

STUDENT COMMENTS

RESTRICTED DISTRIBUTION AFTER "SCHWINN"

A manufacturer typically distributes its goods through a succession of middlemen, wholesalers and retailers. This procedure, while it relieves the manufacturer of the expense and difficulty of assuming its own marketing functions,¹ deprives it of full control over its product's distribution.² A manufacturer may desire this control to prevent tort liability or loss of goodwill which could result from improper handling of its product by distributors. The manufacturer may also desire to influence prices and distribution costs or to insure that its product's full sales potential is realized.

A measure of control sufficient to protect these interests may be achieved through contractual arrangements between the manufacturer and its wholesalers and retailers.³ For example, some manufacturers have sought to control important aspects of distribution by contractually limiting the persons to whom a wholesaler may resell the product. This arrangement—a vertically imposed customer limitation⁴—is aimed at excluding undesirable retailers. Similarly, some manufacturers have contractually limited the territories in which the dealer may trade, thereby providing an incentive for the dealer to develop fully that territory's sales potential.

The Justice Department and the Federal Trade Commission have recently challenged the legality of vertically imposed territorial and customer limitations under the antitrust laws.⁵ In *United States v. Arnold, Schwinn &*

¹ See Preston, *Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards*, 30 *Law & Contemp. Prob.* 506 (1965). For example, it was estimated that for automobile manufacturers to integrate to accomplish their own distribution would require an investment of nearly 5 billion dollars, compared to the total investment by these manufacturers of approximately 7 billion dollars in all other functions. Jordan, *Exclusive and Restricted Sales Areas under the Anti-Trust Laws*, 9 *U.C.L.A.L. Rev.* 111 n.1 (1962).

² See Chaffee, *Equitable Servitudes on Chattels*, 41 *Harv. L. Rev.* 945, 946-48 (1928); Note, *Restricted Channels of Distribution under the Sherman Act*, 75 *Harv. L. Rev.* 795, 819 (1962).

³ A manufacturer may impose contractual limitations on its distributors for other reasons. For example, a manufacturer of a patented product may want to maximize profits by requiring that its distributors sell only to customers who will use the product in a certain way. For the validity of this practice, see *General Talking Pictures v. Western Elec. Co.*, 305 U.S. 124 (1938).

⁴ For purposes of this article, "vertically imposed" or "vertical" restrictions will refer to restrictions imposed by a party at one level of distribution or production on parties at another level. Most vertical restraints originate with the manufacturer. "Horizontal" or "horizontally imposed" restrictions are those which are initiated by parties who are competing at the same level of distribution or production, but parties from several levels of production or distribution may eventually participate. See pp. 1039-42 *infra*, for a discussion of the legal implications of this distinction.

⁵ See *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); *White Motor Co. v. United States*, 372 U.S. 253 (1963); *Sandura Co. v. FTC*, 339 F.2d 847 (6th Cir. 1964); *Snap-On Tools Corp. v. FTC*, 321 F.2d 825 (7th Cir. 1963). Use of these restraints has long been under attack, but until recently, only in combination with other restrictive practices such as price fixing. See, e.g., *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211 (1899); *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

Co.,⁶ the Government achieved a major victory in the United States Supreme Court. Because of the impact of this case on the legality of these important marketing practices, this comment will examine the *Schwinn* decision in light of prior law and Sherman Act policy. This comment will also consider the implications of the case on future use of vertically imposed customer and territorial restrictions.

I. THE HISTORY OF THE "SCHWINN" DECISION

A. *Schwinn's Distribution System*⁷

Although Arnold, Schwinn and Company was the largest domestic producer of bicycle products, after World War II its management felt a new sales program was required to meet competition from foreign manufacturers and manufacturers selling through mass merchandizers like Sears, Roebuck and Company, and Montgomery Ward and Company.⁸ Beginning in 1949, Schwinn made extensive studies of its marketing practices. These studies revealed that after Schwinn sold its product to its retailers, it had almost no control over their distribution. Of the approximately 15,000 retail accounts on Schwinn mailing lists, Schwinn discovered that only about one quarter were active, and that a small number of the active accounts were responsible for a disproportionately large number of sales. These findings troubled Schwinn's management. Not only did carrying inactive and small volume accounts significantly increase administrative and promotional expenses, but Schwinn found that "random and haphazard sales methods" were interfering with its efforts to establish a more successful sales program in which active or aggressive retailers would be used.

To correct the defects that these studies revealed, Schwinn completely revamped its distribution system. At the heart of the new distribution system were vertically imposed customer and territorial limitations. Two kinds of customer limitations were adopted. Wholesalers were requested to agree to sell only to approved retailers, and approved retailers were required to agree to sell only to consumers. Territorial restrictions were imposed on all wholesalers; they agreed to sell only within their assigned territories (all assigned territories were mutually exclusive). Schwinn's management hoped its new distribution system would assure all dealers a market having an adequate sales potential, would establish stability and efficiency in distribution and would assure Schwinn of a competent and aggressive group of dealers.

Schwinn accomplished three types of distribution through this restricted system. First, most of its sales were made to franchised retailers under the "Schwinn Plan." This plan called for Schwinn to ship the product to the

⁶ 388 U.S. 365 (1967).

⁷ The following discussion is derived from information in the District Court opinion and Schwinn's brief before the Supreme Court. See *United States v. Arnold, Schwinn & Co.*, 237 F. Supp. 323 (N.D. Ill. 1965); Brief, and Appendix, for Appellee, 388 U.S. 365 (1967).

⁸ Schwinn had previously sold through Sears, Roebuck and Co. but, at about this time, Sears required its bicycle suppliers to label their products with Sears' brand names rather than the brand names of the manufacturer. Schwinn refused to follow this practice because it felt such action would compromise the high prestige of Schwinn's own brand.

retailer on credit and to invoice the retailer directly.⁹ A commission was paid to the wholesaler servicing the territory in which the retailer was located, even though the wholesaler's function was, at most, to forward orders to Schwinn. Second, Schwinn sold products to various wholesale outlets for resale to approved retailers and sold to firms like B.F. Goodrich which handled their own wholesaling and retailing. Schwinn's third method of distribution was by consignment or agency arrangements with a few wholesalers. Under the consignment method of distribution, the wholesaler-consignee took possession of the bicycles and sold them to franchised retailers. Schwinn insured the goods and retained title until they were sold. The wholesaler then paid Schwinn for the insurance and the goods. Under Schwinn's agency agreements, Schwinn leased floor space from wholesalers and shipped bicycles to that space. The wholesaler-agent handled the sales of these bicycles to franchised retailers and billed them on Schwinn's invoices. Schwinn paid a commission to the wholesaler for these services.

In 1958, the Justice Department sought an injunction against Schwinn, Schwinn Cycle Distributors Association, an association of Schwinn's wholesalers, and B.F. Goodrich Company¹⁰ in the United States District Court for the Northern District of Illinois alleging that the distribution practices of these parties restrained trade in violation of Section 1 of the Sherman Act.¹¹ In substance, the Government alleged three main restraints of trade: price fixing,¹² territorial limitations on wholesalers, and customer limitations on wholesalers and retailers.

B. The Court Decisions

The district court decided that the *Schwinn* case was controlled by the holding in *White Motor Co. v. United States*.¹³ In *White Motor*, the Supreme Court found that there was insufficient evidence of the anticompetitive effects of vertically imposed customer and territorial limitations to declare them per se illegal; that is, illegal regardless of any justifications for their imposition.¹⁴ Instead, the Court held that an independent examination of their anticompetitive effects and the justification for their use must be made in each case to determine whether their use was reasonable under the circumstances. The district court, in *Schwinn*, examined the legality of

⁹ Orders from retailers were sent either directly to Schwinn or to a wholesaler who in turn forwarded the order to Schwinn. In either case, Schwinn billed the retailer directly.

¹⁰ The action against B.F. Goodrich was settled by a consent decree. See *United States v. Arnold, Schwinn & Co.*, 1962 Trade Cas. ¶ 70,445 (N.D. Ill. 1962).

¹¹ 15 U.S.C. § 1 (1964). The Sherman Act provides:

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

¹² The district court found no factual basis for the charge of price fixing and dismissed it. *United States v. Arnold, Schwinn & Co.*, 237 F. Supp. 323, 332 (1965). The Government did not appeal this finding.

¹³ 372 U.S. 253 (1963).

¹⁴ For examples of cases holding other practices to be per se illegal, see *Northern Pac. Ry. v. United States*, 356 U.S. 1, 6-7 (1958); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224 n.59 (1940).

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Schwinn's territorial and customer limitations under this "rule of reason."¹⁵ It upheld the customer restrictions on retailers since it found that those restrictions did no more than prevent the retailer from acting as a wholesaler for unapproved outlets. The court found customer limitations on Schwinn's wholesalers to be legal, likening the wholesaler's status to that of an "agent" upon whom such restrictions could lawfully be imposed.¹⁶ In addition, the court found that customer limitations on both wholesalers and retailers were necessary to Schwinn's survival as a competitor in the bicycle industry. The court drew a distinction between territorial limitations imposed on wholesalers who were *purchasers* of Schwinn's products, and wholesalers who acted under the agency, consignment and Schwinn Plan distributions as *agents* of Schwinn. The court upheld territorial restrictions imposed on Schwinn's wholesalers under either the consignment or agency distribution plan, but held them illegal when imposed on wholesalers who were purchasers. The court felt that these latter restrictions resulted in a horizontal division of markets, an established illegal restraint under the Sherman Act.¹⁷

Schwinn and its distributors did not appeal the finding that the territorial restrictions imposed on purchasers were illegal. The Government appealed the district court's holding that Schwinn's territorial restrictions on agents and all of Schwinn's customer limitations were legal.¹⁸

While the Government had urged in the district court that customer restrictions were a per se violation of the Sherman Act, it abandoned this approach in the Supreme Court. Instead it argued that Schwinn's limitations were illegal under *White Motor* because the restraint they produced was unreasonable under the circumstances.¹⁹ In spite of this change in the Government's contentions, 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 distinguished Schwinn's customer and territorial restrictions imposed in the agency, consignment and Schwinn Plan distributions and examined them under the rule of reason.²⁰ In these situations, the Court found that the restrictions were reasonable, and, therefore, lawful.

Mr. Justice Stewart, joined by Mr. Justice Harlan, dissented in part,²¹ reasoning that the economic factors which established the legality of

¹⁵ For a discussion of the "rule of reason," see *Standard Oil Co. v. United States*, 221 U.S. 1, 62 (1911); *Board of Trade v. United States*, 246 U.S. 231, 238 (1918).

¹⁶ The district court cited no authority for this proposition. In fact the district court opinion is remarkable for its lack of cited authority for any conclusion of law drawn by the court.

¹⁷ The leading case holding horizontal market division illegal per se is *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951).

¹⁸ Direct appeal was taken pursuant to § 2 of the Expediting Act. 15 U.S.C. § 29 (1964).

¹⁹ In response to a direct question from the bench during oral argument before the Court, counsel for the Government disclaimed any intention of arguing for a per se rule. See 35 U.S.L.W. 3372 (U.S. April 25, 1967).

²⁰ Schwinn's agency and consignment sales program will be referred to henceforth in this article by their generic description, agency.

²¹ 388 U.S. at 382.

Schwinn's restrictions in an agency context were equally applicable in a sales context. In addition, they criticized the majority for adopting a rule which would force manufacturers to assume their own distribution functions or to distribute through agents. They argued that such a rule was contrary to the broad antitrust objective of promoting small independent merchants.²²

II. RESTRICTIONS ON PURCHASERS ARE ILLEGAL PER SE

By departing, in part, from the rule-of-reason approach used in *White Motor*, the Court in *Schwinn* announced a new set of rules for determining the legality of vertically imposed *customer* restrictions. By dicta, the Court made it clear that its new rules would also apply to vertically imposed *territorial* limitations. Because *Schwinn* announces new rules in an important area of antitrust law, the opinion warrants extensive examination.²³

A. Support in Prior Law

In *Schwinn*, the Court relied on the rule against restraints on alienation to declare vertically imposed customer and territorial restrictions illegal per se outside of an agency context. The rule against restraints on alienation prohibits a vendor from attaching a condition of sale which interferes with the purchaser's freedom to resell the property.²⁴ The rule is derived from the early common law, but it has retained considerable vitality today as a rule of property law.²⁵ The Court applied the rule to avoid creating a logical

²² Schwinn announced soon after the decision that it would eventually integrate to assume its own distribution function. Keck, *The Schwinn Case*, 23 Bus. Law. 669, 686 (1968). Between the start of the *Schwinn* litigation and the argument before the Supreme Court, Schwinn took over 30% of its wholesaling by vertical integration. 388 U.S. at 387 n.9 (dissenting opinion). It would appear that the dissent's fear that *Schwinn* would force vertical integration was well founded.

²³ *Schwinn's* per se rule is properly limited to vertical customer limitations. But the Court makes it quite clear that its rationale also extends to vertical territorial limitations on purchasers. See 388 U.S. at 371 & n.4. It is also arguable that other kinds of vertical restrictions such as profit passovers, areas of prime responsibility and exclusive territories fall within the broad rationale of the Court. See Address by Edwin M. Zimmerman, First Assistant, Antitrust Div., U.S. Dep't of Justice, 1967 Federal Bar Ass'n, Annual Convention, in San Francisco, California, July 28, 1967:

[C]ontractual terms such as area of prime responsibility clauses, profit passovers, location clauses and the like, even though not formulated as "restraints" upon resale, will suffer the fate of Schwinn restrictions if in operation they effectively serve to bar interterritorial sales or to prevent sales to specified classes of customers.

But see *Albrecht v. Herald Co.*, 36 U.S.L.W. 4171, 4174 (U.S. March 5, 1968), where Justice Douglas, in his concurring opinion, indicated that territorial restrictions will be treated under the rule of reason.

²⁴ See *Adams v. Burke*, 84 U.S. (17 Wall.) 453 (1873); 2 Coke, Institutes § 360 (1812).

²⁵ See, e.g., *McFadden v. McFadden*, 302 Ill. 504, 135 N.E. 31 (1922) where the court invalidated a restraint on real property forbidding voluntary inter vivos alienation for twenty years; *Bowen v. Campbell*, 344 Mass. 24, 181 N.E.2d 342 (1962) where the court stated that a restraint on alienation will fail if it extends beyond the period of the rule against perpetuities. See also Note, Section 202 of the Delaware Corporation Law—Per Se Rules for Stock Transfer Restrictions, 9 B.C. Ind. & Com. L. Rev. 405, 407-08

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inconsistency with its interpretation of the lower court's holding. The Court reasoned that since the lower court had found Schwinn's territorial restrictions to be illegal per se when imposed on customers, and since customer restrictions interfered with a purchaser's freedom to resell his property to the same degree, Schwinn's customer limitations were also illegal per se.²⁶ The Court failed to notice, or chose to ignore, that the district court had not based its holding on the rule against restraints on alienation. In fact, the lower court never mentioned that doctrine. It found territorial limitations to be illegal because they were horizontal divisions of markets, a restraint which has been declared illegal per se, but not because of the rule against restraints on alienation.²⁷

It is apparent that the logical inconsistency upon which the Court sought to avoid was nonexistent, and if the opinion is to be supported, other grounds must be sought. Two possible bases for support of *Schwinn's* per se rule exist in prior law: the rule against restraints on alienation as an anti-trust doctrine or an analogy to the per se rule which has been applied to horizontally imposed restraints, which are similar to the vertically imposed restraints in *Schwinn*.

In order to understand the validity and ramifications of a rationale for a per se rule based on the rule against restraints on alienation, it is necessary to examine the common law prohibition. Even at common law, the rule against restraints on alienation was not absolute.²⁸ The doctrine of ancillary restraints developed to correct injustice which resulted from vigorous application of the rule. The common law doctrine of ancillary restraint allowed a reasonable restraint on alienation if the restraint was necessary to accomplish some legitimate purpose. It was applied in a limited class of cases usually involving purchase and sale of goodwill interest.²⁹

Early in the development of antitrust law, the courts recognized that the Sherman Act's prohibition of restraints of trade also prohibited restraints

(1968), for a discussion of the relevance of restraints on alienation to the legality of stock transfer restrictions.

²⁶ 388 U.S. at 377-78.

²⁷ See *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951). In this leading case the Court did not rely on restraints against alienation to declare horizontal divisions of markets to be illegal per se. The Court stated that the restraint was illegal because the only purpose of the restraint was to eliminate competition between the conspirators.

²⁸ See Handler, *The Twentieth Annual Antitrust Review—1967*, 53 Va. L. Rev. 1667, 1684-85 (1967); Restatement of Contracts §§ 513, 514, 515(d), 516 (1932).

²⁹ The following are examples of situations where the common law doctrine of ancillary restraints permitted a restraint on alienation:

- (1) A seller could restrain a buyer from competing in derogation of the property sold.
- (2) A retiring partner could be restrained from competing with the partnership.
- (3) A person about to enter a partnership could be restrained from competing with the firm.
- (4) A buyer of property could be restrained from competing with the business retained by a seller.
- (5) An agent or servant could be restrained from competing with his principal or master.

See *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 281 (6th Cir. 1898), aff'd, 175 U.S. 211 (1899). See also Restatement of Contracts § 516 (1932).

on alienation. Likewise, the doctrine of ancillary restraints was held to be part of the antitrust law in *Addyston Pipe & Steel Co. v. United States*.³⁰ The doctrine was called the rule of reason in its antitrust application.³¹ Further development broadened the doctrine well beyond the common law limitation to cases involving protection of goodwill. In *United States v. Columbia Pictures Corp.*,³² the court described the modern scope of the doctrine:

Where challenged conduct is subservient or ancillary to a transaction which is itself legitimate [for example distribution of one's products] . . . the doctrine of ancillary restraints is to be applied. It permits, as reasonable, a restraint which (1) is reasonably necessary to the legitimate primary purpose of the arrangement, and of no broader scope than reasonably necessary; (2) does not unreasonably affect competition in the market place; and (3) is not imposed by a party or parties with monopoly power.³³

A distaste for restraints upon alienation still inheres in the antitrust law. In *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,³⁴ a case relied on by the Court in *Schwinn*, the Supreme Court held that resale price maintenance³⁵ effectuated through restraints on alienation was illegal per se. That case, however, does not compel the result reached in *Schwinn*. Even in *Dr. Miles*, the Court recognized that the presence of a restraint on alienation was only the beginning of the required analysis:

The rule laid down [in the common law] is no longer regarded as inflexible, and has been considerably modified. Public welfare is first considered, and if it not be involved, and the restraint upon one party is not greater than protection to the other party requires, the contract may be sustained.³⁶

The last case to consider the rule against restraints on alienation before *Schwinn* is *White Motor Co. v. United States*,³⁷ the case relied upon by the district court in *Schwinn*. There, the Court recognized that the vertically imposed customer and territorial limitations before it resulted in a restraint on alienation, but it refused to hold them per se illegal and instead remanded

³⁰ 85 F. 271 (6th Cir. 1898), aff'd, 175 U.S. 211 (1899).

³¹ An early view of the kinds of conduct prohibited by the Sherman Act was that the Act only restated the common law prohibition of restraints on trade. H. Thorelli, *The Federal Antitrust Policy* 222 (1954). This view gained credence from the similarity between *Addyston Pipe's* statements on conduct prohibited by the Sherman Act and the common law prohibition of restraints on trade. Compare *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), aff'd, 175 U.S. 211 (1899) with *Restatement of Contracts* §§ 513-16 (1932).

³² 189 F. Supp. 153 (S.D.N.Y. 1960).

³³ *Id.* at 178.

³⁴ 220 U.S. 373 (1911).

³⁵ Resale price maintenance occurs when the manufacturer requires its dealers not to resell below a specified price. It is a form of vertical price fixing. Horizontal price fixing was among the earliest restraints to be declared illegal per se. See *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927).

³⁶ 220 U.S. at 406.

³⁷ 372 U.S. 253 (1963).

the case so that the district court could consider the reasonableness of the restraint involved. In his concurring opinion, Justice Brennan stated:

[A] restraint on alienation . . . is . . . historically and inherently suspect under the antitrust laws. That proposition does not, however, tell us that every form of such restraint is utterly without justification and is therefore to be deemed unlawful *per se*.³⁸

Apparently the Court has changed its position.

Although courts traditionally tested the legality of vertically imposed territorial and customer limitations under the rule of reason, equivalent restrictions have been declared illegal *per se* where they have been imposed horizontally. Market divisions between competitors (horizontally imposed territorial restrictions) and group boycotts by competitors (horizontally imposed customer restrictions) have both been held to be *per se* violations of the Sherman Act.³⁹ The illegality of these horizontal restraints suggests that the same rule may be appropriate in vertical cases since once the restraint is established, it would appear to be irrelevant from what source it originated. While *Schwinn* did not follow *White Motor* with respect to *White Motor's* suggested rule-of-reason approach, *Schwinn* did find in *White Motor* a distinction between horizontal and vertical restraints of a similar nature. Although later cases have made the distinction between horizontal and vertical restrictions less clear,⁴⁰ it is submitted that the Court was correct in *Schwinn* in using such a distinction.

The difference between vertical and horizontal restraints may be illustrated by comparing *Schwinn* with *United States v. General Motors*.⁴¹ Both cases presented customer limitations. In *Schwinn*, the manufacturer attempted to limit middlemen to supplying only those outlets it approved. In *General Motors*, the manufacturer and its franchised dealers combined to prevent discount houses from selling the manufacturer's products and the Court held that this combination was illegal. In both cases, the manufacturer and its dealers agreed to the restriction. The Court in *Schwinn*, however, distinguished *General Motors* as a case involving horizontal restraints. The key difference between the cases was the party who *initiated* the restraint. In *Schwinn*, the manufacturer unilaterally initiated the restraint and imposed it on its dealers. In contrast, the restraint in *General Motors* was initiated by competing dealers who were attempting to deprive discount houses of

³⁸ *Id.* at 265. See also *Boston Store v. American Graphophone Co.*, 246 U.S. 8, 27-28 (1918) (Brandeis, J., concurring); *Baker, Agency and Consignment Selling*, 9 Antitrust Bull. 299 (1964); *Pollock, Franchising, Customer Restrictions, and Building a Better Mousetrap*, 10 Antitrust Bull. 381 (1965). Professor Chaffee has suggested that the developing doctrine of equitable servitudes on chattels can be applied to uphold such restrictions if the restraint in the particular case does not otherwise conflict with public policy. Chaffee, *The Music Goes Round and Round: Equitable Servitudes and Chattels*, 69 Harv. L. Rev. 1250 (1956); Chaffee, *supra* note 1.

³⁹ *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951) (horizontal territorial restrictions); *Fashion Originators' Guild of America, Inc. v. FTC*, 312 U.S. 457 (1941) (horizontal customer restrictions).

⁴⁰ See *United States v. General Motors Corp.*, 384 U.S. 127 (1966).

⁴¹ *Id.*

General Motors automobiles.⁴² The dealers supplied the impetus for the restraint and brought the manufacturer into the conspiracy to enforce the agreement.

Because the dealers rather than the manufacturer initiated the restraint in *General Motors*, that case does not determine the legality of the restrictions in *Schwinn*, even though *Schwinn* presents an otherwise very similar limitation. Horizontal cases are distinguishable from vertical cases because the rationale of the per se rules for horizontal restraints depends on the fact that the parties initiating the restraint are in competition with each other.⁴³ Because the party initiating a vertical restraint is not in competition with the restrained parties, the reason horizontal restraints are per se illegal have no applicability to vertical restraints.

A rule of per se illegality for horizontal territorial and customer limitations developed in the following way: The courts discovered from experience with several cases that, except in very rare circumstances, the ultimate purpose of the parties initiating the restraint was to bring about a result which was contrary to antitrust policy. They discovered that horizontal divisions of markets and group boycotts were agreements whose ultimate purpose was to lessen the competition of others on the same level of distribution as those agreeing to the restraint.⁴⁴ The restraints were found to have an anticompetitive impact on markets because they stifled competition either by depriving competitors of the goods they require to compete or by eliminating competition among the parties agreeing to the restraint. Furthermore, the courts found from experience that the intended purpose was achieved in a substantial number of cases.⁴⁵ Rather than make the elaborate inquiry which would be required to isolate the few cases where the restriction had a

⁴² Many of General Motors' dealers in the Los Angeles area became concerned with the large number of automobiles being sold through discount houses. The source of supply for the discount houses was a few General Motors dealers in the area. The dealers initiated a policy of forbidding all dealers from selling to discount houses. These dealers enlisted General Motors' aid to force these agreements on recalcitrant dealers and to help enforce the agreements.

⁴³ See Turner, *The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 Harv. L. Rev. 655, 697-99 (1962) (the author stated that while the fact that the manufacturer has an interest in competition between its dealers is insufficient to justify vertical price fixing, it may be sufficient to distinguish vertical customer and territorial restraints from similar horizontal restrictions); Stone, *Closed Territorial Distribution: An Opening Question in the Sherman Act*, 30 U. Chi. L. Rev. 286 (1963); Note, *supra* note 2, at 800-01. See also Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 Yale L.J. 373 (1966) (the author states that all vertical restraints should be legal because they are introduced for the manufacturer's benefit). But see Preston, *supra* note 1, at 510.

⁴⁴ See *Fashion Originators' Guild of America, Inc. v. FTC*, 312 U.S. 457, 467-68 (1941); *United States v. Timken Roller Bearing Co.*, 83 F. Supp. 284, 307, 310 (N.D. Ohio 1949), *aff'd*, 341 U.S. 593 (1951). See also *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963); *Ethyl Gasoline Corp. v. United States*, 309 U.S. 436, 458 (1940); *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 408 (1911).

⁴⁵ As stated in *Board of Trade v. United States*, 246 U.S. 231, 238 (1918): "knowledge of intent may help the Court to interpret facts and to predict consequences." In *United States v. Timken Roller Bearing Co.*, 83 F. Supp. 284, 307 (N.D. Ohio 1949), *aff'd*, 341 U.S. 593 (1951), the court was able to see an actual reduction in competition from the imposition of the restraint.

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purpose or effect other than reduction of competition, the courts declared all horizontal divisions of markets and group boycotts to be per se violations of the Sherman Act.

In contrast, the ultimate purpose of the party initiating a vertical territorial or customer limitation may not be to lessen competition. For example, a manufacturer may impose customer limitations to prevent incompetent dealers from distributing its product. The manufacturer in such a case intends to reduce competition only in the sense that it realizes that there will be fewer dealers competing with its competent dealers.⁴⁶ Its ultimate purpose, to insure proper handling of its product as it is distributed, is not necessarily inconsistent with antitrust policy.⁴⁷

The purpose of the parties initiating the restraint is not, however, the only consideration. Ultimately, the legality of either a horizontal or vertical restraint must turn on its potential effects.⁴⁸ In theory, perhaps, the effects of either horizontal or vertical restraints would seem to be the same. Likewise, once the vertical restraint is established, its operation and therefore its effect would be identical with a similar horizontal restraint even though the restraints were originated differently. Since the interests of the parties initiating vertical restrictions differ from the interests of the parties initiating horizontal restrictions, however, it is doubtful that the theoretical identity of effect would in fact result.⁴⁹

The very reason why dealers would initiate horizontal restraints—to reduce dealer competition—may be antithetical to a manufacturer's interest.⁵⁰ In general, a manufacturer wants to foster competition among its dealers because it benefits from the lower prices, higher volume and better service such competition may inspire.⁵¹ The manufacturer, therefore, would not be expected to impose customer and territorial restrictions on its dealers unless the reduction in competition were only incidental to some other effect. Thus, the situations in which the manufacturer imposes customer and territorial restrictions may differ greatly from those which the courts have examined in determining the legality of horizontal restrictions. Since horizontal and vertical restraints are likely to be imposed in different situations, there can be no assurance that their effects will be identical.⁵² Furthermore, even if

⁴⁶ A reduction in the number of retail outlets necessarily results in fewer competing units at that level, and in that sense, less competition. To this extent a manufacturer intends to reduce competition since the necessary consequences of an act are presumed to have been intended. See *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211, 234 (1899).

⁴⁷ See *Jordan*, supra note 1, at 154; *Stone*, supra note 43, at 300-01.

⁴⁸ *Board of Trade v. United States*, 246 U.S. 231, 238 (1918). But see *United States v. American Tobacco Co.*, 221 U.S. 106, 182 (1911); *United States v. Timken Roller Bearing Co.*, 83 F. Supp. 284, 307 (N.D. Ohio 1949), *aff'd*, 341 U.S. 593 (1951).

⁴⁹ *Stone*, supra note 42, at 299-300.

⁵⁰ *Id.* at 301; *Jordan*, supra note 1, at 114.

⁵¹ *Stone*, supra note 43, at 301; *Note*, supra note 2, at 800.

⁵² *Jordan*, supra note 1, at 153. See also *Packard Motor Car Co. v. Webster Motor Car Co.*, 243 F.2d 418 (D.C. Cir.), *cert. denied*, 355 U.S. 822 (1957); *Schwing Motor Co. v. Hudson Sales Corp.*, 138 F.2d Supp. 899 (D. Md.), *aff'd per curiam*, 239 F.2d 176 (4th Cir. 1956), *cert. denied*, 355 U.S. 823 (1957). But see *Ford Motor Co. v. Webster's Auto Sales, Inc.*, 361 F.2d 874 (1st Cir. 1966); *Preston*, supra note 1, at 510.

a serious reduction in competition between dealers were to result from a vertical restriction, there can be no assurance that the manufacturer would continue to enforce it.

It is apparent that prior law did not compel *Schwinn's* per se rule. In fact, prior law indicates that the Court should have used a rule-of-reason approach. *Schwinn*, therefore, establishes a new per se violation of the Sherman Act; one based on an estimation of the antitrust significance of a violation of the ancient rule against restraints on alienation.

It is unfortunate that the Court did not present an economic analysis to justify the result it reached or examine *Schwinn's* restraints in light of antitrust policy. The importance of the rule against restraints on alienation to modern antitrust policy was never examined, although it would seem critical to the validity of the Court's position. If other economic or policy considerations influenced the Court, they were not discussed in the opinion. For purposes of this comment it is necessary to determine the policy implications of territorial and customer restrictions aside from their violation of the rule against restraints on alienation to see if the Court's per se rule can be justified on any grounds.

B. Support in Sherman Act Policy

The courts have not yet provided a definitive statement on the broad objective of the Sherman Act. It is clear, however, that "free competition" is a major concern if not the ultimate objective of Sherman Act policy.⁵³ Trade practices such as customer and territorial restraints do interfere with complete freedom of competition, but such an effect need not make them illegal per se. If a compelling business or social need for such restraints can be demonstrated to exist in more than a few circumstances, it is appropriate to treat them under the rule of reason.⁵⁴ To determine which rule to apply it is therefore necessary to examine the precise anticompetitive effect of these restraints and balance this effect with their possible justifications.

1. *Closed Territories*.—There are three common types of territorialization devices: closed territories, profit passovers, and areas of prime responsibility. Closed territories result when a manufacturer assigns only one dealer to an area and confines the dealer's sales to that area. A profit passover requires a dealer who sells outside of its territory to "pass over" or share profit on the sale with the dealer serving the invaded territory. The third, the area of prime responsibility, allows a dealer to sell in any territory, but requires that it meet a certain sales quota in its own territory. Profit passovers and areas of prime responsibility inhibit sales outside of a dealer's territory, but unlike

⁵³ "The very aim of all the anti-trust laws is to ban conduct and practices which destroy free and unhampered competition." *United States v. Timken Roller Bearing Co.*, 83 F. Supp. 284, 307 (N.D. Ohio), aff'd, 341 U.S. 593 (1951). See also *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211, 237 (1899); *United States v. E.C. Knight Co.*, 156 U.S. 1, 16 (1895).

⁵⁴ See *Board of Trade v. United States*, 246 U.S. 231, 238 (1918); *Standard Oil Co. v. United States*, 221 U.S. 1, 63-68 (1911).

closed territories, do not eliminate such sales.⁵⁵ Schwinn chose to use closed territories, the most restrictive territorialization device.

A manufacturer may wish to impose closed territories on its dealers for a number of reasons. It may impose them because it realizes that in order to obtain desired dealers it must offer the dealers a degree of freedom from competition.⁵⁶ The manufacturer may also wish to impose closed territories to satisfy its own primary rather than derivative self interest. It may wish to free its dealers from competition in its brand in order to increase their ability to compete against rival brands. Often, a closed territory results from a combination of such considerations.⁵⁷ A distributor may insist on being the manufacturer's exclusive dealer in an area. In turn, the manufacturer may acquiesce only if the dealer agrees to confine its sales to that area. The dealer then receives the desired protection from competition and the manufacturer receives a measure of assurance that the territory will be covered adequately.

Closed territories produce a definite anticompetitive effect; they completely eliminate competition between dealers in the manufacturer's product.⁵⁸ The public must rely on competition between the manufacturer's dealers and the dealers of rival manufacturers and is thereby deprived of the benefits which might have been derived from competition among the manufacturer's dealers.⁵⁹ Because this effect is obviously contrary to Sherman Act policy, only convincing justification will exclude closed territories from the proper scope of a *per se* rule.

Three general kinds of justifications have been advanced: (1) increased efficiency in distribution;⁶⁰ (2) increased market coverage for the manufacturer's brand;⁶¹ (3) increased competition between the manufacturer's brand and the brands of rival manufacturers.⁶²

Several efficiencies may result from closed territories because, by reducing competition between dealers, a manufacturer is able to develop a more orderly distribution system. If territories are properly allocated, all distributors will be assured of an area with a sufficient sales potential. By guaranteeing sales in that market to the dealer, fewer dealers will fail, and the manufacturer is relieved of the burden of constantly acquiring dealers to replace those who have failed. In addition, administration of an orderly and stable distribution system is less costly.⁶³ For example, a manufacturer can more

⁵⁵ For general background on the use of these kinds of restraints see Note, *Restricted Channels of Distribution Under the Sherman Act*, 75 Harv. L. Rev. 795, 814-17 (1962).

⁵⁶ Stone, *supra* note 43, at 301; Note, *supra* note 55, at 809-10.

⁵⁷ Note, *supra* note 55, at 809.

⁵⁸ See *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 400 (1911).

⁵⁹ *Id.* at 409.

⁶⁰ See Bork, *supra* note 43, at 375, 391; Note, *supra* note 55, at 813.

⁶¹ See Preston, *Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards*, 30 Law & Contemp. Prob., 506, 511 (1965); Stone, *supra* note 43, at 310; Note, *supra* note 55, at 812-13.

⁶² See Baker, *supra* note 38, at 302-03; Stone, *supra* note 43, at 311; Note, *supra* note 55, at 800.

⁶³ Note, *supra* note 55, at 813.

easily plan future production since a dealer's estimates of sales are more likely to be accurate.

It is questionable, however, that the cost and planning efficiencies which result from closed territories are valid antitrust defenses. Sherman Act policy favoring free competition is due in part to the influence of competitive pressures on businessmen, forcing them to keep abreast of innovations in technology and improvements in marketing practices. It is these long-run efficiencies which are fostered by the Sherman Act.⁶⁴ Justifying closed territories on the basis of short-run cost savings at the expense of those long-run goals would not seem consistent with the policy of the Sherman Act.⁶⁵

The second justification for closed territories is that they result in increased market coverage. Since a dealer subject to closed territories may increase sales only by more fully cultivating its own territory, it will devote more attention to marginal accounts in that territory which might otherwise have been ignored. Since high profit accounts in the territory are guaranteed to the dealer, sufficient funds should be available to finance this promotion.⁶⁶ Some manufacturers must offer the protection of closed territories in order to attract dealers to handle their products.⁶⁷

This justification is not convincing, however, because less restrictive practices which produce substantially the same result are available.⁶⁸ Some elimination of market coverage by restraining dealers can be achieved through use of profit passovers or areas of prime responsibility.⁶⁹ These restrictions are more easily justified because they produce effects that are less anti-competitive. Also, the manufacturer may further stimulate market coverage through advertising or by personally covering marginal accounts.

The alternative methods of stimulating market coverage are not entirely satisfactory from the manufacturer's point of view. For example, it is difficult to establish a challenging sales quota in an area-of-prime-responsibility agreement.⁷⁰ Requiring a manufacturer to stimulate market coverage by advertising requires the manufacturer to increase its own promotional expenses. Nor are the alternatives as effective in stimulating market coverage as closed territories.

On balance, however, the fact that substantially less restrictive alternatives are available reflects unfavorably on the justification that closed ter-

⁶⁴ Attorney Gen.'s Nat'l Comm. to Study the Antitrust Laws, Report 317-18 (1955).

⁶⁵ See *White Motor Co. v. United States*, 372 U.S. 253, 278 (1963) (dissenting opinion).

⁶⁶ See Note, *supra* note 55, at 811.

⁶⁷ *Id.* at 809; Preston, *supra* note 61, at 511.

⁶⁸ The holding in *Schwinn* may also make some of these alternatives illegal. See note 23 *supra*. For purposes of testing the soundness of the *Schwinn* decision, however, it will be assumed that the alternatives are not illegal and that a manufacturer is free to employ them.

⁶⁹ Note, *supra* note 55, at 815-16 (1965). See Decision on Grundig-Consten Agreement, 1 CCH Comm. Mkt. Rep. ¶ 2743, at 1866 (1964). But see Stone, *supra* note 43 at 303.

⁷⁰ If quotas are set too low, they will not have the desired effect of forcing dealers to pursue low profit accounts. On the other hand, if quotas are set impossibly high, even aggressive dealers will fail to meet them. Reliable market data to establish a reasonable sales quota can be acquired only at great expense, if at all.

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ritories increase market coverage. Although using alternatives may impose some hardships on the manufacturer, these hardships are not substantial when compared to the elimination of competition between dealers which generally results from closed territories.

This justification may have validity in exceptional circumstances; for example, where the manufacturer is failing or just entering the market.⁷¹ Policy would seem to favor allowing the manufacturer an opportunity to establish its new product or to reestablish itself as a viable competitor. These policy objectives are strong enough to allow use of restrictive practices like closed territories if they are necessary to make this opportunity available.⁷²

In some situations use of closed territories would often be necessary for the failing or entering manufacturer since it would be unable to acquire dealers without offering closed territories. A dealer takes a substantial risk when it distributes the product of a failing or entering firm because such products usually have an untested market appeal or have an unfavorable reputation.⁷³ In order to make distribution risks more manageable for the dealer, the manufacturer may be required to eliminate completely intrabrand competition. Of course, many situations may present some unusual risks to the dealer, but except for failing and entering firms, less protection is needed and less restrictive practices are a satisfactory solution.

Even for failing or entering firms, however, it is unlikely that long term use of closed territories should be allowed. The justification is convincing to the extent it allows the manufacturer to become a viable competitor, but loses force if the manufacturer demonstrates a continuing need for artificial props to remain in business.⁷⁴

The third justification for closed territories is that they increase interbrand competition; that is, competition between the manufacturer's dealers and dealers of rival brands, to a sufficient degree to outweigh the loss of intrabrand competition, competition between the manufacturer's dealers. In essence this justification asserts that in appropriate circumstances, closed territories may actually stimulate rather than depress competition.

Although this justification is difficult to rebut on theoretical grounds it has practical shortcomings. It is very difficult to isolate the effects of the restriction on interbrand competition or to determine when interbrand competition has increased sufficiently to counter any decrease in intrabrand competition.

In some cases that may arise, any increase in interbrand competition would be insufficient to compensate for the total elimination of intrabrand

⁷¹ Stone, *supra* note 43, at 316.

⁷² Justice Brennan, in *White Motor*, intimated that this argument may be relevant in cases where the manufacturer is small in comparison with its competitors, and is experiencing a decline in market share at the time that the restrictions are imposed. *White Motor Co. v. United States*, 372 U.S. 253, 269 & n.8 (1963). See also Stone, *supra* note 43, at 311-12.

⁷³ See *Albrecht v. Herald Co.* 36 U.S.L.W. 4171, 4175 (U.S. March 5, 1968) (Harlan, J., dissenting); Stone, *supra* note 43, at 316-17.

⁷⁴ See *Snap-On Tools Corp. v. FTC*, 321 F.2d 825, 831-32 (7th Cir. 1963); *Baker*, *supra* note 38, at 302-03.

competition which results from closed territories. For example, if the manufacturer originating the restraint holds a very large market share, intrabrand competition is too large a share of total competition in the market to be safely sacrificed. Also, where the manufacturer is selling a product that is differentiated from its competitors' products in the mind of the consumer because of its brand name, intrabrand competition is too important to be sacrificed. Such differentiated brands enjoy a degree of insulation from interbrand competition. If dealers of differentiated products are also relieved of intrabrand competition, the product's isolation from competition becomes even more complete and the abuses of monopoly become a greater threat.⁷⁵

In other situations, it would be possible to show that a reduction in intrabrand competition was justified by a corresponding increase in interbrand competition. Failing and entering firms which cannot obtain dealers without reducing intrabrand competition present clear examples. If a firm is excluded from the market place, there can be no dealers to engage in intrabrand competition in its product.⁷⁶ If the manufacturer is allowed to enter the market by imposing closed territories, intrabrand competition would still be eliminated, but the product would then be in competition with other brands. An increase in total competition would be the net effect of the restraint in such a case. The net effect of the territorial limitation would, therefore, be procompetitive.⁷⁷

Of course, this justification would be subject to the same limitations discussed above. The manufacturer could not use closed territories if less restrictive practices would allow the manufacturer to attract or retain dealers.⁷⁸ In any event, indefinite use of the restraint would not be consistent with Sherman Act policy.⁷⁹

Except for failing and entering firms, most manufacturers will be unable to show that closed territories result in an increase in interbrand competition that outweighs the elimination of intrabrand competition which the restraint produces.⁸⁰ A court can base its rules only on the effects which it can clearly determine. With closed territories, that effect is reduction of intrabrand competition, an effect inimicable to Sherman Act policy. A per se rule except for failing and entering firms may prevent use of closed territories in some cases where their effect is not anticompetitive, but it would be extremely difficult for a court to isolate those cases even under a detailed rule-of-reason examination. A per se rule has the advantage of being workable and predictable.⁸¹

2. *Outlet Limitations.*—Outlet limitations result when a manufacturer's

⁷⁵ See Note, *supra* note 55, at 832-33.

⁷⁶ *Sandura Co. v. FTC*, 339 F.2d 847, 857 (6th Cir. 1964).

⁷⁷ This was the court's conclusion in *id.* at 857, 861.

⁷⁸ *Id.* at 856.

⁷⁹ Stone, *supra* note 43, at 312-13.

⁸⁰ Admitting limited exceptions to the scope of a per se rule does not do violence to the traditional concept of a per se rule. See, e.g., *Appalachian Coals, Inc. v. United States*, 288 U.S. 344 (1933), where price fixing was allowed in a failing industry, and *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961), where the court implied that an exception to a per se rule for tying could be made for an entering firm.

⁸¹ See Bork, *supra* note 43, at 386-87.

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wholesalers and and retailers agree to sell only to outlets approved by the manufacturer. Schwinn imposed this type of customer limitation on its dealers. A manufacturer desires to impose such a restraint in order to confine distribution to those dealers who meet the manufacturer's specifications. Unlike closed territories, outlet limitations need not completely eliminate competition between dealers in the manufacturer's product.⁸² They do have some anti-competitive effects, however, since their use may reduce the number of competitors in the market and thereby reduce competition.⁸³

Use of outlet limitations has been justified on several grounds: (1) that they increase efficiency of distribution;⁸⁴ (2) that they help maintain the product's reputation by excluding price cutters from the distribution chain;⁸⁵ (3) that they allow a manufacturer to exclude unskilled distributors in order to avoid tort liability and maintain the reputation of its product.⁸⁶ These justifications will be evaluated in order.

Reduction of the number of outlets may result in savings of promotional, supervisory and administrative expenses because the manufacturer and its wholesalers have fewer retailers with which to deal. Yet, arguments based on cost savings are not convincing if a significant reduction of competition is necessary to effect cost savings, since reductions in competition relieve manufacturers and dealers of the pressures which promote long-run efficiency. This result has been found to be contrary to Sherman Act policy.

The second justification advanced is that exclusion of price cutters from a product's distribution system may enhance that product's reputation.⁸⁷ This is one of the bases of support for fair trade laws which allow manufacturers to set retail prices of their products in some circumstances.⁸⁸ Outside the fair trade area, however, any intentional tampering with price competition is contrary to antitrust policy in spite of any indirect benefit to the manufacturer's goodwill.⁸⁹ Because the price mechanism is so central to competition, even an indirect interference with it cannot be tolerated.⁹⁰

⁸² In *White Motor Co. v. United States*, 372 U.S. 253 (1963), customer restrictions that eliminated all intrabrand competition were used. Justice Brennan, in his concurring opinion, stated that these customer limitations were inherently more dangerous than closed territories. *Id.* at 272. Justice Brennan's conclusion would not be applicable if intrabrand competition were not eliminated.

⁸³ See Note, Supreme Court—1966 Term, 81 Harv. L. Rev. 112, 238 (1967). In this respect it should be noted that outlet limitations are generally used only by manufacturers of relatively expensive goods. Before purchasing such goods, a consumer is likely to investigate several brands and visit several stores if necessary. Therefore, an outlet limitation will not necessarily limit the number of competitive alternatives available to the consumer so long as an outlet for the brand is available within a reasonable distance.

⁸⁴ See Note, *supra* note 55, at 821-22, 823.

⁸⁵ See Chaffee, *Equitable Servitudes on Chattels*, 41 Harv. L. Rev. 945, 988 (1928); Note, *supra* note 55, at 819-20.

⁸⁶ See Chaffee, *supra* note 85, at 947; Note, 56 Cal. L. Rev. 198, 206-07 (1968); Note, *supra* note 55, at 819-20.

⁸⁷ Chaffee, *supra* note 85, at 988.

⁸⁸ See generally 1 L. Schwartz, *Free Enterprise and Economic Organization* 549-85 (3d ed. 1966).

⁸⁹ *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707, 721 (1944). In *FTC v. Beech-Nut Packing Co.*, 257 U.S. 441 (1922), the Court declared illegal a system of outlet limitations based on excluding price cutters.

⁹⁰ The protection of price competition from conspiratorial restraint is an

A system of outlet limitations based on exclusion of inept dealers is more easily justified. A manufacturer retains an important goodwill interest in its goods as they are distributed:

[T]he manufacturer by his advertising and other commercial devices has brought the consumers into a direct relation with himself. He is trying to make them buy *his* product. . . . Legally, it ceases to be owned by him some time before it reaches them, for he is separated from them by a succession of sales through wholesalers and retailers. These intervening passages of title have their importance for some purposes. . . . But for the purpose of maintaining the reputation of his product, the existence of these intermediaries has very little significance.⁹¹

Most consumers either do not or cannot determine whether defects in products are due to faulty manufacturing or faulty assembly and servicing by dealers. Defects from either of these sources will normally be attributed to the manufacturer and the product.⁹² Furthermore, a manufacturer may be held liable in tort for defects which could be avoided if only skilled distributors handled the product.⁹³

Goodwill and avoidance of tort liability may be of critical importance to the manufacturer of complicated or dangerous products. Furthermore, both of these interests are shared by the public. The public benefits if existing firms are able to achieve long run success and maintain their positions as viable competitors. Irrespective of any anticompetitive impact of outlet limitations, their effect of reducing potential sources of personal injury is in the public interest.⁹⁴

Outlet limitations need not have an unnecessarily large anticompetitive impact. A manufacturer can adequately protect its interests without excluding any qualified dealers. In addition, the number of dealers excluded by the limitation could be reduced if the manufacturer were to make training courses

object of special solicitude under the antitrust laws. We cannot respect that solicitude by closing our eyes to the effect upon price competition of the removal from the market, . . . of a class of traders.

United States v. General Motors Corp., 384 U.S. 127, 148 (1966).

⁹¹ Chaffee, *supra* note 85, at 947. See also Note, *supra* note 55, at 819, 830.

⁹² See United States v. Jerrold Electronics Corp., 187 F. Supp. 545, 556-57 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961).

⁹³ See Comstock v. General Motors Corp., 338 Mich. 163, 99 N.W.2d 627 (1959); McLaughlin v. Mine Safety Appliances Co., 11 N.Y.2d 62, 181 N.E.2d 430, 226 N.Y.S.2d 407 (1962); Ford Motor Co. v. Wagoner, 183 Tenn. 392, 192 S.W. 840 (1946); Note, *supra* note 86, at 206-07.

⁹⁴ See United States v. Bausch & Lomb Optical Co., 321 U.S. 707, 728-29 (1944). But see Ethyl Gasoline Corp. v. United States, 309 U.S. 436, 459-60 (1940), in which the Court rejected a justification for customer limitations based on the dangerous nature of the product. The Court felt that this protection was a matter which should be left to the self interest of the distributor. The Court feared that it would be unwise to allow the manufacturer to employ customer restrictions for this purpose because such restrictive trade practices could also be used for "other and illicit purposes."

available to dealers desiring to acquire the requisite skills to distribute the product properly.⁹⁵

An alternative means of protection is available to the manufacturer which would enable it to avoid use of outlet limitations. The manufacturer could establish its own service centers and thereby gain control over servicing of its product. To the extent that this course of action would protect the manufacturer's legitimate interests, the feasibility of establishing such facilities should be a factor in determining its need to utilize customer limitations.⁹⁶

For all manufacturers, however, service centers do not provide a suitable solution. They do not solve any difficulties which may arise from improper assembly by dealers or insure that dealers will properly adapt the product to the customer's requirements. Also, service is a local affair and a huge investment would be required by any manufacturer servicing a national market. Requiring such an investment has the effect of raising entrance barriers in an industry, an effect which is antithetical to antitrust goals.⁹⁷

On balance then, it would appear that *Schwinn's* per se rule is inappropriate for outlet limitations. It makes illegal the only practical methods by which some manufacturers can protect their goodwill and protect consumers from injury from their products. A better alternative, application of the rule of reason, would allow courts to strike a proper balance between reduction of competition inherent in a system of outlet limitations and the need of a manufacturer to protect its legitimate interests.

C. Closed Territories, Outlet Limitations, and Schwinn

The territorial and customer limitations used by Schwinn are now illegal when imposed on purchasers. Although the reasoning the Supreme Court used to reach this conclusion does not appear correct, the result is sound since Schwinn could not present particularly compelling justifications for its outlet limitations.

Schwinn was neither a failing nor entering firm. As a result, it was not able to show a convincing need for its territorial restrictions. In fact, Schwinn's closed territories are an example of those for which a per se rule is most clearly appropriate. Schwinn had a relatively large market share—it was the largest domestic producer at the time it initiated the restraints.⁹⁸ In addition, Schwinn's product was differentiated from other brands as demonstrated by the fact that Schwinn was able to prosper while charging a premium price even though its bicycles were interchangeable with other brands. Because of its large market share and differentiated product, Schwinn was in a weak position to urge that its territorial restrictions were legal.

Schwinn was scarcely in a better position to argue for the legality of

⁹⁵ See Address by Mary Gardiner Jones, Commissioner, Federal Trade Commission, 1967 Federal Bar Ass'n, Annual Convention, in San Francisco, California, July 28, 1967.

⁹⁶ Requiring a firm to engage in such integration may conflict with another antitrust policy objective—promotion of small business. See *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 386 (1967) (Stewart, J., dissenting).

⁹⁷ See Kessler & Stern, *Competition, Contract, and Vertical Integration*, 69 Yale L.J. 1, 16-21 (1959).

⁹⁸ The Court reports that Schwinn held a 22.5% share of the market in 1951. There are nine domestic producers. 388 U.S. at 368-69.

its customer limitations. Schwinn excluded low volume dealers because it was relatively expensive to carry these accounts. Schwinn could have alleviated this problem by not sending advertising and other promotional materials to these accounts. Schwinn's solution, to discontinue sending bicycles to them, was too drastic.

Nor was Schwinn's principal justification convincing. It attempted to show that its outlet limitations were necessary to exclude dealers who were not skilled in bicycle distribution or who did not offer service facilities. It could not, however, demonstrate any real need to exclude these kinds of dealers. It did not show that bicycles are so complex that special skills are necessary for proper distribution, nor could it show that all of the approved dealers offered service to their customers.⁹⁹ Furthermore, by consistently refusing to approve discount houses, Schwinn indicated that its major concern was not solely the avoidance of tort liability or maintenance of goodwill.

The decision of the Court, however, extends beyond the facts of *Schwinn*. It announces a questionable rule of per se illegality based on the rule against restraints on alienation. In future cases, *Schwinn*'s per se rule will foreclose examination of the legitimate needs of the manufacturer to impose vertical territorial and customer limitations.

An examination of business justifications and procompetitive effects of these restrictions is not wholly academic. The Court's rule of per se illegality for customer and territorial restraints only obtains where there is a restraint on alienation. Where there is no sale to a dealer, there can be no restraint on the dealer's powers of alienation. *Schwinn* states that the rule of reason shall be used to examine restraints imposed in these circumstances.

III. RESTRICTIONS ON AGENTS EXAMINED UNDER THE RULE OF REASON

Schwinn's agency exception will be viewed from two perspectives. The exception will be compared with prior law in an effort to determine the nature of the exception, when it is to apply and how it changes prior antitrust doctrine. Once the nature of the exception has been determined, the exception will be evaluated in light of Sherman Act policy to determine the soundness of the Court's distinction and to predict its viability.

The Court's concept of an "agent" in *Schwinn* can be compared profitably with the common law definition of a selling agent or a purchaser. The distinction between an agent and a purchaser has never been clearly defined; arrangements between manufacturers and their dealers often contain indicia of both types of relationship.¹⁰⁰ The Restatement (Second) of Agency lists seven factors which indicate that a transferee is a selling agent rather than a purchaser: (1) the transferor retains title to the goods; (2) the transferee becomes responsible for an agreed price when the goods are sold rather than immediately upon transfer; (3) the transferee is not free to fix prices at

⁹⁹ Schwinn changed this aspect of its distribution system while the litigation was in progress. For example, B.F. Goodrich, which generally provided no servicing facilities, no longer deals in Schwinn products. The percentage of dealers providing service was increased to 85.6% by 1961. Brief for Appellee, at 67 of n.65, 388 U.S. 365 (1967).

¹⁰⁰ Klaus, Sale, Agency and Price Maintenance: II, 28 Colum. L. Rev. 441, 444 (1928).

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which goods are resold; (4) the transferee completes the process of manufacturing the goods; (5) the transferor retains the risk of accidental loss; (6) the transferee does not deal with the goods of other manufacturers; (7) the transferee does not deal in his own name.¹⁰¹ The Restatement emphasizes that none of the above factors is determinative, and that the relationship must be viewed as a whole.¹⁰²

In *Schwinn*, the Court stated that a restriction on a distributor's freedom to resell would be subject to the rule of reason when the "manufacturer retains title, dominion, and risk with respect to the product and the position and function of the dealer in question are, in fact, indistinguishable from those of an agent or salesman of the manufacturer"¹⁰³ Thus, the Court required a finding of two of the Restatement indicia—retention by the manufacturer of title and risk of loss—and indicated that other factors must be considered to determine when the dealer's function is "indistinguishable from that of an agent or salesman"

Schwinn's definition of agency is apparently in harmony with the common law definition of agency except for making retention of title and risk of loss mandatory requirements. This slight deviation from the common law definition is not disturbing. Passage of title to the goods is probably the most important of the factors listed,¹⁰⁴ and risk of loss generally follows title.¹⁰⁵ By clearly stating its position, the Court has at least made it easier to draft agency agreements meeting *Schwinn's* requirements.

Yet the Court's agency definition goes further and in doing so creates interpretational problems. First, the Court implies that a salesman is an agent and, therefore, that restrictions on salesmen will be subject to antitrust scrutiny. Since the word "salesmen" is often used to refer to employees, the Court may be suggesting that a manufacturer is forbidden to restrict not only independent dealers, but also its own employees. Whether restrictions on employees should be subject to antitrust scrutiny is a subject which has received extensive treatment elsewhere. It is generally concluded that restrictions on employees should be exempt from the antitrust laws to allow manufacturers to exercise control over the internal workings of their firm.¹⁰⁶ Fortunately, the word "salesman" is sufficiently broad that it is possible the Court did not intend that employees be included.¹⁰⁷ In any event, the facts of *Schwinn* presented restrictions on independent dealers, not employees.

The second interpretational problem is raised by the Court's application of its exception to the facts of *Schwinn*. The Court stated that *Schwinn*

¹⁰¹ Restatement (Second) of Agency § 14J, Comment b (1957).

¹⁰² Id.

¹⁰³ 388 U.S. at 380.

¹⁰⁴ Klaus, *supra* note 100, at 443-44.

¹⁰⁵ See Note, *supra* note 83, at 237 & n.11 where it is suggested that *Schwinn's* requirement of risk of loss refers to "entrepreneurial risk" rather than risk of destruction.

¹⁰⁶ See Klaus, *supra* note 100, at 456-57; Note, *supra* note 83, at 236. See also *United States v. Masonite Corp.*, 316 U.S. 265, 279 (1942).

¹⁰⁷ See Address by Edwin M. Zimmerman, First Assistant, Antitrust Div., U.S. Dep't of Justice, 1967 Federal Bar Ass'n, Annual Convention, in San Francisco, California, July 28, 1967. Mr. Zimmerman interprets *Schwinn* as requiring the dealer's function to be very close to that of a salesman. He does not, however, interpret *Schwinn's* prohibition to extend to employees of the manufacturer.

Plan sales would be examined under the rule of reason.¹⁰⁸ The dissenters expressed relief that the majority's per se rule will have only a minimal effect on Schwinn since most of its sales are made through the Schwinn Plan.¹⁰⁹ If the rationale of the majority is applied to the Schwinn Plan,¹¹⁰ however, it is apparent that only that part of the plan that imposes restrictions on wholesalers should be given rule-of-reason treatment. Under the Schwinn Plan, retailers *purchase* the goods, and as a result, the per se rule in the opinion should prohibit Schwinn from imposing restrictions on them. Because the restrictions on retailers are an integral part of the Schwinn Plan, a holding that these restrictions are involved per se would have much more than a minimal effect on Schwinn's distributional system. It would, in fact, seriously undermine Schwinn's ability to select its retail outlets since authorized retailers would be left free to sell to unauthorized retailers.¹¹¹

The apparent inconsistency between the statement of both the majority and dissenters on the effect of *Schwinn* and the majority's rationale leaves two ways of reading the case. The first is that restrictions imposed on wholesalers and retailers who are operating under the Schwinn Plan are examined under the rule of reason in spite of the fact that as to the retailers they are restraints on alienation. If the Court intended this result, it laid no logical framework to reach it. Schwinn's retailers are not agents in any sense. The degree of restraint is no different whether the retailers receive the goods from the wholesalers or directly from the manufacturer under the Schwinn Plan. If there is any distinction to be drawn, the opinion gives no clue as to how to draw it.

The second possible reading is that even though a restraint on alienation is present in Schwinn Plan sales, there is another redeeming feature also present. This is unlikely, however. Redeeming characteristics of distribution systems presenting restraints on alienation on purchasers will henceforth be ignored, and the Court presents no reason why distribution systems like the Schwinn Plan should be treated differently. Perhaps the only conclusion which can be drawn from the Court's inclusion of Schwinn Plan sales in the class of restraints to be measured by the rule of reason is that the Court did not notice that plan presented a restraint on the retailer's power of alienation.

In addition to the vagueness that inheres in the Court's discussion of Schwinn's agency restrictions, the Court's application of the rule of reason to the facts of *Schwinn* creates some difficulty in applying *Schwinn* to future cases. The Court stated that it was favorably impressed with the freedom Schwinn's agents were given to handle other brands of bicycles and to set their own resale prices.¹¹² The Court related these factors to the reasonableness of the restraint, but the Restatement (Second) of Agency lists these

¹⁰⁸ 388 U.S. at 380.

¹⁰⁹ *Id.* at 388.

¹¹⁰ See p. 1033-34 *supra* for a description of the Schwinn Plan.

¹¹¹ See *Keck*, *The Schwinn Case*, 23 Bus. Law. 669, 683-87 (1968), for a discussion of other particular problems Schwinn faces in attempting to comply with the Court's decision.

¹¹² Permitting "agents" to set their own prices may create Robinson-Patman price discrimination problems. Comment, *Restrictive Distribution Arrangements After the Schwinn Case*, 53 Cornell L. Rev. 514, 526 (1968).

factors as indicia of a buyer-seller, not a principal-agent, relationship. A draftsman attempting to draw up an agency agreement meeting *Schwinn's* requirements will find this discussion troublesome. The agreement may have to contain provisions inconsistent with an agency relationship in order to be found reasonable. Unless a delicate balance is achieved, a court may hold either that the agreement does not create an agency relationship or that any restrictions imposed are unreasonable.

Irrespective of the precise breadth of application which *Schwinn's* agency exception will enjoy, it is of critical importance to determine the effect on prior antitrust law of the agency exception to *Schwinn's* per se rule. The Sherman Act proscribes only combinations, conspiracies and contracts in restraint of trade.¹¹³ As a result, a plurality of parties acting together in one of these ways has traditionally been considered a prerequisite to invocation of the Sherman Act. Since the parties in a principal-agent relationship have been considered a single entity, traditional antitrust doctrine has viewed agency as an effective shield to Sherman Act liability.

This view was firmly established by the Supreme Court in *United States v. General Elec. Co.*¹¹⁴ General Electric, by virtue of several patents, held a near monopoly in the manufacture of electric light bulbs. Under license agreements with other firms the licensees were treated as General Electric's agents for the purpose of manufacturing and distributing light bulbs. The license agreements required these agents to follow prices and terms of sale set by General Electric. The Government brought suit charging that the distribution system was merely a device to enable General Electric to fix prices. The Court held that the licensing agreements created a valid agency relationship, and further noted:

[T]here is nothing . . . which requires us to hold that genuine contracts of agency . . . however comprehensive . . . are violations of the Anti-Trust Act. The owner of an article, patented or otherwise, is not violating the common law, or the Anti-Trust law, by . . . fixing the price by which his agents transfer the title from him directly to such consumer.¹¹⁵

General Electric's broad ruling has been eroded. In *Simpson v. Union Oil Co.*¹¹⁶ a private suit was brought by a service station operator, Simpson, against his gasoline supplier, Union Oil. Simpson had leased the station from Union Oil and handled Union's products under a consignment agreement. Union set the minimum price at which all station operators could sell gasoline.

¹¹³ Note 11 supra.

¹¹⁴ 272 U.S. 476, 488 (1926). See also Attorney Gen.'s Nat'l Comm. to Study the Antitrust Laws, Report 30-31 (1955).

¹¹⁵ 272 U.S. at 488. But see *United States v. Masonite Corp.*, 316 U.S. 265, 276-77 (1942):

[H]owever useful [an agency agreement] . . . may be in allocating risks between the parties and determining their rights *inter se*, its terms do not necessarily control when the rights of others intervene, whether they be creditors or the sovereign.

¹¹⁶ 377 U.S. 13 (1964). The language in *Masonite*, quoted above, was substantially repeated in *Simpson*. 377 U.S. 13, 17-18 (1964).

Simpson sold gasoline below this price and Union refused to renew Simpson's license. Simpson brought suit under Section 1 of the Sherman Act. The Court held that even though a valid agency relationship may have been created, Union's policies violated Section 1 of the Sherman Act. The Court distinguished *General Electric* because, unlike *Simpson*, it involved a patented product.

Schwinn follows *Simpson* in not granting antitrust immunity to agency agreements.¹¹⁷ *Schwinn* departs from *Simpson* in one important respect, however. In *Simpson* the Court found that the consignment device was no shield to antitrust liability and applied a per se rule as in other price-fixing cases. In *Schwinn*, the Court held that because the restrictions were imposed through agency agreements, a rule-of-reason approach was required even though the restriction under consideration was per se illegal in a sales context. Using the rule of reason, it upheld *Schwinn's* restrictions.

Because the facts in the two cases are very similar,¹¹⁸ perhaps *Schwinn* overrules *Simpson*.¹¹⁹ It is possible, however, to construct a rationale that will make *Schwinn* and *Simpson* consistent. The focal point of this analysis is the *Schwinn* holding that the presence of an agency relationship makes a per se rule inappropriate. By definition, a per se rule is invoked only where the practice involved is at all times an unreasonable restraint of trade. This definition suggests that *Schwinn* treats the presence of the agency relationship as more than a threshold inquiry to rule-of-reason treatment. That is, if the presence of an agency relationship were not a factor tending to make a restraint reasonable, then any inquiry into the reasonableness of a restraint imposed on an agent would be a useless act. The fact that the restraint is per se illegal in the sales context would demand that the restraint be unreasonable—in effect, per se illegal—in the agency context.

Because of this basic principle, it is clear that in *Schwinn* the agency relation is treated as a valid justification that will outweigh the effect of the restraint. In fact, it is the only justification of sufficient magnitude to outweigh the effect of the restraint. Whether it does outweigh the effect of the restraint depends on a number of factors, one of which must be the kind of restraint involved. It is here that the distinction between *Schwinn* and *Simpson* lies.

Simpson involved price fixing, whereas *Schwinn* involves customer restriction. It may be that the Court considers price fixing to be a more per-

¹¹⁷ In fact, *Schwinn* makes it clear that all agency agreements are subject to anti-trust scrutiny. In *Simpson*, the Court was somewhat ambiguous as to whether its rationale extended to all agency agreements or just to those of questionable validity and to those used as a "device" to effect illegal practices.

¹¹⁸ *Simpson*, unlike *Schwinn*, did present what the Court referred to as coercion. The importance to the Court of coercion in *Simpson* has been minimized by some writers. See, e.g., Rahl, Control of the Agent's Prices: The Simpson Case—A Study in Anti-Trust Analysis, 61 Nw. U.L. Rev. 1, 8-9 (1966); Note, 17 Stan. L. Rev. 519, 523 (1965). But see Note, 37 U. Colo. L. Rev. 293, 294 (1965); Note, 43 Texas L. Rev. 569, 573-74 (1965). In *Schwinn*, coercion is conspicuously absent from the list of factors that the Court indicated were determinative of reasonableness.

¹¹⁹ Some commentators have reached this conclusion. See Keck, *supra* note 111, at 669, 682; Note, *supra* note 86, at 211-12,

icious restraint than customer restrictions.¹²⁰ If so, the agency holdings of *Schwinn* and *Simpson* may be entirely consistent. The agency relationship may be a sufficient justification to outweigh the effect of customer restrictions but not sufficient to outweigh the effect of price fixing.

There are practical problems for the antitrust bar if this rationalization of *Schwinn's* agency holding is correct. Not only would restrictions be classified according to their antitrust treatment—per se rule or rule of reason, but further gradation of per se offenses would be necessary to determine which restraints are significantly less objectionable when imposed on agents. Unfortunately, *Schwinn* provides no standards by which this gradation of “per se-ness” can be accomplished.

The validity of the submitted distinction between *Schwinn* and *Simpson* is dependent upon the antitrust importance of the ancient rule against restraints on alienation.¹²¹ An analysis of the validity of *Schwinn's* agency exception must start with the basis for the Court's per se rule—the rule against restraints on alienation. The rule is applicable where there is a sale, but not where goods are passed from principal to agent. As a result, the per se rule based on the rule must be reexamined in the agency context.

Restraints on alienation conflict with the Sherman Act because they restrain the freedom of a merchant to sell as he wishes.¹²² They restrain the most aggressive dealers and support unaggressive or inefficient dealers. On the other hand the Sherman Act has been used to foster free and open competition. Restraints used to support inefficient competitors and stifle aggressive competitors clearly conflict with this purpose. The benefits from competition which Sherman Act policy fosters are derived from the aggressive competition which is stifled by restraints on aggressive competitors.

The practices of *Schwinn* are good examples of the anticompetitive effects of restraints on alienation. *Schwinn's* customer limitations were used to exclude discount houses from *Schwinn's* distribution chain. This resulted in anticompetitive effects at three levels of distribution: (1) the freedom of *Schwinn's* wholesalers and trailers to choose customers was restricted; (2) competition was reduced at the retail level since some competitors were excluded from the market; and (3) the consumer suffered because a reduction in aggressive price competition resulted from the exclusion of discount houses from *Schwinn's* list of authorized retailers. When a restriction

¹²⁰ Price fixing was an established per se illegal offense before *Simpson*. See *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 221-22 (1940).

¹²¹ See *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 404-07 (1911), for a discussion of how vertical price fixing presents a restraint on alienation.

¹²² The public have an interest in every person's carrying on his trade freely: so has the individual. All interferences with individual liberty of action in trading . . . are contrary to public policy and therefore void.

Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373, 406 (1911), quoting Lord Macnaughten in *Nordenfelt v. Maxim Nordenfelt Guns & Ammunition Co.*, [1894] A.C. 535, 565. See also *Klor's Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 212 (1959):

Even when they operated . . . temporarily to stimulate competition they were banned. For . . . “such agreements . . . cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgement.”

is imposed on an agent, on the other hand, there can be no restraint on alienation because there is no sale. The anticompetitive effects that made the restraint on alienation objectionable under the Sherman Act may still remain, however. If the Court in *Schwinn* was using the absence of a technical restraint on alienation to support its distinction between the sales and agency situation, the Court has ignored this obvious fact. The agents which *Schwinn* leaves subject to customer restrictions are independent merchants, and their freedom to wage aggressive competition and to exercise independent business judgments has been substantially reduced. Despite the lack of a technical restraint on alienation, *Schwinn's* customer limitations on agents appear no less objectionable than customer limitations on purchasers.

It is more likely, however, that the Court considered the agency relationship to be a justification for the restraints imposed. Although the anti-competitive impact of restrictions on independent agents is not appreciably less than would result from imposing a similar restriction on purchasers, an additional factor must be considered. In an agency system of distribution, if the manufacturer restricts the exercise of business judgment of distributors, the manufacturer also assumes the attendant business risks. When a manufacturer directly bears the risks of distribution, the manufacturer is understandably reluctant to submit to the judgment of its distributors on marketing practices and since the dealers stake is smaller, any restriction on the discretion of the dealers is more easily justified.

If the Court considered these factors to be important irrespective of their competitive significance, *Schwinn's* agency exception can be rationalized. It remains difficult, however, to reconcile the agency exception with *Schwinn's* per se rule. If imposition of vertical customer and territorial restrictions is so contrary to antitrust policy that a per se rule is justified for restrictions on purchasers, it is difficult to understand why retention of business risks makes the restriction subject to rule-of-reason treatment. Apparently the Court is applying an inconsistent standard.¹²³

It is particularly difficult to reconcile *Schwinn's* different rules for restrictions on agents and purchasers because *Schwinn* suggests that the assumption of business risks by use of an agency distribution is not only the threshold requirement for rule-of-reason treatment of customer restrictions, but it may be the sole requirement for their legality. Despite *Schwinn's* large market share, its relatively uncomplex product and its practice of excluding discount houses, the Court upheld *Schwinn's* customer restrictions as reasonable. The Court did not reveal in what way allowing *Schwinn* to retain these restrictions would improve its competitive posture in the bicycle manufacturing industry, or what circumstances placed *Schwinn* in need of continuing restrictions on its agent-distributors. Since the Court declared *Schwinn's* restrictions to be lawful, *Schwinn* suggests that the Court is, in fact, declaring a rule of near per se legality for customer restrictions on agents.

¹²³ Professor Handler criticizes the Court for distinguishing between the agency and sale situations: "Form is exalted over substance to a degree unparalleled in the history of antitrust." Handler, *The Twentieth Annual Antitrust Review—1967*, 53 Va. L. Rev. 1667, 1684 (1967). He was particularly disturbed that the Court found sale and agency transactions to have different effects on competition. *Id.* at 1683-84.

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If this interpretation is correct, many other manufacturers should also be able to meet *Schwinn's* rule-of-reason requirements, but some words of caution should be mentioned since *Schwinn* presents a unique fact situation in some respects. In spite of the fact that *Schwinn* was one of the largest firms in the bicycle industry, its distributors were in competition with even larger mass merchandizers such as Sears, Roebuck and Montgomery Ward. Both the district court and the Supreme Court were impressed with the fact that *Schwinn* was only trying to meet competition from vertically integrated rivals by adopting some aspects of vertical integration.¹²⁴ Of equal importance, the price-fixing issue was removed from the case by the Government's failure to appeal the district court's dismissal of that issue. For this reason, later attempts by the Government to show that *Schwinn's* customer restrictions produced an adverse effect on prices met with strong and apparently successful opposition by *Schwinn*. In future cases, the Government will probably not allow itself to be precluded procedurally from showing that an adverse effect on prices will result from customer restrictions. Future defendants who exclude discount houses will probably be at a marked disadvantage compared to *Schwinn* in attempting to justify their restrictions since the Court indicated in *Schwinn* that interferences with price competition will be fatal to the legality of customer restrictions, even if imposed on agents.¹²⁵

Only later litigation can decide whether *Schwinn's* restrictions on agents were tested under a different rule of reason than has been traditionally applied in antitrust cases. The evidence that *Schwinn* does apply a new rule is inconclusive and largely speculative. The safest course for the present would be to assume that *Schwinn* does not announce a rule of per se legality but that the Court simply felt compelled by the lower court's findings to uphold *Schwinn's* customer restrictions imposed on agents.

IV. CONCLUSION

The status of vertical customer and territorial limitations is still not settled. In *Schwinn*, the Court declared vertical territorial and customer restrictions to be illegal per se when imposed on purchasers and subject to the rule of reason when imposed on agents. The per se rule is of questionable validity and its agency exception is illogical. The opinion reflects almost no awareness or examination of the economic or policy issues that were before the Court. But the case is now law, and manufacturers who depend upon vertical territorial and customer restrictions must comply with *Schwinn's* requirements.

In reality, it is doubtful that *Schwinn* has settled the law with respect to vertical territorial and customer limitations, in spite of the announced per se rule. The Court indicates by several passages in the opinion that it is not yet ready to give its final word on their legality, and is postponing to the future a determination of the extent to which it will permit their use. The Court stated: "[W]e are not prepared to introduce the inflexibility

¹²⁴ *United States v. Arnold, Schwinn & Co.*, 237 F. Supp. 323, 334 (1965); 388 U.S. at 380-81.

¹²⁵ 388 U.S. at 380-81.

which a *per se* rule might bring if it were applied to prohibit all vertical restrictions of territory and all franchising . . ."¹²⁶ Furthermore, many parts of the opinion are unclear—for example, the Court's definition of agency, its discussion of whether all restrictions imposed under the Schwinn Plan were found reasonable and the precise rationale for its *per se* rule. In fact, the Court clothes the whole opinion in obscure language which will permit considerable latitude in later interpretation. Perhaps, the Court in *Schwinn* did not go far beyond its position in *White Motor*. It may simply be saying that it is unfavorably impressed with vertical territorial and customer limitations, but if presented with compelling circumstances it may allow them to be used. The Court has gone at least one step beyond its position in *White Motor* since it has drastically limited the kinds of distribution systems in which customer and territorial restrictions can be used. Henceforth, a *per se* rule may be avoided only by use of an agency arrangement with distributors.

It is questionable how long the agency exception will be available. At least with respect to the traditional antitrust policy of promoting free competition, the agency exception is irreconcilable with the rationale for *Schwinn's* *per se* rule. There can be little question what result the Court will reach when forced to choose between *Schwinn's* *per se* rule and its agency exception. The Court was very anxious to declare a *per se* rule in *Schwinn*, and once a *per se* rule has been announced, the Court has never narrowed but rather has broadened its reach.

PETER J. MONTE

¹²⁶ *Id.* at 379.