North Carolina Central Law Review

Volume 10
Number 1 *Volume 10, Number 1*

Article 12

10-1-1978

The Rule of Reason Restored: National Auto Brokers v. General Motors Corporation

V. Thomas Jordan Jr.

The Rule of Reason Restored?: National Auto Brokers v. General Motors Corporation.

In *National Auto Brokers v. General Motors Corporation,*[1] the Court of Appeals for the Second Circuit utilized the Rule of Reason[2] to evaluate a vertical restraint of trade[3] in the first response by a lower court to the Supreme Court's ruling in *Continental Television, Inc. v. GTE Sylvania, Inc.*[4] In *Sylvania,* the Court upheld the result of the United States Court of Appeals in the Ninth Circuit and overruled *United States v. Arnold, Schwinn & Co.*[5], which held that

1. 572 F.2d 953 (1978).

2. The Rule of Reason has been used by the Court largely as a euphemism for nonliability. Posner, *Relections on Sylvania,* 45 Chi. L. Rev. 1, at 20 (1977). It was stated by Justice Brandeis in the Court's only effort to provide some content as follows:

> 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 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 courr to interpret facts and to predict consequences.

Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918). This is as close as the Court has come to defining the Rule, first stated by Justice White.

> The Sherman Act incorporated the economic standards—the prevention or elimination of the power to fix prices, of the power to restrict output, and of the danger of deterioration in product quality—broad enough to embrace every conceivable contract or combination which could be made concerning trade or commerce, the courts must exercise judgment according to a 'standard of reason.'

Standard Oil Co. of N. J. v United States, 221 U.S. 1 (1911). This illusory standard was influential in a few early cases. United States v. New York Coffee & Sugar Exch., 263 U.S. 611 (1924); Cargill v. Board of Trade, 164 F.2d 820 (7th Cir. 1947); United States v. Columbia Pictures Corp. 189 F. Supp. 153 (S.D.N.Y. 1960). Very few modern Supreme Court Decisions have, however, been made using the Rule of Reason. Times Picayune Publishing Co. v. United States 345 U.S. 594 (1953). The use of the Rule of Reason in the Sylvania case reflects an economic position that would exclude some of the factors listed in the standard formulation and look to condemn only those practices that are inefficient in the economic sense. Bork *The Rule of Reason and The Per Se Concept: Price Fixing and Market Division,* (pt. 1), 74 YALE L. J. 775 (1965). As developed below, this reflects one of several economic theories, but what is encouraging is that, unlike Schwinn, this case is decided by an evaluation of economic realities rather than legal formalism.

3. 572 F.2d at 960. Vertical restraints are those imposed as part of a relationship between firms performing functions at successive stages in the production and distribution of a product. L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 376 (1977). In general, Harvard school theorists recognize ways in which restrictions imposed by a seller on buyers for the seller's own purposes may adversely affect competition; by contrast, Chicago school theorists regard such restraints as efficiency-producing, unless the buyers are the real instigators of the restraint, in which case the arrangement is necessarily a horizontal central. *Id.* at 380 (1977).

4. 433 U.S. 36 (1977)

5. 388 U.S. 365 (1967)

vertical restraints were per se illegal.[6] In *Sylvania*, the Court held that the Rule of Reason, rather than per se illegality,[7] is the standard for determining whether § 1 of the Sherman Anti-trust Act[8] is violated by vertical nonprice restraints.[9] Until the ruling in *Sylvania*, the *Schwinn* decision was considered the leading authority on the per se illegality of vertical territorial and customer restrictions imposed by a manufacturer upon its distributors.[10] Justice Fortas, the author of the opinion in *Schwinn*, wrote that pursuant to "the Ancient Rule", a bicycle manufacturer who restricted its distributors to sales in a specific territory after the distributor purchased the products from the manufacturer was placing a

---

6. *Id.* at 379. Although the Schwinn Court limited their holding to arrangements in which the manufacturers actually sold the product to the distributor, the clear intent of the Court was to make vertical, non-integrated arrangements per se illegal.

7. Although stated in a very simplistic form in early cases, United States v. Joint Traffic, 171 U.S. 505 (1898); United States v. Addyston Pipe and Steel Co., 175 U.S. 211 (1899), the first definitive statement of the per se rule was in a case concerned with price-fixing:

> Congress . . . has not permitted the age-old cry of ruminous competition and competitive evils to be a defense to price-fixing conspiracies. It has no more allowed genuine or fancied competitive abuses as a legal justification for such schemes than it has the good intentions of the members of the combination. . . . Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interestate commerce is illegal per se.

United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 221-23 (1940). It is settled that in price fixing cases no question is to be asked about the defendants' power if their purpose is to fix prices or if their conduct will be to affect market price. L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 192 (1977). This is generally true in the area of vertical as well as horizontal arrangements. Although many of the commentators who argue that vertical restraints should be upheld make no distinction between price or non-price distinctions, the scope of this note is limited to the non-price restraints.

The definition of the per se rule which was used in the Schwinn case and is generally accepted as the modern application of the rule was suggested in United States v. Northern Pacific Ry.:

> 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. This principle or *per se* unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to 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 fruitless when undertaken. 356 U.S. 1, 5 (1958).

8.

> 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. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the Court.

15 U.S.C. § 1 (1970).

9. 433 U.S. at 37 (1977).

10. United States v. Topco Assoc., Inc. 405 U.S. 596 (1972); Albrecht v. Herald Co. 390 U.S. 145 (1968); F.T.C. v. Sperry & Hutchinson Co. 405 U.S. 233 (1972). Comaner, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath*, 81 HARV. L. REV. 1419 (1968).

trade restriction on the distributor that was illegal per se.[11] However, this "Ancient Rule," an undeviating rule against any restraints on alienation, may never have existed even at common law, and thus, the jurisprudential underpenning of *Schwinn* may have been weak or nonexistent from the beginning.[12] Many legal commentators have questioned the prudence of *Schwinn*, even if one assumes that it is grounded in precedent.[13]

Because of the overly formalistic approach to vertical restraints taken by the *Schwinn* Court, the response by the lower courts has been inconsistent. On the surface, this response would indicate a very narrow Supreme Court ruling. However, the Court, itself, has cited *Schwinn* as an authority for the per se rule, not only on the facts of *Schwinn*, but in responding to vertical restraints generally.[14] The lower courts resorted to fictions in order to distinguish *Schwinn* and evade what might otherwise be an authoritative determination by the Supreme Court. The lower courts distinguished *Schwinn* and found several exceptions to the per se rule stated therein.[15] In reviewing the history of cases since *Schwinn*, it is useful to understand the atmosphere in which *Schwinn* was decided. Just four years earlier, in *White Motor Company v. United States*,[16] the Court held that vertical restrictions, as opposed to horizontal restrictions, must be examined as to their actual impact upon competition.[17] *White Motor*, although wavering,[18] was in keeping with "a venerable body of law sustaining such restraints under the traditional rule of reason as legitimate means for fostering effective interbrand competition."[19] So *Schwinn* flew in the face of recent authority to the contrary. Further, the *Schwinn* decision provided an

11. 388 U.S. at 380. Justice Fortas did not cite any authority for this "Ancient Rule"

12. Robinson, *Recent Antitrust Developments:* 1974, 75 COLUM. L. REV. 243, 271 (1974).

13. Even if it did exist, ancient English land law is inappropriate as a grounds for decision in antitrust analysis of capitalism. *See, e.g.*, Handler, *Twenty-Five Years of Antitrust (Twenty-Fifth annual Antitrust Review)*, 73 COLUM. L. REV. 415, 458-59 (1973); Pollock, *Antitrust Problems in Franchising*, 15 N.Y.L. FORUM 106, 110-13 (1969); McLaren, *Marketing Limitations on Independent Distributors and Dealers—Prices, Territories, Customers, and Handling of Competitive Products*, 13 ANTITRUST BULL. 161, 168 (1968); Pollock, *Distribution in the Wake of Schwinn, White Motor, Et Al.*, 23 RECORD OF N.Y.C.B.A. 241, 245 (1968); Keck, *The Schwinn Case*, 23 THE BUSINESS LAWYER 669 (1968); Handler, *The Twentieth Annual Antitrust Review—1967*, 53 VA. L. REV. 1667, 1680-86 (1967); Orrick, *Marketing Restrictions Imposed to Protect the Integrity of "Franchise" Distribution Systems*, 36 ABA ANTITRUST L. J. 84 (1967); Williams, *Distribution and the Sherman Act—The Effects of General Motors, Schwinn and Sealy*, 1967 DUKE L. J. 732, 740 (1967); Note, *Territorial Restrictions and Per Se Rules—A Re-evaluation of the Schwinn and Sealy Doctrines*, 70 MICH. L. REV. 616 (1972); Note, *The Supreme Court, 1966 Term*, 81 HARV. L. REV. 69, 235-39 (1967); Comment, *The Impact of the Schwinn Case on Territorial Restrictions*, 46 TEXAS L. REV. 497, 511 (1968). Comegys, Moderator, *Restraints in Distribution: General Motors, Sealy, and Schwinn, a Symposium on Ancilliary Restrictions*, 36 ABA ANTITRUST L.J. 84 (1967).

14. *See, e.g.*, United States v. Topco Assoc., Inc. 405 U.S. 596 (1972); Albrecht v. Herald Co. 390 U.S. 145 (1968); F.T.C. v. Sperry & Hutchinson Co. 405 U.S. 233 (1972).

15. *See* note 7, *supra*.

16. White Motor Co. v. United States 372 U.S. 253 (1963).

17. The traditional distinction between horizontal and vertical restrictions is one which indicates whether the parties to the restrictions are competitors. 30 A.L.R. Fed. at 23.

18. The court stated that customer restrictions placed on a distributor by a truck manufacturer, while not held per se illegal at the time of the decision, could not really be determined as illegal or not since more about the kind of restrictions involved needed to be determined. 372 U.S. at 259.

19. *See* Robinson, *supra* note 12, at 270.

anomaly which commentators and judges seized upon as authority for distinguishing the case. While territorial and customer restrictions were held to be per se illegal if made pursuant to an outright sale, if these restrictions were pursuant to an agency or consignment relationship, they could be examined to determine whether they met the rule of reason.[20] Keeping in mind the place in antitrust history in which *Schwinn* was decided and the anomalous message "built-into" the case itself will lend understanding to the confusion exemplified by the lower courts attempts to distinguish *Schwinn*.

Because of the harsh results which would inevitably come from a literal "stare decisis" following of *Schwinn*, the lower courts tended to find various exceptions in which practices may be examined by the rule of reason rather than the per se illegality rule. The most consistently utilized exception to the *Schwinn* rule arises from a finding that the vertical restriction is pursuant to a relationship in which the manufacturer retains title, dominion, and control of the product, and the distributor is more or less an agent or consignee. In such cases the restriction may be examined to determine whether it meets the rule of reason, and thereby be upheld.[21] An example of such an agency relationship is a manufacturer's utilizing its distributors as sales agents when the manufacturer is subject to take a loss in the event of poor sales or damaged goods.[22] Another example is the manufacturer's retention of dominion over the goods with power to determine quantities while subject to a risk of loss.[23] Surprisingly, there have been some cases in which an agency relationship appeared to exist, but which were held to be per se illegal. Where the manufacturer sold feed to his distributor to be distributed through the manufacturer's consignment warehouses, the court found that there was no agency relationship.[24] In another case, a possibility of reverter in the goods sold was held to be inadequate to take the relationship out of the per se illegality rule.[25] So not only have courts sought to read *Schwinn* narrowly, at times they have gone to the other end of the spectrum and extended the rule to practices which were presumably very legitimate.

Another exception to the *Schwinn* rule, developed to prevent harsh results, is the interpretation that unless the manufacturer placed firm and resolute enforcement of the restrictions on the distributors, the restrictions were not per se illegal.[26] Utilizing this approach, one case held that in spite of *Schwinn*, the cases turn on facts.[27] However, even though Justice Fortas, in *Schwinn*, noted that the manufacturer had been firm and resolute in enforcing its restrictions, such a requirement has never been made of the practices which have

20. 388 U.S. at 380.
21. 30 A.L.R. fed. at 23, n.1.
22. Stan Togut Corp. v. Hobart Mfg. Co., 398 F. Supp. 1323 (D.C.N.Y. 1974).
23. Fagan v. Sunbeam Lighting Co., 303 F. Supp. 356 (D.C. Ill. 1969).
24. Cook v. Ralston Purina Co., 366 F. Supp. 999 (D.C.Ga. 1973).
25. Easterx Aviation, Inc. v. Sperry Hutchinson Co., 522 F.2d 1299 (5th Cir. 1975).
26. "The mere existance of contractual clauses containing territorial and customer restrictions does not constitute a per se violation, and the court must view the alleged violations in the context of the entire relationship between the parties." Janel Sales Corp. v. Lanvin Perfume, Inc., 396 F. 2d 398 (2d Cir. 1968) 389 F. Supp. at 1327.
27. Todhunter-Mitchell & Co. v. Anheuser Busch Inc., 375 F. Supp. 610 (D.C.Pa. 1974).

traditionally been seen as per se illegal.[28] So to use this language as a requirement is an exercise in fiction which the courts have used to avoid harsh results.

Other exceptions turning on the nature of the restriction have been found to be factually distinguishable from *Schwinn*, and courts have latched onto these differences to get away from the *Schwinn* rule in spite of Supreme Court authority that *Schwinn* was not so distinguishable.[29] The rule has been held to not apply to isolated restrictions which are not a part of a manufacturer's general plan or scheme of distribution,[30] to the practice of simply designating areas of primary responsibility,[31] and even to practices of restricting to specific locations,[32] later overruled specifically in *Sylvania, supra*.

The "firm and resolute" language was not the only language used by Justice Fortas in *Schwinn* which the lower courts have taken out of context and used to distinguish the case. His language, that "it is unreasonable, without more, to impose post-sale restrictions,"[33] has been interpreted to mean that if more justification could be found, then the practice may be evaluated by the rule of reason. In *Tripoli Co. v. Wella Corp.*,[34] for instance, the court found the "more" to be that the restriction was for the protection of the consumer. However, Fortas stated that "without more" was qualified by his words, "that their mere existence is enough."[35] Certainly this was meant to be a test of inclusion and, in fact, other lower courts have held that the Third Circuit's ruling in *Tripoli* is "highly suspect."[36] Here, again, the *Schwinn* decision was interpreted as narrow and limited to its facts. In fact, in the area of a unique, dangerous, or characteristically singular product, the Tenth Circuit, while applying *Schwinn*, requested that the Supreme Court make "an exception to the per se rule when a product is unique and where the manufacturer can justify its territorial restraints under the rule of reason."[37]

The licensing of trademarks is still another general exception to the *Schwinn* rule, because of the difficulty in determining whether control or dominion over the trademark can be released.[38] Here again, a difficult distinction was made in order to distinguish *Schwinn* and reach fair results.

In *Schwinn*, Justice Fortas mentioned that the per se rule may not apply to newcomers in a field or to failing businesses because such a status may be "relevant to a showing that the challenged vertical restraint is sheltered by the rule of reason because it is not anticompetitive."[39] However, as might be

28. Hensley Equipment Co. v. Esco Corp., 383 F. 2d 252 (5th Cir. 1967).
29. *See* note 14, *supra*.
30. Wilson v. I.B.E. Industries, Inc., 510 F.2d 986 (5th Cir. 1975).
31. Kaiser v. General Motors Corp. 396 F. Supp 33 (D.C.Pa. 1975).
32. Salco Corp. v. General Motors Corp. Buick Motor Div., 517 F.2d 567 (10th Cir. 1975).
33. 388 U.S. at 379.
34. 425 F.2d 932 (1970).
35. 388 U.S. at 379.
36. Clairol Inc. v. Cosmetics Plus, 1974-2 Trade Cas.¶75,260 (N.J. Super. Ct. 1974).
37. Adolph Coors Co. v. F.T.C., 1974-1 Trade Case.¶75,090 at 96,854 (10th Cir. 1974) *cert. denied* 43 U.S.L.W. 3388 (U.S. Jan. 13, 1975).
38. Mid-America ICEE, Inc. v. John Mitchell Co. 1972 Trade Case. ¶ 73,833 (Or. Dist. Ct. 1972).
39. 388 U.S. at 374.

expected from the way the lower courts have treated the other exceptions to the *Schwinn* rule, there has been little agreement as to when a company met the "newcomer" or "failing business" status for reasons of escaping the per se rule. In fact, in most of the cases where this exception has been mentioned, it was held not to apply either because the restrictions in question were illegal for some other reason,[40] or the business did not qualify for either status.[41] Where it did apply, there were other exceptions under which the per se rule failed.[42] So, here again, the *Schwinn* rule met inconsistent application even when a exception validated by the *Schwinn* case itself was interpreted.

It should be noted that in each of these areas there have been cases on either side of the issue. There were, in many instances, a considerable number of cases. There is no reasonable explanation for this morass of inconsistent decisions except that the various courts simply could not routinely apply a per se illegality rule in situations in which, not only was there no competitive advantage taken by the practices used, but competition was actually stimulated on the interbrand level by controlling territorial and customer practices on the intrabrand level. These economic realities could not be ignored in the lower courts even if legal formalism was adherred to in the Supreme Court.

The cases have been so confusing that at times, the lower courts viewed the *Schwinn* decision as one which is limited to the facts of that case, in spite of its use as authority for a broader interpretation by the Supreme Court.[43] One case, apparently utilizing the "without more" language in *Schwinn*, suggested that "where a manufacturer's restriction is related to a legitimate business purpose, *Schwinn* may be inapplicable."[44] This of course, would be the exact opposite of the holding in *Schwinn* since this position is really placing the restraints involved under the rule of reason, and begging the question.

Perhaps in response to all the confusion, but more likely because of a change in the composition of the Court,[45] the Supreme Court finally overruled the *Schwinn* rule. Having been swallowed by the exceptions, the rule died a natural and not unexpected death. In *Continental Television, Inc. v. GTE Sylvania, Inc.*, the Court held that the legality of a manufacturer's location restriction should be determined by the rule of reason, specifically overruling the *Schwinn* per se rule.[46] The respondent GTE Sylvania (Sylvania), is a manufacturer of television sets that markets its products through distributors. These distributors sell the products to a large group of retailers. This exemplifies the classic vertical business relationship paradigm (manufacturer-distributor-retailer). Because of

40. Ammerman v. Bestline Products, Inc., 352 F. Supp. 1077 (D.C. Wisc. 1973).

41. Sulmeyer v. Coca Cola Co. 515 F.2d 835 (5th Cir. 1975).

42. Jack Winter, Inc. v. Koratron Co. 375 F. Supp., (D.C.Cal. 1974), a case in which the per se rule failed under the trademark rubric.

43. *See* note 14, *supra*.

44. Scooper Dooper Inc. v. Kraftco Corp., 494 F.2d 840, 847 n. 13 (3d Cir. 1974).

45. Three justices who participated in the five-man majority opinion in Schwinn are no longer on the Court. Justice Stewart, one of the two dissenters in Schwinn remains an influential voice in antitrust decision making.

a decline in sales during 1962, the company adopted a franchise plan that limited the number of retail franchises in a given area and required each franchisee to sell only from the location or locations at which it was franchised. The goal of such a plan was to preserve quality in merchandising through stimulating intrabrand competition at the retail level. The company hoped to attract more aggressive and competent retailers. Sylvania reserved the right to increase the number of retailers in a given area.[47] In utilizing this practice, Sylvania decided in 1965 to franchise Young Brothers in San Francisco, about a mile from the petitioner, Continental Television (Continental). The suit which resulted in the present decision was a result of Continental's attempt to open another store in Sacramento, California. Pursuant to Sylvania's location restriction, the franchise was turned down and Continental was refused the right to sell the products under its old franchise at the Sacramento outlet. Continental claimed that Sylvania had violated § 1 of the Sherman Antitrust Act by entering into and enforcing franchise agreements that prohibited the sale of Sylvania's products other than from specified locations.[48]

The District Court denied a requested jury instruction that the location restriction was illegal only if it unreasonably restrained or suppressd competition.[49] Instead, relying on *Schwinn*, the District Court instructed the jury that it was a per se violation of § 1 of the Sherman Act if Sylvania entered into a contract, combination, or conspiracy with one or more of its retailers, pursuant to which it attempted to restrict the locations from which the retailers resold the merchandise they had purchased from respondent (Sylvania). The jury, pursuant to this instruction, found for Continental and awarded treble damages.[50]

The Court of Appeals reversed.[51] However, the court distinguished *Schwinn* and in still another use of one of the exceptions developed to the per se rule, held that the manufacturer's location restriction had less potential for competitive harm than the restriction invalidated in *Schwinn* and thus should be judged under the rule of reason rather than the *Schwinn* rule.[52] Perhaps the inconsistencies of these two decisions were enough to point out how mangled this area of the law had become, or perhaps the new Court was predisposed toward overruling *Schwinn* when the chance presented itself in order for antitrust law to more nearly effectuate economic reality. But for whatever reason, the Supreme Court eschewed either reaffirming the *Schwinn* rule or the more likely position of perpetuating still another exception to the rule.

The Court affirmed the Court of Appeals. However, in doing so, it held that the statement of the per se rule in *Schwinn* was broad enough to cover the

46. 433 U.S. at 59.
47. *Id.* at 38.
48. *Id.* at 39.
49. *Id.* at 40.
50. *Id.* at 41.
51. Continental T. V. Inc. v. GTE Sylvania, Inc. 537 F.2d 980 (9th Cir. 1972).

location restriction used by GTE Sylvania. The retailer-customer restriction in *Schwinn* was held to be functionally indistinguishable from the location restriction by Sylvania, the restrictions in both cases limiting the retailer's freedom to dispose of the purchased products and reducing but not eliminating intrabrand competition.[53] In an apparent response to the confusion engendered by *Schwinn* and perpetuated by lower court decisions, and to the criticism of *Schwinn* by legal commentators,[54] generally seeking an understanding of why restrictions, in the case of a sale "were so obviously destructive of competition that their mere existence is enough to violate Section 1; but when imposed on an agent they mysteriously lost their pernicious character and could be justifiable as reasonable restraints of trade,"[55] the Supreme Court, in a six to two decision specifically overruled the *Schwinn* per se rule and held that the vertical restrictions should be judged under the traditional rule of reason.[56]

So the historical context in which *National Auto Brokers v. General Motors Corporation*[57] was decided was just after an overruling of a major antitrust decision. The history of the Supreme Court's involvement in vertical non-price trade restraints however, was a mere ten years.[58] *Schwinn* was the first case in which the Supreme Court made an affirmative decision in this area since the Court had taken a pass just four years earlier in *White Motor.*[59] *Schwinn,* as noted above, was roundly criticized for its approach and its result.[60] But the majority of the criticism was that the decision was based upon a formalistic approach to antitrust law rather than a reaction to economic realities, resulting in a confusion stemming from lower courts attempting to come to equitable economic decisions when the law of the land was based upon legal formalism. There are two distinct schools of economic thought in this area. One is that restrictive vertical distribution arrangements may, in some circumstances intensify interbrand competition at the sacrifice of some intrabrand competition. Such restrictions may allow a manufacturer to obtain distributors and thereby gain access to markets, to induce distributors to make investments, and to encourage distributors to provide maximum market penetration through

52. *Id.* at 980.

53. 433 U.S. at 46.

54. *See, e.g.,* Handler, *Twenty-Five Years of Anti-trust (Twenty-Fifth Annual Antitrust Review,* 73 COLUM. L. REV. 415, 458-9 (1973); Polluck, *Antitrust Problems in Franchising,* 15 N.Y.L. FORUM 106, 110-13 (1969).

55. *See* Robinson, *supra* note 12, at 277.

56. 433 U.S. at 37. Of the six majority justices, five of them, Powell, J., who delivered the opinion, Burger, C. J., and Stewart, Blackmun, and Stevens, J. J., joined in the opinion to overrule Schwinn. White, J. who filed concurring opinion would have distinguished Schwinn, but affirmed the Court of Appeals decision. Brennan, J., who filed a dissenting opinion, and Marshall, J., who joined, dissented.

57. 572 F.2d 953 (1978).

58. Schwinn was decided in 1967 and as noted in the text, was the first case to hold vertical restraints (non-price) per se illegal.

59. White Motor co. v. United States, 372 U.S. 253 (1963). Here, the Court held that vertical restraints should be examined to determine their legality.

60. *See* note 13, *supra.*

indepth coverage of limited markets.[61] The opposite economic approach is that such restrictions increase market power, promote product differentiation, raise barriers to entry, and encourage non-price instead of price competition, all to the detriment of overall competition.[62] The range of positions taken is from per se legality of vertical restraints[63] to the per se illegality position of *Schwinn.*

What is important in the *Sylvania* decision is that it was decided in the context of what was the best *economic* decision, or at least, what the Court considered to be the best. It came at a time when vertical restrictions were considered to be less of a block to competition. The major argument against them had been that they enabled the stronger companies to gain power by forfeiting present profits for later gains which would be made by driving the smaller competitors out of business. However, in the real world of business, the majority of corporations were shown not to follow this paradigm. Rather, the restraints they imposd were in the best interest of themselves and the industry.[64] This is not to say that all vertical restraints are legal, but that they should be determined by the rule of reason.

Sylvania was decided in this context and the decision was based upon these economic principles. What is left is the question of what the response to the decision will be. The commentators who would tend to disallow the vertical restrictions would look to the restrictions themselves and determine whether they would be likely to produce more power and discourage competition.[65] The commentators who would opt for the traditional rule of reason approach would look to the intent of the restraints and the actual effect they produced, a position which historically was to look to reasonableness in theory, but to give blanket approval in fact.[66] That is, once the challenged defendant presented an acceptable theory of efficiency, they have escaped the per se rule or passed the "inherent nature" test.[67] Once this hurdle is met, the vertical restriction should always be held legal because nothing is lost to the consumer that was not already lost due to the horizontal position of the firm imposing the restraint.[68] This

61. *See* note 3, *supra* . Note the discussion of Chicago school theorists.

62. *See* note 3, *supra.* Note the discussion of Harvard school theorists.

63. Professor Bork has defended this position. His thesis is that every vertical arrangement should be lawful. "Analysis shows that every vertical restraint should be completely lawful. R. BORK, THE ANTITRUST PARADOX 288 (1978).

64. Telser argued that manufacturers impose minimum resale prices on their dealers not to give the latter monopoly profits, which would be an absurd motivation for a manufacturer, but to induce optimal presale services. Dealers would compete with each other in offering successively greater services until their marginal cost curve rose to intersect the price fixed by the manufacturer. Therefore, the manufacturer would, by simply altering that price automatically vary the level of presale services. This is easily extended to non-price restraints. Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision,* 45 CHI. L. REV. 1, 4 (1977).

65. Comanor, *Vertical Territorial and Customer Restrictions: White Motor and its Aftermath,* 81 HARV. L. REV. 1419 (1968).

66. L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST § 65 (1977).

67. This language was used by Justice White in his classic formulation of the rule of reason. Standard Oil Co. of New Jersey v. United States 221 U.S. 1, (1911).

68. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division,* (pt. 2), 75 YALE L. J. 373, 397 (1966).

position points up the inconsistency of the *Schwinn* position that the legality should turn on whether the arrangement was pursuant to a sale or an integration agreement. This distinction has little meaning when the economic effect is the same in both kinds of arrangements. Bork even goes so far as defending the position that every vertical restraint should be completely lawful.[69] (This includes price restraints as well as distribution restraints.) He would simply look to whether the cartel formed involved a sufficient number of dealers to make it an effective restraint on competition.[70]

A third, more moderate approach, is to take a closer look at the restraint itself to determine 1) whether it embraces so large a fraction of the market as to make cartelization a plausible motivation and 2) if so, whether the dealers in the product provide any resale services. If the answer to the first is no, the restraint should be held lawful. If the answer to the second is no, it should be unlawful.[71] "Free-riding" should always be a "red flag".[72] If the answer to both of the questions is yes, then the effect of the restraint should be looked at to determine the legality. If output increased, the government must show that it did so because of other reasons than the restriction. If the output decreases, the restriction would be deemed unlawful. This system is an alternative which is not a palatable to the school which would opt for per se illegality as the one which would support the rule of reason. However, it does not simply rubber stamp all practices considered under the rule of reason either. Posner suggests that approach for consideration in post-*Sylvania* cases as is his opinion that the *Sylvania* decision marks a readiness on the part of the Court to consider the economic realities when leading with antitrust.

National Auto Brokers[73] may be an indication of a beginning tendency of the lower courts to look to economic principles to decide antitrust cases. It represents the first response by a lower court to *Sylvania*. Here, the plaintiff company had attempted to capitalize on the marketing of automobiles by selling them through brokers and not using showrooms, maintaining inventories, or providing repair service. By doing this, they attempted to cut their costs to the extent that they could under-sell regularly franchised dealers. They were to obtain these cars by buying them from the regular manufacturer franchised dealers, getting them cheaper because of the volume of business they represented.[74] In this way, they were hoping to undercut the very dealers from whom they bought. This scheme proved to be a complete failure. National Auto Brokers, however, contended that it was damaged by a "blacklist" procedure which General Motors used to keep it from getting new cars, and a "whitelist" procedure whereby Gen-

69. *See* note 63, *supra*.
70. Bork, *Vertical Restraints: Schwinn Overruled*, 1977 Sup. Ct. Rev. 171, 190-91.
71. *See* Posner, *supra* note 64, at 19.
72. *Id.* at 6. The free rider concept desinnates that practice whereby a restriction on intrabrand competition is necessary in order to prevent competing dealers in the same product who provide no services from underpricing dealers who offer pre-sale services.
73. 572 F.2d 953 (1978).
74. *Id.* at 955.

eral Motors made fleet allotments available to certain customers out of which no cars were sold individually. They were earmarked to be sold only to volume operations, such as carleasing and rental companies.[75] National Auto Brokers, in spite of the fact that they could not show that this practice disabled them from acquiring any cars, attacked it as illegal. The District Court found that they lacked any proof to sustain their case that they were damaged by the practice, and directed a verdict for General Motors. The facts showed that National was not actually damaged as the business itself was a complete failure and the plaintiff was not actually deprived of any car it needed.[76] The facts showed that even if the General Motors plan would not have qualified National for fleet allotments, they were never actually deprived of a car for this reason.

The Court of Appeals found that the District Court was correct but looked into the merits of the charges. It found that the vertical restraints placed upon the franchises by General Motors were reasonable business practices.[77] Citing *Sylvania*, the court found that these vertical restraints must be judged by the rule of reason as the Supreme Court had held that such non-price vertical restraints were not per se violations of the Sherman Antitrust Act.

This holding, as a yardstick, however, may be suspect. The court, in its opinion, stated from the start that the plaintiff was one whose activity was not favored by the court.[78] The National Auto Brokers represented a company which the court saw as attempting to profit from a "get-rich-quick" scheme. They were attempting to cash in on a "free-riding" system which supporters of vertical restraints have, for years, warned against.[79] Further, it is just the kind of practice which courts should be concerned with in formulating antitrust precedent, according to Posner.[80] So, this case presented the court with a convenient way to rubber-stamp the *Sylvania* holding without looking to any alternatives. However, in recent antitrust litigation, the cases have gone both ways and the courts have tended to find exceptions to an apparently definitive rule. At least this was the lesson of *Schwinn.* For every exception found to the *Schwinn* rule, there were cases which went both ways and the resulting confusion occurred. The question which the *Sylvania* and now the *National Auto Brokers* cases leave unanswered is whether the same kind of ambivalence which met *Schwinn* in the courts will meet *Sylvania.*

Sylvania left the door open for there to be some vertical nonprice restraints which could be determined to be per se illegal.[81] Just what these are is left to be determined. The real danger is that the *Sylvania* decision will be met with the

75. *Id.* at 956.
76. *Id.* at 957.
77. *Id.* at 958.
78. "This case demonstrates that unsound ideas cannot be turned into a profit through frivolous antitrust claims and costly litigation." 572 F.2d at 955.
79. *See* note 72, *supra.*
80. Posner, *The Rule of Reason and the Economic Approach: Reflections of the Sylvania Decision,* 45 Chi. L. Rev. 1 (1977).
81. 433 U.S. at 58.

same kind of confusion as was *Schwinn*. Since some vertical restraints may be per se illegal and some may be determined by the rule of reason, does *Sylvania* merely add to the confusion? Instead of seeking exceptions to a per se rule, will courts begin to distinguish cases as appropriate for the per se exception left open in *Sylvania*? The hypothesis is that since *Sylvania* set realistic economic criteria for evaluating practices, this evaluation can take place consistently within the rule set out by *Sylvania*. The courts will not have to look to fictions and exceptions in order to make the evaluation of any practice before it.

Whatever the judicial response, by its very nature the rule of reason would allow less confusion. Looking at the relationship between the parties within the business context in which that relationship exists and determining whether a restraint is one which unlawfully restrains trade appears to be a practice in which all of the previous exceptions to *Schwinn* may fall. Also, the practices previously held to be per se violations would not automatically become legal. They would merely be determined to be illegal or legal when their impact upon the particular business is reasonably considered and their potential negative effects are weighed against their potential good. Further, the *Sylvania* reservation that there may still be some vertical non-price restraints which are per se illegal[82] would allow for the kind of activity referred to in *Nothern Pactific Railway Co. v. United States*, the ones with a "pernicious effect on competition" that "lack any redeeming virtue,"[83] to be per se illegal. Whether there will be any method applied to these overriding parameters remains to be seen. But, the framework is set for a logically consistent judicial determination of what is or is not per se illegal. Responsible decisions come from a framework which offers guidance and which may be respected as a useful judicial and economic tool. *Schwinn* offered little guidance, or, at least, the courts took little guidance from it. The courts' responses to *Sylvania* will determine whether it presented a more workable framework.

Taken as an indication of a potential response for the courts to make, *National Auto Brokers Corp. v. General Motors Corporation*,[84] made a strong definitive statement of what the law is at this point. In fact, when considered in light of the fact that the case could have gone off on the "failure to state a claim" grounds, the Second Circuit can be interpreted as making just such a statement by reviewing the case at all. The court stated that General Motors' "whitelist" practice—the practice of reserving automobiles for fleet distribution—did not violate the rule of reason and that the rule of reason standard was "required by the Supreme Court's recent decision in *Continental Television, Inc. v. GTE Sylvania, Inc.*, which held that such non-price vertical restraints are no longer per se illegal."[85]

82. 572 F.2d at 956.
83. 356 U.S. at 5.
84. 572 F.2d 953 (1968).
85. *Id.* at 960.

In using this interpretation, the court stated the rule of reason formulated in *Chicago Board of Trade v. United States*[86] in 1918. In that formulation, for a business practice to fail the test of the rule of reason, it must be unreasonable in view of "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."[87] This compares favorably to the evaluation encouraged by some of the more moderate economic commentators. So essentially, what the court held in *National Auto Brokers* was that the *Sylvania* holding enabled the courts to disavow the per se rule when considering vertical non-price territorial and customer restraints. If *National Auto Brokers* does no more, it gives this much interpretation to the Supreme Court's holding in *Sylvania*.

Applying these formulations of the present rule to the framework which is to be developed in post-*Sylvania* cases, it appears that a developing rule of reason will be used to evaluate vertical restraints. If the cases support this trend, perhaps the most that will be said for the *Schwinn* era is that it provided a means to investigating and eliminating the use of per se illegality as applied to the kinds of vertical restraints which the courts grappled with after that decision. If so, the result is a rule which will enable economic planners and courts to have an opportunity to develop a meaningful system for evaluating vertical restraints in the field of antitrust law.

V. THOMAS JORDAN, JR.

86. 246 U.S. 231 (1918).
87. *Id.* at 238.