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THE FUTURE OF RECIPROCITY: A STUDY IN ANTITRUST DECISIONAL TECHNIQUE

INTRODUCTION

With deference to oversimplification, it may be said the Supreme Court by numerous holdings¹ has denoted certain types of business agreements as being per se violative² of section 1 of the Sherman Antitrust Act.³ Recent decisions,⁴ however, as well as articles⁵ indicate that the per se doctrine needs further delineation or, at a minimum, clarification in respect to what is commonly called reciprocal dealing agreements.⁶ The need for clarification seems timely in the area which the Solicitor General loosely labels "accommodation reciprocity."⁷

Reciprocity has been defined generally as any business dealing between independent firms whereby they make mutual concessions designed to promote the business interests of each.⁸ Primarily as a result of three decisions,⁹ corporate advisors presently are unable to predict with certainty potential antitrust consequences resulting from a client's entering into an agreement which provides for reciprocal dealing.¹⁰

One United States district court recently held¹¹ that since mutual dealing agreements—heretofore unchallenged under the Sherman Act—may result in restraining trade, such agreements consequently are within

1. *E.g.*, *United States v. Gen. Motors Corp.*, 34 U.S.L. WEEK 4383 (April 28, 1966); *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951).

2. These agreements, which subsequently will be more fully described, include: price fixing; group boycotts; allocation of markets; allocation of customers, and tying arrangements.

3. 26 Stat. 209 (1890), as amended, 15 U.S.C. § 1 (1958).

4. See *FTC v. Consolidated Foods Corp.*, 380 U.S. 592. *United States v. Gen. Dynamics Corp.*, 246 F. Supp. 156 (S.D.N.Y. 1965); *United States v. Gen. Dynamics Corp.*, 35 U.S. LAW WEEK 2125 (Sept. 13, 1966).

5. Handler, *The Polarities of Antitrust*, 60 NW. U.L. REV. 751 (1966); Handler, *Gilding the Philosophic Pill—Trading Bows for Arrows*, 66 COLUM. L. REV. 1 (1966); Handler, *Recent Antitrust Developments—1965*, 40 N.Y.U.L. REV. 823 (1965), and Austin, *A Survey of Problems Encountered in Combating Reciprocal Trading Under Existing Trade Regulation Laws*, 41 IND. L.J. 165 (1966).

6. For a discussion of reciprocal dealing agreements generally, see STOCKING, *WORKABLE COMPETITION AND ANTITRUST POLICY* 289-318 (1961).

7. Brief for the FTC, p. 23, *FTC v. Consolidated Foods Corp.*, 380 U.S. 592 (1965).

8. STOCKING, *op. cit. supra* note 6, at 289.

9. *FTC v. Consolidated Foods Corp.*, 380 U.S. 592 (1965); *United States v. Gen. Dynamics Corp.*, 246 F. Supp. 156, 158 (S.D.N.Y. 1965). *United States v. Gen. Dynamics Corp.*, 35 U.S. LAW WEEK 2125 (1966).

10. See discussion *infra*, pp. 134-38.

11. *United States v. Gen. Dynamics Corp.*, 35 U.S. LAW WEEK 2125 (Sept. 13, 1966).

the reach of section 1.¹² The same court had earlier held that reciprocity may be an anticompetitive device since agreements giving rise to reciprocity, place restraints upon trade.¹³ However, the court at that time did not answer the crucial inquiry—whether the restraints imposed on trade by an agreement calling for reciprocity, are in *all* instances *unreasonable*. This inquiry was partially answered a few weeks ago by the United States District Court for the Southern District of New York.¹⁴ That court declared that reciprocal agreements giving rise to reciprocity constitute a per se violation of section 1 of the Sherman Act, *provided* a “not insubstantial amount of commerce is affected.”¹⁵ In so stating the law, the district court rejected both the blanket per-se-illegal-decisional approach as well as the Brandeis-rule-of-reason technique (which effectually permits each case to be decided on the totality of its particular facts).

This note, although surveying various reciprocal practices, focuses upon a particular business arrangement—the cross-franchise distribution agreement.¹⁶ Cross-franchising results in the practice denoted “reciprocal selling” as subsequently herein distinguished from “reciprocal buying.”¹⁷ Prior to the analysis of distinguishable reciprocal dealing ar-

12. 26 Stat. 209 (1890), as amended, 15 U.S.C. § 1 (1958).

13. *United States v. Gen. Dynamics Corp.*, 246 F.Supp. 156, 166 (S.D.N.Y. 1965).

14. *United States v. Gen. Dynamics Corp.*, 35 U.S. LAW WEEK 2125 (Sept. 13, 1966).

15. *Id.* at 2126.

16. Under terms in cross-franchise agreements, the parties appoint each other as agents for the respective distribution of each other's manufactured products. The cross-selling aspect will be analyzed in detail in subsequent text discussion.

Franchise distribution is a method of product and/or service channel distribution where generally the market supplier (who may or may not be the manufacturer) makes an agreement with a distributor. Generally, the franchise limits the number of distributors in a restricted and specific territory. Often only one franchised dealer is appointed for a particular area—called an exclusive franchise agent. Franchise provisions may restrict the dealer from selling outside the specified territory—called closed franchise provisions. These closed provisions have been frequently invalidated by the courts. Yet, since 1945, franchise distribution has grown rapidly. Averill, *Antitrust Consideration of the Principle of Distribution Restrictions in Franchise Agreements*, 15 AM. U.L. REV. 28 (1964).

As a general proposition, exclusive as opposed to closed franchise-distributive arrangements will be upheld if shown not to unreasonably restrain trade. *United States v. Bausch Lomb Optical Co.*, 321 U.S. 707 (1944); *accord*, *Schwing Motor Co. v. Hudson Sales Corp.*, 138 F. Supp. 899 (D. Md. 1956), *aff'd per curiam*, 239 F.2d 176 (4th Cir. 1956), *cert. denied*, 355 U.S. 823 (1957).

For a general discussion of possible antitrust consequences resulting from closed franchise agreements, see Stone, *Closed Territorial Distribution: An Opening Question in the Sherman Act*, 30 U. CHI. L. REV. 286 (1963) (the author contends that territorial limitations should be allowed only when a *newcomer* adopts such limitations for a reasonable time).

17. See generally Handler, *Recent Antitrust Developments—1965*, 40 N.Y.U.L. REV. 823 (1965).

Analytically, reciprocal buying may be broken down into three categories:

rangements there is presented a conceptual discussion of two principle decisional techniques used by courts in applying section 1 of the Sherman Act. Following this conceptual analysis is a discussion of case law involving territorial division practices. The cases discussed illustrate the courts' use and application of the contrasting decisional processes. Finally, the note suggests judicial application of the flexible rule of reason decisional technique to reciprocal dealing situations.¹⁸

Although this note is limited to a discussion of reciprocity under section 1 of the Sherman Act,¹⁹ it should be remembered that reciprocal dealing may result not only in a "restraint of trade," but also in: (1) a "substantial lessening of competition" as prohibited by section 3 of the Clayton Act;²⁰ (2) "an unfair method of competition" as prohibited by section 5 of the Federal Trade Commission Act;²¹ (3) "a tendency to create a monopoly" as prohibited by section 3 of the Clayton Act;²² and (4) "price discrimination" as defined and prohibited under various provisions of the Robinson-Patman Act.²³

SUPREME COURT ANTITRUST DECISIONAL TECHNIQUE IN APPLYING § 1 OF THE SHERMAN ACT

Section 1 of the Sherman Act provides that any agreement which results in a restraint of trade or commerce among the states or with foreign nations is illegal.²⁴

first, coercive reciprocity induced by explicit or implicit force—'If you want me to buy from you, you'd better buy from me'; second, consensual reciprocity established by voluntary agreement of the parties—I will buy from you and you will buy from me'; and finally mutual patronage, absent any coercion or agreement—'He has bought from me, *ergo*, I will buy from him.' Although the lines separating these categories may not always be clear-cut in practice, they nevertheless provide an instructive tool for discriminating antitrust treatment. . . .

Handler, *supra* at 837.

18. The flexible rule of reason approach apparently was endorsed by the Supreme Court in the *White Motor Co.* case, which held that vertical territorial distributive agreements may not be within the per se category of illegality. *White Motor Co. v. United States*, 372 U.S. 253 (1963).

19. 26 Stat. 209 (1890), as amended, 15 U.S.C. § 1 (1958).

20. 38 Stat. 731 (1914), 15 U.S.C. § 14 (1958).

21. 66 Stat. 632 (1952), 15 U.S.C. § 45(a) (1958).

22. 38 Stat. 731 (1914), 15 U.S.C. § 14 (1958).

23. 49 Stat. 1526 (1936), 15 U.S.C. § 13 (1958).

24. "Every 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." 26 Stat. 209 (1890), as amended, 15 U.S.C. § 1 (1958).

For a discussion of the legislative history and background of § 1, see generally VAN CISE, *UNDERSTANDING THE ANTITRUST LAWS* 20 (1963); Van Cise, *The Future of Per Se in Antitrust Law*, 50 VA. L. REV. 1165 (1964); Kalinowski, *The Per Se Doctrine—An Emerging Philosophy of Antitrust Law*, 11 U.C.L.A. L. REV. 569, 571 (1964); Chadwell, *Competition and Section 1 of the Sherman Act—Instant Antitrust or Long Run Policy?*, 27 A.B.A. ANTITRUST SECTION 60 (1965), and Schwartz, *A Law Profes-*

Historically, and primarily due to contrasting antitrust decisional techniques used by the Supreme Court,²⁵ there have developed two nominal categories of illegality within the purview of section 1. One category comprises those agreements adjudged to be illegal *per se*, i.e., judicially determined to be unjustifiable under *any* circumstances.²⁶ The second category of illegality consists of those agreements which courts have held unreasonable in restraining trade or commerce under *particular* circumstances.²⁷

Employing a mechanistic dialysis of the above two categories, a court often will first inquire whether the type of business agreement may be justifiable—i.e., whether it is capable of being legally rationalized by showing probable and consequential trade effects. If a court considers the general “type” of agreement potentially justifiable, in effect the court decides not to employ the expedient decisional technique of de-

sor's View of the Sherman Act—Fluid Fronts in the War Against Excessive Concentration of Economic Power, 27 A.B.A. ANTITRUST SECTION 87 (1965).

25. *E.g.*, United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); *Cf.* Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918).

26. See Int'l Salt Co. v. United States, 332 U.S. 392 (1947); *accord*, Holophane Co. v. United States, 352 U.S. 903 (1956).

The commercial facts . . . may, on occasion, reveal a statutory restraint of a nature clearly prohibited by the competitive objective of the antitrust laws such as, for example, an agreement between competitors which establishes the prices in, or excludes others from, the market. In this event the court will condemn the conduct out of hand as indefensible, or *per se* in violation of these laws. 1955 ATT'Y GEN. NAT'L COMM. ANTITRUST REP. 24, citing United States v. Columbia Steel Co., 334 U.S. 495, 522 (1948).

Usually it is said that the ‘per se’ types under Section 1 are (a) horizontal and vertical price fixing agreements, (b) horizontal allocation of markets and customers, (c) tying arrangements, and (d) group boycotts.

CHADWELL, *op. cit. supra* note 4, at 63.

Few will quarrel with rules which condemn price agreements among competitors to reduce market competition or to divide up the market. These rules deal with the most obvious direct restraints of competition, and alone cover a high percentage of the actual antitrust cases brought. But, even in these classic areas, there is a danger of being too mechanical.

Chadwell, *supra* at 63, 64.

27. Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918). In writing the Court's opinion, Mr. Justice Brandeis formulated the now classic rule of reason to be applied in § 1 prosecutions:

Every agreement concerning trade, every regulation, restrains. To bind, to restrain, is of their very essence. 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 is 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 particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.

Chicago Bd. of Trade v. United States, *supra* at 238.

noting the agreement to be within the per se illegal category of section 1 violations.²⁸ Subsequently, the court in determining the particular agreement's legality or illegality will apply the so-called "rule of reason test."²⁹

The phrase "rule of reason" tends to be misleading for the term "rule" implies "certainty" in application. Antitrust analysis, however, involves no such simplistic mathematical formulae.³⁰ Rather, the rule of reason "test" has developed as an intentionally vague standard affording courts a flexible technique for deciding particular cases primarily on their own facts.³¹ The two deceptively distinguishable categories of illegality referred to above, reflecting contrasting decisional techniques, represent convenient boundaries for an analytical discussion of section 1's potential

28. See, e.g., *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958). But see *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940), where the Court never mentioned justification, but rather held that per se illegality resulted from an "actual or potential threat to the central nervous system of the economy." See generally 1955 ATT'Y GEN. NAT'L COMM. ANTITRUST REP. 23.

29. See, e.g., *Standard Oil Co. v. United States*, 221 U.S. 1 (1911). In this case, Mr. Chief Justice White formulated what today is known generally as the rule of reason. This rule of statutory construction, was further developed in the same year in *United States v. Am. Tobacco Co.*, 221 U.S. 106 (1911).

Construing both sections [of the Sherman Act], the Rule of Reason as the general rule of construction . . . requires interpreting the Act in light of a broad public policy favoring competition and condemning monopoly. While *Standard Oil* gave the courts discretion in interpreting the word 'every' in Section 1, such discretion is confined to consideration of whether in each case the conduct being reviewed under the Act constitutes an undue restraint of competitive conditions, or a monopolization, or an attempt to monopolize. This standard permits the courts to decide whether conduct is significantly and unreasonably anticompetitive in character or effect; it makes obsolete once prevalent arguments, such as, whether monopoly arrangements would be socially preferable to competition in a particular industry, because for example, of high fixed costs or the risks of 'cut-throat' competition or some other similar unusual conditions.

1955 ATT'Y GEN. NAT'L COMM. ANTITRUST REP. 10. For a summary of the development of the rule of reason doctrine and decisional technique, see generally Bergson, *In Restraint of*, 1953 A.B.A. ANTITRUST SECTION 49.

30. The predictive task of the attorney attempting to predetermine antitrust consequences of a client's proposed intra or intercorporate agreement is a complicated process. In addition to often confusing case law, the practitioner is confronted with vacillating enforcement policies—policies promulgated by the Justice Department's Antitrust Division, as well as the Federal Trade Commission. Furthermore, the attorney must be knowledgeable of arguable policy considerations while keeping abreast of continuing developments under four distinct but overlapping federal antitrust statutes. Add to this labyrinth the numerous economic considerations which pervade antitrust law—corporate bigness, relevant markets, competitive status, market dominance, market composition, product differentiation, etc. Finally, to participate in the antitrust arena whether as a litigator or counselor, the practitioner must know the language of antitrust specialization—market allocation, coercive reciprocity, tying agreements, resale price maintenance, refusals to deal, customer allocation and/or preference, corporate conspiracy, vertical integration, conglomerate mergers, group boycotts, horizontal territorial allocation, patent grant backs and patent pools, exclusive and closed franchises, etc. Such terminology may be likened to semantic tools, available to aid courts in attaining the objects of a free enterprise economy.

31. See *White Motor Co. v. United States*, 372 U.S. 253 (1963).

application to particular executory or executed business agreements challenged thereunder. Consequently, one may consider the labels "per se" and "unreasonable" as nominal designators which have been judicially applied as a result of using contrasting decisional techniques to the polar extremities of section 1's encompassment of illegal business agreements. Although the results may be the same—for example, a determination of illegality—the methods used to reach the eventual result are, as will be shown subsequently, quite dissimilar.

Arguments favoring the use of the per se decisional technique include: (1) ease of judicial administration;³² (2) the avoidance of what otherwise might turn into protracted litigation;³³ (3) predictive certainty resulting from an either/or approach;³⁴ (4) the avoidance of hard decisions in close cases;³⁵ (5) the probable discouragement of appeals and petitions for writs of certiorari;³⁶ and (6) the possible discouragement of corporate attempts to circumvent section 1.³⁷ The administration of a per se technique is simple. The court limits the factual determination to

32. Travers & Wright, *Restricted Channels of Distribution Under the Sherman Act*, 75 HARV. L. REV. 795 (1962). See generally Ward, *Franchise Restrictions: "Tied" Sales and Territorial Limitations*, 23 WASH. & LEE L. REV. 66 (1966).

33. In *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958), the Supreme Court stated:

This principle of *per se* unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain in the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable—an inquiry so often wholly fruitless when undertaken.

Northern Pac., *supra* at 5.

34. During the past decade—indeed from the very birth of our federal anti-trust laws in 1890—strong forces have urgently sought the evolution of some automatic or per se rules of antitrust liability. And these forces are still at work. On the one hand, the business community understandably has been 'hot for certainty' in the law in order to be able to plan with assurance its day-to-day transactions. Congress, the enforcement agencies, and the courts have wanted to be able to avoid the complexities and delays resulting from large records in prolonged trials, and accordingly they too have urged the adoption of simplified tests of illegality.

These forces have worked together over the years in contributing to the development of judicial rulings that certain, specified practices are per se unlawful under the antitrust laws.

Van Cise, *The Future of Per Se in Antitrust Law*, 50 VIR. L. REV. 1165, 1166 (1964).

35. By hard cases are meant those in which the restraints upon trade are counter-balanced by economic facts which would tend to justify the agreement, according to the classic formula of Mr. Justice Brandeis in *Chicago Bd. of Trade v. United States*, 246 U.S. 231 (1918); see note 27 *supra*. See also *Snap-On-Tools Corp. v. FTC*, 321 F.2d 825 (7th Cir. 1965).

36. It is suggested that appeals would increase if the flexible rule of reason decisional technique were substituted in those situations which presently are decided by using the per se technique. However, there is no authority for this assertion.

37. See, e.g., dissent in *White Motor Co. v. United States*, 372 U.S. 253 (1963).

the question essential for application of the per se standard—Did the defendants agree to fix prices? If the evidence shows that they did agree, the court decides that the agreement constitutes a per se violation of section 1. Similarly, by limiting the factual inquiry, protracted litigation which could result from exhaustive attempts to show justification, may be avoided.³⁸ Moreover, an either/or polarity technique which ignores the possibility of greys obviously affords a degree of predictive certainty unattainable under a flexible decisional standard.³⁹ Consequently, by using the polarity approach courts avoid the necessity of struggling to rationalize a hard decision, since per se seemingly overrides what in lieu of per se technique would be called countervailing considerations.⁴⁰

The major defect in per se technique is that it tends to be overly inclusive in application. An undesirable consequence of extending the per se technique to a general category of distinguishable business agreements is that traditional defenses to section 1 actions, defenses based upon the doctrine of justification⁴¹—being permitted to attempt to justify the agreement by showing economic necessity or by showing that the agreement's effects did not unreasonably restrain trade or commerce—may be deemed immaterial.⁴²

The rule of reason technique, however, permits such defenses as a newcomer's entry into a distant market, or a corporation's proportionally insignificant share of its relevant market.⁴³

38. See, e.g., *United States v. Gen. Motors Corp.*, 34 U.S.L. WEEK 4383 (April 28, 1966), which held that the defendants had per se violated § 1 of the Sherman Act—that upon a showing of the group boycott, the case became dispositive.

39. See Handler, *Gilding the Philosophic Pill—Trading Bows for Arrows*, 66 COLUM. L. REV. 1 (1966). But see Bork, *The Rule of Reason & The Per Se Concept: Price Fixing & Market Division*, 74 YALE L.J. 775, 777 (1965).

40. See generally Markham, *Economic Analysis*, 1954 A.B.A. ANTITRUST SECTION 145. See also STOCKING, *WORKABLE COMPETITION AND ANTITRUST POLICY* 13-27 (1961).

41. See note 43 *infra*. See generally Stone, *Closed Territorial Distribution: An Opening Question in the Sherman Act*, 30 U. CHI. L. REV. 286 (1963).

42. In general, the significance of the "per se" concept is that upon a finding that a certain type of agreement is present, the agreement is adjudged to be 'unreasonably restrictive of competition' without further inquiry into intent, effect, or other circumstances deemed relevant to a policy of competition. The approach taken is not significantly different from that of nuisance law, for example, where a court will call a boiler factory in a residential district a 'nuisance per se'—without scrutiny of the facts about how the boiler operates, why it was built there, and what its actual effect on home owners would be. Chadwell, *Competition and Section 1 of the Sherman Act—Instant Antitrust or Long Run Policy?*, 27 A.B.A. ANTITRUST SECTION 60, 63 (1965).

43. The Supreme Court has never faced a situation in which an antitrust defendant based its defense upon its status as a market newcomer; however, it can be safely predicated from Court asides that such a defense would always have considerable weight and would likely be dispositive in a number of instances. . . . The term 'newcomer' as used herein, includes any company selling

Although the per se technique affords methodological ease and predictive certainty unattainable under the more flexible rule of reason technique, when the per se approach is applied to an entire class of agreements (for example, horizontal territorial division agreements), consistent adherence to strict application could result in courts invalidating certain intercorporate agreements the effects of which would foster and encourage interbrand competition.⁴⁴

The either it is per se illegal or per se legal approach of the fundamentalist seeking predictive certainty, typifies, as Professor Milton Handler points out,⁴⁵ the polarity either/or approach to antitrust analysis.⁴⁶

Adhering to this predictive certainty goal, the Supreme Court utilizing the polarity technique has by numerous holdings⁴⁷ denoted the following general classes of business agreements to be per se violative of section 1: price fixing;⁴⁸ group boycotts;⁴⁹ customer allocation;⁵⁰ and allo-

its product in a market which is novel for that company; therefore, it may refer to a new entrant into an established industry.

Flicker, *Newcomer Defenses: Reasonable Use of Tie-Ins, Franchises, Territorials & Exclusives*, 18 STAN. L. REV. 457 (1966). Flicker states his underlying assumption to be that competition should be stimulated by encouraging product innovation and new industries, and by keeping "entry barriers to established industries at reasonable levels." Flicker, *supra* at 457.

Concerning the issue of de minimis, or insubstantial effects—often said to be privileged conduct of small business units—see generally Oppenheim, *Small and Big Business: Orientation of Antitrust Points and Counterpoints*, 39 U. DET. L.J. 155 (1961).

44. See the discussion model of a reciprocal selling arrangement outlined subsequently in the text.

45. Handler, *The Polarities of Antitrust*, 60 NW. U.L. REV. 751 (1966).

46. Professor Handler discusses the development of the polarity theory, citing the article by the late Professor Morris Cohen [Cohen, *Concepts and Twilight Zones*, 24 J. OF PHILOSOPHY 673 (1936)].

Cohen theorized that in order to make logic applicable to empirical issues, one must invoke the "principle of polarity"; empirical facts are generally resultants of opposing and "yet inseparable tendencies" like the north and south poles. Consequently, the twilight zones are those regions about the point of equilibrium of opposite tendencies. Cohen, *supra* at 678.

Applying Cohen's methodology, Handler views as antipodal positions, those who would "apply black letter rules of per se illegality or per se legality to all forms of non-coercive reciprocal dealings." Handler, *supra* at 755. "The judicial polarists, whether they favor total validity or total invalidity, are essentially legal fundamentalists. . . . The polar view thus enhances the certainty and enforceability of our rules. While I strongly oppose this philosophy, I do not deny the potency of its rationale." Handler *supra* at 756. See also HANDLER, ANTITRUST IN PERSPECTIVE 17 (1957).

47. United States v. Gen. Motors Corp., 34 U.S.L. WEEK 4383 (April 28, 1966); Radiant Burners, Inc. v. Peoples Gas, Light & Coke Co., 364 U.S. 656 (1961); Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959); Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951); United States v. Nat'l Lead Co., 322 U.S. 319 (1947); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933); United States v. Trenton Potteries Co., 273 U.S. 392 (1927); E. States Retail Lumber Dealers Ass'n v. United States, 234 U.S. 600 (1914), and Addyston Pipe & Steel Co. v. United States, 175 U.S. 211 (1899).

48. United States v. Trenton Potteries Co., 273 U.S. 392 (1927); accord, Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933). But see Chicago Bd. of Trade

cation resulting in division of markets.⁵¹

Yet, the fact that there are judicially recognized exceptions⁵² to these per se classifications has caused some commentators to suggest that per se technique is merely a shorthand method of indicating that a particular agreement is unreasonable under any construction or application of the rule of reason—that there is no possible justification, or at least, no justification was shown in the particular facts of the case presented for adjudication.⁵³ However, there is sufficient language⁵⁴ in Supreme Court decisions which has warranted lower federal courts to strictly observe the apparent distinction between the two classes of illegality.⁵⁵

Even if it is true that denoting a particular agreement as per se illegal is merely a summary method for deciding that the agreement is unreasonable, there nonetheless exists the possibility that courts will stamp the per se label on a particular agreement before hearing and examining all evidence which under the peculiar economic facts of the case might legally justify the agreement.⁵⁶ The danger, in short, is that application of the per se technique precludes opportunity for justification.

v. United States, 246 U.S. 231 (1918). Cf. United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

49. United States v. Gen. Motors Corp., 34 U.S.L. WEEK 4383 (April 28, 1966); accord, Klors, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959).

50. Boro Hall Corp. v. Gen. Motors Corp., 317 U.S. 695 (1942).

51. Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951); Addyston Pipe & Steel Co. v. United States, 175 U.S. 211 (1899); accord, United States v. Nat'l Lead Co., 322 U.S. 319 (1947). Contra, White Motor Co. v. United States, 372 U.S. 253 (1963).

52. E.g., Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918) involving resale price maintenance; White Motor Co. v. United States, 372 U.S. 253 (1963) involving vertical territorial restrictions.

53. The current shibboleth of per se illegality in existing law conveys a sense of certainty, even of automaticity, which is delusive. The per se concept does not accurately describe the law relating to agreements eliminating competitions as it is, as it has been, or as it ever can be. Along side cases announcing a sweeping per se formulation of the law, there has always existed a line of cases refusing to apply it. Doubtless some of the cases in the latter group were wrongly decided, but it would be naive to write them all off as simply incorrect or aberrational. The persistent refusal of courts to honor the literal terms of the per se rules against price-fixing and market division agreements demonstrates a deep-seated though somewhat inarticulate sense that those rules, as usually stated are inadequate.

Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 74 YALE L.J. 775, 777 (1965).

54. See, e.g., the opinion written by Mr. Justice Fortas in United States v. Gen. Motors Corp., 34 U.S.L. WEEK 4383 (April 28, 1966).

55. E.g., United States v. Aluminum Co. of Am., 91 F.Supp. 65 (S.D.N.Y. 1955); United States v. Gen. Dyestuff Corp., 57 F. Supp. 642 (S.D.N.Y. 1944); Cf. United States v. Gen. Elec. Co., 40 F. Supp. 627 (S.D.N.Y. 1941); accord, United States v. Bayer Co., 135 F. Supp. 65 (S.D.N.Y. 1955).

56. An illustration of an agreement which although placing restraints on trade, also results in permitting a substantial increase in effective interbrand competition among actual competitors, will be presented subsequently in the text.

DECISIONAL TECHNIQUE APPLIED

Illustrative of this absolutist either/or per se decisional technique on the one hand, and the more flexible rule of reason on the other, is the judicial history of territorial division practices following the Supreme Court's decision in the *Timken Roller Bearing* case.⁵⁷ Timken, a United States based manufacturer of tapered roller bearings, entered into agreements with a British company and subsequently a French company, whereby American Timken, British Timken and French Timken by cross licenses agreed not to distribute or manufacture tapered roller bearings outside of their respective marketing areas. The principal effect and purpose of the agreements was to divide the production and distribution of tapered roller bearings into exclusive, segregated world markets.⁵⁸

The trial court found in its opinion⁵⁹ as a matter of fact,⁶⁰ and emphasized by the Supreme Court in its subsequent affirmance,⁶¹ that these companies enjoyed near total domination of their respective portions of the relevant market.⁶² American Timken possessed 78% of the relevant United States tapered roller bearing market; French Timken's portion amounted to 80% of its relevant market, while British Timken enjoyed 90% of its relevant market.⁶³ The principal effect on international trade which resulted from the agreements was the virtual elimination of exports and imports of tapered roller bearings into or out of the United States. Consequently, the relevant market dominance enjoyed by American Timken in the United States did not merely go unchallenged, but more significantly, was virtually unchallengeable.⁶⁴

A close reading of the facts in *Timken* reveals that the case involved: (1) patent license agreements including grant backs; (2) trademark license agreements; (3) linkage through stock ownership; (4) wholesale distributive arrangements drawn up for and executed by competitors; (5) marketing division agreements extending for over thirty-five years; (6) a single product commonly manufactured; and (7) virtual dominance of the relevant markets by the agreeing parties in their respective territories. In spite of this peculiar factual combination, certain courts subsequently cited *Timken* for the broad proposition that any agreement which

57. *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951).

58. *Ibid.*

59. *United States v. Timken Roller Bearing Co.*, 83 F. Supp. 284 (S.D.N.Y. 1949).

60. *Ibid.*

61. 341 U.S. 593 (1951).

62. *Id.* at 597 (1951).

63. 341 U.S. 593 (1951).

64. *Id.* at 604 (1951).

provides for a division of markets per se violates section 1 of the Sherman Act.⁶⁵

Moreover, the Department of Justice prior to the *White Motor* case of 1964,⁶⁶ took the position that territorial restrictions, whether imposed by dealers (horizontal restrictions) or imposed on dealers (vertical restrictions) were per se unlawful.⁶⁷

Horizontal restrictions result from suppliers, dealers or manufacturers agreeing to divide marketing, retailing or manufacturing territories respectively.⁶⁸ Such arrangements have been characterized as agreements among competitors to allocate markets.⁶⁹ Vertical restrictions, imposed by a manufacturer or distributor on his dealers or retailers, are of two principal varieties: first, those restrictions based on a dealer's considered promise (usually a franchise) not to sell the manufacturer's products outside a specified restricted marketing area, called closed territorial restrictions;⁷⁰ second, those restrictions represented by a manufacturer's or distributor's promise not to appoint any other retail agent or dealer within the restricted specified area assigned to a particular agent or dealer, often labeled "exclusive" territorial restrictions, generally in the form of an exclusive limited franchise.⁷¹

In *White Motor Company v. United States*,⁷² the Supreme Court in

65. See *United States v. Hollophane Co.*, 119 F.Supp. 114 (S.D. Ohio 1954), *aff'd per curiam*, 352 U.S. 903 (1956); *accord*, *United States v. Imperial Chem. Indus.*, 100 F.Supp. 504 (S.D.N.Y. 1951).

66. *White Motor Co. v. United States*, 372 U.S. 253 (1963).

67. The Justice Department in 1948 issued a policy statement declaring that in its view, territorial and customer restrictions were illegal per se. See *Hearings Before the Subcommittee on Automobile Marketing Legislation of the House Committee on Interstate and Foreign Commerce*, 84th Cong., 2d Sess. 362 (1956).

In the *White Motor* case, the Justice Department took the position that territorial restrictions on dealers should be held unlawful per se. "The Supreme Court declined to do so, on the ground that sufficient information was not available for making a judgment of this kind." Address by Donald F. Turner, Assistant Attorney General in Charge of the Antitrust Division, prepared for delivery before the Antitrust Section of the American Bar Association, Miami, Florida, August 10, 1965. For the latest statement by Mr. Turner on the per se position of the Justice Department, see 1966 N.Y. STATE BAR ASS'N ANTITRUST LAW SYMPOSIUM 1-9.

68. See generally Rifkind, *Division of Territories*, in *ANTITRUST LAW AND TECHNIQUES* 49 (Hoffman ed. 1963); Travers & Wright, *Restricted Channels of Distribution Under the Sherman Act*, 75 HARV. L. REV. 795 (1962).

69. *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951).

70. See generally Stone, *Closed Territorial Distribution: An Opening Question in the Sherman Act*, 30 U. CHI. L. REV. 286 (1963).

71. See generally Timberg, *Territorial Exclusives*, 29 A.B.A. ANTITRUST SECTION 233 (1965).

A recent case applying the rule of reason technique is *FTC v. Brown Shoe Co.*, 34 U.S.L. WEEK 4468 (June 6, 1966).

For a survey of various distributive franchise agreements, see Stewart, *Exclusive Franchises and Territorial Confinements of Distributors*, 22 A.B.A. ANTITRUST SECTION 33 (1963).

72. 372 U.S. 253 (1963).

essence held that vertical territorial restrictions are not within the horizontal territorial per se category of illegality, reasoning that vertical arrangements *may be justifiable* at a trial by the introduction of evidence showing the purpose as well as probable competitive and trade effects of such arrangements.⁷³ After winning the right to introduce evidence in an attempt to show justification for its product distributive arrangement, White Motor subsequently settled its litigation with the government by a consent judgment⁷⁴ in which White agreed not to impose any territorial restrictions upon its retail dealers.⁷⁵

A further assault on the citadel of polarity per se technique as applied to territorial arrangements resulted from a number of decisions⁷⁶ upholding the establishment of vertical distributive arrangements in which the only territorial restriction contained in the franchise agreement was the so-called "primary responsibility" provision, a provision incorporated in many of the government's consent judgments.⁷⁷ Under these provisions, the manufacturer may designate geographical areas in which specific distributors would be primarily responsible for promoting the manufacturer's product and would be obliged to adequately represent the manufacturer in the designated area.⁷⁸

The tendency of courts to reject the per se approach, and thereby sanction under certain circumstances territorial restrictions, is further illustrated by the 1963 Seventh Circuit decision of *Snap-On Tools Corp. v. F.T.C.*⁷⁹ There the Federal Trade Commission in seeking

73. *White Motor Co. v. United States*, 372 U.S. 253, 261 (1961). The majority's opinion concluded that "the applicable rule of law should be designated after trial." 372 U.S. 253, 261 (1963). For an interesting analysis of *White Motor*, see Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 74 YALE L.J. 775 (1965). Bork opines that the majority failed to state the criteria by which per se and unreasonable categories of illegality are to be distinguished, suggesting the opinion is ambiguous since it is capable of being read as premised on economic theory, or premised on factors overriding economic considerations. Bork, *supra* at 778.

74. *United States v. White Motors Co.*, 1964 Trade Cases ¶ 71195 (N.D. Ohio 1964).

75. Thus, the franchised dealers were permitted to seek sales outside their respective territories. Lack of such restrictions it is presumed, increases effective intrabrand competition.

76. *E.g.*, *Boro Hall Corp. v. Gen. Motors Corp.*, 124 F.2d 822 (2d Cir. 1942), *rehearing denied*, 130 F.2d 196 (2d Cir. 1942).

77. *E.g.*, *United States v. Arnold, Schwinn & Co.*, 237 F. Supp. 323 (N.D. Ill. 1965). The 26 cases are collected in Timberg, *Territorial Exclusives*, 29 A.B.A. ANTI-TRUST SECTION 233, 235 n.10 (1965).

78. The "primary responsibility" clause was suggested by the "zone of influence" case of *Boro Hall Corp. v. Gen. Motors Corp.*, 124 F.2d 822 (2d Cir. 1942), *rehearing denied*, 130 F.2d 196 (2d Cir. 1942). In his concurring opinion, Mr. Justice Brennan in *White Motor Co.* suggested White Motor use this device. 372 U.S. 253, 271 (1963).

For a discussion of problems enforcing primary responsibility provisions, see Stewart, *Exclusive Franchises and Territorial Confinements of Distributors*, 22 A.B.A. ANTI-TRUST SECTION 33 (1963).

79. 321 F.2d 825 (7th Cir. 1963).

to have affirmed its previous cease and desist order entered under section 5 of the Federal Trade Commission Act,⁸⁰ argued that geographic restrictions placed on dealers who sold Snap-On-Tools were per se illegal.⁸¹ The majority of the Seventh Circuit overruling the Commission⁸² held that the *White Motor*⁸³ case governed in permitting a trial for presentment of evidence for possible justification of the arrangement. The court added that the Commission's hearing "was the trial" and that Snap-On had prevailed, noting that there were over eighty competing firms in the hand tool industry.⁸⁴ The court indicated that any other less rigid system of distribution would result in "confusion and chaos."⁸⁵ *Snap-On* stands for the proposition that the actual or, if unascertainable, probable anticompetitive and trade effects resulting from a distributive agreement must be shown at the trial, and if none are shown, the vertical distributive arrangement will be permitted.⁸⁶

Similarly, in 1964 the Sixth Circuit noted that a closed territorial distributive system was not per se illegal,⁸⁷ holding that such an agreement will be declared illegal only if shown either to be unreasonable in restraining trade, or in constituting an unfair method of competition.⁸⁸

In summary, the judicial history of territorial distributive arrangements subsequent to the *Timken* decision⁸⁹ has been a history characterized by correlative tendencies: first, a tendency to limit the scope of per se polarity technique; and second, the corresponding tendency to extend factual situations to which the rule of reason technique may be applied.

A recent Supreme Court decision⁹⁰ applying section 1 of the Sherman Act was announced on April 28, 1966, in *United States v. General*

80. 66 Stat. 632 (1952), 15 U.S.C. § 45(a) (1958).

81. Brief for the FTC, p. 17, *Snap-On-Tools Corp. v. FTC*, 321 F.2d 825 (7th Cir. 1963).

82. *Snap-On-Tools Corp. v. FTC*, 321 F.2d 825 (7th Cir. 1963).

83. *White Motor Co. v. United States*, 372 U.S. 253 (1963).

84. 321 F.2d 825 (1963). The majority noted that the Supreme Court in *White Motor* refused to hold territorial vertical arrangements per se illegal. The majority in *Snap-On* stressed the importance of effective interbrand competition, declaring:

Furthermore, we believe manufacturers should be encouraged by the workings of the antitrust laws to meet and promote competition of their products with those of competing brands, rather than to be hampered by those laws in the 'orderly' marketing of their products.

Snap-On-Tools, *supra* at 833.

Referring to a proposed alternative of assigning dealers areas of primary responsibility, the majority concluded that this alternative would merely be a "sterile exercise in language." *Snap-On-Tools*, *supra* at 832.

85. 321 F.2d 825, 833 (1963).

86. *Ibid.*

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

88. *Id.* at 851.

89. *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951).

90. *United States v. Gen. Motors Corp.*, 34 U.S.L. WEEK 4383 (April 28, 1966).

Motors,⁹¹ involving both alleged group boycotts and alleged unreasonable restrictive territorial agreements.

The factual background is significant. The trial court found that by 1960 numerous Chevrolet franchised dealers located throughout the Los Angeles, California metropolitan area had entered into agreements with so-called "discount houses."⁹² Under terms in these agreements, a discounter would sell new Chevrolet automobiles to buyers by referring the buyer to a particular dealer. The buyer would pay the discounter a price, substantially marked down from suggested retail prices. The discounter would then retain a certain percentage of the net profit over dealer cost, and the remaining proceeds would be turned over to the dealer. These agreements were characterized as "referrals."⁹³ The majority of Los Angeles Chevrolet dealers, however, opposed this referral program. Their opposition resulted in an effective group boycott. The Justice Department's Antitrust Division, upon complaints that discounters were going out of business, investigated. As a result of this investigation, the Justice Department subsequently brought suit against various Chevrolet dealer associations as well as against General Motors charging that by concerted action, these defendants had eliminated the discount house referral business.⁹⁴ The Supreme Court in reversing the district court's entry of judgment for the defendants⁹⁵—the order was appealed directly under section 2 of the Expediting Act⁹⁶—held that the factual findings constituted by law a "classic conspiracy in restraint of trade" since the franchised Chevrolet dealers were deprived of their freedom to trade with and deal through discounters.⁹⁷ The Court declared: "Elimination, by joint collaborative action, of discounters from access to the market is a per se violation of the [Sherman] Act."⁹⁸

For purposes of this discussion, the *General Motors* case is significant for the position the Department of Justice took both at the trial and on appeal toward an issue which the Supreme Court did not decide,⁹⁹ declaring the issue to be nonessential to the determinative question of group boycotting. The nonessential issue pertained to a so-called "location clause" incorporated in the franchise agreements between General Motors

91. *Id.* at 4384.

92. *Ibid.*

93. *United States v. Gen. Motors Corp.*, *supra* note 90, at 4385.

94. *Ibid.*

95. The United States district court concluded that the proof failed to establish the alleged violations of § 1 of the Sherman Act.

96. 15 U.S.C. § 29 (1964 ed.)

97. 34 U.S.L. WEEK 4383, 4386 (April 28, 1966).

98. *Ibid.*

99. *Ibid.*

and each Chevrolet dealer. This clause prohibits a dealer from moving to or establishing a new or different location, branch sales, or other sales location, without obtaining prior written approval of General Motors.¹⁰⁰

On the basis of this clause, General Motors as appellee maintained that the referral agreements executed between a minority of the Los Angeles Chevrolet dealers and area discount houses were in violation of the standardized Dealer's Agreements. The Justice Department countered by claiming that the location clauses were illegal as placing *unreasonable* restraints upon trade. This position is significant as it represents a major shift from the Department's pre-*White Motor* stand that all territorial restrictions are illegal per se.¹⁰¹

Mr. Justice Fortas, writing for the Court, commented that the "location clause" was of no avail against the fact of unlawful combination.¹⁰² Thus, the Court based its decision on what it considered to be clear and convincing proof of a conspiracy in the nature of joint and concerted refusals to deal.¹⁰³ In accordance with earlier decisions, the Court applied the per se technique to an obvious group boycott arrangement.

In sum, courts when confronted with factual situations involving territorial exclusives, challenged under section 1 of the Sherman Act, have determined the legality or illegality of these arrangements by using both the per se decisional technique (to horizontal division practices) and the rule of reason technique (to vertical open arrangements). However, a few courts would utilize the per se technique in blanket fashion. Such an extension of what in essence amounts to a simplistic method for deciding complex cases is unwarranted.

ACCOMMODATION RECIPROCITY

Discussion Model

OCO Corporation manufactures OBLETS. A thinly capitalized corporation, OCO markets OBLETS in fourteen states east of the Mississippi through franchised dealers who agree to have the primary responsibility of selling and servicing OBLETS in certain specified geographical territories. The franchise agreements contain no exclusive dealing, customer preference, customer restriction, resale price or tying

100. *Ibid.*

101. See note 6 *supra*. For the latest public statement of the Justice Department regarding per se theory, see the published remarks of Donald F. Turner, Assistant Attorney General in Charge of the Antitrust Division, Department of Justice, entitled *Some Reflections on Antitrust*, in 1966 N.Y. STATE BAR ASS'N ANTITRUST LAW SYMPOSIUM 1-9 (CCH, June, 1966).

102. 34 U.S.L. WEEK 4383, 4386 (April 28, 1966).

103. *Ibid.* See generally Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655 (1962).

provisions. However, each franchise designates the territory in which the franchise is to be exclusive.

Incorporating four years ago, OCO now desires to utilize more fully existing distributor facilities by the procurement of a complementary line of merchandise which could be marketed and serviced by OCO dealers. Meanwhile, ICO, a California corporation, manufactures IBLETS. IBLETS are commercially related to OBLETS, but the two commodities have clearly distinguishable markets due to significant product differentiation reflecting a wide variance in raw material costs. This product differentiation may be envisioned if one imagines an OBLET to be either a Rolls Royce or an \$85.00 Swiss time piece, and an IBLET to be a Simca or a \$3.95 Little Ben watch.

ICO, vertically integrated, distributes IBLETS in seven western states through an entirely owned marketing subsidiary, ICO-M. ICO-M likewise desires, by acquiring for distribution a complementary product line, to utilize more fully its existing chain of staffed and operated retail outlets. Eventually, OCO, ICO and ICO-M present to their respective legal staffs the following proposed agreements:

ICO grants OCO an exclusive franchise distributorship in order for OCO to distribute IBLETS, the duration of the grant to run five years.

OCO in return agrees to appoint ICO-M the former's exclusive agent for distribution of OBLETS in the seven western states where ICO-M currently is doing business. This proposed agreement contains a further provision which provides that although the license is exclusive, the licensee is not confined to the expressed territory set out in the agreement for distribution of the licensor's product. However, the licensee agrees that this territory shall be his area of "primary responsibility" and that he will not actively seek sales outside this area.

Furthermore, OCO agrees not to compel directly or indirectly through economic coercion its existing OBLET dealers to also sell IBLETS, as a condition for sustaining or renewing their franchise. Rather, OCO agrees to make a preferential offering to OBLET dealers inviting them to also become IBLET dealers. The ICO license is for five years.

Analysis of Reciprocal Practices

The above described cross-franchise agreement involves reciprocal dealing, since two independent firms have agreed to buy and sell each

other's products, supposedly for their anticipated mutual benefit.¹⁰⁴ The concept of reciprocity has been appropriately described as multi-faceted.¹⁰⁵ Professor Handler distinguishes three situations all involving reciprocal dealing: first, coercive reciprocity;¹⁰⁶ second, voluntary reciprocity;¹⁰⁷ and third, free and voluntary mutual patronage.¹⁰⁸

Beginning in the 1930's, the Federal Trade Commission attacked coercive reciprocity as an unfair method of competition.¹⁰⁹ As Professor Handler points out, coercive reciprocity resembles quite closely a tie-in since there is coercive use of power in one market to gain sales in another.¹¹⁰

Like the tie-in, the anti-competitive effect of coercive reciprocity is twofold: (1) The customer is forced to buy from a particular supplier when he would not do so if left to his own devices; and (2) competitors are foreclosed from selling to that customer.¹¹¹

When a seller patronizes customers not as a condition of sale or as part of any bargain but as a matter of unilateral action and independent decision, Handler argues, there should result no antitrust liability. Handler describes such arrangements as involving mere free and voluntary mutual patronage.¹¹²

In the ICO-OCO model above, the changing of a few facts will alter substantially the economic and trade effects consequent to the agreement. For example, suppose either ICO or OCO has established market leadership in its relevant market; further, that the companies have been in operation for ten years or longer. It should be apparent that under such facts a cross-franchise agreement between ICO and OCO would not only place restraints upon trade, but also might ultimately lessen com-

104. "Business reciprocity" . . . describes business dealings between independent firms whereby they make mutual concessions designed to promote the business interests of each." STOCKING, WORKABLE COMPETITION AND ANTITRUST POLICY 289 (1961).

105. Handler, *Gilding the Philosophic Pill—Trading Bows for Arrows*, 66 COLUM. L. REV. 1 (1966).

106. Handler, *supra* note 105, at 3.

107. *Ibid.*

108. *Ibid.*

109. California Packing Corp., 25 FTC 379 (1932); Mechanical Mfg. Co., 16 FTC 67 (1932); Waugh Equip. Co., 15 FTC 232 (1931).

110. Handler, *supra* note 105, at 5.

111. *Ibid.*

112. Handler opines that voluntary reciprocity does not involve coercion or duress, but does imply an agreement to deal reciprocally. Handler observes that mutual patronage implies no agreement at all. Handler suggests rather that mutual patronage involves voluntary unilateral actions. See Handler, *supra* note 105, at 6. He seemingly implies that economic convenience rather than economic compulsion forms the basis of mutual patronage agreements. Handler, *supra* note 105, at 7.

petition by increasing the multiplicity of contacts among competitors. The net effect might be similar if not identical to the so-called conglomerate merger situation.¹¹³

Reciprocal Selling

A cross-franchise agreement has some similarity to what is often referred to as reciprocal buying arrangements. Fundamentally, reciprocal buying involves use by a firm of its *buying power* to promote its sales.¹¹⁴ It is little more than "I'll patronize you if you patronize me." Typically, reciprocal buying involves a service for a product.¹¹⁵ Thus, some railroads at one time offered to purchase their steel and coal needs

113. As I understand the term, a 'conglomerate' enterprise is one that does business in a number of separate markets. These separate markets involve different 'product' markets, or they may involve separate 'geographic' markets in the same product. We have learned to refer to the first as a 'product extension' and the second as a 'market extension' merger. In either case, a firm selling, say, 25 different products, and one selling a single product in 25 different geographic markets, would both have the essential characteristics; each of them—to quote Professor Edwards—operates in a series of different markets, in each of which it encounters *different competitors and different conditions of demand and supply* and thus may be able to *charge different prices and make different profits*.

The conglomerate acquisition often raises some of the same problems as the more conventional horizontal merger, but with special complications of its own. Take the basic question of whether the acquisition poses a danger of ultimate single-firm dominance, of some form of "price leadership." It is often said that the conglomerate firm—by reason of its general overall superiority of resources, its capacity to 'subsidize' local expansion out of profits earned in other markets, and the like—is apt to dominate the local market in which the acquisition occurs, ultimately becoming, if not a monopoly in the classical sense of the word, certainly enough of 'price leader' to impose on the market a price well in excess of a genuinely competitive price.

Then there is the question of whether the merger increases the likelihood that the oligopoly Congress was so concerned about will eventually emerge. Conglomerate mergers are said to pose a double danger on this score. The acquiring conglomerate firm will be susceptible not only to all of the *local* oligopoly-producing forces, put to a variety of influences stemming from its operations in all of its *other* markets as well. As a firm expands the number of its markets in which it operates, it begins to encounter many of the same competitors in different areas. This 'multiplicity of their contacts' may 'blunt the edge of their competition.'

Dixon, *Merger Policy and the Preservation of the Competitive System*, 30 A.B.A. ANTITRUST SECTION 86, 88 (1966).

114. "Reciprocal dealing is both the use of purchasing power to obtain sales and the practice of preferring one's customers in purchasing."

Hausman, *Reciprocal Buying and the Antitrust Laws*, 77 HARV. L. REV. 873 (1964). Writing prior to the 1965 *Consolidated Foods* decision, Hausman commented that the legality under § 1 of the Sherman Act was unresolved "because there are no decided cases." Hausman, *supra* at 886. For a discussion of the various economic interpretations regarding reciprocal buying, see Ferguson, *Tying Arrangements and Reciprocity: An Economic Analysis*, 30 LAW & CONTEMP. PROB. 552, 566 (1965).

115. See generally Edwards, *Conglomerate Bigness as a Source of Power*, in NAT'L BUR. OF ECONOMIC RES., BUSINESS CONCENTRATION AND PRICE POLICY 331, 342 (1955).

from those companies who in consideration therefor, would ship on those railroads in lieu of using competitive lines.¹¹⁶

Cross-franchising, however, essentially involves what might best be described as *reciprocal selling* since the basis of the reciprocity rests upon the *mutual selling potential* of the two firms, rather than on present *buying need*. Unlike the railroad above which needed coal to stoke locomotives and steel to construct its track, ICO and OCO do not need each other's product for their respective continued economic existence.

Consequently, reciprocal buying often results from what in essence amounts to a forced sale—coerced by one party having a dominant bargaining position, as e.g., a manufacturer's essential-material supplier. Thus, a reciprocal buying agreement which would require such a manufacturer to sell finished products to the supplier as consideration for the supplier's promise to continue selling essential-materials to the manufacturer, would place a restraint on trade not only between the supplier and other manufacturers, but more significantly, also between the manufacturer and other would be buyers. In such arrangements, inducement for the reciprocal buying agreement would stem from present economic needs.¹¹⁷

In situations which have involved so-called reciprocal buying practices, coercion is often the dominant theme. For example, suppose ICO needs material A. Further, suppose ICO has a substantial need for material A and pursuant thereto, ICO goes to OCO and says: "I will buy all my A requirements from you, but only if you in turn agree to buy all your B requirements from me." Often this coercive arrangement involves three parties. Thus, ICO might say to OCO: "I will buy my A requirements from you, but only if you buy your B requirements from Company Z." It is obvious that such coerced reciprocal dealing could result in lessening of competition in addition to placing restraints on the potential flow of trade.

In contrast, the inducement for a cross-selling franchise is not the existing buying power of the parties resulting from current needs, but rather is the anticipated mutual selling potential of the parties based upon reasonable expectations of available markets. The fact that a cross-franchise agreement, wherein two companies agree to expand existing marketing capability through cross-selling of dissimilar products, is mutually advantageous does not mean there also will result either a lessening

116. *Reciprocity in Purchasing and Routing*, 188 ICC 417, 418 (1932); see generally STOCKING, *op. cit. supra* note 104, at 293. According to the ICC's 1932 report, railroads generally engaged in reciprocal practices with shippers during the 1920's and early 1930's. 188 ICC 417, 419 (1932).

117. See STOCKING, *op. cit. supra* note 104, at 293.

of competition, or an unreasonable restraint on trade. By means of a cross-franchise agreement substantially identical to the model above outlined, a *newcomer's* entry into a market may increase interbrand competition within that market, while not placing any unreasonable restraint on trade.

For example, suppose A Mower Co. has 17% of the relevant lawn mower market in Texas, but none of the relevant mower market in Oklahoma. Also, suppose B Mower Co. has 24% of the relevant Texas mower market, and 31% of the Oklahoma mower market. Thus, A and B are competitors. Now, suppose X Garden-Tool Co. possesses 12% of Oklahoma's relevant garden tool market, but none of the Texas market. Further suppose, Y Garden-Tool has 29% of the Texas garden tool market as well as 14% of the Oklahoma market. Thus, X and Y are competitors. Both A Mower and X Garden-Tools distribute through franchised dealers, under exclusive franchise agreements. A and X respectively wish to more effectively compete with B and Y respectively. Thus, they enter into an agreement similar to the ICO-OCO agreement above described. Possible competitive effects resulting from the agreement between A Mower and X Garden-Tool are shown by the following table.

MARKET COMPOSITION BEFORE AND ONE YEAR AFTER THE AGREEMENT

<i>Company</i>	<i>Market</i>	<i>% Before</i>	<i>% After</i>
A Mower.....	Texas.....	17%.....	17%
B Mower.....	Texas.....	24%.....	24%
X Garden-Tool....	Texas.....	0%.....	6%
Y Garden-Tool....	Texas.....	29%.....	23%
A Mower.....	Oklahoma.....	0%.....	8%
B Mower.....	Oklahoma.....	31%.....	23%
X Garden-Tool....	Oklahoma.....	12%.....	12%
Y Garden-Tool....	Oklahoma.....	14%.....	14%

As a result of the cross-selling agreement, A and X are able to distribute in markets previously dominated by B and Y respectively. Consequently, A competes with B for the Oklahoma mower market, while X competes with Y for the Texas garden tool market. Note that the agreements which enabled the parties to enter the marketing territories of their competitors involve "reciprocity."¹¹⁸ Moreover, the agreement also results in a restraint of trade, A and X being restricted from trading with other distributors in their respective franchised territories. But since the Supreme Court has recognized the fact that every intercorporate agree-

118. See suggested general definition of reciprocity incorporated in note 104 *supra*.

ment by its very nature places a restraint on trade to some extent, the crucial inquiry becomes whether the above conjectured reciprocal selling arrangement constitutes an *unreasonable* restraint.

To determine the issue of reasonableness of restraint, all the economic effects flowing from the agreement must be considered.¹¹⁹ So considering the above hypothetical, one notes that the agreement enabled A and X to enter and thereby compete for the markets controlled by B and Y respectively.

Now, suppose C, a garden tool retail chain located in Oklahoma, offers to purchase and distribute A's mowers in Oklahoma, in addition to other brands of mowers which C distributes and retails through its chain stores. By provisions of the franchise agreement with X, A would be compelled to reject C's offer. Thus, the agreement between A and X constitutes a restraint on trade—as between A and C. In this hypothetical, C represents a potential distributor of A's mowers, and as such, may be considered a “potential” competitor of X, who, in addition to actually competing with Y for the Oklahoma garden tool market, also distributes A's mowers throughout the state pursuant to provisions of the cross-selling agreement.

Therefore, the precise issue involved is: Whether an increase in effective competition between actual competitors (manufacturers A and B), resulting from a cross-selling agreement between manufacturer A and distributor X, justifies a restraint on trade between manufacturer A and other potential distributors (for example, C), who in effect are potential competitors of distributor X. The issue as above formulated goes only to the reasonableness of one side of the cross-selling agreement.

The overriding economic issue is whether a restraint on trade is reasonable when the agreement which resulted in the restraint also resulted in increasing effective interbrand competition among actual competitors.

Recent Decisions

In light of these economic considerations, it seems unrealistic that a court might categorically label “reciprocity” an “anticompetitive device” without attempting to ascertain all the economic effects of an agreement challenged under section 1. Moreover, to declare reciprocal dealing agreements to be per se violative of the Sherman Act would evidence a desire to find an easy solution to difficult problems of economic interpretation.

A decision involving reciprocity was announced by the United

119. *Snap-On-Tools Corp. v. FTC*, 321 F.2d 825 (7th Cir. 1961); *accord*, *Chicago Bd. of Trade v. United States* 246 U.S. 231 (1918).

States District Court for the Southern District of New York in July, 1965, in *United States v. General Dynamics Corp.*¹²⁰ This civil antitrust action charged that the defendant had violated not only section 7 of the Clayton Act, but also section 1 of the Sherman Act by a merger and a resulting special sales program. Specifically, in 1957 General Dynamics Corporation merged with Liquid Carbonic Corporation, which at that time was the nation's largest producer of carbon dioxide. The government charged first that as a result of this merger there would eventually result a substantial lessening of competition, and that the merger would have the effect of tending to create a monopoly, both of which are prohibited by Clayton's section 7.

After the acquisition of Liquid Carbonic, General Dynamics entered into a special sales program with its suppliers whereby sales of these suppliers of products manufactured by Carbonic's facilities were encouraged. The government charged that these "sales" amounted to a reciprocal practice tending to lessen competition in violation of Clayton's section 7, as well as placing restraints on trade, thereby violating section 1 of the Sherman Act. Professor Handler characterizes the decision as illustrative of "lump concept thinking."¹²¹ Yet, rather than declaring reciprocity to be per se violative of the Sherman Act, the Court declared:

It is also abundantly clear that the purpose of the [sales] program, reciprocal dealing, is one of the 'anticompetitive practices at which the antitrust laws are aimed' and 'an irrelevant and alien factor' which may affect an otherwise unimpeded competitive choice. . . . A branch of the defendant's argument before this court has been that reciprocity is a normal and expected business practice without any aura of illegality surrounding it. Insofar as the generic status of reciprocity is concerned, Consolidated foods silences any argument of *per se* legality.^[39] Though this § 1 charge is a matter of first impression, the novel aspects concern the characterization and classification of the *effects of reciprocity, not of its essential nature.*"¹²² [emphasis supplied].

In a significant footnote [39], the court states: "Of course it does not follow, however, that the use of reciprocity is per se illegal."

The court's decision specifically overruled defendant's motion to

120. *United States v. Gen. Dynamics Corp.*, 246 F. Supp. 156 (S.D.N.Y. 1965). See 54 GEO. L.J. 680 (1966).

121. Handler, *Gilding the Philosophic Pill—Trading Bows for Arrows*, 66 COLUM. L. REV. 1 (1966).

122. *United States v. Gen. Dynamics Corp.*, 246 F. Supp. 156, 166 (S.D.N.Y. 1965).

dismiss the government's complaint.¹²³ The decision is to be commended for opening the door for investigation into the *effects of reciprocity*. Professor Handler, on the other hand, observes that the judge follows the modern practice of painting with a broad brush. "He does not pause to define what he terms the essential nature of reciprocal dealing. . . ."¹²⁴ It is true that in the 1965 *General Dynamics* decision¹²⁵ Judge Cannella did not distinguish reciprocal arrangements on the basis of their essential nature as has Professor Handler. For Judge Cannella in his 1965 ruling indicated that the legality or illegality of reciprocal agreements should depend on the effects of the agreements, not on the agreements themselves. Professor Handler, on the other hand, would adjudge a particular reciprocal arrangement primarily on the inducement factor, contending that coercive reciprocity is anticompetitive, whereas mutual and voluntary reciprocity (including most instances of reciprocal buying) is not.

If Judge Cannella impliedly rejected Professor Handler's analysis in the 1965 *General Dynamics* ruling, the judge expressly and affirmatively rejected the inducement criterion in his 1966 *General Dynamics* decision.¹²⁶ Reciprocity, the judge declared, whether mutual or coercive, serves to exclude competitors by the exercise of large scale purchasing power. He then analogized reciprocity to tying-in arrangements, holding that for purposes of applying section 1, the standards of decision as delineated by the Supreme Court in tying-in cases are appropriate for deciding the legality or illegality of reciprocal agreements.

Applying the technique as used by the Supreme Court in *Times-Picayune Publishing Co. v. United States*,¹²⁷ and *International Salt v. United States*,¹²⁸ the judge declared that reciprocal arrangements are not per se violative of section 1 of the Sherman Act if a "not insubstantial amount of commerce is affected."¹²⁹ To prove the presence of anticompetitive reciprocity, Judge Cannella stated that particular contracts with identifiable parties must be introduced into evidence or legitimately inferred from the conduct of such identifiable parties.¹³⁰ The court's analysis of the section 1 aspect of the *General Dynamics* litigation may have been unnecessary because the court held that *General Dynamic's* acquisition of *Liquid Carbonic* followed by the reciprocal sales program violated section 7 of the Clayton Act. This holding was in accordance

123. *Id.* at 158.

124. Handler, *supra* note 121, at 3.

125. 246 F. Supp. 156 (S.D.N.Y. 1965).

126. *United States v. Gen. Dynamics*, 35 U.S. LAW WEEK 2125 (Sept. 13, 1966).

127. 345 U.S. 594 (1953).

128. 332 U.S. 392 (1947).

129. 35 U.S. LAW WEEK 2125, 2126 (Sept. 13, 1966).

130. *Ibid.*

with the acquisition-reciprocity principle announced by the Supreme Court in *FTC v. Consolidated Foods Corp.*¹³¹ That case concerned specifically the issue whether reciprocal buying following a conglomerate merger was shown to have resulted in a lessening of competition.¹³² The Federal Trade Commission had found at the initial hearing that competition was lessened as a result of reciprocal practices.¹³³ Subsequently, the Seventh Circuit reversed the Commission's finding,¹³⁴ and ultimately the Supreme Court reversed the Seventh Circuit.¹³⁵ The facts as presented revealed a situation involving coercive reciprocity.¹³⁶ The Court's opinion, however, did not use the term "coercive." Moreover, the Court apparently chose neither to discuss nor distinguish various reciprocal arrangements, either on the basis of distinguishable inducements, or on the basis of clearly ascertainable market effects. Nor, for that matter, did the Court refer to the practices denoted either as accommodative reciprocity by the Solicitor General,¹³⁷ or termed mutual patronage arrangements by Professor Handler.¹³⁸

CONCLUSION

To hold reciprocal selling per se illegal would contravene judicially acknowledged Congressional policy underlying enactment of the antitrust laws—a policy favoring rigorous competition in free markets.¹³⁹ While certain reciprocal practices which can be shown to lessen competition and place unreasonable restraints upon trade are obviously prohibited by the antitrust laws, other reciprocal practices under certain market and other economic conditions may be justifiable. To justify a reciprocal agreement one must convince a court that the resulting competitive benefits of the agreement outweigh the resulting restraints on trade. To balance

131. 380 U.S. 592 (1965).

132. *Id.* at 594.

The first commission merger case to reach the Supreme Court, *FTC v. Consolidated Foods Corp.*, resulted in a landmark decision holding that the acquisition by Consolidated Gentry, Inc., violated section 7 of the Clayton Act because of the opportunities it created for the operation of anticompetitive reciprocity. Following this decision of the Supreme Court, the Commission is conducting investigations of acquisitions which may create similar opportunities for the use of reciprocity in other industries.

133. — *FTC* — (1964), 1964 FTC Docket 700.

134. *Consolidated Foods Corp. v. FTC*, 329 F.2d 623 (7th Cir. 1964).

135. *FTC v. Consolidated Foods Corp.*, 380 U.S. 592 (1965).

136. See note 114 *supra*.

137. Brief for the FTC, p. 23, *FTC v. Consolidated Foods Corp.*, 380 U.S. 592 (1965).

138. Handler, *supra* note 121, at 5.

139. Basic to the faith that a free economy best promotes the public weal is that goods stand the cold test of competition; that the public, acting through the market's impersonal judgment, shall allocate the Nation's resources and thus direct the course its economic development will take.

Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 605 (1953).

economic pros and cons, a court must use a technique for decision making which is flexible—a technique capable of considering all economic, competitive and trade effects consequent to a particular agreement.

In sum, it is suggested that courts should ascertain the overall effects on both trade and competition of any challenged reciprocal agreement. Professor Handler's analysis of the competitive-anticompetitive nature of a reciprocal agreement fails to consider as decisionally-determinative the agreement's overall effects on trade and competition. Judge Cannella, on the other hand, in his 1966 *General Dynamics* decision considers the effects of the agreement on trade but refuses to consider the effects on competition. Thus, Judge Cannella has used a modified per se technique—if a *substantial amount* of trade is affected as a result of a particular agreement, then the agreement is per se violative of section 1 of the Sherman Act. This limited-inquiry technique could lead to unfortunate decisions. For as this note has attempted to show, a particular agreement may, while placing restraints on trade, foster a substantial increase in effective interbrand competition among actual competitors. Consequently, to determine the legality or illegality of any particular agreement, an overall analysis of the totality of economic facts surrounding the agreement is appropriate. The timeless Brandeis-rule-of-reason approach permits such thoroughness.