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## *Restrictive practices of cooperative buying association not a per se violation of antitrust laws*

by Linda A. Kerns

In *United States v. Topco Associates, Inc.*, 319 F. Supp. 1031 (N.D. Ill. 1970), the district court held that Topco Associates, Inc. ("Topco") did not violate the Sherman Act when it provided member supermarket chains with a cost-effective source for private label brand groceries and non-food items even though competition among the members may have been reduced. The court ruled that the Sherman Act was not violated because the benefit of an overall increase in national competition outweighed the incidental decrease in competition among the members of Topco. Further, the court concluded that Topco's practices did not harm the consuming public or inflate prices. The court also determined that prohibiting Topco's practices would result in the demise of the Topco organization while substantially diminishing competition, an unintended result under the antitrust laws.

Topco was a cooperative buying association owned and controlled by 25 firms. The 25 controlling firms engaged in the sale of grocery and non-food items and operated as supermarket chains. Topco procured and distributed more than one thousand different food and related non-food items exclusively to these supermarket chains. In order to compete with larger, national grocery chains, Topco imposed territorial limitations and membership restrictions upon the supermarket chains, resulting in a decrease of competition on the local level but an increase in competition nationally. Despite the overall increased competitiveness of the Topco members as a whole, the United States Government ("Government") brought suit against Topco, alleging that the limitations on the members constituted a per se violation of the Sherman Act. The Government contended that even if the ultimate effect of the practices increased national competition, the territorial arrangements substantially reduced competition among certain manufacturers and dealers. The Government argued that these practices restricting competition were unlawful despite any other benefits that may have resulted in national competition.

### **Competition in the food industry required innovative approach to sales**

In the years before the litigation of this case, the retail food industry had become increasingly competitive. Large, multi-unit retail food chains achieved significant economic and competitive advantages over smaller operators, particularly in purchasing and distribution. Independent grocers and smaller chains disappeared at an accelerated rate as the size and resources of the national and large regional food chains virtually eliminated the ability of smaller businesses to compete. The most competitively significant innovation of national and large regional food chains was the use of private label products. Private label products, less expensive counterparts to larger, national brand name products, provided an alternative choice to both the retailer and the consumer.

Private label brands permitted significant competitive advantages to retailers, including but not limited to: (1) higher profits on private labels (resulting in lower prices on other products); (2) a broader supply base of manufacturers; (3) greater merchandising flexibility for the retailer; (4) a versatile pricing approach; (5) brand recognition to attract and retain customers; and (6) customer good will. The consumer benefited because private label brands were generally priced below national brands, stimulating better quality and service from national brand manufacturers.

To achieve a reasonable degree of success, a comprehensive private label program had to cover hundreds of items and reflect two or possibly even three quality lines. The three largest national supermarkets which led the industry in overall sales developed more than one thousand items in their private label lines. To justify the heavy developmental costs of a product under the private label, a successful program required substantial sale volumes in each product category. Becoming affiliated with a buying organization was the only feasible way that grocery stores and chains the size of the typical Topco member could obtain the volume necessary to achieve effective and

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economically feasible private label competition.

### **Topco assigned restrictions and limitations on member supermarket chains**

Apart from their membership affiliation with Topco, the 25 supermarket chains remained wholly independent, each having separate and independent management. The chains operated as separate entities and did not pool earnings, profits, capital management, advertising, or promotional resources. Topco bylaws controlled the disposition of both common and preferred stock. Whenever a supermarket chain terminated its membership affiliation with the association, Topco determined how the stock would be disposed. In addition to safeguarding against a competitor takeover, Topco executed a "Member and Licensing Agreement," designating areas where each supermarket chain could operate as exclusive, nonexclusive or coextensive territories. The agreement further specified trademarks or trade name products which could be sold. Topco prohibited its members from selling any Topco brand products outside of their designated licensed territory. Topco retained the right to revoke membership from any member which did not follow the guidelines. The Topco licensing provisions did not control or affect price, leaving the chains free to sell Topco brand products along with all other merchandise at any price.

Topco constantly added new supermarket chains in areas where distribution of Topco brand products was limited or nonexistent. The agreements among the supermarket chains to allocate geographic markets and classes of customers tended to eliminate competition in Topco brand products between Topco members. However, the members' ability to compete with other national and local chains became substantially reduced.

### **Government seeks an injunction**

In response to Topco's restrictions on its members, the Government sought an injunction to prevent a limitation or restriction of territories within which members could sell Topco controlled brands and to prevent a limitation or restriction of membership on a territorial basis. The Government contended, however, that competition in Topco controlled brands dropped and

that Topco's exclusivity practices constituted a per se violation of the Sherman Act even though the ultimate result of the practices increased overall supermarket competition. Yet, the Government conceded that if Topco had been a single, large national chain rather than a buying organization for smaller local and regional chains, none of its practices would have been objectionable under the antitrust laws. The Government also conceded that Topco's private label program enabled the members to compete more effectively both with the larger national chains as well as with other medium or smaller regional or local chains and independents.

Topco countered by arguing that the territorial limitations on membership were necessary to enable its members to compete effectively with national food chains and that the competitive advantages afforded its members far outweighed the limitations. Since virtually all of the national supermarket chains possessed extensive private label programs featuring products exclusive to their store, the Topco members believed that exclusivity in a particular region was an indispensable element of Topco's success.

### **Topco did not violate Sherman Act**

The district court held that Topco's practices did not constitute a per se violation of the Sherman Act. The court reasoned that the increased ability of Topco members to compete with the national chains and other supermarkets operating in their respective territories far outweighed any anti-competitive effect that resulted from Topco's practices. Overall, the court concluded that the Topco cooperative served a legitimate pro-competitive purpose by providing its members with commonly procured, private label merchandise and the ability to offer the consumer quality, low-priced products. The Topco association allowed its members to compete more effectively in their respective markets against the stronger national and large regional chains while continuing to exist as independently owned and operated businesses. The court considered the economic conditions peculiar to the industry, practices maintained, sales plans, consequences of sales practices and other matters affecting the public interest. The court concluded that eliminating the closed territory arrangement would impair competition rather than foster it.

In the court's opinion, the demise of the Topco

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