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ANTITRUST—Horizontal Territorial Allocations Held to be *Per Se* Antitrust Violations.

Topco Associates, Inc.,¹ is an association comprised of retail grocers.² The basic functions of the association are to purchase grocery goods from manufacturers and to distribute them under its private label³ to its member grocers. The purchased goods are generally shipped from the manufacturer to the member grocers. Payment is made directly by the member, or through the association, at "virtually" the same price.⁴

The Government instituted the present action in the federal district court for the Northern District of Illinois.⁵ The Government charged that Topco had conspired with its members to restrict the geographic area within which each member was allowed to sell Topco brand products,⁶ thereby limiting the number of retail sellers of its products in those geographic areas.⁷ The Government alleged that this restriction of competition violated § 1 of the Sherman Act, and, therefore, sought to enjoin the practice.⁸

The district court accepted Topco's argument that its distribution scheme was economically necessary. The court found that private labels were an extremely important facet in the success of modern su-

1. Hereinafter referred to as *Topco*.
2. "Member" firms are either individual stores or independent local chains of stores. The association is a corporation, but ownership of all stock having voting rights is restricted to members of the association. The board of directors is selected from the members; this board elects the officers of the association, and must select the highest officers from the board itself. The Supreme Court found that these procedures give the association "complete and unfettered control over the operations of the association." United States v. Topco Associates, Inc., 405 U.S. 596, 599 (1972) (Hereinafter cited as *Topco*.)
3. "Private label" goods are those produced for and branded by the retailer, and sold exclusively by that retailer.
4. 405 U.S. at 598.
5. "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states . . . is hereby declared to be illegal. . . ." 15 U.S.C. § 1 (1970).
6. This restriction was effectuated by the agreement of membership, in which each member was assigned certain territory outside which he was specifically forbidden to sell Topco goods.
7. Topco distributed its goods only to its members. Once a member was assigned a territory, no other firm could be granted the right to sell in that territory without the consent of the member to whom the territory was originally assigned.
8. The government had filed a subsidiary challenge to Topco's requirement that no member resell its goods at wholesale without Topco's consent. This prohibition limited the class of customers to whom the member store was allowed to sell, and, claimed the Government, was therefore in violation of § 1 of the Sherman Act, 15 U.S.C. § 1 (1970).
permarket ventures, but that a very large sales volume was necessary to establish a successful private brand program. Furthermore, "it is essential to any private brand program that the retailer selling that brand be the only dealer in that brand in his geographic area."

The Topco members could not have attained sufficient sales volume to implement a private brand program without forming an association combining their sales volumes; and, they could not have had exclusive dealership in Topco brand products without the imposition of geographic allocations of market territory. The court said that these restrictions on competition in Topco brand products had increased the ability of Topco's members to compete with the large national grocery chains, which already had established lines of private label products.

The court then held that Topco's restrictions were reasonable in view of this benefit to competition among supermarkets, and that the restrictions did not violate § 1 of the Sherman Act. The court refused to apply the per se rule as asked by the government, but, rather, applied the "rule of reason."

The Government appealed directly to the Supreme Court under the Expediting Act. The Supreme Court reversed, holding that the District Court should have applied the per se rule. The Supreme Court reached this conclusion by characterizing Topco's distribution scheme as a "horizontal" agreement to allocate market territory among the Topco members. The term "horizontal" envisions an agreement "between companies performing similar functions in the production or sale of comparable goods or services."

The Court cited eight cases

9. United States v. Topco Associates, Inc., 319 F. Supp. 1031, 1035-36 (N.D. Ill. 1970). Private label goods can be sold at lower retail prices but at a higher profit than national brand name goods because the grocer deals directly with the manufacturer, bypassing the distributor. This higher profit not only permits the grocer to lower his prices for non-private label goods, but it also builds good will by enhancing the grocer's public image as a low-cost store. Id., at 1035.
10. Id. at 1036.
11. Only by retaining exclusive dealership in a brand can a retailer obtain identification of that brand with his store, thereby gaining customer loyalty not only to the brand but also to the retailer itself. Id., at 1035.
12. Id. at 1036.
13. Id. at 1043.
14. Id.
15. Under the per se rule, the restrictions would have been held illegal upon proof of their existence. See text accompanying notes 26-30, infra.
17. 405 U.S. 596 (1972). The case was remanded "for entry of an appropriate decree."
18. Id. at 599.
as justification for its holding that restraints in the form of horizontal allocation of market territory are *per se* illegal under §1 of the Sherman Act, and believed that its experience with such restraints required the application of the *per se* rule. Chief Justice Burger, dissenting, focused on this point. He stated that the Court made new law rather than followed precedent, because an analysis of the cases relied upon by the majority demonstrated that the Supreme Court had never squarely held horizontal allocation of market territory illegal *per se*.20

THE RULE OF REASON

Read literally, §1 of the Sherman Act21 would bar any commercial contract which touches upon trade or business.22 But the statute has been interpreted, in light of common law, to prohibit only *undue* restraints on trade.23 An undue restraint of trade is one which “may suppress or even destroy competition,” as opposed to one which “merely regulates and perhaps thereby promotes competition.”24 Under this test, usually called “the rule of reason,” the District Court found that Topco’s restrictive practices promoted competition among supermarkets, so that the restrictions were reasonable and, therefore, not in violation of §1 of the Sherman Act.25

THE PER SE RULE

Ever since the inception of the rule of reason, there has been recognition that there are certain types of business arrangements to which the rule will not be applied. In *United States v. Addyston Pipe &
Steel Co., the Supreme Court stated that principle in terms of the purpose of the restraint: "[W]here the sole object of both parties in making the contract as expressed therein is merely to restrain competition, and enhance or maintain prices, it would seem that there was nothing to justify or excuse the restraint, that it would necessarily have a tendency to monopoly, and therefore would be void." This statement is the essence of the per se rule.

In its discussion of the per se rule, the Supreme Court in Topco quoted a restatement of the principles governing the application of the rule: "$T$here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." The wording "lack of any redeeming virtue" seems to indicate that the per se rule can be applied only when it is theoretically impossible to advance a justification for a business arrangement which does have some "redeeming virtue".

In practice, however, the Supreme Court has only applied the per se rule to arrangements with which the Court has had sufficient experience to refuse to consider the economic effects of the arrangements. This is exemplified in White Motor Co. v. United States, in which the Court refused to apply the per se rule to vertical territorial restrictions, stating: "We do not know enough of the economic and business stuff out of which these arrangements emerge to be certain that they are illegal. . . . We need to know more than we do about the actual impact of these arrangements on competition" to apply the per se rule. A question as to whether the Court in Topco had sufficient experience with horizontal allocations of market territory to apply the per se rule. Chief Justice Burger's analysis of the market-division cases cited in Topco indicates that at least he felt that it did not. A review of these decisions is appropriate.

In Addyston Pipe & Steel Co. v. United States, pipe manufacturers agreed to limit the sale of pipe in certain cities to specified manufacturers; but an agreement which directly fixed the sale price of pipe

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26. 85 F. 271 (6th Cir. 1898), aff'd, 175 U.S. 211 (1899).
27. 85 F. at 282-83.
30. Id. at 263.
31. Id. at 608.
32. Id. at 615-20.
33. 175 U.S. 211 (1899), aff'g 85 F. 271 (6th Cir. 1898).
was also involved. In United States v. Arnold, Schwinn & Co., the defendant bicycle manufacturer agreed with its retailers to require its distributors to refrain from reselling bicycles to customers other than consumers. The manufacturer retained title until sale by the distributors. The Court characterized this as a vertical distribution scheme because Schwinn and the distributors and retailers involved were at different levels of the market structure.

In Timken Roller-Bearing Co. v. United States, the Supreme Court struck down horizontal agreements between an American roller bearing manufacturer and its two foreign subsidiary manufacturers. The agreements divided the world into three market territories. They also agreed to fix prices on goods sold by one company in a territory of another; to restrict United States imports and exports by participating in cartels; and to otherwise cooperate in eradicating outside competition in roller bearings in any territory. Although the central purpose of the agreement was the allocation of market territory, the per se rule was applied only to the "aggregation" of restraints, not to horizontal allocation of market territory alone.

In a case decided the same day as Schwinn, United States v. Sealy, Inc., the Court held that horizontal price-fixing by a group of mattress manufacturers which constituted Sealy, Inc., was per se illegal. The Court also struck down, as per se illegal, the territorial restrictions which the members of the Sealy association had imposed upon themselves because the restrictions were very closely connected with the price-fixing scheme. The Court expressly declined to decide whether the per se rule would have been applied had the price-fixing not been present. If the Court had believed that such allocations were per se illegal under established precedent, it would have been unnecessary to

35. 388 U.S. 365 (1967). (Hereinafter cited as Schwinn.)
36. Also a part of Schwinn's distribution program were goods the title to which passed from Schwinn to the distributor, who was nevertheless forbidden to sell the bicycles to anyone other than franchised distributors. Although Schwinn did not appeal the District Court's ruling that those restraints were illegal per se, 388 U.S. at 367-68, the Supreme Court in very strongly worded dictum agreed that such restrictions, as restraints on alienation, were illegal per se under § 1 of the Sherman Act. 388 U.S. at 379.
37. 388 U.S. at 372.
38. 341 U.S. 593 (1951).
39. Id. at 598.
40. Id. at 597-98.
41. 388 U.S. 350 (1967).
42. Id. at 355.
43. Id. at 357.
find the strong connection between the two types of activities involved in the case. Rather, the Sealy Court would have struck down the territorial allocations upon finding that they existed, without inquiring into their relationship with price-fixing. Two other cases cited by the Court in Topco did not concern allocations of market territory.44

Therefore, there is much validity in Chief Justice Burger's view of the prior Supreme Court cases cited in Topco.45 By his analysis, the Supreme Court has never squarely held that a per se rule should be applied to horizontal allocations of market territory, separate and apart from direct price-fixing. As persuasive as Chief Justice Burger's analysis is, however, the Topco decision firmly establishes that such allocations are per se illegal.

The Court stated in Topco that "it is only after considerable experience with certain business relationships that courts classify them as per se violations of the Sherman Act."46 Nevertheless, the lack of previous cases involving horizontal market allocations without price-fixing did not deter the Court from applying the per se rule in Topco. This indicates that either the Court was satisfied that its experience with horizontal allocations of market territory, though connected with price-fixing, was enough to refuse to consider possible justifications even when price-fixing was not involved; or, that the justifications which could theoretically be advanced for such allocations required such an extensive inquiry into the economics of the industry involved that the Court refused to consider them in the interest of judicial economy.

Topco: An Implicit Limitation of Schwinn

Topco's chief contention was that the territorial restrictions which rendered Topco brand products obtainable only at one supermarket in a given geographic area, gave that supermarket the benefit of customer loyalty to those products, and thereby enabled it to compete better with large chain supermarkets which also had products exclusive to that chain. The Court did not rule whether this increase in supermarket competition justified Topco's restrictions because utilization of the per se rule avoids judicial determination of whether a particular restraint

45. 405 U.S. at 615-20.
46. Id. at 607-08.
of competition in one sector of the economy is outweighed by a corresponding increase in competition in another sector.\textsuperscript{47} This indicates that such a justification is inapplicable to vertical territorial allocations as well. In \textit{Schwinn}, the Court upheld vertical territorial restrictions on sales of goods to which Schwinn retained ownership, by applying the rule of reason. The Court's holding was based upon a finding that there was an adequate supply of bicycles other than Schwinn. The Court concluded that there was no unreasonable restraint of trade because the "net effect [of the restraints] was to preserve and not to damage competition in the bicycle market."\textsuperscript{48}

An essential distinction between \textit{Schwinn} and \textit{Topco} is that \textit{Schwinn} involved vertical territorial allocations. But the argument the Court used to uphold the \textit{Schwinn} restraints is similar to one which the Court in \textit{Topco} refused to consider; that interbrand competition was being promoted by the restrictions on intrabrand competition. Had the refusal been based solely upon the complexity of the economic investigation necessary to judge such an argument, then the two decisions could be read consistently. This type of extensive judicial inquiry would be justified in vertical allocation situations, but would not be justified in considering the more restrictive horizontal allocations of territory.\textsuperscript{49}

The \textit{Topco} Court stated a further reason for refusing to consider the argument that restrictions on competition in \textit{Topco} brand products were beneficial to competition among supermarkets: a ruling on such an argument would require a decision that the value of competition in one part of the economy, supermarket competition, is more valuable than competition in another part, sales of \textit{Topco} products by different stores in the same geographic area. For such a "delicate judgment" to be made, the Court stated, "the judgment of the elected representatives of the people is required."\textsuperscript{50} It is difficult to understand why the value judgment required would be more appropriate for judicial, as opposed to Congressional, determination in a vertical setting than in a horizontal one, or why the form of restraint in question would make a court more competent to make that judgment.

\begin{itemize}
\item \textsuperscript{47} \textit{Id.} at 609-10.
\item \textsuperscript{48} 388 U.S. at 382.
\item \textsuperscript{49} The suggestion has been made that the Schwinn Court, upon being faced with a voluminous record with the Court was unable or unwilling to examine closely, resolved the issue of whether intrabrand restraints could be justified by promotion of interbrand competition, by fashioning a simple test based on ownership of the goods affected by the restraints. R. McLaren, \textit{Marketing Limitations on Independent Distributors and Dealers-Prices, Territories, Customers, and Handling of Competitive Products}, 13 \textit{Antitrust Bull.} 161, 167-69 (1968).
\item \textsuperscript{50} 405 U.S. at 612.
\end{itemize}
The *Topco* case did not present a clear case of balancing interbrand with intrabrand competition. Topco's argument was that the increase in competition between *supermarkets* as business entities justified the restrictions on intrabrand competition in Topco products. The relationship between these areas of competition is remote enough to consider them "different sectors of the economy,"⁵¹ while interbrand and intrabrand competition in the same *product* market (as in the bicycle market) would not constitute two different sectors of the economy.

The *Topco* decision leaves much doubt about the validity of the proposition that restraints of intrabrand competition in any form can be justified on the ground they promote interbrand competition. Yet *Topco* is somewhat different from the intrabrand-interbrand situation, so that that proposition may still be valid. The question becomes whether the Court will extend the analysis used in *Topco* to include a clearly defined intrabrand-interbrand case. This will depend upon the Court's view of how different a "sector of the economy" the market for a single brand of one product is, from the market for all brands of that product.

**CONCLUSION**

The net effect of *Topco* is the narrowing of the range of permissible allocations of market territory. The decision may mark the removal of an important justification which is applicable to vertical territorial allocations where title has not passed, *viz.*, the argument that the effect of the arrangement is to increase interbrand competition. If this justification is no longer valid, then only manufacturers which own their own retail outlets will be able to obtain the efficiency of vertical integration. Because this requires a large amount of capital, only the large firms will have this economic efficiency, so that smaller firms will operate at a disadvantage.⁵² The Court, however, will probably strike down any restrictions justifiable only by their effect on interbrand competition. As Justice Blackmun stated in his opinion concurring with the *Topco* majority, "Relief, if any is to be forthcoming, apparently must be by way of legislation."⁵³

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⁵¹ Id. at 610.
⁵³ 405 U.S. at 613.