

Antitrust - Franchise Agreement Between Manufacturer and Distributors - Concerted Action to Enforce Held a Per Se Violation of Sherman Act

Bruce Bauer

Follow this and additional works at: <https://via.library.depaul.edu/law-review>

Recommended Citation

Bruce Bauer, *Antitrust - Franchise Agreement Between Manufacturer and Distributors - Concerted Action to Enforce Held a Per Se Violation of Sherman Act*, 16 DePaul L. Rev. 196 (1966)

Available at: <https://via.library.depaul.edu/law-review/vol16/iss1/12>

This Case Notes is brought to you for free and open access by the College of Law at Via Sapientiae. It has been accepted for inclusion in DePaul Law Review by an authorized editor of Via Sapientiae. For more information, please contact wsulliv6@depaul.edu, c.mcclure@depaul.edu.

CASE NOTES

ANTITRUST—FRANCHISE AGREEMENT BETWEEN MANUFACTURER AND DISTRIBUTORS—CONCERTED ACTION TO ENFORCE HELD A PER SE VIOLATION OF SHERMAN ACT

Defendant, General Motors, marketed its Chevrolet automobiles in the Los Angeles area through franchised dealers. Each franchise agreement contained a "location clause," which prohibited the dealer *inter alia* from establishing branch sales offices without the prior written approval of General Motors. Beginning in the late 1950's, a minority of the dealers began to violate the terms of the location clauses by supplying discount houses with new Chevrolets to be sold to the public. Following protests from the three defendant Associations of Chevrolet Dealers, General Motors obtained agreements from each dealer to abandon the activities in question. The associations then jointly undertook to police the agreements and General Motors used the information obtained through the associations' surveillance to confront recalcitrant dealers and force them to capitulate. In 1964 the United States commenced an action in the district court to enjoin defendants from conspiring and combining to effect an unreasonable restraint of trade. Relief was refused on the grounds that the Government had failed to prove a conspiracy and that General Motors had acted legally to protect its dealer organization.¹ Direct appeal was taken to the Supreme Court of the United States under section 2 of the Expediting Act.² The Supreme Court reversed and remanded for appropriate equitable relief finding that a classic conspiracy in restraint of trade did in fact exist. The Court bottomed its decision on the elimination of a class of competitors from access to the market and the deprivations of franchised dealers' freedom to deal through discounters. No determination was made as to the validity or economic desirability of the location clauses; the Court holding that the joint collaborative action of the de-

¹ *United States v. General Motors Corp.*, 234 F. Supp. 85 (S.D. Cal. 1964). It is of interest to note that the Government first proceeded criminally. The defendants were found not guilty. *United States v. General Motors Corp.*, 216 F. Supp. 362 (S.D. Cal. 1963).

² The statute provides for direct appeal to the Supreme Court from a district court's final decision in civil antitrust suits in which the plaintiff is the Government. 32 STAT. 823 (1903), 15 U.S.C. § 29 (1964). For arguments supporting and criticizing the Act see Cellar, *Case in Support of Application of the Expediting Act to Antitrust Suits*, 14 DE PAUL L. REV. 29 (1964) and Comment, 13 DE PAUL L. REV. 261 (1964), respectively.

defendants was a per se violation of the Sherman Act.³ *United States v. General Motors Corp.*, 384 U.S. 127 (1966).

The purpose of this case note is to analyze the Supreme Court's reasoning and ascertain to what extent it has restricted the means by which a manufacturer or producer may attempt to secure adherence to lawful restrictions placed upon the distributors of its product. The significance of the Court's decision lies not in the fact that defendant General Motors is the largest manufacturing corporation in the United States, but in the possibility and probability of its being used as precedent in future cases involving similar distribution and market structures.⁴ A great number of consumer products are marketed through similar systems of selective distribution in order to achieve maximum sales volume.⁵

The Supreme Court in holding the activities of the defendants as unlawful per se has significantly expanded the scope of per se violations of the Sherman Act. Before the prospective effect of the Court's ruling on restrictive marketing and the property of its decision can be determined, it is necessary to review the judicial interpretations of the Sherman Act, including the application of the marketing terms "vertical" and "horizontal" to resale price maintenance, group boycotts and selective distribution.

Section 1 of 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 hereby declared to be illegal. . . ." The statute has been judicially interpreted to mean that only "unreasonable" restraints of trade are illegal.⁶ In *Chicago Board of Trade v. United States*⁷ the Supreme Court said:

The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the Court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the

³ 26 STAT. 209 (1937), 15 U.S.C. § 1 (1964).

⁴ The Supreme Court rejected a plea by numerous manufacturers who appeared as Amici Curiae to treat the automobile industry as sui generis and limit the scope of the decision to the specific realities of the industry.

⁵ Note, 75 HARV. L. REV. 795 (1962). Relatively expensive goods for which consumers will shop around and compare prices and defer purchases are usually marketed through selective channels of distribution viz. exclusive franchises, franchises with territorial restrictions, and franchises with customer restrictions, as opposed to intensive distribution to achieve maximum sales volume.

⁶ *Standard Oil Company of New Jersey v. United States*, 221 U.S. 1 (1911).

⁷ 246 U.S. 231 (1918).

particular remedy, the purpose or end sought to be attained, are all relevant facts.⁸

However some conduct has been declared to be illegal per se without regard to its reasonableness.⁹ As stated in *Northern Pac. R. Co. v. United States*:¹⁰

there 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.¹¹

Resale price maintenance unquestionably constitutes a per se violation of the Sherman Act. The term "vertical" as used in marketing refers to the channel of distribution through which goods flow from the manufacturer to the ultimate consumer. Goods can be sold directly to the ultimate purchaser, but more commonly they will be handled by one or more intermediaries, such as a retailer or a wholesaler.¹² In vertical resale price maintenance situations a manufacturer will typically try to induce its wholesale and retail distributors to buy and resell its product in accordance with a published price list. The producer will also attempt to prevent its distributors from purchasing from and selling to other distributors who do not follow the producer's price maintenance policy.

It was first held that written agreements obligating distributors to resell at fixed prices were invalid and unenforceable by a manufacturer, because such undertakings obviously restrained trade and destroyed retail competition.¹³ In *United States v. Colgate & Co.*¹⁴ the Court granted that a manufacturer having announced a price maintenance policy, may bring about adherence to it by refusing to deal with customers who do not observe that policy. But a refusal to deal in the future does not mean that a manufacturer can secure adherence through an implied agreement, thus defendant could not after its investigators discovered a violation of its price list suspend the recalcitrant merchant's source of supply until an

⁸ *Id.* at 238.

⁹ The pursuant discussion of per se violations is not intended to be exhaustive but is limited to those cases cited by the Supreme Court in support of its opinion. See generally, Bloom, *A Guide to Antitrust*, 20 BUS. LAW. 61 (1964); Gottlieb, *The Tentative Commandments of Antitrust*, 8 PRAC. LAW. 91 (Dec. 1962); and von Kalinowski, *The Per Se Doctrine—An Emerging Philosophy of Antitrust Law*, 11 U.C.L.A. L. REV. 569 (1964).

¹⁰ 356 U.S. 1 (1958).

¹¹ *Id.* at 5. In the case at bar the Court said: "We need not inquire into the economic motivation underlying their conduct." 384 U.S. at 146.

¹² See ALEXANDER, SURFACE AND ALDERSON, *MARKETING* (3d ed. 1953); CLEWETT, *MARKETING CHANNELS* (1954).

¹³ *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911).

¹⁴ 250 U.S. 300 (1919).

adequate assurance of future obedience was received. Such an arrangement, an implied in fact agreement, to maintain resale prices is as invalid and injurious to the public interest as an express agreement.¹⁵ The case of *Federal Trade Comm'n v. Beech-Nut Packing Co.*¹⁶ further limited the scope of lawful activity that can be taken by a supplier to obtain adherence to its price list. There the defendant had enlisted the assistance of its wholesalers, jobbers, and retailers in detecting price cutters to assure compliance with its price policy. It was held that an agreement is not necessary to establish an illegal conspiracy, if such co-operation exists by which the natural flow of commerce and freedom of competition is naturally restrained.¹⁷ The doctrine of the invalidity of vertical resale price maintenance reached its present bounds in *United States v. Parke, Davis & Co.*¹⁸ where the Court pronounced the area of permissible conduct:

It must be admitted that a seller's announcement that he will not deal with customers who do not observe his policy may tend to engender confidence in each customer that if he complies his competitors will also. But if a manufacturer is unwilling to rely on individual self-interest to bring about general voluntary acquiescence which has the collateral effect of eliminating price competition, and takes affirmative action to achieve uniform adherence by inducing each customer to adhere to avoid such price competition, the customers' acquiescence is not then a matter of individual free choice prompted alone by desirability of the product. The product then comes packed in a competition-free wrapping—a valuable feature in itself—by the virtue of concerted action induced by the manufacturer. The manufacturer is thus the organizer of a price-maintenance combination or conspiracy in violation of the Sherman Act.¹⁹

Thus it can be said that a pre-announced price maintenance policy coupled with a practice of discontinuing sales to violators is legal, but the potentiality of a violation is multiplied once the supplier engages in more than mere customer selection. Distributors cannot be engaged in a program to promote general compliance, dealings cannot be suspended until adequate assurance of future compliance is received, nor can a supplier terminate dealings and then give the violator a second chance by resuming dealings under probation.²⁰

¹⁵ *Accord*, *United States v. Schrader's Sons, Inc.*, 52 U.S. 85 (1920); and *Fry & Son v. Cudahy Packing Co.*, 256 U.S. 208 (1921), in which it was held that the dealers co-operation by merely following the manufacturer's price list did not amount to an implied agreement to maintain resale prices.

¹⁶ 257 U.S. 441 (1922).

¹⁷ *Accord*, *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707 (1944), wherein only wholesale price maintenance was attempted.

¹⁸ 362 U.S. 29 (1960).

¹⁹ *Id.* at 46-47.

²⁰ The supplier cannot indirectly coerce compliance by consigning his goods, rather than selling to its retailer-sublessee, *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964). See generally Note, 14 DE PAUL L. REV. 165 (1964).

The word "horizontal" as applied to marketing relates to those, as a group, who are at the same level in a channel of distribution. It may be used in connection with the wholesalers of a class of merchandise or it may concern the producers or consumers of a commodity.²¹ Horizontal conspiracies to fix or maintain prices consisting of concerted activity by competitors at the same level of distribution are also illegal per se.²²

In the case at bar it should be recalled that the Court proceeded on the basis of a per se violation without concerning itself with the legality of the location clause. Furthermore no inquiry was made into the lawfulness of the unilateral enforcement of the location clause assuming arguendo its validity. The Court reasoned:

Exclusion of traders from the market by means of combination or conspiracy is so inconsistent with the free-market principles embodied in the Sherman Act that it is not to be saved by reference to the need for preserving the collaborators' profit margins or their system for distributing automobiles. . . .²³

In applying this rationale the Court relied on *Fashion Originators' Guild of America, Inc. v. Federal Trade Comm'n*²⁴ and *Klor's Inc. v. Broadway-Hale Stores, Inc.*²⁵ Both involved group boycotts or concerted refusals by traders not to deal with their competitors. Such horizontal arrangements involving competitors have long been forbidden and deemed per se violations of the Sherman Act. In the former case members of an association of women's garments manufacturers agreed not to sell their goods unless the buyer agreed not to use or deal in goods which were copied by non association members from the designs of the members of the association. The Supreme Court ruled that if the object of the agreement, i.e. boycott of certain competitors, was unlawful, the reasonableness of the method of enforcement and the fact that prices were lowered were immaterial. *Klor's Inc. v. Broadway-Hale Stores*²⁶ involved a conspiracy of a retail department store chain and distributors and manufacturers of household appliances not to sell appliances to plaintiff or to sell to it at discriminatory prices and at highly unfavorable terms. The combination was held to be of a monopolistic nature and character and therefore forbidden even if allegedly reasonable in the specific circumstances and innocuous to prices.

In *White Motor Co. v. United States*²⁷ the Court for the first time examined the validity of territorial restrictions in a vertical arrangement.

²¹ *Supra* note 12.

²² *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940), wherein gasoline companies combined to purchase the excess production of independent refiners thereby increasing their contract prices, which were based upon current market prices.

²³ 384 U.S. 127, 146 (1966).

²⁴ 312 U.S. 457 (1949).

²⁵ 359 U.S. 207 (1959).

²⁶ *Ibid.*

²⁷ 372 U.S. 253 (1963).

Here the defendant, a manufacturer of trucks and truck parts, marketed its products in part through a system of distributors who were limited to specified geographic areas in which they could sell, as well as being prohibited from vending their stock to certain classes of purchasers, such as governmental agencies and fleet accounts. The Supreme Court held that the illegality of such arrangements could not be tested with a motion for a summary judgment and that their reasonableness should be determined in a trial. The rule that horizontally imposed territorial restrictions are per se violative of the antitrust laws was not extended to vertical arrangements. Instead the Supreme Court stated that the Sherman Act required the application of the rule of reason and therefore an inquiry into the facts particular to the business to which the restraint was applied. Mr. Justice Brennan in his concurring opinion stated that although territorial restrictions might have the same effect on intra-brand competition as resale price maintenance, they can be justified by a demonstration of a salutary effect on inter-brand competition.

It is interesting to contrast the system of distribution employed by White Motor Co. with that of General Motors. In the noted case the relationship between the manufacturer and its individual dealers was incorporated in a comprehensive uniform Dealer Selling Agreement, which did not restrict or define to whom the dealer could sell, nor did it limit the territory within which the dealer could sell. It can be seen that White's dealers were restrained to a much greater degree than those of General Motors. The relative autonomy enjoyed by the Chevrolet Dealers was conducive to the vigorous price competition that existed among them.

Judicial interpretation of the Sherman Act had established the illegality of horizontal boycotts and resale price maintenance—both horizontal and vertical. As per se violations of the Sherman Act, they cannot be economically justified and any contract, combination or conspiracy to effectuate one is unlawful. Conversely, the possibility of economic justification and reasonableness has been recognized in the situation of vertically imposed restrictions. However the instant case involved a vertical restriction enforced by a method conclusively held to be unlawful when used to effectuate horizontal boycotts and resale price maintenance. The goals of resale price maintenance and horizontal boycotts are illegal, not concert of action. Therefore, although it is illegal per se to use concerted activity to achieve a prohibited goal, it does not inexorably follow that when similar concerted activity is used to attain a lawful goal a per se violation of the Sherman Act must follow, as the Court held.

It should be plain why there is a real danger of the abuse of the *per se* principle by those predisposed to offer mechanical or dogmatic solutions to legal problems. In every antitrust case there are two routes to a finding of illegality:

critically analyzing the competitive effects and possible justifications of the challenged practice; or subsuming it under one of the *per se* rules. The latter route is naturally the more tempting; it is easier to classify a practice in a forbidden category than to demonstrate from the ground up, as it were, why it is against public policy, and should be forbidden. It is wholly improper, however, to dispose of an antitrust case by invoking a *per se* rule unless the challenged practice really fits the policy and rationale of the rule. If the rule must be stretched, or its language wrenched from context, to include the practice under it, the result will be to outlaw a business practice without any analysis of, or practical experience with, its actual competitive effects and possible economic justification.²⁸

Although vertically imposed restrictions have not themselves been declared to be of such a pernicious effect as to be without redeeming virtue, any attempt to enforce them in a manner similar to that previously employed for resale price maintenance might prove to be not only nugatory, but illegal as well. A full application of the *per se* rule would leave vertical restrictions totally enervated. A manufacturer could merely announce his scheme for restricted distribution and then hope that its individual dealers would voluntarily comply and that overzealous supporters of the plan would not engage in enforcement or investigative activities to encourage dissenters to co-operate. Noncompliance could be punishable only by the cancellation of a franchise or dealership, a very expensive price for both parties to pay.

In the present case it is evident that the Supreme Court rejected many strong economic arguments in favor of the defendants' activities.²⁹ The district court stated that a denial of General Motors' right to set standards for its dealers on the theory of an unreasonable restraint on trade would

²⁸ Remarks by Federal Trade Commissioner Philip Elman before the First Annual Antitrust Institute in Pittsburgh, Pennsylvania, November 5, 1965 in Practice Materials for First Antitrust Institute, Appendix "A" 4-5.

²⁹ Some of the main arguments were: (1) Manufacturers of trademarked items have a vital interest in the marketing process in order to protect their goodwill. (2) The discount houses did not provide service and maintenance facilities and franchise dealers were forced to provide service and repairs pursuant to General Motors' warranties on automobiles which had been purchased from discounters, because of the latter's inability to do so. (3) Franchise dealers have large investments in showrooms, inventory, service facilities, equipment, parts and accessories, and trained personnel. (4) Restricted distribution of automobiles actually reduces prices by placing the dealers in a better position to compete with dealers of other makes of automobiles. (5) Only intra-brand competition was affected. Protection of the franchise dealers strengthens them and thereby enhances inter-brand competition. See generally: Brief for Appellee General Motors Corp.; Brief for Appellees Losor Chevrolet Dealers Association, Dealers' Service, Inc., and Foothill Chevrolet Dealers Association; Brief for Amici Curiae; Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division II*, 75 YALE L. J. 375 (1966); McLaren, *Territorial Restrictions, Exclusive Dealing, and Related Sales Distribution Problems under the Antitrust Laws*, 11 PRAC. LAW. 79 (April 1965).

probably entirely eliminate the distribution system. In conclusion it is hoped that in the future that the instant case will be treated as *sui generis* and the Court's comprehensive language will not be sweepingly applied to categorize attempts at restricted distribution as *per se* violations of the Sherman Act.

Bruce Bauer

CONSTITUTIONAL LAW—BALANCING OF FREE PRESS AND FAIR TRIAL—INHERENT PREJUDICE FROM MASS PUBLICITY

In 1954, Dr. Samuel Sheppard was convicted of murdering his wife. Sensational publicity attended the murder investigation and trial, saturating the community with prejudice. In addition, it was alleged that the trial judge's permissive attitude toward the press resulted in disorder in the courtroom.¹ In 1964 the United States District Court of Ohio, upon a writ of habeas corpus, held that Sheppard was not afforded a fair trial. The Court of Appeals reversed by a divided vote, and the Supreme Court granted certiorari. Upon review, the Supreme Court held that the failure of the trial judge to protect the trial from inherent prejudicial publicity deprived Sheppard of a fair trial consistent with due process. The courtroom lacked the "judicial serenity and calm to which he was entitled."² *Sheppard v. Maxwell*, 384 U.S. 333 (1966).

The *Sheppard* case represents a classic example of publicity interfering with the trial process. There has been a prevalence of such interference in recent years, due to the development of mass communication media. Possibly in response to this, the High Court in the *Sheppard* case sets forth suggestions for the prevention of prejudice in future trials. This note will

¹ Sheppard was convicted in 1954 in the Court of Common Pleas of Cuyahoga County, Ohio. His conviction was affirmed by the Court of Appeals for Cuyahoga County, *State v. Sheppard*, 100 Ohio App. 345, 128 N.E.2d 471 (1955), and the Ohio Supreme Court, 165 Ohio St. 293, 135 N.E.2d 340 (1956). The United States Supreme Court denied certiorari on the original appeal. 352 U.S. 910 (1956).

Examples of the prejudicial publicity and the trial judge's errors may be enumerated: a three day televised inquest in which Sheppard's counsel were not allowed to participate; articles in all three Cleveland newspapers stressing Sheppard's alleged extramarital affairs as a murder motive; repeated criminating statements by law enforcement personnel; publication in all three Cleveland newspapers of the veniremen and their addresses, resulting in letters and calls to all of them; the trial judge's permitting a news table to be set up within the bar and directly in back of counsel table; his failure to question jurors as to their exposure to news publicity; his failure to sequester the jury.

² *Sheppard v. Maxwell*, 384 U.S. 333,334 (1966). *Accord*, *Estes v. Texas*, 381 U.S. 532 *passim* (1965).