

1997

Horizontal Restraints on Competition are Violations Per Se of the Sherman Act

Tom O'Connor

Follow this and additional works at: <http://lawcommons.luc.edu/lclr>



Part of the [Antitrust and Trade Regulation Commons](#)

Recommended Citation

Tom O'Connor *Horizontal Restraints on Competition are Violations Per Se of the Sherman Act*, 9 Loy. Consumer L. Rev. 92 (1997).
Available at: <http://lawcommons.luc.edu/lclr/vol9/iss2/11>

This Related Case is brought to you for free and open access by LAW eCommons. It has been accepted for inclusion in Loyola Consumer Law Review by an authorized administrator of LAW eCommons. For more information, please contact law-library@luc.edu.

organization would not result in unfair benefit in competition regarding the sale private label brand products. Further, the court stated that competition between Topco members and national supermarket chains would be substantially reduced by the elimination of Topco's practices. Thus, the court concluded that the relief which the Government sought would not increase competition in Topco private label brands, but would

substantially diminish competition in the supermarket field. Since the court found that the antitrust laws were not intended to accomplish such a result and that the consuming public would be disadvantaged if the Government prevailed, the district court entered judgment for Topco and held that the practices did not constitute a per se violation of the Sherman Act.

Horizontal restraints on competition are violations per se of the Sherman Act

by Tom O'Connor

In *United States v. Topco Associates, Inc.*, 405 U.S. 596 (1972), the Supreme Court held that a cooperative purchasing association for independent supermarket chains violated the Sherman Act by restricting intraassociation competition. Despite a lack of price-fixing on the part of the cooperative purchasing association, the Court further held that the association's practices violated the Sherman Act because the association restricted competition by limiting the area in which members could sell certain goods.

The federal Government ("Government") brought an action for injunctive relief against Topco Associates, Inc. ("Topco") for granting exclusive marketing territories to the association's members. The Government argued that Topco engaged in a horizontal restraint of trade in violation of the Sherman Act. Topco contended that its marketing restrictions were necessary for the association to stay in business and that these restrictions actually increased competition

in the supermarket field by allowing the members of the association to compete with the larger, rival supermarket chains. The Court rejected Topco's arguments and ruled in favor of the Government.

Topco created to help small supermarket chains compete with large chains

Topco was a cooperative association of approximately 25 independently operated small- and medium-sized supermarket chains, created in the 1940s in order to obtain high quality merchandise under a private label. The manufacturer of a private label permits only a limited number of stores to sell its goods. A private label allows retailers of the specified goods to take advantage of the economies of scale in all levels of production while maintaining the same standard of quality as other name brands. A private label arrangement facilitates the sale of private label goods at a lower price than other brand name items and competition with large, national

chains. By 1964, Topco's members had combined retail sales of \$2.3 billion, less than only three national chains.

Topco members operated under geographic limitations

Each of the members of the Topco association operated in a specific geographic territory. Topco defined the boundaries of each member's territory and required the receipt of special permission for a member to sell private label goods in another district. Topco also required its members to obtain special permission to sell goods wholesale. According to Topco's by-laws, each member possessed one of three types of licensed territories: (1) an exclusive territory, in which the licensed member was the only member allowed to sell the private label; (2) a nonexclusive territory, in which the licensed member might have to share the territory with another member; or (3) a coextensive territory, in which two or more

members were licensed to sell within the same territory. When a potential member applied for admission to the association, Topco required the applicant to apply for one of these three specific licenses. The association members voted to approve or deny all new applications. Members already licensed to do business within 100 miles of the applicant's prospective territory could essentially veto an application.

After joining the association, Topco required each member to sign a contract not to sell Topco-brand products outside of its designated territory. Most of the territories were exclusive and most of the coextensive or nonexclusive territories were, in practice, also exclusive.

The Government argued that Topco's division of markets violated the federal antitrust laws by prohibiting competition with Topco-brand products. The Government also submitted a subsidiary challenge to the association's policy of prohibiting members from selling their products wholesale. The Government maintained that this policy constituted a territorial restriction and a restriction on customers, both violating the Sherman Act.

Topco contended restrictions on intraassociation competition led to greater overall competition

In answering the complaint, Topco accepted most of the facts stated by the Government as true. However, Topco maintained that the facts did not suggest that the association restricted competition. Rather, Topco contended that the facts supported an increase in

competition. Topco argued that the system of allocating exclusive marketing rights by territory encouraged competition in the supermarket field as a whole by allowing the smaller firms in the association to compete with the mammoth, rival supermarket chains. Topco further asserted that its members would not be able to realize a sufficient profit margin on Topco-brand goods to maintain operations without the exclusivity arrangements. Topco argued that the elimination of the association would lead to further dominance by the big chains and the demise of the smaller chains. Topco argued that this chain of events would decrease competition to the detriment of the consumer.

Supreme Court establishes rule of reason doctrine

The United States District Court for the Northern District of Illinois entered judgment for Topco. Despite the reduction in competition between retailers of Topco-brand products, the increase in competition in the supermarket market as a whole proved more important to the district court. The district court noted Topco's practices to be procompetitive. However, the Supreme Court disagreed and reversed and remanded the case.

The Supreme Court based its decision, in part, on Section 1 of the Sherman Act. The Sherman Act, in relevant part reads, "[e]very contract, combination in the form of a trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal." Sherman Act, 15 U.S.C. § 1

(1995). The Court explained that this section appears to *theoretically* bar any and every commercial contract. However, the Court relied on the (legislative) history of the antitrust laws—which demonstrates that Congress did not intend to bar *every* contract. In fact, the legislature intended to allow the courts to consider the circumstances surrounding a contract before determining whether a violation of the antitrust laws exists. The circumstances a court should consider include the nature of the business in question, the nature of the restricting contract, and the history of the reason for the restraint. The Court labeled this analysis the 'rule of reason' doctrine. Under the rule of reason doctrine, a court ruling on possible antitrust violations can consider, among other circumstances, the intention of the parties involved in the contract.

In applying the rule of reason doctrine on remand, the district court ruled that Topco did not commit a violation of the Sherman Act because the exclusivity arrangement promoted competition more than the arrangement restricted it.

Violations per se can be determined without 'rule of reason'

The Supreme Court also discussed 'violations per se' of the Sherman Act and indicated that the violations should be considered before applying the 'rule of reason' doctrine. Violations per se result from contracts which are so obviously detrimental to free trade that a court should bar them without regard to their reasonableness. The Court labeled a horizontal restraint

as one example of a violation per se. A horizontal restraint is a contract between competitors in the same industry and at the same level in the production pyramid which reduces competition. The Court stated that Topco's exclusivity contracts, which imposed territorial restrictions, were horizontal restraints and, thus, violations per se. Therefore, the Court determined the rule of reason doctrine to be inapplicable in this case.

Drawing a comparison to a previous Supreme Court decision in *United States v. Sealy, Inc.*, 388 U.S. 350 (1967), the Court found that the situations were factually and functionally similar. In *Sealy*, the defendants, licensed manufacturers of bedding materials, sold Sealy products. Sealy was a corporation owned by its licensees. Sealy maintained an exclusivity arrangement with its licensees similar to Topco's arrangement. In *Sealy*, the Court held that the defendant was guilty of horizontal restraints—a violation per se of the Sherman Act.

The Court defended the rigidity of the per se rule as necessary to guide business people and the courts. The Court reasoned that business people would be unable to discern whether Topco's practices are legal or illegal without direction of which actions constitute violations of the antitrust laws.

The Court further indicated that the courts need a sign-post to avoid weighing, among other issues, the relative importance of different levels of restriction in different sectors of the economy because so many subtle economic considerations exist in every case. According to the Court, these rules should be applied notwithstanding any

possible defenses, i.e., particular economic circumstances or market strategies. In this case, horizontal restriction of competition violates Section 2 and, thus, is illegal despite rules of reason components to the contrary.

The Court rejected Topco's argument that the association increased competition in the aggregate. The Court reasoned that Topco possessed no authority to compare the relative worth of one sector of the economy to another, especially given its prominent role within certain sectors of the super-market market. Comparing the antitrust laws to the Magna Carta, the Court stated that the freedom to compete could not be foreclosed in one sector in favor of promoting competition in another sector. The Court noted that Congress could make an exception to the antitrust laws but that neither the Court nor private economic entities possess the right to make that change.

Finally, the Court concluded that the reasoning which it applied to the territorial restrictions applied equally as well to the restriction that Topco's members could not sell at wholesale. The Court reasoned that the restriction on the right of Topco's members to sell goods at wholesale essentially regulated Topco's customers. Thus, the Court held that the restriction constituted a violation per se of the Sherman Act.

Justice Blackmun concurred

Justice Blackmun wrote a concurring opinion to express his concern that the majority's decision, while technically sound, would ironically reduce competition as

predicted by the defendants. He was also reluctant to argue against the application of the per se rule because the rule had been "firmly established." Justice Blackmun closed by agreeing with Justice Marshall and declaring that "[r]elief, if any is to be forthcoming, apparently must be by way of legislation."

Chief Justice Burger dissented

Chief Justice Burger dissented, arguing that Topco did not commit a per se violation of the Sherman Act. Burger implicitly argued that the 'rule of reason' doctrine should be the threshold inquiry rather than whether an arrangement is a 'violation per se.' He attacked the applicability of the cases the majority looked to in supporting the principal holding. In particular, the Chief Justice attacked *United States v. Sealy* as failing to conclude that horizontal limitations by themselves qualify as per se violations.

The Chief Justice concluded by stating that the majority, in effect, created a new per se violation standard. The Chief Justice quoted Senator Sherman's 1890 address to Congress in support of what would become the Sherman Act. Senator Sherman described his goal in creating the bill as one which would attempt:

... only to prevent and control combinations made with a view to prevent competition, or for the restraint of trade, or to increase the profits of the producer at the cost of the consumer. It is the unlawful combination, tested by the rules of common law and

human experience, that is aimed at by this bill, and not the lawful and useful combination

Chief Justice Burger argued Senator Sherman's this address

indicated that the legislature intended the 'rule of reason' doctrine to apply to each case, especially when an argument can be made that the arrangement under question promoted competition.

In conclusion, despite Chief

Justice Burger's dissent, the Court ruled in favor of the Government in holding that any horizontal restraint of competition constitutes a violation per se of the Sherman Act, regardless of the intended effect on overall competition.

Supreme Court ruling of Sherman Act violations given limited application on remand

by Erin Quinlan

On remand from the Supreme Court, Judge Will modified his original opinion in *U.S. v. Topco Associates, Inc.*, 405 U.S. 596 (1976), to conform to the Supreme Court's holding, but in a way which preserved the substance of his original decision. *U.S. v. Topco Associates, Inc.*, No. 68 C 76, 1972 WL 669 (N.D. Ill. Sept. 26, 1972).

Judge Will limited the Supreme Court's finding of a violation of Section 1 of the Sherman Act to those Topco arrangements which promoted exclusivity. Judge Will concluded that the Court only addressed Topco's arrangements which prevented other members and nonmember small chains from selling Topco brand products in certain regional territories. Judge Will found that the Supreme Court held this containment to be noncompetitive behavior.

Conversely, Judge Will viewed these arrangements as a way for small and local chains to compete with the national chains. According to Judge Will, limiting the sale of the generic Topco brands allowed the local stores and smaller chains to compete with the national chains, thus, producing economic efficiencies. Judge Will concluded that eliminating Topco's arrangement would hurt consumers by forcing them to purchase only national store brand products.

In his final judgment, Judge Will followed the Supreme Court's holding, but wanted to ensure that his

ruling would not completely eliminate what he believed to be economically efficient arrangements. Furthermore, Judge Will felt that the arrangements were beneficial in promoting competition between the national and local and smaller chains, so long as they were not misused. Therefore, Judge Will included a paragraph in the opinion permitting exclusive arrangements in certain instances.

To ensure that these arrangements could still exist but not be misused, Judge Will implemented regulatory procedures in his final judgment. These regulations required Topco to file a report with the government every year for ten years setting forth the steps it undertook during the prior year in advising its officers, directors and employees of their obligations under this judgment.

In addition, the final judgment granted the Department of Justice, upon written request from the Attorney General, access to Topco's files, records, and ledgers, relating to any matters addressed in the final judgment. The Department was also given the right to interview any of Topco's officers and employees regarding such matters. The final judgment further stated that the Department must give Topco reasonable notice if it intends to exercise these procedures.

These regulatory guidelines threaten to infringe upon Topco's right to privacy and confidentiality. The final