

CASE NOTES

Trade Regulation—Exclusive Territories—Justification—Private Label Grocery Products—*United States v. Topco Associates*.¹

Topco Associates is a cooperative corporation wholly owned and controlled by some 25 small and medium-sized supermarket chains operating stores in 33 states.² Topco's sole function is to serve as a cooperative buying organization through which its members can purchase at relatively low prices over 1000 different items, most of which are sold under brand names owned by Topco. The principal purpose of the Topco organization is to provide its members with an effective and cost competitive private label program so as to enable the individual members to compete effectively with the national and large regional chains. Most memberships in the association are exclusive³ and possess the sole right to sell Topco controlled brands and Topco provided products in the geographic territory defined in the membership agreement. The government sought an injunction against Topco to prevent it from limiting or restricting the territories within which its members might sell Topco brands and products. The government contended that this practice constituted a division of the market among competitors, and was, therefore, a per se violation of Section 1 of the Sherman Act.⁴ Topco defended on the grounds that a private label program is necessary to enable a small chain to compete effectively against national chains, and that the successful operation of such a program requires a division of the market among the respective participating members. It further argued that any limitations on competition among Topco members were far outweighed by the increase in competition in the overall supermarket field. The District Court for the Northern District of Illinois HELD: The defendant's practice of allocating territories within which its members have the exclusive right to sell Topco private label products is not a per se violation of the Sherman Act. The court further held that the territorial limitations on memberships are necessary to enable defendant's members to compete effectively with the national food chains, and that the limitations on competition among

¹ 319 F. Supp. 1031 (N.D. Ill. 1970).

² The members do not conduct business under the "Topco" name. Each succeeds or fails as a separate entity. Star Markets, Giant Food, Inc. and Hill's Korvette Supermarkets are three of the more well known chains belonging to the association. 319 F. Supp. at 1033.

³ In some cases, co-extensive and non-exclusive licenses have been granted for particular territories, but since at least in some cases these territories have been large enough for more than one licensee to operate without actually competing, even these licenses have tended to be de facto exclusive. 319 F. Supp. at 1042.

⁴ Section 1 of the Sherman Act, 15 U.S.C. § 1 (1964), provides in part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."

Topco members are, on balance, reasonable and not violative of the antitrust laws.

The division of territory by competitors, a practice early and seemingly categorically condemned as a per se unlawful trade restraint,⁵ continues to reappear in new forms.⁶ The creation of a buying cooperative with each member having a closed territory illustrates this development. Equally persistent, the government continues to challenge such variations as mere disguises of the condemned practice. The results of the ensuing litigation have not always been uniform⁷ and the holdings have left room for speculation.⁸ The instant case provides no exception to this pattern. It is the purpose of this note, first, to examine the *Topco* decision in light of the decisional and statutory underpinnings of the defense of "reasonableness." The note will then attempt to answer the question of why the *Topco* court reached this defense in light of the generally accepted proposition that the horizontal division of a market is per se illegal. Finally, this note will point out possible weaknesses in the "necessity" argument made by Topco and adopted by the court, examine the court's designation of the relevant product market, and explore the potential for price fixing by the Topco members.

The court's conclusion that Topco's market division practices were not violative of the Sherman Act was based upon an application of the "rule of reason."⁹ This approach was first adopted in *Standard Oil Co. v. United States*,¹⁰ which held that the Sherman Act prohibits only

⁵ See *White Motor Co. v. United States*, 372 U.S. 253 (1963); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951); and *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), aff'd, 175 U.S. 211 (1899). See also Report of the Attorney General's National Committee to Study the Antitrust Laws, at 26 (1955).

⁶ In addition to the territorial restraints in the instant case, the courts have had to deal with divisions of market incident to a plan of trademark licensing, *United States v. Sealy, Inc.*, 388 U.S. 350 (1967), and a vertically imposed division of the market resulting from the allocation of exclusive distributorships by a manufacturer, *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967).

⁷ See *Sandura Co. v. FTC*, 339 F.2d 847 (6th Cir. 1964), upholding the restrictions, and *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), striking down the restrictions.

⁸ See discussion of *United States v. Sealy, Inc.*, 388 U.S. 350 (1967), *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), and *Sandura Co. v. FTC*, 339 F.2d 847 (6th Cir. 1964); *infra*. See also Rudnick, *The Sealy Case: The Supreme Court Applies The Per Se Doctrine To a Hybrid Distribution System for Trademarked Bedding Products*, 57 *Trademark Rep.* 459 (1967); see also McLaren, *Territorial and Customer Restrictions, Consignments, Suggested Resale Prices and Refusals To Deal*, 37 *ABA Antitrust L. J.* 137 (1968).

⁹ The rule of reason had its origins in the common law ancillary restraints doctrine which provided that a trade restraint "ancillary" to the main purpose of a business transaction was valid if the restraint was reasonable and necessary. For a comprehensive survey of common law ancillary restraints cases, see *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898).

¹⁰ 221 U.S. 1 (1911).

undue restraints of the trade.¹¹ *Appalachian Coals, Inc. v. United States*¹² applied the rule of reason to a situation where the restraints would perhaps strengthen the overall competitive nature of the industry. If a restraint is found to be devoid of any positive competitive benefits, it is characterized as illegal per se and condemned without further inquiry into its reasonableness.¹³ As for the criteria to be considered in judging the reasonableness of a restraint, *Chicago Board of Trade v. United States*¹⁴ held that the court must ordinarily consider all facts "peculiar to the business to which the restraint is applied. . . ."¹⁵

The peculiar facts of the food merchandising industry in general, and of private label programs in particular, played a decisive role in the court's analysis of Topco's territorial restrictions.¹⁶ The supermarket industry is characterized by the dominance of large national food chains which tend to set the competitive pace.¹⁷ Recently, there has been a marked concentration of economic resources and retail outlets among a few powerful national and large regional chains, while independent grocers and smaller chains, such as those belonging to the Topco association, have disappeared at an accelerating rate.¹⁸ A significant factor in these developments has been the ability of the larger chains to establish and maintain private label programs.¹⁹ Once a chain establishes with its customers an acceptance of its private label products, it enjoys a customer loyalty which no competitor can exploit since no chain sells its private label products to competitors.²⁰ Thus, if a customer believes that Ann Page or Sultana products are the best buys for the money, he must shop at an A&P food store, since only that chain carries those private label products. Those chains without private label programs are limited to competing in those brands which are available to all supermarkets, and thus cannot benefit from private label customer loyalty.

Since a major factor in the acceptance of private label products

¹¹ Id. at 60.

¹² 288 U.S. 344 (1933).

¹³ See *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958).

¹⁴ 246 U.S. 231 (1918).

¹⁵ The Court said:

Every agreement concerning trade, every regulation of trade, restrains. To bind, to strain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end to be attained are all relevant facts.

246 U.S. at 238.

¹⁶ See the court's findings of fact and conclusions of law, 319 F. Supp. at 1032-038.

¹⁷ 319 F. Supp. at 1034.

¹⁸ Id.

¹⁹ Id. at 1035.

²⁰ Id. at 1039-040.

is their low prices,²¹ only those firms that are large enough to take advantage of the economies of high-volume buying can successfully utilize a private label program. There was evidence produced in the *Topco* case that an annual sales volume of \$500 million was required to support such a program with optimum economic efficiency.²² In view of the fact that the largest *Topco* member had a sales volume of only \$182.8 million,²³ it is clear that individually the *Topco* members would be unable to avail themselves of the benefits of a private label program. The chains solved this problem by combining to form a cooperative that would mass purchase products for all of the members from manufacturers and processors. The economies thus achieved allowed the individual members to price their private label products at relatively low price levels. Nevertheless, the members still faced the problem of convincing the consumer that their private label products were the best buys, quality-wise, for the money. An extensive advertising and promotional campaign, if successful, would develop desired customer acceptance of these products, but would not give the chains the type of customer loyalty enjoyed by the national chains in the operation of their own programs. This was so because, unlike those of the national chains, the *Topco* private label products were not the exclusive products of any one chain. Since each member of the association could obtain *Topco* products, any one chain would be in a position to let an associate member bear the costs of advertising and promotion in a particular area, and then move in to reap the benefits of that member's promotional campaign. Realizing that this possibility significantly detracted from the value of a private label program,²⁴ the chains found it necessary to insure that the respective members of the association would not engage in such practices. This was accomplished by the assignment of exclusive territories to each member, within which only one member could sell *Topco* private label products. Having thus arranged to receive the benefits of both mass procurement and exclusive customer loyalty, the individual *Topco* members found themselves on a competitive plane with their national competitors. The only significant differences between the two were the manner in which the exclusivity was obtained and the size of the area in which the exclusivity applied. While the national chains' exclusivity resulted from their status as single, integrated chains, that of the *Topco* chain stemmed from its exclusive right to sell *Topco* products in a specified territory. Similarly, while the national chains' exclusivity gave them a monopoly in their private label products in the entire nation, that of the *Topco* chain provided it with a comparable monopoly only in a certain territory. The fact that the national chains had a legal monopoly in their private label products, combined with the particular nature of the

²¹ Id. at 1035.

²² Id. at 1036.

²³ Id. at 1033.

²⁴ Id. at 1036.

supermarket industry, no doubt influenced the court in its analysis of the reasonableness of Topco's practices.

To the extent that the territorial restrictions are a necessary part of the private label program,²⁵ they can be said to be responsible for the benefits that result from such a program. The private label program enables Topco members to compete more effectively with the dominant national chains, and thus lessens the oligopolistic nature of the supermarket industry.²⁶ The Topco program provides the customer with another choice of high-quality, low-priced merchandise. Further, the program benefits the small manufacturers and processors which are the principal sources of private label products.²⁷ These small manufacturers are generally unable to develop national brand name recognition for their products. Thus, they benefit from the Topco private label program by the assurance of a substantial market for their products and by having the Topco members sustain the costs and risks of product and label development, promotion and marketing. Thus, the Topco arrangement served to strengthen the overall competitive nature of the industry.²⁸

The court found that these results were obtained with no significant lessening of competition.²⁹ It noted that the territories were only as large as a member could adequately serve,³⁰ thus insuring that the public would have the benefits of the Topco chain's overall competition. It also observed that the restrictions did not preclude member chains from selling non-Topco products outside their territories.³¹ If one considers that non-Topco products accounted for 94 percent of the members' average sales,³² it can be seen that there remained room for significant competition among members. Somewhat related to this point was the finding that in any case, the average market share of the Topco members was only 5.87 percent,³³ thus indicating that regardless of the Topco practices, there was other substantial competition within the various markets. Finally, the court observed that the restraints were of a non-permanent duration; membership was not static, but changed frequently as new, smaller members entered and old, larger members

²⁵ See discussion of the necessity for the restraints at pp. 1244-45 *infra*.

²⁶ In 1967, the 25 largest supermarket chains accounted for 85.6% of total supermarket chain sales. 319 F. Supp. at 1034. The combined retail sales of Topco's member chains totaled \$2.3 billion, placing it fourth in total sales behind the big three of the industry—A&P, Safeway and Kroger. 319 F. Supp. at 1033. The resulting argument in favor of upholding the validity of Topco's practices is that an industry with 4 leaders is less oligopolistic than one with only three. Of course, Topco Associates is not a single chain and thus cannot accurately be compared to the "big three," but the comparison does indicate the relative strengths of a single Topco member and a single A&P store in a given territory.

²⁷ 319 F. Supp. at 1035.

²⁸ See *Appalachian Coals, Inc. v. United States*, 288 U.S. 344 (1933).

²⁹ 319 F. Supp. at 1038.

³⁰ *Id.* at 1036.

³¹ *Id.* at 1037. The significance of this accessibility is discussed at p. 1251 *infra*.

³² *Id.* at 1033.

³³ *Id.*

left to carry on their own private label programs.⁸⁴ Viewed in that light, the Topco arrangement, rather than being a restrictive organization dedicated to the preservation of a monopoly, was instead a means by which smaller chains could grow in strength to assume a competitive position in the industry.

In summary, it seems evident that significant pro-competitive results were accomplished in the overall industry. Given the facts that characterize the supermarket industry and the particular benefits and requirements of a private label program, the court appears to have been justified in finding that Topco's market division practices were reasonable.⁸⁵

The question arises, however, whether the court should ever have reached the issue of reasonableness. The court seems to conclude that Topco market divisions are not per se illegal *because* they are reasonable. This analysis defeats the purpose of the per se rule. The principal purpose of a per se rule is precisely to preclude inquiry into the reasonableness issue. The government had reason to believe that the per se illegality of a market division among competitors had long been settled.⁸⁶ Although the court in *Topco* did not explain its departure from the per se rule, there appear to be several ways its decision can be reconciled with past cases.

In *United States v. Sealy, Inc.*,⁸⁷ the Supreme Court found a per se violation on facts somewhat similar to *Topco*. There was language in the decision, however, that appears to open the door to exceptions to a strict application of the per se rule in market division cases. The defendant in *Sealy* was a corporation that owned the Sealy tradename and licensed small manufacturers throughout the country to make Sealy bedding products. Like Topco, however, Sealy was owned and controlled by its licensees, thus making the organization horizontal in nature. Besides providing central advertising, promotion, technical and managerial assistance and research, Sealy worked with the licensees to set retail prices. Finally, it served as a device whereby each manufacturer could maintain an exclusive territory in which to sell its prod-

⁸⁴ Id. at 1038.

⁸⁵ The court said:

The Topco licensing provisions are not inherently unreasonable and have no substantial adverse effect on competition in the relevant market. They are ancillary and subordinate to the fulfillment of the legitimate, procompetitive purpose of the Topco cooperative, reasonable and in the public interest.

319 F. Supp. at 1038.

⁸⁶ See cases cited in note 5 supra. In *United States v. Aluminum Co. of America*, Judge Learned Hand wrote:

It is settled, at least as to § 1, that there are some contracts restricting competition which are unlawful, no matter how beneficent they may be; no industrial exigency will justify them; they are absolutely forbidden. Chief Justice Taft said as much of contracts dividing a territory among producers . . . [in *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 291 (6th Cir. 1898)].

148 F.2d 416, 427 (2d Cir. 1945).

⁸⁷ 388 U.S. 350 (1967).

uct. Sealy licensed only one manufacturer to make and sell Sealy products in a particular area. In return, each manufacturer agreed not to make or sell outside its area. The district court issued a decree enjoining the price-fixing practice, but upheld the agreements to allocate territory on the ground that they were ancillary to a lawful plan of trademark licensing and, therefore, reasonable.³⁸ On an appeal limited to the market division issue, the Supreme Court reversed, and held that the territorial arrangements were per se illegal. Significantly, however, the Court did not rely exclusively upon the readily available and supposedly well established rule that a horizontal division of a market among competitors is per se illegal. Instead, the Court reasoned that the Sealy territorial division should be found per se unreasonable because it was part of a per se unreasonable plan of price-fixing:

[The] existence and impact of the practice [of price-fixing] cannot be ignored in our appraisal of the territorial limitations. . . . It may be true, as appellee vigorously argues, that territorial exclusivity served many other purposes. But its connection with the unlawful price-fixing is enough to require that it be condemned as an unlawful restraint. . . .³⁹

It seems fair to infer that the *Sealy* decision has not foreclosed the possibility that a market division, in the absence of a price-fixing scheme, may be upheld under a rule of reason approach.⁴⁰ Indeed, *Sealy* itself suggests a fact situation which may be validated if presented to the Court:

It is argued . . . that a number of small grocers might allocate territory among themselves on an exclusive basis as incident to the use of a common name and common advertisements, and that this sort of venture should be welcomed in the interests of competition, and should not be condemned as *per se* unlawful. But condemnation of appellee's territorial arrangements certainly does not require us to go so far as to condemn that quite different situation, whatever might be the result if it were presented to us for decision.⁴¹

It is submitted that if allocation by competitors of exclusive territories is a per se violation of the Sherman Act, there should have been no doubt in the Court's mind that the hypothesized practices of the small grocers would be per se illegal. Implicit in the Court's hypothetical, then, is the idea that there might be some cases in which market

³⁸ Trade Cas. ¶ 71,258 (N.D. Ill. 1964).

³⁹ 388 U.S. at 355-57.

⁴⁰ Richard McLaren, Assistant Attorney General in charge of the Antitrust Division, suggests that the significance of *Sealy* is that the Court failed to discard the ancillary restraints doctrine in the licensing of capital assets such as trademarks. He concludes that, absent price fixing, selling restrictions in manufacturing-type licenses are still "arguably defensible." McLaren, *supra* note 8, at 142.

⁴¹ 388 U.S. at 357.

divisions are permissible. More specifically, the Court's underscoring of the price-fixing scheme in *Sealy*, and its hypothetical concerning "small grocers," implies that "small" businesses which divide markets without fixing prices,⁴² for the purpose of promoting competition, may be judged under a rule of reason.

It seems strange that *Topco* did not accept the apparent invitation of *Sealy* to apply a rule of reason to the "right" market division case. Instead, the Court relied upon *Sandura Co. v. FTC*,⁴³ a case which not only lacked the similarity of fact present in *Sealy*,⁴⁴ but which had been narrowly limited, if not overruled, by the Supreme Court's decision in *United States v. Arnold, Schwinn & Co.*⁴⁵ Both *Sandura* and *Schwinn* were concerned with the legality of a manufacturer's allocation of exclusive territories to its distributors rather than the horizontal agreement by the "distributors" themselves which characterized *Topco* and *Sealy*. *Sandura* and *Schwinn*, then, were concerned with the legality of vertically imposed market divisions—the legality of which prior to *Schwinn* had never been established by the Supreme Court. The Supreme Court's first occasion to rule on vertically imposed restraints occurred in *White Motor Co. v. United States*,⁴⁶ but the Court reversed the lower court's summary judgment for the government stating that the formulation of the applicable rule should occur only after a trial.⁴⁷ *Sandura*, decided by the Court of Appeals for the Sixth Circuit, interpreted *White Motor* to hold that the mere demonstration of vertically imposed territorial allocations was not sufficient to support a finding of per se illegality.⁴⁸ Accordingly, it proceeded to examine the particular effects upon competition and the facts offered to justify the restraint. Two years later, however, the Supreme Court, in *Schwinn*,

⁴² As to the possibility that the division of the market in *Topco* might result in artificial price setting, see discussion at pp. 1252-54 *infra*.

⁴³ 339 F.2d 847 (6th Cir. 1964).

⁴⁴ In both *Sealy* and *Topco*, the licensees owned and controlled the licensor, thus making any agreements horizontal in nature. In *Sandura*, however, the licensees were mere distributors of the licensor and had no control over it, thus making the arrangement vertical in nature. While both horizontal and vertically imposed market divisions have been found illegal, the cases have recognized that the two devices may have important differences. See *White Motor Co. v. United States*, 372 U.S. 253 (1963).

⁴⁵ 388 U.S. 365 (1967).

⁴⁶ 372 U.S. 253 (1963). In this case, the defendant, a manufacturer of trucks, granted licenses to distributors, which licenses restricted the geographic areas within which the distributors were permitted to sell trucks and parts. The Court reviewed the per se and rule of reason doctrines but, noting that the case was before it on an appeal from a summary judgment, said that it intimated no view one way or the other on the legality of the particular arrangement before it. It felt that the applicable rule of law should be "designed" after a trial, saying: "This is the first case involving a territorial restriction in a vertical arrangement; and we know too little of the actual impact of . . . that restriction . . . to reach a conclusion on the bare bones of the documentary evidence before us." 372 U.S. at 261. It should be noted, however, that the Court in *White Motor* thought that the rule was well settled that horizontal market divisions are per se illegal. 372 U.S. at 263.

⁴⁷ 372 U.S. at 261.

⁴⁸ 399 F.2d at 849-50.

answered the question it had left open in *White Motor*, and held that vertically imposed territorial restrictions were per se unreasonable.⁴⁹ Despite the apparent finality of the *Schwinn* decision,⁵⁰ the court in *Topco* reached back to *Sandura* to justify its refusal to find a per se violation. It is submitted, however, that what *Topco* reads as relevant in *Sandura* is not its use of a rule of reason examination, but rather its refusal to apply a per se rule where such relief would not benefit competition at any level.

Sandura Company, a manufacturer of vinyl floor covering, had acquired a very unfavorable reputation when imperfections appeared in its leading product. Sales rapidly declined, and most of its distributors, not wishing to be associated with a defective product, refused to carry Sandura products. Finding itself on the verge of bankruptcy, Sandura corrected the defects in its products, but encountered a continued reluctance among distributors to finance the advertisement and promotion that would be necessary to overcome Sandura's tarnished reputation, unless each distributor could be sure that it alone would reap the benefits of such a campaign. To overcome this resistance, Sandura offered to grant to its distributors exclusive rights to sell Sandura products in a given territory. Numerous distributors agreed to promote Sandura products on these terms. What impressed the court in *Sandura* was the fact that if it enjoined the territorial allocations, the distributors would refuse to carry Sandura products, and Sandura, unable to finance its own promotion and distribution, would go bankrupt.⁵¹ Such a result obviously would not benefit competition in the Sandura product line, and, moreover, the demise of Sandura would serve to lessen competition in the overall floor-covering industry. The court concluded: "We are of the opinion that *on this record*, the only justified conclusion is that elimination of the closed territory arrangement would impair competition, rather than foster it."⁵²

Such was not the case in *Schwinn*. Schwinn was a healthy, competitive entity which created a closed territory arrangement among its distributors in order to maximize efficiency and compete more effectively against increasing competition from imports and the growing

⁴⁹ See discussion of *Schwinn* at note 53 infra.

⁵⁰ But see *Albrecht v. Herald Co.*, 390 U.S. 145, 155 (1968), where Justice Douglas, in his concurring opinion, intimated that a rule of reason may sometimes be applicable to a vertically imposed division of the market: "Under our decisions the legality of exclusive territorial franchises in the newspaper distribution business would have to be tried as a factual issue. . . ." See also McLaren, *supra* note 8, at 144, where it is suggested that the Supreme Court, in *Schwinn*, faced with reviewing a 23 volume record in a short period of time, threw up its hands at the idea of even trying to make a rule of reason analysis in that case.

⁵¹ 339 F.2d at 851.

⁵² *Id.* at 859. The court considered the point that Sandura could not continue to maintain its closed distribution system after the particular reasons justifying such a system ceased to exist (see *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1900), *aff'd per curiam*, 365 U.S. 567 (1961), but concluded that at the time of the trial, the closed system was still necessary. 339 F.2d at 853.

practice on the part of its domestic competitors to market through mass merchandisers.⁵³ The removal of the territorial restraints in *Schwinn* resulted in increased competition among the various wholesalers and retailers which carried Schwinn products, and not in an elimination of a competitor, as would have occurred in *Sandura*.

The court in *Topco* was convinced that the Topco members would refuse to carry Topco products without the protection of closed territories. The court thus reasoned that if it enjoined the territorial restraints, the result would be the disintegration of Topco Associates and the loss of Topco private label products to competition. Recognizing that such a result would not generate competition in the Topco products among former Topco members, and further, that by depriving the member chains of the private label weapon, competition between former Topco members and the national chains would decline in all products, the court could see no point in applying the per se rule. If one were to try to formulate the holding of *Topco* so as to reconcile it with prior per se cases, it could be said that *Topco* does not abrogate the per se rule against market division by competitors, but rather, finds that rule inapplicable where the elimination of the territorial restraints would produce a result devoid of any competitive benefits. Implicit in this holding is the reasoning that the restraints made possible a product—Topco private label products—which had not existed in competition prior to imposition of the restraints. Therefore, even if competition among Topco members in this new product were restricted by the restraints, there is at least as much competition as there was before the imposition of the restraints when the Topco products did not exist. And, as the court pointed out, the very existence of the Topco private label product has actually increased competition in the overall supermarket industry by strengthening the competitive position of the individual Topco members. Where competition is restrained only in a

⁵³ Schwinn's new system of distribution included vertically imposed customer and territorial limitations. Two kinds of customer limitations were adopted. Wholesalers were required to sell only to approved retailers, and approved retailers were required to sell only to consumers. Territorial restrictions were imposed upon all wholesalers. The district court upheld the customer restrictions on both retailers and wholesalers, and the territorial restrictions imposed on wholesalers operating under either a consignment or agency distribution plan, but held the territorial restraints to be per se illegal when imposed upon wholesalers who were purchasers. Schwinn did not appeal the decision that the territorial restrictions on purchasers were illegal per se. The government appealed the district court's holding that Schwinn's territorial restrictions on agents and all of its customer limitations were legal. The Supreme Court held that Schwinn's customer limitations were illegal per se when imposed on the resale of products which the wholesalers and retailers had purchased. The Court, however, treated the customer and territorial restrictions imposed on agents and consignees under a rule of reason and found them valid. Thus, Schwinn's per se rule at the Supreme Court level technically is limited to vertically imposed customer limitations on purchasers. The Court did, however, indicate its acceptance of the district court's holding that the vertically imposed territorial limitations on purchasers were per se illegal. 388 U.S. at 379. For a general discussion of *Schwinn*, see Comment, Restricted Distribution After "Schwinn," 9 B.C. Ind. & Com. L. Rev. 1032 (1968).

product or group of products which can exist only as a result of the restraints, it would seem pointless to apply a per se rule of illegality. On the other hand, this is not to say that the arrangement is per se legal, but rather, that the court should examine the need, reasonableness and pro-competitive results of the restraints—in short, the court should use a rule of reason approach. Because of the sui generis nature of the private label program in the supermarket industry, such an approach should not have a deleterious effect on the general per se illegality of market division by competitors.

The soundness of the court's holding, however, depends upon the resolution of several factors not fully explored in the opinion. Of utmost importance is the validity of the court's finding that territorial restrictions were in fact necessary to the continued existence of Topco. The determination of this crucial issue is one of the weakest points of the case. In the first place, the only evidence that the Topco members would have refused to maintain the Topco structure comes from the members' own testimony.⁵⁴ In light of the self-serving nature of this testimony, its validity must be thoroughly investigated. Similar testimony was offered in *Sandura*, but there the court found that the entire record supported the proposition that the distributors would be unwilling to undertake to spend the money necessary to resurrect the tarnished Sandura name if the final sales could be made by another distributor.⁵⁵ The record in *Topco* is not so clear on this point. First, it does not appear what the costs of promotion would include. There is no problem here of a bad reputation; therefore, no extraordinary promotional expenses would seem necessary. Given the fact that the members have a product which they are able to obtain at a relatively low price, the force of their advertising could be directed to the price factor rather than to the quality of the product itself. The results obviously would not be as good as they would be if both price and quality were extensively promoted, but there would still be some benefit, and, therefore, reason to continue to carry the Topco products. The argument that another Topco member in the same territory would unfairly reap the rewards of his competitor's advertising would not hold true if price were the focus of the advertising because each member would set its own prices.

Even if it were true that substantial promotional expenditures aimed at quality would be required to capture customers, it is not clear why the individual members would necessarily have to bear this cost. It might be argued that if Topco Associates can provide extensive central procurement and quality control for each member,⁵⁶ it should

⁵⁴ The government offered no live witnesses. Its evidence consisted of documents from Topco Associates and several newspaper clippings. In defense, Topco offered the oral testimony of its vice president and general manager, the executives of six of its members, and two experts in supermarket merchandising—all of whom testified as to the importance of exclusivity to private label programs. 319 F. Supp. at 1040.

⁵⁵ 339 F.2d at 856.

⁵⁶ 319 F. Supp. at 1032.

also be able to finance central advertising.⁵⁷ Whether such a course was practical should have been investigated in more detail. It is submitted, however, that a plan of central advertising would probably be unfeasible in the *Topco* situation. It seems certain, for example, that difficulties would arise in seeking to insure that each member received an equal benefit from the advertising. An advertisement in a nationally circulated newspaper, for instance, would benefit chains in the larger cities where such newspapers are more likely to be available and read, but would be of little value in an area where only local newspapers are read. In general, it would seem that each member would be best able to recognize and use the appropriate media for its advertising. However, since the possibility of an alternate plan for financing the development of *Topco* products would have seriously undercut the members' argument of "necessity," this aspect should have been examined more thoroughly by the *Topco* court.

Another factor important in an analysis of the *Topco* arrangement is the determination of the relevant product market. Although the court examined both the *Topco* private label brands, on the one hand, and all supermarket products, regardless of brand, on the other, it in effect concluded that the latter was the more important.⁵⁸ The court, however, should have considered more fully a third arguably relevant product market—non-*Topco* products sold in *Topco* stores. Although *Topco* members were precluded from selling *Topco* products in another member's territory, they were not prohibited from opening a store in that area and selling non-*Topco* products. The court noted that on some occasions, *Topco* members who desired to expand into adjacent territories cancelled their plans when they were denied permission to sell *Topco* products in those areas; on the other hand, the court found that others expanded despite the membership agreement and operated without the *Topco* private labels.⁵⁹ It is submitted, however, that the question of whether competition was lessened in non-*Topco* products is not resolved merely by examining the cases where *Topco* chains did attempt to expand into other territories. What is more significant is the number of *Topco* members who, because they recognized the need for maintaining the closed territories, never even attempted to expand into another member's territory, but chose to expand, if at all, into an unclaimed territory where they could employ the private label program. Since this course of action is most consistent with the inherent purpose of the *Topco* organization, it is submitted that *de novo* entry into the

⁵⁷ In *Sandura*, the financial status of *Sandura* precluded the company from conducting a promotional campaign. In *Sealy*, the central organization provided common advertising, but the Court did not discuss this aspect of the case.

⁵⁸ The court said:

Whatever anti-competitive effect these practices may have on competition in the sale of *Topco* private label brands is far outweighed by the increased ability of *Topco* members to compete with the national chains and other supermarkets operating in their respective territories.

⁵⁹ 319 F. Supp. at 1037.

various geographic markets was discouraged to a greater degree than the court was willing to recognize. To the extent that there was a voluntary avoidance of expansion into other members' territories, the Topco system resulted in a de facto lessening of competition in all non-Topco products.

The significance of this effect, however, is diminished in those areas where there are already numerous other supermarkets because non-Topco products there are already in competition. The parties to an agreement dividing a market can "gain only if the result is to give each a substantial degree of power in his own market."⁶⁰ The significance is further attenuated when one considers that although Topco private label products account for only six percent of the average member's sales,⁶¹ the preference for these products that brings a customer into a Topco store is likely to result in his remaining in the store to complete his purchase of non-Topco products. Thus, even if there were another Topco store in the area, the competition would be between the Topco private label products of each, and not the non-Topco products. Indeed, it is this potential to acquire a "total" customer that enhances the competitive position of the Topco member vis-à-vis the national chain. If the Topco member can convince a customer that Topco private label products are better buys than those of its competitor, the Topco member is also likely to win the battle to sell non-private label products.

A final observation, directly related to the monopoly factor, concerns the court's treatment of the pricing policies of the Topco members. The court found that each member priced merchandise as it desired, and it was apparently satisfied that there was no agreement to fix prices.⁶² This finding removed the case from the application of the per se rule against price-fixing agreements set forth in *United States v. Trenton Potteries Co.*,⁶³ but it did not exclude the possibility that a market division's inherent potential for artificial price maintenance⁶⁴ might run afoul of *United States v. Socony-Vacuum Oil Co.*⁶⁵ This latter case held that interference with the free setting of prices by normal market forces is a per se violation of the Sherman Act. Although the court in *Topco* did not deal with this consideration, it is submitted that *Topco* can be distinguished from *Socony-Vacuum*. In that case, a group of major oil companies was convicted of combining to stabilize

⁶⁰ See Report of the Attorney General's National Committee to Study the Antitrust Laws, at 26 (1955).

⁶¹ 319 F. Supp. at 1033.

⁶² 319 F. Supp. at 1037.

⁶³ 273 U.S. 392 (1927).

⁶⁴ The potential for artificial price maintenance stems from the possibility that as a result of a market division, a competitor may acquire a monopoly in a particular geographic market. The price it then assigns to its products will be artificial in the sense that the price will not depend upon free market forces.

⁶⁵ 310 U.S. 150 (1940). For an excellent discussion of *Socony-Vacuum*, see Rahl, Price Competition and the Price Fixing Rule—Preface and Perspective, 57 Nw. U.L. Rev. 137 (1963).

and raise gasoline prices by buying excess supplies of "distress" gasoline from independents.⁶⁶ The defendants tried to distinguish their case from *Trenton Potteries* on the ground that they had made no agreement to set prices. The Court, however, held that the price-fixing rule is not limited to the direct setting of market prices, but applies to any kind of arrangement intended to affect prices.⁶⁷ The required intent was not difficult to perceive in *Socony-Vacuum* since there was no other practical purpose for buying up the distress supplies. The element of intent is not at all observable in *Topco*. Here the defendant's intent was to make possible a private label program so that smaller chains could meet the larger national chains on their own grounds. Far from attempting to alter artificially the market prices, Topco's system would facilitate the free market's setting of prices by providing significant competition to the large, price-setting national chains.

Absent an agreement to set prices, and absent an intent to affect prices, it can be argued that the court should examine the effect of defendant's practices on prices. This was done to some extent in *United States v. Container Corp. of America*.⁶⁸ In that case, it was alleged that the defendants altered market prices by their practice of exchanging price information. The Court apparently did not find an intent to fix prices, but it did find such an effect and held the practice illegal.⁶⁹ The anti-competitive effects of the market division agreement in *Topco* are not as evident as those in *Container*. The argument that Topco's monopoly in its private label products allows it to set prices without regard for competition is not accurate. The Topco private label product is in competition with the corresponding private label products of the national chains. This is not the type of monopoly where the "product" is available from only one source. Lettuce, for example, is sold by both Topco and the national chains. Each, however, has a monopoly in the brand name it puts on its lettuce. Thus, the price of the one acts as a limit beyond which the other cannot be priced without a probability that customers will change their preference for private labels. In the case of competition between a Topco member

⁶⁶ The defendants thereby prevented the gasoline from being dumped on the market at "distress" prices, which would depress the entire market. 310 U.S. at 171.

⁶⁷ 310 U.S. at 223-24. See Rahl, *supra* note 65, at 141. See also *American Column & Lumber Co. v. United States*, 272 U.S. 377 (1921), where an agreement to exchange price information was found illegal because the purpose was to raise prices; and *Maple Flooring Mfrs. Ass'n v. United States*, 268 U.S. 563 (1925), where a similar agreement was upheld because no purpose to affect prices was found.

⁶⁸ 393 U.S. 333 (1969). See Comment, *Price Exchange Agreements: Moving Toward a Per Se Rule*, 11 B.C. Ind. & Com. L. Rev. 319 (1970); Handler, *Antitrust*: 1969, 55 Cornell L. Rev. 161, 171-78 (1970).

⁶⁹ The lower court found neither a purpose to affect prices nor such an effect. *United States v. Container Corp. of America*, 273 F. Supp. 18, 60-61 (M.D.N.C. 1967). The Supreme Court was silent on the purpose issue but found that the agreement had in fact affected prices: "The inferences are irresistible that the exchange of price information has had an anticompetitive effect in the industry, chilling the vigor of price competition." 393 U.S. at 337.

and a national chain, it is submitted that the prices of the latter's private label products are likely to be sufficiently low to eliminate effectively any opportunity for artificial price setting in the Topco products. On the contrary, the presence of the Topco private label product probably served to diminish the national chain's ability to take undue advantage of its own private label monopoly. In essence, the argument for the preservation of Topco's monopoly is that it lessens the overall oligopolistic nature of the supermarket industry by increasing the number of strong firms. Topco's success in this endeavor will further encourage other small grocers and chains to form associations to take advantage of the private label weapon and thus open the market to an even greater degree.

However, even if an effect upon prices could be shown, it is submitted that Topco should prevail on the grounds that a slight artificiality in the prices of Topco products is not too high a price to pay to offset the competitive advantages of the national chains' legal private label monopolies.⁷⁰ The court appeared to recognize this when it stressed the point that "if Topco, rather than being a buying organization for smaller local and regional chains, were a single, large national chain, none of its practices would be objectionable under the antitrust laws."⁷¹ Carrying this proposition to its logical conclusion, the Topco members would be able to obtain the full advantages of a private label program only by merging into a single company. Such a course of action, however, would be clearly incompatible with one of the recognized purposes of the antitrust laws—to promote the economic health of many small and independent businesses.⁷² Topco's arrangement treads a middle ground. It provides the private label monopoly that only a merger could produce, and yet insures the basic independence of its respective members. If one also considers the fact that membership in the association is generally only temporary, it seems fair to conclude that little in the way of competition in the private label product market

⁷⁰ The notion that an otherwise illegal, restrictive practice is valid if it offsets the competitive advantages enjoyed by rivals was, however, specifically rejected in *Schwinn*: [T]his argument, [that competitive restraints should be allowed to offset the advantages enjoyed by larger, integrated rivals], appealing as it is, is not enough to avoid the Sherman Act proscription; because, in a sense, every restrictive practice is designed to augment the profit and competitive position of its participants.

338 U.S. at 375. But in *Brown Shoe Co. v. United States*, the Court indicated that a merger of two small companies to enable them to compete with larger corporations dominating the market may be valid, even though a merger between a large and small firm or two large firms, foreclosing an identical share of the market, may be invalid. 370 U.S. 294, 331 (1962).

⁷¹ 319 F. Supp. at 1040. The government had conceded this point.

⁷² See *United States v. Aluminum Co. of America* where Judge Learned Hand said of the antitrust laws:

Throughout the history of these statutes 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.

148 F.2d 416, 429 (2d Cir. 1945).

has been sacrificed to effect a significant gain in competition in the overall supermarket industry.

The government is adamant that the *Topco* court has erred in not applying a per se rule.⁷³ Accordingly, it has filed a jurisdictional statement with the Supreme Court.⁷⁴ The manner in which the Supreme Court disposes of the case will have a significant effect upon future antitrust cases in the supermarket industry and other product markets having similar characteristics. If the Court reverses and finds a per se violation, the government will have weathered the doubts raised by the *Sealy* case, and will be relieved of the difficult task of marshalling evidence to prove the unreasonableness of such restraints. On the other hand, if the Court affirms the decision, or reverses because it reads the evidence to show a clear case of unreasonableness, the government will face the unpleasant prospect of litigating the all-too-difficult question of reasonableness. This burden would be weighty even if the holding were limited to factual settings similar to that found in *Topco*. It is submitted, however, that the final disposition should rest on the merits of the case rather than on the government's burden of enforcement.

The issue is not whether to do away with the per se rule in market division cases, but rather, whether a decision should be made to exempt certain situations from its application. In this regard, the principle articulated in *Appalachian Coals, Inc. v. United States*⁷⁵ is particularly appropriate: "Realities must dominate the judgment."⁷⁶ There are exceptions to all rules, and a blind adherence to a general rule without an occasional pause to reexamine the applicability of that rule to changing conditions runs the risk of overlooking realities.

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Labor Law—Labor Management Relations Act—Secondary Boycotts—Construction Industry—NLRB v. Local 825, Operating Engineers (Burns and Roe, Inc.)¹—Burns and Roe, Inc. (Burns), the general contractor for the construction of a nuclear power generator, subcontracted all of the construction work to three companies; White Construction Co. (White), Chicago Bridge and Iron Co. (Chicago Bridge), and Poirier and McClane Corp. (Poirier). All three companies employed operating engineers who were members of Local 825. However, White was the only contractor who did not have a collective

⁷³ The Justice Department believes that the decision in *Topco* effectively overrules 70 years of Supreme Court decisions. BNA Antitrust & Trade Reg. Rep., No. 501, at A-2.

⁷⁴ 39 U.S.L.W. 3362 (Feb. 23, 1971).

⁷⁵ 288 U.S. 344 (1932).

⁷⁶ Id. at 360.

¹ 400 U.S. 297 (1971).