defendant's restrictive distribution practice justified by the need to provide dealers with insulation from intrabrand competition in order to induce local advertising effort).

[74] 433 U.S. at 55 n. 23. The Court did not imply that the possible justifications for the use of vertical restraints were exhausted by its discussion. Rather, the range of such justifications might be very broad. *See, e.g.*, Adolph Coors Co. v. FTC, 497 F.2d 1178, 1187 (10th Cir. 1974) (suggesting that a justification for vertical restrictions may exist where a unique product requires controlled distribution to prevent spoilage), *cert. denied*, 419 U.S. 1105 (1975); Snap-On Tools Corp. v. FTC, 321 F.2d 825, 832 (7th Cir. 1963) (need to achieve market penetration accepted as justification for territorial restraints on distributors); MONOGRAPH, *supra* note 59, at 67-70.

[75] 433 U.S. at 59.

[76] *Id.* at 58 n. 29. In addition to territorial, customer and location restraints, manufacturers have exercised at least two other means of retaining control over the post-sale distribution of their products: area-of-primary responsibility and profit pass-over arrangements. Although both of these restrictions limit intrabrand competition to some extent, they both had been regarded as falling outside the scope of *Schwinn*. *See* MONOGRAPH, supra note 59, at 20-22.

An area-of-primary responsibility restriction requires dealers to concentrate their primary selling effort within a specified territory or class of customers, but does not prohibit selling outside of that area or customer group. *See, e.g.*, United States v. Arnold, Schwinn & Co., 291 F. Supp. 564, 565-66 (N.D. Ill. 1968) (final judgment allowing a primary responsibility restriction).

A profit pass-over clause requires a dealer selling in another dealer's territory to pay a portion of its profit from the sale to the dealer whose territory has been violated. *See, e.g.*, Superior Bedding Co. v. Serta Assoc., 353 F. Supp. 1143, 1150 (N.D. Ill. 1972) (profit pass-over not per se illegal).

[77] 433 U.S. at 58-59.

Although concurring with the majority's conclusion that Sylvania's location practice should be judged under the rule of reason, Justice White vigorously disagreed with the Court's action in overruling *Schwinn.*[78] Accepting the Ninth Circuit's reasoning,[79] Justice White argued that the location restraint at issue in *Sylvania* could be distinguished from the restrictions present in *Schwinn* on the basis of the nature of the location restraint, its competitive impact, and the market share held by Sylvania.[80] Justice White initially found the majority's conclusion—that the location restraint in *Sylvania* was indistinguishable in intent and competitive impact from the customer restriction in *Schwinn*—economically unsound.[81] The customer restraint in *Schwinn,* which prevented retailers from reselling to nonfranchised dealers, eliminated discount stores as a source of intrabrand competition.[82] In contrast, a dealer bound by Sylvania's location agreement was free to sell to discounters, thus allowing this source of price competition to survive. For this reason, the anticompetitive impact of Sylvania's location restrictions was seen by Justice White to be significantly less than that of Schwinn's customer restraints.[83]

Justice White's second ground for distinguishing Sylvania's vertical restraints from those present in *Schwinn* was based on the disparity in the relative market shares held by Sylvania and Schwinn. Since Schwinn had held a far greater degree of market power in the bicycle market than had Sylvania in the television market,[84] Justice White argued that Sylvania was subject to a greater degree of interbrand competition than was Schwinn.[85] This interbrand competition reduced any anticompetitive impact visited on the market by Sylvania's location restraints. Justice White also observed that in 1962, when its franchise plan was instituted, Sylvania was threatened with market expulsion.[86] Thus, Justice White found Sylvania's location restraints justified on the basis of Sylvania's precarious market position and the relatively high degree of interbrand competition existing in the television market.[87] Unlike the majority, however, Justice White concluded that the *Schwinn* per se rule should not be abandoned so easily; instead, he advocated its retention with the added prerequisite that the defendant have sufficiently dominant market power in order for the rule to apply.[88]

In addition to distinguishing Sylvania's location restraints on economic grounds, Justice White sharply criticized the *Sylvania* majority's contention that the *Schwinn* Court had established a sale-nonsale distinction as a com-

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[78] *Id.* at 59-71 (White, J., concurring).
[79] See text at notes 16-21 *supra.*
[80] 433 U.S. at 59-66 (White, J., concurring).
[81] *Id.* at 60.
[82] 388 U.S. at 370-71.
[83] 433 U.S. at 61.
[84] Sylvania held a five percent market share in 1965. *Id.* at 38. Schwinn held a thirteen percent market share in 1961 when its distribution program was challenged. 388 U.S. at 368. Schwinn also had succeeded in differentiating its products to a substantial degree. *See* United States v. Arnold, Schwinn & Co., 237 F. Supp. 323, 335 (N.D. Ill. 1965), *aff'd,* 388 U.S. 365 (1967).
[85] 433 U.S. at 63-66 (White, J., concurring).
[86] *Id.* at 64.
[87] *Id.* at 65.
[88] *Id.* at 65-66.

promise between the intrabrand harm and interbrand benefits of vertical restrictions.[89] Rather, he perceived the policy of *Schwinn* to be the protection of individual business autonomy. Conceding that the sale-nonsale distinction in *Schwinn* might bear little relationship to the economic impact of vertical restraints, Justice White nevertheless argued that the "concern for the freedom of the businessman to dispose of his own goods as he sees fit"[90] should not be wholly obscured by the "notions of 'free rider' effects and distributional efficiencies borrowed . . . from the 'new economics of vertical relationships.' "[91] Moreover, Justice White criticized the majority for appearing to be unmindful of its decision's obvious relevance to the well established per se rule against vertical price restraints.[92] Believing that the justifications the Court offered in behalf of nonprice vertical restraints bore equal applicability to resale price maintenance, Justice White faulted the majority for casting substantial doubt over the continued validity of that rule in antitrust practice.[93]

The differences between Justice White and the majority in *Sylvania* are grounded on divergent perceptions of the competitive impact of nonprice vertical restraints and the underlying policy goals of antitrust enforcement in the area of vertical restraints. The Supreme Court has never before directly examined the economic and policy implications of nonprice restrictions on intrabrand competition. The opinions in *Sylvania* thus stand as the Court's first analysis of this subject.

B. *An Analysis and Evaluation of* Sylvania

Although Justice White and the Ninth Circuit majority advanced several arguments to show that the location restraints at issue in *Sylvania* were not implicated by *Schwinn*, the Supreme Court appears to have been correct in finding otherwise. As to Justice White's first contention, that location restrictions may have less of an anticompetitive impact on intrabrand competition than the territorial and customer restraints held illegal in *Schwinn*,[94] the majority accurately recognized that it would have been inconsistent with *Schwinn* to find on economic grounds that location restraints justify different treatment. First, *Schwinn* indicated no distinction between restraints which merely *limit* intrabrand competition and those which totally *preclude* it. Moreover, the existence of a location restraint imposes an economically determined territory beyond which limitations on dealer advertising and delivery costs will discourage intrabrand competition. Through the use of location restraints, therefore, manufacturers are able to impose de facto

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[89] *Id.* at 66-69.

[90] *Id.* at 67.

[91] *Id.* at 69, *quoting id.* at 54-57 (majority opinion).

[92] *Id.* at 69-70. Vertical price restraints have long been regarded as illegal per se. *See, e.g.*, Albrecht v. Herald Co., 390 U.S. 145 (1968) (maximum resale prices illegal per se); Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911) (minimum resale prices illegal per se). See text at notes 132-144 *infra*, for further discussion of Sylvania's impact upon the per se rule against resale price maintenance.

[93] 433 U.S. at 70 (White, J., concurring).

[94] *Id.* at 60-62. *See also* Pollock, *Alternative Distribution Methods After* Schwinn, 63 Nw. U. L. Rev. 595, 603-04 (1968); Robinson, *supra* note 60, at 277-78.

territorial restraints on retailers.[95] Thus, if *Schwinn* was premised upon the Supreme Court's belief that there are no benefits to competition sufficient to justify vertical restraints on intrabrand competition, then the use of a location restraint clearly should act as a sufficient barrier to intrabrand competition to invoke the application of *Schwinn*.

Justice White's second ground for distinguishing Sylvania's location restraints, that Sylvania's low market share justified an exception to *Schwinn*, also seems less compelling than the majority's rule of reason approach. Under the rule Justice White evidently would have adopted—a market power test triggering a per se rule—further consideration of the legality of a distributional restraint would be precluded once the presence of a certain degree of market power was shown.[96] This approach seems undesirable for two reasons. First, the level of market power at which a per se rule would be invoked is highly problematic. As the majority correctly observed, "[h]aving crossed the 'failing firm' line, Mr. Justice White neither attempts to draw a new one nor to explain why one should be drawn at all."[97] Second, the assumption implicit in Justice White's suggestion, that all vertical restraints imposed by a manufacturer with more than a minimal degree of market power should be illegal per se, seems unwarranted. As the *Sylvania* Court implicitly recognized, a broad range of manufacturer market power exists within which vertical restraints may be highly beneficial to interbrand competition.[98]

Thus, the *Sylvania* Court correctly refused to recognize exceptions to *Schwinn* based on variations in the economic impact of the restraint involved or the degree of market power held by the defendant. The Court perceived that, in view of the possible procompetitive benefits of vertical restraints, such an approach would be inappropriate. Not only would such a rule frustrate the certainty inherent in a per se rule, but it would be economically disadvantageous, in addition, by mandating lower court prohibition of potentially desirable marketing devices.

In addition to arguing that *Sylvania* could be distinguished from *Schwinn* on economic grounds, Justice White expressed "substantial misgivings"[99] over the Court's abandonment of what he perceived to be *Schwinn*'s concern for the freedom of individual businessmen to act according to

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[95] For example, Sylvania franchisees were limited to an "economic" territory of 25-50 miles from their franchised locations "[b]y reason of the inherent limitations respecting advertising and promotion and delivery and service of sets sold . . . ." 537 F.2d at 1010 (Kilkenny, J., dissenting).

[96] Justice White drew a specific analogy to Northern Pac. R. Co. v. United States, 356 U.S. 1 (1958), where the Court held that tying agreements are illegal per se "whenever a party has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product and a 'not insubstantial' amount of interstate commerce is affected." *Id.* at 6.

[97] 433 U.S. at 46 n. 12. A per se rule based on market power alone would also have the undesirable effect of creating a high degree of uncertainty among manufacturers regarding the legality of their restrictions. *See, e.g.*, United States v. Topco Assoc., 405 U.S. 596, 609 n. 10 (1971) (major benefit of per se rules is the certainty they provide to businessmen regarding what practices are legal and illegal under the Sherman Act). Moreover, it might create an incentive for complex and lengthy litigation on the issue of market power alone. For an example of the problems inherent in market definition in a differentiated product market, see Telex Corp. v. IBM Corp., 510 F.2d 894, 915-19 (10 Cir. 1975).

[98] 433 U.S. at 53 n. 22.

[99] *Id.* at 66 (White, J., concurring).

their own choice and discretion.[100] Sherman Act enforcement has often recognized noneconomic goals, such as decentralized decision making and the preservation of small business, in addition to promoting economic efficiency.[101] As Justice White correctly observed, *Sylvania* represents a change in the Court's perception of the policy goals of antitrust enforcement in the area of vertical restraints. The nature of the Court's analysis in *Schwinn* strongly supports Justice White's assertion that the *Schwinn* per se rule was based on the policy of encouraging individual business autonomy rather than economic efficiency.[102] In contrast, the *Sylvania* Court, by emphasizing economic efficiency to the exclusion of other considerations, has rejected noneconomic goals as an explicit aim in formulating an antitrust policy for nonprice vertical restraints.[103]

Despite this tension between the Court's policy objectives in *Schwinn* and *Sylvania,* it is submitted that the Court in *Sylvania* correctly rejected *Schwinn*'s concern for business autonomy. To the extent that vertical restraints affect business at different levels of distribution in varying ways,

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[100] *Id.* 66-69.

[101] Primary among the policies of the antitrust laws has been a concern with economic values as a means of achieving the ultimate economic benefit to consumers. This objective was expressed by Justice Black in Northern Pac. Ry. Co. v. United States, 356 U.S. 1 (1958):

> The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions.

Id. at 4

However, antitrust enforcement at times has also sought to achieve additional objectives, such as the preservation of small business units, regardless of whether or not the resulting market is economically efficient. As Judge Learned Hand observed in United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945): "Throughout the history of [the antitrust laws] it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other." *Id* at 429.

A third goal of the antitrust laws, most apparent in the treatment of vertical price restraints, has been the preservation of individual economic freedom of action. *See, e.g.*, Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211, 213 (1951), where the Supreme Court held maximum resale prices illegal per se in part because they "cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment." *See generally* Bohling, *Franchise Termination Under the Sherman Act: Populism and Relational Power,* 53 TEXAS L. REV. 1180, 1186-92 (1975); Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division,* 74 YALE L.J. 775 (1965); Elzinga, *The Goals of Antitrust: Other Than Competition and Efficiency, What Else Counts?,* 125 U. PA. L. REV. 1191 (1977).

[102] The contention that *Schwinn* was not grounded in economic efficiency is supported by the Court's reliance upon the "ancient rule against restraints on alienation," 388 U.S. at 380, to establish the sale-nonsale transaction distinction. *See, e.g.*, GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 1023 (9th Cir. 1976) (en banc) (*Schwinn* has "located the boundary for application of the per se rule in a way that serves the Sherman Act's purpose of preserving the competitive freedom of independent businessmen") (Browning, J., dissenting), *aff'd,* 433 U.S. 36 (1977); Jones, *The Growth and Importance of Franchising and the Role of Law,* 12 ANTITRUST BULL. 717, 741 (1967) ("The Supreme Court [in *Schwinn*] would appear to be evolving a doctrine which embraces the freedom of an individual businessman to conduct his business as he sees fit.").

[103] The *Sylvania* Court rejected the view that *Schwinn* had been based on noneconomic concerns, stating that "an antitrust policy divorced from market considerations would lack any objective benchmarks." 433 U.S. at 53 n. 21.

the pursuit of noneconomic policy goals in this area of antitrust law is highly elusive. Although *Schwinn* protected the business autonomy of independent franchisees, it may have actually frustrated the policy of ensuring the survival of those same distributors because, in effect, it encouraged large manufacturers to integrate vertically and to eliminate their wholesalers and retailers.[104] Furthermore, by preventing manufacturers from achieving distributional efficiencies through the use of vertical restraints, *Schwinn*'s per se rule may have impaired the ability of small manufacturers to compete effectively against large competitors.[105] Thus *Schwinn*, while allowing independent franchisees business autonomy, may have conflicted with the perceived antitrust policy of ensuring the survival of small business. Under *Sylvania*, while some small wholesalers may suffer a loss of business autonomy and find their aspirations for growth defeated through the use of restrictive franchise agreements, the survival of small business may be encouraged by the ability of small manufacturers to use vertical restraints to enable them to compete against large business chains.[106] The *Sylvania* majority's correct resolution of this discord between noneconomic goals was to ground its return to the rule of reason in terms of market efficiency.[107]

III. NONPRICE VERTICAL RESTRAINTS UNDER THE RULE OF REASON

By removing nonprice vertical restraints from the category of restraints of trade which are illegal per se, the Supreme Court has opened the door to their use in a wide variety of commercial settings. However, the absence of rule of reason guidelines in *Sylvania* leaves a large degree of discretion to the lower courts in determining the legality of vertical restrictions Accordingly, two compelling questions remain open after *Sylvania*: first, to what extent will a manufacturer's market power limit its legal ability to impose vertical restraints; and second, which manufacturer justifications will be recognized under the rule of reason.

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[104] Schwinn, for example, vertically integrated its distribution system following its litigation. Keck, *The Schwinn Case*, 23 BUS. LAW. 669, 686 (1968). *See also* Simon, *Dual Distribution*, 37 ANTITRUST L.J. 168, 170 (1968) (pressures for vertical integration created by *Schwinn* may "hasten the demise of many independent distributors").

[105] *See, e.g.*, United States v. Arnold, Schwinn & Co., 388 U.S. 365, 380 (1967) (recognizing the extent to which a per se rule "might severely hamper smaller enterprises resorting to reasonable methods of meeting the competition of giants"); GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 999-1000 (9th Cir. 1976) (en banc) ("the ultimate result of a per se rule might be to undermine franchising as a tool to enable the small, independent businessman to compete with the large vertically integrated giants of many industries"), *aff'd*, 433 U.S. 36 (1977).

[106] *See, e.g.*, Sandura Co. v. FTC, 339 F.2d 847, 857 (6th Cir. 1964); see note 73 *supra*.

[107] The Ninth Circuit opinions in *Sylvania* illustrate the difficulty of attempting to encourage objectives other than efficiency through the use of legal standards for vertical restraints. The majority premised its holding that location restraints were to be judged under the rule of reason, in part, on the apprehension that a per se rule "would undoubtedly hasten the disappearance from the American marketplace of the small independent merchant . . . ."537 F.2d at 999. In contrast, in advocating the application of a per se rule, Judge Browning, in dissent, found that Sylvania's location practice ran afoul of the Sherman Act by threatening individual business autonomy. *Id.* at 1018-19 (Browning, J., dissenting).

The degree of market power[108] held by a manufacturer is an essential consideration in determining whether that manufacturer's vertical restrictions have a harmful or beneficial effect on interbrand competition. If a manufacturer holds an insubstantial degree of market power in an industry characterized by strong interbrand competition, vertical restraints will have little impact on overall competition. Thus, the likelihood that the use of vertical restraints in a competitive market context will enable a manufacturer to maximize efficient distribution, and thereby consumer satisfaction, is strong.[109] Conversely, where a manufacturer holds a substantial degree of market power there is less of a likelihood that interbrand competition will be benefited by vertical restrictions which impede intrabrand competition.[110] Under conditions of strong product differentiation and substantial market share, the ability of territorial and customer restrictions to enhance interbrand competition to a degree which more than offsets the loss to intrabrand competition is greatly reduced. The *Sylvania* Court specifically reserved the possibility that upon a showing of "demonstrable economic effect" particular applications of vertical restraints might justify a per se rule.[111] It would not be surprising, therefore, if after repeated judicial inquiry into the competitive impact of vertical restraints under the rule of reason, courts establish a rule of presumptive illegality based on market power.[112]

Similarly relevant in rule of reason analysis is the validity of a manufacturer's justification for employing vertical restrictions. Although the Court in *Sylvania* stated that the need to attract new dealers and to avoid free-rider effects among distributors could justify the use of vertical restraints,[113] the *Sylvania* opinion neither suggested other justifications, nor intimated where vertical restraints might be inappropriate. It appears manifest that limitations to otherwise acceptable justifications for vertical restraints do exist, however, and analysis of a proffered justification in individual market situations is an essential requirement for effective application of the rule of reason.

One justification recognized in *Sylvania* was the use of vertical restraints to attract investment by new distributors.[114] A new manufacturer,

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[108] Economic theory defines market power as a function of market share and product differentiation. Product differentiation occurs when consumer preferences for otherwise substitutable products are influenced through physical differences, ancillary services or advertising. Market power, whether achieved through market share or product differentiation, enables its possessor to exercise some degree of power over price. F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 10 (1970). *See also* Comanor, *supra* note 60, at 1423.

[109] *Cf.* F. SCHERER, *supra* note 108, at 512 (vertical restraints most likely to yield benefits in unconcentrated, weakly differentiated market).

[110] *See* Adolph Coors Co., [1973-76 Transfer Binder] TRADE REG. REP. (CCH) ¶ 20,403 at 20, 293 (F.T.C. 1973) ("It is where the manufacturer . . . possesses substantial market power . . . that vertical territorial restrictions are especially pernicious, for they eliminate the possibility of intra-brand competition which in an imperfect market is a critical supplement to competition between and among different brands."), *aff'd*, 497 F.2d 1178 (10th Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975).

[111] 433 U.S. at 59.

[112] *Cf.* Baker, *Vertical Restraints in Times of Change: From* White *to* Schwinn *to Where?*, 44 ANTITRUST L.J. 537, 545-46 (1975) (proposing a rule of presumptive illegality based on market power).

[113] 433 U.S. at 55.

[114] *Id.*

or an established manufacturer entering a new product line, may be able to induce dealer investment only by providing some degree of insulation from intrabrand competition.[115] The use of territorial restrictions, by eliminating or reducing the price erosion which results from intrabrand competition, may allow new dealers to recover high investment costs initially incurred in distributing a new product line. This justification must be qualified, however, by the recognition that once a new manufacturer attains a viable market position, or a new product line gains consumer acceptance, competitive forces in the market place should be allowed to determine the extent to which further dealer investment takes place. The continued use of vertical restraints, at this point, may serve primarily to increase industry concentration and raise entry barriers for potential entrants.[116] Hence, a court evaluating a dealer recruitment justification should be alert to two possibilities before sustaining a distribution restriction. First, it should determine whether vertical restraints are in fact necessary to attract dealer investment. For example, an established manufacturer with a favorable brand image may not need to use vertical restraints to induce dealers to carry its new product. Second, if restraints are alleged to be necessary to attract investment, it should be determined whether the product has had sufficient time, under the restrictive distribution plan, to attain commercial viability. Once such a period of time has passed, as determined by industry standards, the dealer recruitment justification should lose its vitality.[117]

A second justification for vertical restraints noted by the *Sylvania* Court was the fact that without such restraints, dealers providing point-of-sale services, such as showrooms, advertising and repair facilities, would have their territories invaded by "free-riders" who would take advantage of local sales efforts.[118] However, the free-rider justification may not always be valid for one of several reasons. First, most low priced, nondurable "convenience goods" are distributed through a saturation sales method to as large a group of retailers as possible.[119] Hence, in the distribution of convenience goods the need to reduce intrabrand competition for the purpose of avoiding the free-rider effect will rarely be present. The free-rider justification, therefore, is limited primarily to "shopping goods," products

[115] *See, e.g.*, Copper Liquor, Inc. v. Adolph Coors Co., 506 F.2d 934, 938 (5th Cir. 1975) (beer distributors unwilling to make necessary capital expenditure unless insulated from intrabrand competition); Note, *supra* note 18, at 806.

[116] *See* Comanor, supra note 60, at 1438. Professor Comanor observes that consumer demand for a product should attract dealer investment, rather than high returns artificially created through the use of vertical restraints. He contends that investment risk at the dealer level should no more serve as a justification for vertical restraints than investment risk at the manufacturing level should serve as a valid justification for horizontal restrictions. *Id.* at 1428-29. *See also* Louis, *supra* note 60, at 296-300.

[117] *Cf.* United States v. Jerrold Electronics Corp., 187 F. Supp. 545 (E.D. Pa. 1960) (although a tying arrangement was justified at its inception to protect product reputation, defendant failed to prove that it remained justifiable throughout the period of its use), *aff'd per curiam*, 365 U.S. 567 (1961).

[118] 388 U.S. at 55. See note 73 *supra*.

[119] *See* M. PORTER, INTERBRAND CHOICE, STRATEGY AND BILATERAL MARKET POWER 24 (1976). Convenience goods, such as toothpaste, soap or cigarettes, are usually purchased by consumers at the nearest "convenience outlet." Most product differentiation for convenience goods, therefore, is achieved through manufacturer advertising, rather than by point-of-sale services. *Id.* at 26.

which are infrequently purchased and for which price and quality gains can be achieved through comparison shopping.[120]

Second, the ability of manufacturers to avoid free-riders on dealer advertising through the use of vertical restraints has been significantly limited by the increasingly high concentration of nonconvenience retail outlets in many metropolitan areas. The broad reach of conventional advertising methods, such as television, radio and newspapers, along with increased consumer mobility, makes the free-rider effect on dealer advertising in many areas difficult to avoid. The courts should be alert, therefore, to the fact that in many markets advertising is likely to be provided by the manufacturer rather than by local dealers.[121] In such situations, it is submitted, vertical restrictions should be strictly scrutinized.

Another limitation on the free-rider justification is the extent to which product differentiation at the dealer level may promote low consumer substitutability, thereby diminishing sensitivity to interbrand price competition and contributing to manufacturer market power.[122] The ability of retailers to contribute to product differentiation varies, depending on the extent to which a store's reputation and image reflects upon the quality of the product. In the case of some nonconvenience goods, the extent to which a specialized retail outlet is able to contribute to product differentiation may be substantial.[123] In this context the Court's concern for beneficial product differentiation may serve as a shield for product differentiation which is spurious.[124] By uncritically accepting the free-rider justification, the lower courts may encourage some manufacturers to increase their market power through the use of retail product differentiation which adds nothing to product quality. Therefore, the free-rider justification should be carefully considered under the rule of reason to determine whether retail services

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[120] *Id.* at 24. Shopping goods, which are purchased at "nonconvenience outlets," generally require demonstration, inspection and information services to be provided by the retail outlet. *Id.* at 30.

[121] Comanor, *supra* note 60, at 1433.

[122] Professor Comanor contends that the primary motive for restricted distribution is a desire by the manufacturer and its dealers to achieve the higher prices attainable through product differentiation. *Id.* at 1425. He also observes that point-of-sale services induced by vertical restraints result in resource misallocation, since consumers are forced to pay a joint price for services and product, where in an open market consumers might opt for lower prices and fewer services. *Id.* at 1429-30.

[123] *See* M. PORTER, *supra* note 119, at 31.

[124] The *Sylvania* Court dismissed the contention that vertical restraints result in spurious product differentiation leading to a decrease in interbrand competition, stating that "[t]his argument is flawed by its necessary assumption that a large part of the promotional efforts resulting from vertical restrictions will not convey socially desirable information about product availability, price, quality and services." 433 U.S. at 56 n. 25.

Although product differentiation often may fulfill a socially desirable function, as the Court observed, it may also result in substantial economic costs. Professor Scherer has found that

> [s]ome of the most serious market performance problems in the contemporary American economy are due more to inadequate knowledge on the consumer's part than to structural imperfections of a traditional sort . . . . [C]onsumers pay unnecessarily high prices for heavily advertised and otherwise differentiated products because they lack the technical knowledge to tell whether a particular gasoline, dentifrice, detergent, pain remedy, vacuum cleaner, weed killer or fabric is actually better than less expensive unadvertised substitutes.

F. SCHERER, *supra* note 108, at 417.

are being encouraged primarily for the purpose of gaining market power through product differentiation, or of providing valid services which might otherwise be eroded by free-riders.

A third justification for vertical restraints recognized by the courts and commentators, although not articulated in *Sylvania,* concerns the manufacturer's interest in achieving full market coverage for its product.[125] Absent vertical restraints, there may be competition among distributors over wide geographical areas for large, high profit accounts.[126] Under some circumstances, therefore, distribution may not reach small, relatively low profit customers.[127] By eliminating intrabrand price competition for high profit accounts through the use of vertical restraints, however, dealers may be encouraged to concentrate on sales in their own territories. Moreover, profits obtained from high profit customers may be used to subsidize sales to buyers who, in a competitive market, otherwise might not be reached.[128] Thus, through the use of territorial restrictions some manufacturers may be able to achieve greater market coverage for their products.

Significantly, though, the consequence of such a system may be economic price discrimination[129] and resource misallocation.[130] The free market alternative would allow varying costs of distribution to be reflected in prices in order to permit consumer demand for a product to regulate its distribution. Because the widest distribution of goods in the economy benefits the consumer as well as the manufacturer, the justification of greater market coverage may be acceptable in some instances. But a distribution system which severely restricts intrabrand competition under this justification should be examined to determine whether the same degree of market coverage could be attained through a less restrictive system of restraints.[131] Society's interest in a broad distribution of goods and its concomitant interest in avoiding the misallocation of resources should engender a sensitive judicial balancing process in evaluating market coverage justifications for nonprice vertical restraints.

The Supreme Court's return to a rule of reason standard in *Sylvania* will require the lower courts to engage in complex economic investigations to determine the overall competitive impact of vertical restraints in various market contexts. Moreover, the *Sylvania* Court has given the lower courts

[125] *See, e.g.,* Copper Liquor, Inc. v. Adolph Coors Co., 506 F.2d 934, 942 n. 5 (5th Cir. 1975); Sandura Co. v. FTC, 339 F.2d 847, 853 (6th Cir. 1964); Preston, *Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards,* 30 LAW AND CONTEMP. PROB. 506, 512-19 (1965); Warren, *Economics of Closed Territory Distribution,* 2 ANTITRUST LAW & ECON. REV. 111, 117-18 (1968).

[126] *See* Note, *supra* note 18, at 811. This activity is termed "skimming the cream" of a given area. *Id.*

[127] *Id.*

[128] *See* Comanor, *supra* note 60, at 1430; Louis, *supra* note 60, at 304.

[129] By encouraging its dealers to charge a single price to all buyers, the manufacturer is able to use profits from low-cost customers to subsidize sales to high-cost customers. Because sales costs are not reflected in price under this scheme, the low-cost "cream accounts" suffer from economic price discrimination. Comanor, *supra* note 60, at 1430-31.

[130] By encouraging market coverage through the use of vertical restraints, a greater commitment of resources is being made to distributive activity than would result from the free interplay of market forces. *Id.* at 1431.

[131] *See* Zimmerman, *supra* note 60, at 1184-85. For example, the use of a profit pass-over or area-of-primary responsibility agreement may encourage dealers to concentrate on sales within a given territory without eliminating all or as much intrabrand competition.

substantial discretion in determining what justifications for distributional restrictions will be accepted under the rule of reason, and to what degree the potentially anticompetitive implications of those justifications will be recognized. Only through careful analysis of the economic impact of vertical restraints in different market situations will the courts develop the knowledge essential to enable them to deal effectively with challenges to vertically restricted distribution systems.

IV. *SYLVANIA:* IMPLICATIONS FOR RESALE PRICE MAINTENANCE

Although the *Sylvania* Court specifically rejected the contention that its holding had any negative implications for the continued validity of a per se rule against resale price maintenance,[132] Justice White was correct in observing the uncertain rationale for such a rule in light of the procompetitive benefits of nonprice vertical restraints recognized in *Sylvania*.[133] The economists relied upon by the Court in *Sylvania* have argued forcefully that the same distributional efficiencies available from the use of nonprice vertical restraints may be derived through the use of vertical price restraints.[134] *Sylvania* therefore calls into question the propriety of refusing to allow manufacturers to provide justifications for vertical *price* restraints which would be accepted for *nonprice* restraints.[135]

In an effort to distinguish resale price maintenance from nonprice vertical restraints, the *Sylvania* Court suggested several differences which would justify per se treatment. First, the Court contended that vertical price restraints hold a significantly greater risk of reducing interbrand price competition than nonprice restraints.[136] It is unclear, however, whether the risk of harm to interbrand competition is as great as the Court suggested. The imposition of vertical price restraints does not enable a

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[132] 433 U.S. at 51 n. 18.

[133] *Id.* at 69-70 (White J., concurring).

[134] Vertical price restraints serve the same purpose as nonprice vertical restraints by reducing intrabrand competition and allowing dealer profits to be maintained at supracompetitive levels. As Professor Posner has observed,

> if [the free rider effect] is a good justification for exclusive territories, it is an equally good justification for resale price maintenance, which . . . is simply another method of dealing with the free rider problem . . . . In fact, *any* argument that can be made on behalf of exclusive territories can also be made on behalf of resale price maintenance.

Posner, *supra* note 60, at 293. *See also* Bork II, *supra* note 73, at 391; Carstensen, *Vertical Restraints and the* Schwinn *Doctrine: Rules for the Creation and Dissipation of Economic Power*, 26 CASE W. RES. L. REV. 771, 824-25 (1976); Elman, *"Petrified Opinions" and Competitive Realities*, 66 COLUM. L. REV. 625, 627-34 (1966).

[135] As the Supreme Court noted in Albrecht v. Herald Co., 390 U.S. 145, 151 n. 7 (1968), resale price maintenance may benefit manufacturers by enabling them to influence the availability of dealer services. Hence, the justifications for resale price maintenance are essentially the same as those recognized in *Sylvania* for nonprice vertical restraints. 433 U.S. at 55. Professor Posner has observed that resale price maintenance may be *more* efficient than nonprice vertical restraints in encouraging point-of-sale services from dealers, because it enables manufacturers to set resale prices at a level which will provide precisely the level of services desired. Posner, *supra* note 60, at 294.

[136] 433 U.S. at 51 n. 18. The Court cited Justice Brennan's somewhat cryptic statement in *White Motor* that "[r]esale price maintenance is not designed to, but almost invariably does in fact, reduce price competition not only *among* sellers of the affected product, but quite as much between that product and competing brands." 372 U.S. at 268 (Brennan, J., concurring) (emphasis in original).

manufacturer to achieve a greater degree of retail market power than it would otherwise possess.[137] Manufacturers engaging in resale price maintenance remain subject to the same level of interbrand competition that dealers would be faced with if free to set their own prices. Hence, in many competitive industries manufacturers imposing vertical price restraints should remain highly responsive to interbrand price competition. Balanced against this analysis, however, is the possibility that, due to the broad impact of a price reduction, manufacturers will not be as responsive to local price competition as would be individual dealers. Furthermore, resale price maintenance may result in inefficiencies by allowing efficient distributors to realize high profit margins which otherwise would be eliminated through interbrand price competition, and by permitting inefficient distributors to remain in the market. Whether these anticompetitive implications of resale price maintenance are sufficient to outweigh its procompetitive effects is uncertain. However, it is incorrect to suppose, as the Court did in *Sylvania*, that resale price maintenance "invariably"[138] reduces interbrand competition.

The second reason proposed by the Court in distinguishing resale price maintenance from nonprice vertical restraints was that resale price maintenance might facilitate dealer or manufacturer cartelization.[139] It is uncertain, however, whether the threat of cartelization is sufficiently great to justify a per se rule against resale price maintenance. In the case of a dealer cartel, a majority of the dealers in an industry or a market would have to be included to give the cartel effective market power. In many industries, this would involve a large number of dealers, and organizational requirements of such a cartel suggests a low likelihood of its evading detection.[140] This may be equally true with respect to manufacturer cartels. As in the case of dealer cartels, an effective manufacturer cartel would have to be comprised of the manufacturers controlling the industry. In many industries differences in production costs and changing market conditions require frequent readjustment of retail prices. The parallel movement of retail prices which would result under these conditions significantly reduces a manufacturer cartel's ability to conceal itself under the guise of indepen-

[137] By vertically restricting competition, a manufacturer can affect only as much of the total output of an industry as it produces. Bork II, *supra* note 73, at 402.

[138] 433 U.S. at 51 n. 18.

[139] *Id.* A *dealer* price cartel consists of a horizontal agreement between dealers, whereby the manufacturer supplying the dealers is coerced to administer a resale price maintenance program at price levels set by the cartel. Bork II, *supra* note 73, at 405-06. A *manufacturer* price cartel is an agreement between competing manufacturers to set resale prices at an agreed upon level. Resale price maintenance enables manufacturer cartels to police their members by ensuring that any change in retail prices has as its origin the manufacturer, rather than individual dealers. *Id.* at 411.

The possibility is also present that cartelization will occur in the context of nonprice restraints. However, the Court in *Sylvania*, although recognizing that there may be "occassional problems" in distinguishing dealer cartels, did not "regard the problems of proof as sufficient to justify a *per se* rule." *Id. But see* Note, *The Supreme Court, 1976 Term,* 91 HARV. L. REV. 70, 237-38 (1977).

[140] Bork II, *supra* note 73, at 408-09. Professor Posner suggests that enforcement agencies can base an inferrence concerning the existence of a dealer price cartel on the nature of the product. If the product typically is sold with services, it is likely that resale price maintenance is vertically imposed by the manufacturer to encourage those services. Alternatively, if the product is not sold with services, an inference may be drawn that resale prices are being imposed on the manufacturer to eliminate dealer competition. R. POSNER, *supra* note 73, at 134.

dently imposed vertical restraints.[141] Moreover, in the case of both dealer and manufacturer cartels, the high visibility of industry wide uniform prices would serve to call government attention to industries where there was a possibility of cartelization. Thus, in light of the inherent instability of cartels, the Court's belief that a per se rule against resale price maintenance is justified by the threat of cartel formation may be unfounded.

Despite the *Sylvania* Court's inability to adequately distinguish resale price maintenance from nonprice restraints on economic grounds, it is unlikely that a doctrine so strongly rooted in antitrust law will be significantly weakened as a direct consequence of *Sylvania*. The particularly sensitive reaction which the courts have demonstrated toward restrictions on price suggests that the use of vertical price restraints is unlikely to be accepted as easily as nonprice vertical restraints.[142] Furthermore, the *Sylvania* Court found the recent repeal of the fair trade laws,[143] which had previously allowed the states to provide an exemption to the judicially created per se rule against resale price maintenance, suggestive of a congressional intention that a rule of per se illegality be applicable to all vertical price restraints.[144] The *Sylvania* Court's recognition of the efficiency based justifications for nonprice restraints, however, creates some pressure for the Court to reexamine the economic rationale underlying the per se rule against vertical price restraints.

CONCLUSION

In *Sylvania* the Supreme Court found, upon reexamination of the *Schwinn* per se rule, that nonprice vertical restraints hold sufficient economic benefit to require determinations of legality to be made under the rule of reason. Viewing vertical restraints solely as a means of attaining economic efficiency in distribution, the Court rejected *Schwinn*'s sale-nonsale distinction and its reliance upon the "ancient rule against restraints on alienation" as grounds for a per se rule. Rather, the Court held that restrictions on intrabrand competition may be justified by their overall benefit to interbrand competition. However, by requiring the lower courts to engage in a complex economic balancing process without providing rule of reason guidelines, the Supreme Court has left the impact of its decision largely to the discretion of the lower courts. Adequate enforcement will require a substantial degree of economic sophistication on the part of the lower courts, and a recognition that limitations to manufacturer justifications do exist.

In addition, the Supreme Court's efficiency-based approach to nonprice vertical restraints in *Sylvania* leaves in some doubt the validity of the rule of per se illegality for resale price maintenance. By recognizing that economic justifications for restricted distribution may often exist the Court has, by implication, created a strong case for the limited use of vertical price restraints.

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[141] *Cf.* Bork II, *supra* note 73, at 412-15.

[142] *See, e.g.*, United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 221 (1940); United States v. Trenton Potteries Co., 273 U.S. 392, 397 (1927); Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

[143] The fair trade laws were repealed by the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801.

[144] 433 U.S. at 51 n. 18.