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EXCLUSIVE ARRANGEMENTS AND REFUSAL TO DEAL PROBLEMS*

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Justification for including a discussion on exclusive dealing arrangements and on refusal to deal decisions in a symposium devoted to trade practices rests upon the practical consideration that there exists on the part of business management a considerable interest in the two commercial tools.

Business executives find appeal in the prospect of using a contract calling for exclusive dealing.[1] Those engaged in commerce have for a variety of purposes frequently employed as a lever the refusal to deal.

Possible antitrust implications in the use of the two devices has not always been understood by business. In recent years, however, the volume of litigation[2] and various efforts at education have more and more induced a consciousness of possible antitrust liability and encouraged questions of lawyer advisors to business.

This analysis is intended to give guidance which will assist in answering the questions which may be raised.

Since exclusive dealing arrangements and refusal to deal take different forms and are used for varied purposes, it is logical to define under appropriate headings variations in pattern and to discuss the application of the law of trade practice to each enumerated variation. Part I will concern itself with the area of exclusive dealing and part II with that of refusals to deal.

I—Exclusive Dealing Arrangements

Seller Sponsored Exclusive Supply And Total Requirement Contracts

The least sophisticated and most elementary type of exclusive deal-

* This Article will concern itself solely with federal legislation affecting exclusive dealing and refusal to deal efforts. Obvious justification for such limitation rests upon the recognition that so much of business endeavor involves interstate commerce.

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1. See Lockhart and Sacks, *The Relevance of Economic Factors in Determining Whether Exclusive Arrangements Violate Section 3 of the Clayton Act,* 65 HARV. L. REV. 913 (1952), for an exhaustive discussion of the many good economic uses for exclusive dealing contracts.
2. The number of cases reported in *CCH Trade Cases* since 1932 is most impressive.

ing arrangement is one forced upon a purchaser by a seller even though the purchaser in no way solicits or encourages the arrangement. Sometimes the offer is couched in terms which require the purchaser to buy full requirements from the seller. If the pressure of the seller could always be explained on the ground of desire to restrain trade or intent to monopolize, there would be little quarrel with a rigid application of the Sherman Act[3] for the purpose of curbing the seller. As a practical matter, however, such intent frequently does not motivate sellers. The purpose may be to insure maximum sales effort on the part of dealers. The full requirement approach may be made to reduce sales cost. Some sellers, highly conscious of the value of good will, may feel that exclusion of competing lines is necessary in order to make certain of the development of a specialized service department.[4]

The mere fact that the seller may have a reason apart from restraint of trade and intent to monopolize obviously does not mean that all exclusive dealing patterns can be upheld which do not run afoul of the Sherman Act. This is because efforts on the part of the seller may injure others. Competing suppliers may be harmed by the closing of markets. Newcomers may find it most difficult to break into the field if enough outlets are tied up. The consumer may suffer if sufficient competition is affected.

The federal trade regulation laws recognized this in section 3 of the Clayton Act[5] which in relevant part forbids any person

> to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States . . . or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of the lease, sale, or contract for sale on such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

Section 3 has become the major tool used in assessing the validity of exclusive arrangements. It is particularly recognized that the test applied under the Clayton Act is less stringent than the Sherman Act test of "unreasonable restraint of trade" because the Clayton Act was designed to condemn practices before fruition.[6]

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3. 26 STAT. 209 (1890), 15 U.S.C. § 1-7 (1952).
4. All of the enumerated reasons are mentioned by Lockhart and Sacks, *supra* note 1, at 921-22.
5. 38 STAT. 731 (1914), 15 U.S.C. § 14 (1952).
6. See Rashid, *Antitrust Aspects of Exclusive Dealing Arrangements*, 40 GEO. L.J. 241, 267 (1952).

In commenting upon the fact that section 3 must be recognized as the dominant statute bearing upon exclusives, Handler[7] argues that if an agreement is valid under section 3, it should never be condemned under the Sherman Act or the Federal Trade Commission Act[8] unless some additional pressure has been exerted.

The "effect" clause of section 3, which speaks of substantially lessening competition or tending to create a monopoly in any line of commerce, has drawn the most scrutiny. The meaning of the words may appear rather self-evident to the casual reader or to those uninitiated in trade regulation law. It may seem that those accused of violation of section 3 could always prove that there had not been a lessening of competition. The words may suggest that a defendant would always be permitted to show such facts as an increase in the number of competitors, an increase in the volume of competitors, and a decrease in plaintiff's share of the market.

There has, however, been no such universal interpretation of the "effect" clause. In *Standard Fashion Co. v. Magrane-Houston Co.*[9] the United States Supreme Court gave early indication that it would not require a complete market analysis to support a finding of violation under section 3. The fact that the manufacturer-seller or the holding company controlling it had by means of exclusive dealing arrangements control on a national basis of about forty per cent of the existing 52,000 retail outlets for dress patterns caused the court to infer that competition has been or probably would be lessened.[10] The "dominant" position of the seller was enough of a test to satisfy the court.[11]

As recently as 1954 the "dominance" test was unequivocally approved by a strong court. Judge Harold Medina, writing for the United States Court of Appeals for the Second Circuit in *Dictograph Products v. FTC*[12] was willing to ignore evidence tending to indicate that numbers of competitors in a particular line of commerce had increased in spite of Dictograph's exclusive dealing requirements. This willinguess was grounded upon the fact that proof at any early stage had shown that Dictograph (a manufacturer of hearing aid products) dominated and was a leader in the industry.

Judge Medina saw the birth of section 3 of the Clayton Act as a reaction to a 1903 Circuit Court of Appeals holding[13] that the Sherman Act did not apply to the refusal by a leading producer of chewing tobacco to sell to a dealer who would not agree to deal exclusively in

7. Handler, *Recent Antitrust Developments,* 9 RECORD 171 (1954).
8. 38 STAT. 717 (1914), 15 U.S.C. §§ 41-58 (1952).
9. 258 U.S. 346 (1922).
10. *Id.* at 357.
11. Note, 33 N.C.L. REV. 706 (1955).
12. 217 F.2d 821 (2d Cir. 1954), *cert. denied,* 349 U.S. 940 (1955).
13. Whitwell v. Continental Tobacco Co., 125 Fed. 454 (8th Cir. 1903).

the seller's products. Medina stated directly that the inclusion of the qualifying phrase of section 3 "in no way supports the view that it was designed to effect a renaissance of the Sherman Act type of inquiry into all economic factors."[14] And a few paragraphs later, he continued: "[I]t is hard to believe that the Congress envisioned a full dress inquiry into economic motives or effects of such contracts in all cases, including those involving the use of these devices by established leaders or prominent businesses in an industry."[15]

While admitting that the history of the "except" clause shows an intent on the part of Congress to give a limited legal sanction to certain exclusive dealing activities of newcomers or small business enterprises so as to permit them to more effectively compete with established concerns, Judge Medina found no difficulty in submitting that Congress did not intend to sanction the exclusive dealing endeavors of a concern in the economic position of Dictograph. He did this by pointing out that

> it seems clear that whatever utility the elaborate economic inquiry contended for by the petitioner may still have under section 3 of the Clayton Act when applied to organizations not doing a substantial share of the business or not yet firmly established in a particular line of commerce, it has no place in a case such as this where the condemned contracts are being employed by a corporation which does almost $2,000,000 worth of business each year, is one of the industry's three leaders . . . and which alone controls by such means over one fifth of the nation's prime retail outlets for [hearing aid] products. . . .[16]

Complete market analysis as a test for violation of section 3 was passed over by the United States Supreme Court in the very significant 1949 decision of *Standard Oil Co. v. United States.*[17] The Court made clear also that it would not insist on a finding that the seller enjoyed dominant leadership. The fact that impressed the five man majority was that Standard Oil sold $58,000,000 worth of gasoline under the full requirement contracts it made with about five thousand independent dealers in a seven state western area. It saw in this fact that competition had been foreclosed in a substantial share of the gasoline market and created the probability of economic harm. It made no difference that the exclusive supply contracts covered only 16% of the retail gasoline outlets and 6.7% of the total gasoline sales in the western area. The Court declined to appraise the economic consequences. The majority explicitly refused to consider whether the requirement contracts might have been economically beneficial or

14. 217 F.2d at 827.
15. *Ibid.*
16. *Ibid.*
17. 337 U.S. 293 (1948).

might have intensified rather than reduced competition in the market as dissenting Justices Jackson, Vinson and Burton contended it should have done. Section 3 was held not to require the same proof of market consequences as the Sherman Act. Contracts covering any substantial share of commerce appeared to be labeled per se illegal because by their very nature they exclude competition from that segment of the trade which they cover.

In 1952 in *Richfield Oil Corp. v. United States*[18] the United States Supreme Court felt impelled to follow the recently decided *Standard Oil* case. Involved factually were exclusive contracts made by another of the big seven oil companies on the west coast with thousands of service stations which have sales of over forty million dollars annually.

The Supreme Court's "quantitative substantiality" test has evoked a great deal of criticism. Lockhart and Sacks spoke out forcefully in the *Harvard Law Review* as early as 1952.[19] While acknowledging that the quantity test facilitates the task of enforcing section 3 and removes a great deal of uncertainty as to the legality of proposed or existing exclusive agreements, the authors doubt the propriety of this consideration where Congress has made reasonably plain that it wanted an analysis in each case of the effect of the particular arrangements upon competition.

Writing in the February 1955 *American Bar Association Journal*,[20] Thomas E. Sunderland, General Counsel of Standard Oil of Indiana, makes a broad attack on per se illegality in exclusive dealing cases. His argument is particularly forceful as an answer to condemnation of exclusive arrangements on the mere ground of coverage of a substantial volume of commerce. Noting that there is most frequently other thousands of dealer and jobber outlets, Sunderland contends that other sellers are not denied access to a market even though some exclusive dealing arrangements may produce large volume return. Most frequently, he says, the public is not harmed where a dealer chooses to distribute through a reseller who agrees to concentrate on the seller's line of products.

Of major significance is the attitude of the Attorney General's National Committee to Study the Antitrust Laws. In its Report of March 1955 the Committee states: "[T]he mere coverage of a substantial volume of commerce by exclusive dealing arrangements, while a factor to be considered, is not tantamount to a foreclosure of rivals from access to a substantial market, so that some analysis of

18. 343 U.S. 922 (1952).
19. Lockhart and Sacks, *supra* note 1.
20. Sunderland, *Antitrust Developments: A New Era for Competitive Pricing*, 41 A.B.A.J. 113, 115 (1955).

particular distributive patterns is essential to any determination of actual foreclosure."[21]

It is significant that the Report of the Attorney General's Committee concentrates its attack on the philosophy of *Standard Oil* on the ground that it creates a per se rule of liability. As Handler points out, the Committee does not condemn the actual result in *Standard Oil* because factually "the use of exclusive dealing contracts by Standard Oil's competitors withdrew most of the suitable retail outlets from the smaller marketing companies" and "as a result, competition may possibly have been foreclosed not only quantitatively, but also qualitatively."[22]

The attacks on *Standard Oil* and on the efforts to create per se liability under section 3 of the Clayton Act have to date forced no reversal on the part of the courts.

Of course, after *Standard Oil* Justice Frankfurter, who wrote the opinion in *Standard Oil,* did explain in his dissent in *FTC v. Motion Picture Advertising Serv., Inc.*[23] that more than mere quantitative substantiality was in fact involved in *Standard.* In 1953 the FTC broke with the philosophy of *Standard Oil* in its *Maico Hearing Aid Co.*[24] decision by stating that it was wrong of its hearing examiner to reject all of the attempts of Maico Hearing Aid Company to present evidence for the purpose of showing: (1) that there had been an increase in the number of competitors, (2) that the volume of business of its competitors had increased, (3) that its share of the market had been decreasing, (4) that its dealers constitute a small percent of the total number of hearing aid dealers in the country, and (5) other matters relating to effect on competition.

Although the Maico Hearing Aid Company was of substantial size and its volume was growing, it was not dominant in the industry and, therefore, did not stand at all in the way of the court which tussled with the *Dictograph Products* case.

Authorities take a most pessimistic attitude as to the future influence which the FTC market analysis approach of *Maico* may have on court decisions. Handler feels that the FTC itself is giving only lip service to *Maico.* "It is not clear," he states, "that the application of the doctrine provides any different results from the *Standard Sta-*

21. REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 147 (1955). The Committee says, "Our conception of substantiality is whether competitors in fact have ready access to adequate sources of supply and to a sufficient number of outlets to enable their products to be effectively marketed." *Id.* at 147 n. 73.

22. Handler, *Annual Review of Antitrust Developments,* 10 RECORD 332, 340-41 (1955).

23. 344 U.S. 392, 398 (1953).

24. CCH TRADE REG. REP. ¶ 25329 (1955).

tions[25] rule of quantitative substantiality."[26] Citing *Revlon Products Corp.*[27] he contends that the Commission has forbidden arrangements in circumstances at least suggesting that competitors had fairly effective and ready access to markets. *Beltone Hearing Aid Co.*[28] is mentioned to establish that some of the commission examiners not only apply the quantitative substantiality test but refer uncritically to *Standard Oil.*

Sunderland cautions that the decision of the FTC in *Outboard Marine and Mfg. Co.*[29] "revives the confusion as to whether and to what extent economic evidence is pertinent to the proof of injury to competition."[30]

Buyer Requested Full Requirement Contract

Often instead of a seller exerting pressure to force a full requirement or exclusive dealing contract, the purchaser requests that the seller agree to fulfill requirements. In return the purchaser will frequently agree to handle only the products of the seller.

Good reasons can motivate the buyer's attitude. The Attorney General's Committee on Antitrust in its Report acknowledges that requirement contracts may be preferred by customers "as assuring a steady, adequate source of supply, affording protection against price fluxuation and facilitating long term business plans."[31] In the *United States v. American Can Co.*[32] decision the court indicated awareness that some exclusive arrangements might serve mutual interests of the contracting parties without unreasonably foreclosing others from the market. The court was able to see that in the canning industry full requirement contracts assure the canner the necessary quantities whatever the size of the unpredictable pack.[33]

The realization that the buyer may desire the benefit of a full requirement contract suggests a question. Does such desire have any impact upon the interpretation of section 3 of the Clayton Act?

Judge Nordbye helps give an answer in the *J. I. Case*[34] controversy. Although showing a recognition that exclusive handling arrangements may result from a mutual recognition that sound business practice demands them[35] the tenor of much of his discussion indicates that a voluntary request on the part of a purchaser-dealer will not clothe

25. The name used to identify the case of Standard Oil Co. v. United States, 337 U.S. 293 (1948).
26. Handler, *supra* note 22, at 341.
27. CCH TRADE REG. REP. ¶¶ 25184, 25249 (1954).
28. CCH TRADE REG. REP. ¶ 25397 (1955).
29. CCH TRADE REG. REP. ¶ 26087 (1956).
30. *Recent Developments in Antitrust Laws,* 38 CHI. B.R. 151 (1957).
31. REPORT, *op. cit. supra* note 21, at 146.
32. 87 F. Supp. 18 (N.D. Cal. 1949).
33. *Id.* at 31, 32.
34. United States v. J. I. Case Co., 101 F. Supp. 856 (D. Minn. 1951).
35. *Id.* at 862.

exclusive arrangements with legality if there is a showing that the likely effect will substantially weaken competition in the final market.[36] In *FTC v. Motion Picture Advertising Serv., Inc.*[37] the United States Supreme Court supported the Commission and refused to clothe with legality exclusive exhibition agreements on the ground that there was no coercion involved and that the theater owners actually requested them.

There is, however, in both *Motion Picture Advertising Service* and *American Can* a philosophy which can be applied with particular appropriateness in a situation where it is found that the buyer desires the exclusive dealing arrangement. The courts in both cases indicated that the length of the exclusive contract may have something to do with its reasonableness as respects competition. In each case five year contracts were condemned but one year contracts were upheld.

In spelling out its position the court in *American Can* said: "To strike down the requirements contracts and to declare them totally void . . . without at the same time affording the user-consumer a supply over a limited period of time, would be destructive, illogical, unsound and not in consonance with the acute and particular problems confronting the canning industry."[38] The court in *American Can* was not deterred by the fact that the defendant did 46% of the total competitive sales with almost all of its volume under requirement contracts. In *Motion Picture Advertising Service* defendant had exclusive contracts with 40% of the theaters in the area in which it operated.

The Report of the Attorney General's Committee on Antitrust strongly supports the thinking of the courts in the cases just cited. Flexible short-term contracts, says the committee, "may leave greater opportunities to rivals than an absolute sale of a larger quantity which would fill the buyer's needs for a longer time."[39]

It must be noted that neither *American Can* nor *Motion Picture Advertising Service* were grounded on section 3 of the Clayton Act. Therefore, in relation to such section they are of importance only because of the philosophy they enunciate. Actually *American Can* applied the Sherman Act and held that section 3 of the Clayton Act did not pertain to full requirement contracts because of the inapplicability of the specific language before the "effect" clause which has to do with sale on condition that the purchaser will not deal in the goods of a competitor. *Motion Picture Advertising Service* was prosecuted under the "unfair methods of competition" proviso of section 5 of the Federal Trade Commission Act.[40]

36. *Id.* at 865, 866.
37. 344 U.S. 392 (1953).
38. 87 F. Supp. at 31.
39. REPORT, *op. cit. supra* note 21, at 146.
40. 52 STAT. 111 (1938), as amended 15 U.S.C. § 45 (1952).

The writer cannot agree that section 3 has no application to full requirement contracts. Most persuasive on the point is a case note in the 1950 *Minnesota Law Review*[41] which criticizes the technical approach of *American Can*. Certainly a sale on condition may be implied so that section 3 can be employed.

Exclusive Distributorships

An exclusive distributorship program takes the form of placing a restraint upon the seller. The seller agrees not to deal with any other buyer, typically within a prescribed territory. The arrangement may also require the buyer to agree to sell only within an assigned territory. The validity of the two types of arrangement must be discussed separately.

In the case where the seller merely agrees not to deal with any other buyer within a prescribed territory, section 3 of the Clayton Act does not apply because there is no restriction placed upon the buyer.[42] The Sherman Act may, however, have an impact upon the situation. Consideration must be given to the question as to whether there is restraint of trade or a scheme to monopolize. In thinking through the problem it must be remembered in accordance with the rule at common law[43] that exclusive selling agreements have been regarded under the Sherman Act as an ancillary restraint having a legitimate business purpose.[44] This is because it has been recognized that many such agreements will afford fair protection to the buyer without injuring the public. This will be true where effective competition exists at both seller and buyer levels. The Report of the Attorney General's Committee to Study the Antitrust Laws expresses the feeling that if the seller agrees not to deal with any other buyer within a reasonably defined area, the arrangement should be sustained as lawful if it is created to serve a valid business purpose and if there is no attempt to monopolize the field.[45]

This philosophy is forcefully and logically enunciated by the district court[46] and approved by the Fourth Circuit[47] in *Schwing Motor Co. v. Hudson Sales Corp.* Although aware of the fact that an exclusive

41. See 34 MINN. L. REV. 570 (1950). The author cites a number of cases in support of his thesis.
42. Marine Equipment & Supply Co. v. Trojan Boat Co., CCH TRADE REG. REP. (1957 Trade Cas.) ¶ 68708 at 72862 (Pa. C.P. of Lancaster County).
43. RESTATEMENT, CONTRACTS § 516 (1932); Black and White Taxicab and Transfer Co. v. Brown and Yellow Taxicab and Transfer Co., 276 U.S. 518 (1928).
44. Bascom Launder Corp. v. Telecoin Corp., 204 F.2d 331, 335 (2d Cir. 1953); United States v. Bausch & Lomb Optical Co., 45 F. Supp. 387, 398-99 (S.D.N.Y. 1942), *aff'd*, 321 U.S. 707, 719 (1944).
45. REPORT, *op. cit. supra* note 21, at 27-28.
46. 138 F. Supp. 899 (D. Md. 1956).
47. 239 F.2d 176 (4th Cir. 1956).

dealership involved a limited monopoly to sell the product of a manufacturer in the area covered by the exclusive agreement, the courts felt that the arrangement was not per se an illegal extension of the right of a manufacturer to exercise his independent judgment as to the selection of parties with whom he will deal.[48] Spelled out by District Judge Thomsen was the test of whether the arrangement prejudiced the public interest by unduly restricting the free flow of interstate commerce. Turning to the facts Thomsen found no evidence that the public was unable to purchase at competitive prices all the automobiles it desired. He observed that the evidence did not even indicate that the public could not buy at competitive prices all the Hudson cars it wanted.

The court made clear that its attitude would be different if the facts had shown a horizontal conspiracy among competitors or if Hudson enjoyed a dominant position in the industry or in the local market.[49]

The philosophy of the *Hudson* case has been bolstered by the very recent holding of the Court of Appeals for the District of Columbia in *Packard Motor Car Co. v. Webster Motor Car Co.*[50] where in tussling with an exclusive distributorship given by Packard Motor Company to one dealer in the city of Baltimore, the court overruled Judge Holtzoff who had passed upon the matter at the district level.[51]

In coming to its conclusion the appeals court was not impressed with the argument of the district court or with that of dissenting Judge Bazelon that it made a difference if pressure for an exclusive distributorship came from the dealer rather than from the seller. Obviously the court, like Judge Thomsen in the *Hudson* case, must have felt that it could not ignore the practicalities of the situation which included a recognition that "such decisions are not made in a vacuum" and that it could not be supposed that a manufacturer would "decide to reduce the number of its dealers in a particular city from 5 to 3 or from 2 to 1 without discussing the matter with dealers whom it wished to retain."[52] In this connection it is pertinent to reflect upon the fact that since the exclusive selling covenant is to protect the dealer from competition in the manufacturer's product and there is no necessity for the manufacturer to impose a contractual restraint upon himself, it is logical to expect that impetus for the agreement will typically come from the dealer.[53]

The appeals court was not troubled by the fact that as a result of

48. 138 F. Supp. at 902-03.
49. *Id.* at 904-05.
50. 243 F.2d 418 (D.C. Cir. 1957).
51. Webster Motor Car Co. v. Packard Motor Car Co., 135 F. Supp. 4 (D.D.C. 1955).
52. For Judge Thomsen's views see 138 F. Supp. at 906.
53. This is the thought expressed by Handler, *Annual Antitrust Review*, 11 RECORD 367, 372 (1956).

the arrangement only one Packard dealer remained in Baltimore. Relying upon the *Cellophane*[54] case the court found "no monopoly or attempt or conspiracy to monopolize within the meaning of the Sherman Act"[55] because there are other cars reasonably interchangeable by consumers and, therefore, in competition with Packards.

The court found no unreasonable restraint. Rather it saw a good business reason for the arrangement and concluded by saying: "The short of it is that a relatively small manufacturer, competing with large manufacturers, thought it advantageous to retain its largest dealer in Baltimore and could not do so without agreeing to drop its other Baltimore dealers. To penalize the small manufacturer for competing in this way not only fails to promote the policy of the antitrust laws but defeats it."[56]

Now it seems necessary to turn attention to the exclusive distributorship arrangement where the seller agrees not to deal with any other buyer within a prescribed territory but in return requires the buyer to agree to sell only within an assigned geographical area. In determining the validity of this quite usual provision in a grant of exclusive distributorship the basic consideration should be whether the dealers appointed as exclusive distributors face effective competition from other sales outlets. In a number of cases involving a dealer restrictive territorial clause the courts have been satisfied that the seller does not occupy a monopolistic position and that there was effective outside competition.[57]

The government recently, however, started action against J. P. Seeburg Corporation, alleging that the company produced more than forty per cent of the total national output of coin operated phonographs and was the largest manufacturer in the United States of such equipment. Undoubtedly, aware of its vulnerable position on the ground of lack of effective competition, Seeburg consented to a decree prohibiting it from limiting or restricting the persons to whom or the territory within which any distributor may choose to sell phonographs.[58]

Tying Arrangements

Another form of exclusive arrangement which requires some analysis is the tying agreement. Most frequently the arrangement obligates a lessee or purchaser of a device (very often a patented device) to

54. United States v. E. I. du Pont de Nemours & Co., 351 U.S. 377 (1956).
55. 243 F.2d at 418.
56. *Id.* at 421.
57. Boro Hall Corp. v. General Motors Corp., 124 F.2d 822 (2d Cir. 1942), *cert. denied,* 317 U.S. 695 (1943); Tillar v. Cole Motor Car Co., 246 Fed. 831 (5th Cir. 1917), *cert. denied,* 247 U.S. 511 (1918); Phillips v. Iola Portland Cement Co., 125 Fed. 593 (8th Cir. 1903), *cert. denied,* 192 U.S. 606 (1904).
58. United States v. J. P. Seeburg Corp., CCH TRADE REG. REP. (1957 Trade Cas.) ¶ 68613 (N.D. Ill. Jan. 31, 1957).

use with it only the supplies sold by the lessor or seller. Less commonly a sale is made and the buyer is required to make a simultaneous purchase of a complimentary product.

A rather logical argument can be presented to support labeling tying arrangements per se illegal under section 3 of the Clayton Act. Lockhart and Sacks[59] reason "that it should not be necessary to determine the precise degree of market control over the controlled product" to conclude that the tying device has an effect on competition. They pointed out that unless there are quite exceptional facts the very existence of the tying arrangement would seem to indicate that the supplier has sufficient market control to force his customers to adhere to the tying arrangement and thus to lessen competition in the tied product. Their argument continued through the submission of the idea that the competition which section 3 of the Clayton Act intends to safeguard will not be preserved by practices which promote sales not on the basis of the merit of a product but on the strength of the market control which a seller is able to secure over some other product.

Both the *Standard Oil*[60] and *Times-Picayune*[61] cases emphasize that tying arrangements "serve hardly any purpose beyond the suppression of competition." The Attorney General's Committee on Antitrust Laws agrees with the court's observation in *Times-Picayune* that "in the usual case only the prospect of reducing competition would persuade a seller to adopt such a contract and only his control of the supply of the typing device, whether conferred by patent, monopoly or otherwise obtained, could induce a buyer to enter one."[62]

A warning against finding tying agreements per se illegal was sounded in 1954 by the FTC in the *Insto-Gas Corporation*[63] litigation. The Commission remanded to a hearing examiner a case in which Insto-Gas Corporation of Detroit was charged with unlawful use of tying contracts (under section 3) in connection with the leasing of propane gas cylinders and propane gas and appliances. The Commission said that in spite of Justice Frankfurter's statement in *Standard Oil,* that tying arrangements serve hardly any purpose beyond the suppression of competition, it knew of no case in which tying contracts without more have been declared illegal per se. The Commission commented that in the *Standard Oil* case the court rejected the necessity of demonstrating economic consequences once it had been established that the volume of business affected is not insiguificant or insubstantial.

59. Lockhart and Sacks, *supra* note 1, at 944.
60. 337 U.S. at 305.
61. Times-Picayune Publishing Co. v. United States, 345 U.S. 594 (1953).
62. REPORT, *op. cit supra* note 21, at 145
63. CCH TRADE REG. REP. ¶ 25188 (1954).

One of the justifications defendants often present in answer to a charge that a tying arrangement is illegal is the necessity of protecting good will. In the *General Motors*,[64] *Sinclair*,[65] and *J. I. Case Co.*,[66] cases the protection of good will defense was given some recognition, but for the most part the courts have been hard to convince that good will was really in danger in cases where tying agreements were an issue. *International Business Machines Corp. v. United States*,[67] is an example. The Attorney General's Committee on Antitrust Laws has a logical reason to explain why the good will defense will not ordinarily succeed.[68] It says: "[O]rdinarily the manufacturer's good will is adequately safeguarded by reasonable specifications of the supplies the main product requires."

It is necessary to scrutinize carefully the actual steps that have been taken before concluding that the parties have entered into an illegal tying arrangement. The recent case of *Technical Tape Corp. v. Minnesota Mining & Mfg. Co.*[69] alerts us to such fact. In that litigation it was alleged that a patent holder abused its monopoly on transparent adhesive tape by selling it on condition that the purchaser thereof buy other tape made by the patent holder but not covered by the patent and by selling its patented transparent tape on condition that the purchaser thereof refrain from buying other adhesive tape products from any other manufacturer.

In reacting to the allegation the second circuit found no violation of section 3 of the Clayton Act but merely a legitimate refusal to deal for good business reasons.[70] Persuasive was the evidence that certain distributors and jobbers were guilty of one or more of the following practices: Disparaging a defendant's product in order to substitute other cheaper brands of tape, failure to fairly display or sell defendant's tape, pushing competitors' products to the detriment of the defendant's product and making no effort to sell defendant's product.[71] The court concluded by stressing that "this is not a case where the manufacturer imposed a uniform exclusive dealing contract on its jobbers and distributors such as was the situation in *Dictograph* . . . ."[72]

The impact on tying arrangements of the Sherman Act is discussed in *Times-Picayune*,[73] a case which involved efforts of a New Orleans

64. Pick Mfg. Co. v. General Motors Corp., 80 F.2d 641 (1935), *aff'd per curiam*, 299 U.S. 3 (1936).
65. FTC v. Sinclair Refining Co., 261 U.S. 463 (1923).
66. See note 34 *supra*.
67. 298 U.S. 131 (1936). See also United States v. American Linen Supply Co., 141 F. Supp. 105 (N.D. Ill. 1956).
68. REPORT, *op. cit. supra* note 21, at 142.
69. 247 F.2d 343 (2d Cir. 1957).
70. *Id.* at 350.
71. *Id.* at 355.
72. *Id.* at 358.
73. Times-Picayune Publishing Co. v. United States, 345 U.S. 594 (1953).

publisher to force each advertiser to use both a morning and evening newspaper which he owned. The court contrasted the application of the Clayton Act and the Sherman Act in a tying arrangement situation. It said that "when the seller enjoys a monopolistic position in the market for the 'tying' product, or if a substantial volume of commerce in the 'tied' products is restrained, a tying arrangement violates the narrow standards expressed in § 3 of the Clayton Act because from either factor the required potential lessening of competition is inferred."[74] On the other hand the court pointed out that there would be no violation of section 1 of the Sherman Act unless there is found a monopolist who forecloses competition from any substantial market.[75] This conclusion follows, the court argued, because the restraint could not be justified under any rule of reason.[76]

II—Refusals to Deal

Refusals to deal include both refusals to sell and refusals to buy. Because refusals to deal might be used as a lever to encourage exclusive dealing, it is logical that the discussion on the antitrust aspects of the problem should follow part I of this article.

Even a most general awareness of the protection given in the United States to freedom of choice of the businessman will suggest that any discussion on the antitrust aspects of refusals to deal must be concerned with balancing the right of freedom of choice against any specific intent that is expressed in the Sherman or Clayton Acts.

That the United States Supreme Court would require such balancing was early indicated in *United States v. Colgate & Co.*[77] in the comment

> The purpose of the Sherman Act is . . . to preserve the right of freedom to trade. In the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell.[78]

74. *Id.* at 608-09.
75. *Id.* at 609.
76. In the *Times-Picayune* case a Sherman Act violation was alleged. There was no claim of violation of § 3 of the Clayton Act because the FTC had given an opinion to the effect that advertising space was not a "commodity" within the meaning of the Clayton Act. (See 345 U.S. at 609 n. 27.) A five man majority treating both the morning and evening newspapers in New Orleans as comprising one market and noting that the tie-in did not adversely effect defendant's sole competitor found no violation of the Sherman Act over the forceful dissent of four who complained that the majority overlooked that the defendant enjoyed a distinct monopoly of access to morning readers and used that monopoly to restrain unreasonably the competition for advertising between its evening paper and another evening paper in New Orleans.
77. 250 U.S. 300 (1919).
78. *Id.* at 307.

The broad sweep of the language in the *Colgate* case, where under the facts the manufacturer's terms in respect to price maintenance have been announced in advance, has caused many to feel that there is an unqualified privilege of refusal to deal. That this is not actually a legitimate inference is logically demonstrated in an article by McLaughlin in the *University of Pennsylvania Law Review*.[79] In a thorough analysis the author shows that the United States Supreme Court procedure required the court to follow the district court's conclusion that the indictment did not charge an agreement and hence, merely boiled down to alleging that Colgate was refusing to sell its goods to price cutters. Such background finding forced the Court to uphold freedom of choice. Justice McReynolds, who wrote the opinion in the *Colgate* case, made clear in *Schrader's Son, Inc.*[80] that he was not enunciating an unqualified privilege to refuse to deal. He stated that there is an "obvious difference between the situation presented when a manufacturer merely indicates his wishes concerning prices and declines further dealing with all who fail to observe them, and one where he enters into agreements—whether express or implied from a course of dealing or other circumstances . . . which undertakes to bind to observe fixed resale prices."[81]

Construing the application of section 5 of the FTC Act in the *Beech-nut*[82] controversy the Supreme Court did infer an agreement and condemned the refusal to deal stand of the defendant company.

The three cases just cited all involved efforts to enforce price maintenance. However, the philosophy enunciated by the courts on the matter of the refusal to deal has significant application to the validity of refusals as a technique to enforce exclusive dealing plans. One important difference exists between the two factual situations. At common law resale price maintenance agreements were per se illegal. Hence, if the court found such an agreement, refusal to deal would be condemned under the Sherman Act. When, however, refusal to deal is a lever used to force exclusive arrangements or territorial restrictions in the form of contracts or agreements, it will become necessary, absent monopoly, to determine whether the restraint was unreasonable or substantially affected competition. Tests for ascertaining the reasonableness of restraint or effect upon competition were analyzed in part I of this article.

The important matter which must now be approached is the determination of what constitutes evidence from which the court may infer a contract or agreement. Certainly there are innumerable in-

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79. McLaughlin, *Fair Trade Acts,* 86 U. PA. L. REV. 803, 808-10 (1938).

80. United States v. Schrader's Son, Inc., 252 U.S. 85 (1920).

81. *Id.* at 99.

82. 38 STAT. 719 (1914), 15 U.S.C. § 45 (1952); FTC v. Beech-nut Packing Co., 257 U.S. 441 (1922).

stances when no agreements have been inferred, and a refusal to deal has been approved as an individual right.[83]

Any reflection on the right of freedom to select customers leads inevitably to the conclusion that a manufacturer must be allowed to protect himself against the results of ineffective selling. The manufacturer has to be concerned with sales volume. He must, therefore, be given the right to refuse to deal further with the distributor who fails to produce satisfactory results. The fact that the poor sales results may be influenced by the distributor's handling several products should not affect the basic right of the manufacturer to act. Even a warning which calls dilution of the selling effort to the attention of the distributor and results in his election to handle only the products of the protesting manufacturer should not be construed as anything other than the exercise of a valid business right. The acquiescence of the distributor should not create the agreement necessary to bring the refusal within any condemnation of the antitrust laws.

Section 2 of the Clayton Act specifically preserves for sellers the right to select their own customers. In part the section states: "Nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade."[84]

The business decision to refuse to deal, which is taken after study of the results produced by an individual distributor, is a far different act than a general announcement in advance of sale of a policy of refusing to deal with a distributor who handles the products of competitors. If a distributor heeds such general pronouncement, it does not seem unreasonable to infer an agreement which may support a violation of section 1 of the Sherman Act.[85] Certainly in the circumstances pictured the business right of the seller is outweighed by the intent of the antitrust law. If such a scheme of distribution is not condemned, the seller will be placed in a position where he can force exclusive dealing by indirection.

Section 2 of the Sherman Act[86] can under certain circumstances be used as a weapon against refusals to deal. A violation of the section can be shown if a seller has a purpose to create or maintain a monopoly. *Eastman Kodak Co. v. Southern Photo Materials Co.*[87] and *Lorain Journal Co. v. United States*[88] revealed clearly that purpose could be deduced from connecting the refusal to sell to an illegal course of conduct. In *Eastman Kodak* the defendant was embarked upon a

83. See, for exhaustive citation of cases, Barber, *Refusals to Deal Under the Federal Antitrust Laws*, 103 U. PA. L. REV. 847, 857-58 (1955).
84. STAT. 730-31 (1914), 15 U.S.C. § 13 (1952).
85. 26 STAT. 209 (1890), 15 U.S.C. § 1 (1952).
86. 26 STAT. 209 (1890), 15 U.S.C. § 2 (1952).
87. 273 U.S. 359 (1927).
88. 342 U.S. 143 (1951).

plan to gain control of competing supply houses. When plaintiff, a supply house, refused to sell out to Eastman, the defendant refused to continue to deal. In the *Lorain Journal* controversy a newspaper, which reached ninety-nine per cent of Lorain, Ohio, families, refused to deal with advertisers who spent money with the radio station in a neighboring town. In both *Eastman Kodak* and *Lorain Journal* the Court was merely affirming the philosophy earlier expressed in *Colgate* that the right to refuse to deal did not exist if there was any purpose to create or maintain monopoly.[89]

When the majority of the United States Supreme Court interpreted the evidence in *Times-Picayune* as leading to the conclusion of motivation by "legitimate business aims"[90] it had no problem in finding that the refusal to deal did not run afoul of section 2 of the Sherman Act.

The issue of the applicability of section 2 of the Sherman Act is also found in a fact situation where the seller refuses to deal with the buyer with whom he competes in the sale of a finished product. The question is particularly significant when the facts reveal that the buyer cannot get the product in sufficient quantity if he does not get it from the seller who refuses to deal. Certainly if the seller achieved his monopolistic position through predatory practices, a refusal to sell to a competitor would almost surely be condemned by the courts. The same condemnation cannot be predicted with assurance if the seller rose to his position through efficiency or legitimate patent control. It would seem that except in unusual circumstances[91] the seller should have full freedom of choice. Certainly the philosophy of the *du Pont*[92] case would not penalize the seller if there were substitutes in the market which a buyer could purchase.

In discussing the impact of the Sherman Act upon refusals to deal little time need be devoted to concerted refusals to deal. Whatever difficulty exists in bringing individual refusals within the statutory prohibitions of the Sherman Act disappears when the refusal stems from group action. Then it becomes apparent that there is offensive agreement and combination. *Fashion Originators Guild v. FTC*[93] expresses the Supreme Court's opposition to refusals to deal in the form of group boycotts. The Court was not impressed with the fact that there was a rather plausible business purpose for the actions.

89. 250 U.S. at 307.

90. 345 U.S. at 622, 627.

91. Judicial distaste for a seller suspected of profiteering on Government contracts in time of war appears to be the unusual circumstance which supported a finding of violation of § 2 of the Sherman Act in United States v. Klearflax Linen Looms, Inc., 63 F. Supp. 32 (D. Minn. 1945).

92. United States v. E. I. du Pont de Nemours & Co., 118 F. Supp. 41, 229 (1953); see also note 54 *supra*.

93. 312 U.S. 457 (1941).

Columbia Steel by dictum stated flatly that group boycotts were illegal per se.[94]

It is now necessary to turn attention to the possible impact of section 3 of the Clayton Act on refusal to deal problems. Scrutiny discloses that it appears to make quite a difference whether the government brings the action or whether it is brought by a disgruntled buyer.

Citing cases the Attorney General's National Committee to Study the Antitrust Laws points out that private antitrust suits brought by cut off buyers have not succeeded.[95] Barber asserts that in an action between a cut off dealer and a seller section 3 is not involved because it outlaws sales on condition and not refusals to sell.[96]

That the government can more effectively use section 3 is indicated by Barber's comment that "in a suit brought by the government a refusal to sell to a dealer who takes on or handles a competing line may tend to establish that sales to other dealers are not being made on condition or understanding that they shall not deal in competing lines."[97] The Attorney General's Committee would also envision this result by its statement that "termination of trade relations with some one distributor who handles competing products may confirm the supplier's implicit insistence on exclusive dealing with others (and) may reveal that continued sales to retained distributors are conditioned on their exclusion of all rivals' goods and hence come within the prohibitions of section 3 of the Clayton Act."[98]

The approach in *Nelson Radio and Supply Co. v. Motorola, Inc.*[99] of not finding a contract and hence no violation of section 3 when the suit was brought by an aggrieved plaintiff is contrasted by a comment writer in the *New York University Law Review*[100] with that of finding a contract and section 3 offense in *Carter Carburetor Corp. v. FTC*[101] when action was instituted by the government. The writer complains about the overly technical approach in *Motorola* and argues that the spirit of the Clayton Act is better served by allowing its prophylactic character to operate to induce individuals not to enter into illegal contracts rather than to withhold relief until such a contract is consummated.[102]

It would seem necessary to keep in mind that section 3 should never be manipulated so as to nullify the legality of a refusal to deal

94. United States v. Columbia Steel Co., 334 U.S. 495, 522 (1947) (dictum).
95. REPORT, *op. cit. supra* note 21, at 136.
96. Barber, *supra* note 83, at 860.
97. *Ibid.*
98. REPORT, *op. cit. supra* note 21, at 135.
99. 200 F.2d 911 (5th Cir. 1952), *cert. denied*, 345 U.S. 925 (1953).
100. 28 N.Y.U.L. REV. 1170 (1953).
101. 112 F.2d 722 (8th Cir. 1940).
102. 28 N.Y.U.L. REV. 1170 (1953).

grounded upon a good business reason. In many of the actions brought by private parties such defense is likely to be available. In most cases it may be that the government will not begin action unless it feels confident that the "good business reason" plea cannot be successfully presented. If the government has been careful in its analysis, it should enjoy success in the courts. Of course, even if section 3 of the Clayton Act seems to cover the situation, it must be remembered that no violation can be found unless the effect "may be to substantially lessen competition or tend to create a monopoly in any line of commerce."[103] The first part of this article has presented tests to assist with such determination.

Conclusion

It should by now be apparent that a decision on the legality of an exclusive dealing arrangement or on a refusal to deal requires as a first step a thorough factual determination of the type of exclusive arrangement or refusal to deal and the reason for the business decision. As a second step it will be necessary to carefully apply the antitrust philosophy enumerated by trade regulation authorities, the Federal Trade Commission and the courts.

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103. See note 4 *supra*.