



5-1-1962

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Recommended Citation

Robert J. Paley, *Antitrust Pitfalls in Exclusive Dealing Recent Developments under the Sherman, Clayton and FTC Acts*, 37 Notre Dame L. Rev. 499 (1962).

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ANTITRUST PITFALLS IN EXCLUSIVE DEALING RECENT DEVELOPMENTS UNDER THE SHERMAN, CLAYTON AND FTC ACTS

*Robert J. Paley**

Several significant cases, involving exclusive dealing arrangements, have been decided recently by the courts and the Federal Trade Commission. These decisions give some indication of the criteria and approach that will be relied upon in determining the legality of such agreements under Sections 1 and 2 of the Sherman Act,¹ Section 3 of the Clayton Act,² and Section 5 of the Federal Trade Commission Act.³

Exclusive dealing arrangements are effectuated by one of three methods: (1) arrangements whereby a party agrees not to deal in the products of competitors of the supplier; (2) arrangements whereby a party agrees to purchase all or a part of his requirements from one supplier; and (3) tying arrangements where the supplier requires, as a condition of the sale or lease of one item, that other supplies or services must be procured from him. The common denominator of all three methods is the exclusion of rival suppliers from competing with the seller in the market place. Tying arrangements involving patented products will not be discussed in this article because of special considerations involved under the law of patents.⁴

Brief History

At common law, exclusive dealing arrangements were almost universally allowed in the absence of a plan to create a monopoly.⁵ The first American

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1 26 Stat. 209 (1890), as amended by 50 Stat. 693 (1937), 69 Stat. 282 (1955), 15 U.S.C. §§ 1-2.

2 38 Stat. 731, 15 U.S.C. § 14.

3 38 Stat. 719 (1914), as amended, ch. 745, § 2, 66 Stat. 632 (1952), as amended, 15 U.S.C. 45.

4 Section 271 of the 1952 Patent Act allows a patentee to grant a license on a patented combination and have the license tied to the condition that the licensee purchase a material element of the combination, if it is not a staple item of commerce, from the patentee.

(c) Whoever sells a component of a patented . . . combination . . . constituting a material part of the invention, knowing the same to be especially made or especially adapted for use in an infringement of such patent, and not a staple article or commodity of commerce suitable for substantial noninfringing use, shall be liable as a contributory infringer.

(d) No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having done one or more of the following: (1) derived revenue from acts which if performed by another without his consent would constitute contributory infringement of the patent; (2) licensed or authorized another to perform acts which if performed without his consent would constitute contributory infringement of the patent. . . . 66 Stat. 811 (1952), 35 U.S.C. §§ 271 (c) and (d).

However once the article covered by the patent has been sold by the patentee or licensee, they lose all control over the article. The patent protection, at that time, no longer includes even material parts of the patented combination, and such parts may be purchased from another as replacements to be used in the combination. See, *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 365 U.S. 336 (1961); 37 NOTRE DAME LAWYER 263 (1961).

5 2 RESTATEMENT, CONTRACTS § 516(e) (1932). See also Note, 30 HARV. L. REV. 72 (1916) for a collection of cases under the common law.

statutory limitations on exclusive dealing arrangements were enforced under the Sherman Act.⁶ However, the results achieved thereunder were deemed unsatisfactory,⁷ so Congress, in response to the over-all problem of impediments to competition, passed Section 3 of the Clayton Act in 1914. The principal factor in the passage of this Section appears to have been the need for an effective means to combat the tying device⁸ which was being utilized by patentees.⁹ In addition, however, Congress sought to restrain other exclusive dealing arrangements which had as their primary objective, the inducement of the buyer's undivided efforts in the marketing of the seller's products.¹⁰ The undesirable effect of such practices was thought to be twofold: numerous retail outlets were tied up, thereby successfully blocking off competitors from a given consumer market; and an artificial limitation was imposed upon the purchasing public's freedom of choice among competing products. Congress apparently felt that a blanket prohibition of exclusive dealing was undesirable, so Section 3 was aimed only at arrangements which would be likely to have the effect of "substantially" lessening competition or of tending to create a monopoly.

Section 3 of the Clayton Act Attitude of the Courts

The law of exclusive dealing (excluding the tying device) under Section 3 of the Clayton Act was most recently promulgated by the Supreme Court in *Standard Oil Co. of Calif. v. United States*.¹¹ In that case, the Court pronounced a "quantitative substantiality" test in striking down *full* requirements contracts,¹² stating that Section 3 is satisfied by proof that competition has been foreclosed in a substantial share of the line of commerce affected.¹³ These

6 See, e.g., *Whitwell v. Continental Tobacco Co.*, 125 F. 454 (8th Cir. 1903).

7 See, e.g., *United States v. United Shoe Machinery Co.*, 247 U.S. 32 (1918); *Henry v. A. B. Dick Co.*, 224 U.S. 1 (1912); *W. T. Rawleigh Medical Co. v. Osborne*, 177 Ia. 208, 158 N.W. 566 (1916); cf. *Continental Wall Paper Co. v. Voight & Sons Co.*, 212 U.S. 227 (1909) where exclusive dealing was not directly condemned; rather the court attacked the combination formed to restrain commerce through control of production and prices, among other things.

8 For an analysis of the legislative history of Section 3 of the Clayton Act, see Lockhart & Sacks, *The Relevance of Economic Factors in Determining Whether Exclusive Dealing Arrangements Violate Section 3 of the Clayton Act*, 65 HARV. L. REV. 913, 933-35 (1952).

9 *Henry v. A. B. Dick Co.*, 224 U.S. 1 (1912).

10 See OPPENHEIM, *FEDERAL ANTITRUST LAWS* (2d ed. 1959). The author suggests that *Whitwell v. Continental Tobacco Co.*, 125 F. 454 (8th Cir. 1903), was a principal factor for the inclusion in the Clayton Act of a specific provision relating to exclusive dealing arrangements.

11 337 U.S. 293 (1949). See also, Comment, 48 MICH. L. REV. 505 (1950); Comment, 49 COL. L. REV. 241 (1949).

12 Justice Douglas, in his dissenting opinion, feared the consequences of the *Standard Stations* case in the retail gasoline market:

The elimination of these requirements contracts sets the stage for Standard and the other oil companies to build service-station empires of their own. The opinion of the Court does more than set the stage for that development. It is an advisory opinion as well, stating to the oil companies how they can build their empires. . . . I dissent from the outlawry of the requirements contract on the present facts. The effect which it has on competition in this field is minor as compared to the damage which will flow from the judicially approved formula for the growth of bigness as tendered by the Court as an alternative. Our choice must be made on the basis not of abstractions but of the realities of modern industrial life. 337 U.S. at 320.

13 The contracts affected gross sales of gasoline approximating \$57,000,000 made to 5,937 stations, accounting for 6.7% of the total gasoline sold, and 16% of the retail gasoline outlets in the relevant market.

economic factors in *Standard Stations* were held to go "far toward supporting the inference that competition has been or probably will be substantially lessened,"¹⁴ despite the lack of any direct proof offered of actual or potential injury to competitors resulting from these contracts. While the general judicial attitude toward exclusive dealing is that such arrangements are not unreasonable *per se*,¹⁵ *Standard Stations*, by imposing a test of quantitative substantiality, makes such arrangements unreasonable *per se* where a substantial amount of the relevant line of commerce is affected by such arrangements.¹⁶

The test of quantitative substantiality was extended to partial requirements contracts in *United States v. Sun Oil Co.*¹⁷ In that case, the agreement attacked by the Justice Department provided in part that the dealer would buy in any month not less than 75% of the number of gallons of gas delivered by Sun to the premises during the corresponding month of the previous year. The agreement further provided that Sun would not be obligated to sell to the dealer over 125% of the gallonage it delivered to the premises during that same period. In effect, this provision approaches a full requirements contract in the event purchases for any one month drop below those of the same month for the previous calendar year, and in the circumstance where the purchases fall more than 25% below the purchases for the corresponding month of the previous year, the clause extends beyond a full requirements contract. In striking down this agreement as a violation of Section 3, the court relied on the *Standard Stations* test of "quantitative substantiality."¹⁸

Apparently, the quantitative factors, as stated by the court, which were fatal to Sun's agreements were threefold: (1) Sun's share of the branded gasoline motor fuel sales in its market area was 8.42% in 1954; (2) its sales of gas, oils, lubricants and TBA¹⁹ were over \$168 million in 1949; and (3) the number of independent service stations with which it conducted business was in excess of 6500. The court gave little consideration to evidence that the number of Sun's dealers declined from over 9,000 in 1936 to 6,984 in 1956,²⁰ although Sun had increased the territory in which it marketed its petroleum products approximately 36% during this period. This decline in the number of Sun's dealers and its relatively slower growth as compared with some of its leading competitors would seem very relevant in determining whether there was a likelihood that competition would be substantially lessened. However, imposition of the quantitative substantiality test justified only passing attention to these

14 337 U.S. at 305.

15 See, e.g., *United States v. American Can Co.*, 87 F. Supp. 18 (S.D. Calif. 1949). See also, ATT'Y. GEN. NAT'L. COMM. ANTITRUST REP. 146 (1955) where it is stated that the prime consideration should be whether there is actual foreclosure of competitors from a substantial market. See also, Lockhart & Sacks, *supra* note 8; Stockhausen, *The Commercial and Antitrust Aspects of Term Requirements Contracts*, 23 N.Y.U. L. REV. 412 (1948) where advantages of term requirements contracts are listed.

16 337 U.S. at 314.

17 176 F. Supp. 715 (E.D. Pa. 1959). See also, *Richfield Oil Corp. v. United States*, 343 U.S. 922 (1952), *rehearing denied*, 343 U.S. 958. For a general analysis, see Helman, *Partial Requirements Contracts Under Section Three of the Clayton Act*, 55 Nw. U. L. REV. 288 (1960).

18 176 F. Supp. 715 at 738-39.

19 Tires, batteries and accessories.

20 176 F. Supp. at 739.

factors. The court seemed more impressed with the almost complete disappearance of stations purchasing from more than one supplier, which it felt was a probable consequence of exclusive dealing practices such as those employed by Sun.

The Fourth Circuit, in *Miller Motors, Inc. v. Ford Motor Co.*,²¹ indicated that a partial requirements contract obligating a dealer to maintain an assortment of Ford-manufactured or approved parts and accessories "may raise serious antitrust questions."²² Such questions would arise, the court stated, if the effect of this provision would be to compel the dealer to overstock on Ford-manufactured or approved parts and accessories, consequently interfering with his ability to stock the products of competitors, and restricting an automobile owner's freedom of choice.

The use of the "quantitative substantiality" test is of doubtful validity in determining the legality of full requirements contracts²³ and is a most unreliable standard when applied to partial requirements contracts, particularly where the percentage requirement is not overwhelmingly large.

The undesirable feature of exclusive dealing contracts — actual or potential injury to competition — is somewhat ameliorated by the partial requirements contract which does not exclude competitors completely from a segment of the market. In such cases the courts should not automatically apply the quantitative substantiality test, but rather should resort to economic data to determine whether there has been actual or potential injury to competition.

In determining the legality of exclusive dealing arrangements under Section 3, the importance of determining the relevant market was emphasized in *Tampa Electric Co. v. Nashville Coal Co.*²⁴ In that case, a contract required the Tampa Electric Co. to purchase for a 20-year period all the coal it used as fuel in producing electricity at its Gannon Station plant in Tampa, Florida. The utility had eleven oil-burning units at other locations to furnish electricity, and it was not obligated to use coal in the construction of future units. The Supreme Court, reversing the decisions of the District Court²⁵ and the Court of Appeals,²⁶ held that the contract in question did not foreclose competition in a substantial share of the relevant market — a necessary requisite for a violation of Section 3.

The Court outlined a procedure that was to be followed in determining the legality of exclusive dealing arrangements:

First, the line of commerce . . . involved must be determined, where it is in controversy, on the basis of the facts peculiar to the case. *Second*, the area of effective competition in the known line of commerce must be charted by careful selection of the market area

21 252 F.2d 441 (4th Cir. 1958).

22 *Id.* at 449.

23 See, e.g., ATT'Y. GEN. NAT'L. COMM. ANTITRUST REP. at 147 (1955); Lockhart & Sacks, *supra* note 8; Oppenheim, *Federal Antitrust Legislation: Guideposts to a Revised National Antitrust Policy*, 50 MICH. L. REV. 1139, 1180 (1952). *Contra*, Schwartz, *The Schwartz Dissent*, 1 ANTITRUST BULL. 37, 57 (1955).

24 365 U.S. 320 (1961). For analyses of this case see 75 HARV. L. REV. 202 (1961); 60 COL. L. REV. 1188 (1960); 46 VA. L. REV. 1463 (1960). An exhaustive discussion of the problems arising out of exclusive dealing is contained in BOK, 1961 SUPREME COURT REVIEW 267 (1962).

25 168 F. Supp. 456 (D. Tenn. 1958).

26 276 F.2d 766 (6th Cir. 1960).

in which the seller operates, and to which the purchaser can practically turn for supplies. . . . *Third*, and last, the competition foreclosed by the contract must be found to constitute a substantial share of the relevant market. That is to say, the opportunities for other traders to enter into or remain in that market must be significantly limited. . . .²⁷

The lower courts in *Tampa* had erred by failing to give the required effect as to what constituted the relevant market. The Court noted that 700 coal producers were able to serve peninsular Florida, but that the relevant market was not peninsular Florida, but rather "that the relevant effective area of competition was the area in which these producers operated, and in which they were willing to compete for consumer potential."²⁸ This conclusion had the effect of extending the relevant market to include the whole area in which the Appalachian coal producers effectively compete. Statistics indicated "that the proportionate volume of the total relevant coal product as to which the challenged contract pre-empted competition, less than 1%, is, conservatively speaking, quite insubstantial."²⁹

Of particular significance was the Court's dismissal of the absolute dollar volume of sales³⁰ affected by the challenged contract. The Court admitted that the dollar volume "is, of course, not insignificant or insubstantial," but "the dollar volume, *by itself*, is not the test."³¹ The import of this pronouncement is that the percentage of the applicable market affected is the most important measurement which must be made in determining the legality of exclusive dealing arrangements.

However, it should be recognized that dollar volume cannot be completely disregarded because the Court stated explicitly that this *by itself* was not the test today. Because of the Court's failure to completely define the operation of the dollar volume test, this test may still be expected to play a supporting role in the determination of the legality of exclusive dealing arrangements, perhaps as additional evidence to establish a violation of the antitrust laws.

In striking down the contract as illegal in *Tampa*, the lower courts had based their decisions on the line of commerce involved, holding that coal was the appropriate product to consider. The majority of the Supreme Court assumed for the purposes of the decision that coal alone was the appropriate line of commerce because a conclusion as to this aspect of the case was unnecessary to the decision.³²

The failure of the lower courts to consider carefully what constituted the

27 365 U.S. at 327-28.

28 *Id.* at 331.

29 *Id.* at 333. (Emphasis added.) It was shown that in 1954, of the 359,289,000 tons of coal mined by these producers, 290,567,000 tons were sold on the open market, of which Florida and Georgia together consumed only 2,304,000 tons of the coal sold.

30 \$128,000,000.

31 365 U.S. at 334. (Emphasis added.)

32 Perhaps the Court could have found that coal and oil were functionally interchangeable. Then the appropriate line of commerce would include all such interchangeable fuels. A number of cases have considered functional interchangeability. See, e.g., *United States v. E. I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956) (cellophane and flexible wrapping material); *Times-Picayune Pub. Co. v. United States*, 345 U.S. 594 (1953) (morning and evening newspapers); *Standard Oil Co. (Indiana) v. United States*, 283 U.S. 163 (1931) ("cracked" and "natural" gasoline). For a general survey see 54 *Col. L. Rev.* 580 (1954).

relevant market is probably attributable to the almost mechanical application of the "quantitative substantiality" test, where other data is not used. These decisions point out a glaring weakness in this area: courts too often are prone to resort merely to quantitative figures rather than undertaking a careful analysis to determine the anticompetitive effects of the contract in question. To bypass this weakness *Tampa* poses an initial question to be asked: What constitutes the market in which competition is alleged to be effected? The determination of the relevant market must always be made *prior* to the application of the "quantitative substantiality" test. Until this question is resolved, no court can intelligently determine whether competition is likely to be substantially diminished as a result of an exclusive dealing arrangement.

In *Tampa*, the Court listed three factors³³ that it considered essential in determining whether an agreement violated the antitrust laws. These factors were listed in sequence, evidently as a guide to further decisions; but in the course of its decision the Court ignored the sequence it sought to establish. The first factor in the sequence to be determined is the appropriate line of commerce. Here, the Court willingly assumed the correctness of the lower courts' conclusion that the appropriate line of commerce was coal only, rather than all fuels satisfactory for the production of electricity. Perhaps the Court can be justified for failing to analyze this first factor on the ground that the decision turned on a determination of the relevant market — and cases generally are decided on the narrowest basis possible.

In general, however, the sequence for case analysis established in *Tampa* should be followed. It is only by determining the appropriate line of commerce that the relevant market will be ascertainable.

Protection of Good Will as Justification

The Supreme Court has in the past recognized that protection of good will is a legitimate justification for exclusive dealing arrangements.³⁴ The Sixth Circuit recently reversed the dismissal of a private antitrust action against the Ford Motor Company, and remanded the case for trial to determine, among other factors, whether imposed restraints were necessary and intended to protect Ford's good will and guaranty.³⁵ In speaking of Ford's good will and guaranty, the court seemed to be discussing proof of a violation of Section 1 of the Sherman Act, though not specifically limiting the issue to that statute. The agreement in controversy provided that Ford dealers must handle exclusively Ford automobiles, and Ford-made or approved parts and accessories for such vehicles. This agreement was limited to business locations where the dealer displays the Ford Motor Company's name or any sign or other indication that the business establishment is an authorized Ford dealer or service station.

The Sixth Circuit, interestingly enough, made no reference to *Pick Mfg. Co.*

³³ See text at note 27 *supra*.

³⁴ See *Pick Mfg. Co. v. General Motors Corp.*, 299 U.S. 3 (1936), *affirming per curiam*, 80 F.2d 641 (7th Cir. 1935); *FTC v. Sinclair Refining Co.*, 261 U.S. 463 (1923); See also, *International Business Machines Corp. v. United States*, 298 U.S. 131 (1936) — the exclusive arrangement must be *in fact* for the protection of good will.

³⁵ *Englander Motors, Inc. v. Ford Motor Co.*, 267 F.2d 11 (6th Cir. 1959).

v. General Motors Corp.,³⁶ involving repair parts where a similar type of provision was upheld, although this may be due to the failure of the court to discuss the merits of the plaintiff's claim. In *Pick*, it was stated that such a restriction was reasonable if made "with the intent to promote and preserve the good will of the purchasing public, essential to business success."³⁷ Possibly a factor distinguishing *Pick* from the *Ford* case was evidence in *Pick* that competition in repair parts had increased since the restrictions had been in operation, which would seem to overcome any finding that competition might be substantially lessened. Nevertheless, the indication by the court in the *Ford* case that the protection of good will and guaranties must be "soundly based"³⁸ to justify its interposition as a valid defense to an exclusive dealing charge, reflects somewhat of a retreat from *Pick* where there was no apparent requirement of such a showing.

Refusals to Deal Under Section 3

*United States v. Colgate Co.*³⁹ upholding the legality of individual refusals to deal, has been applied in the exclusive dealing area. Accordingly, Section 3 has been held not to prohibit individual refusals to deal or to continue to deal pursuant to a seller's policy of acquisition of exclusive dealers.⁴⁰ In *McElhenny Co. v. Western Auto Supply Co.*,⁴¹ this doctrine was recently reaffirmed by the District Court. However, the Fourth Circuit remanded the case to permit the plaintiffs to plead and prove the existence of an exclusive dealing agreement by the conduct of the parties,⁴² indicating a continual narrowing of the *Colgate* doctrine. The courts have been guarding jealously the "limited dispensation which *Colgate* confers."⁴³ A possible trap exists where the supplier indicates that he will refuse to deal with a customer who handles competitive products. Anyone who deals with the supplier, having been informed that he must exclusively deal with such supplier, would seem to be adhering to the supplier's condition.⁴⁴ Thus, this might constitute sufficient evidence to justify a finding that the supplier did in fact impose exclusive dealing contracts on his distributors

36 80 F.2d 641 (7th Cir. 1935), *aff'd per curiam*, 299 U.S. 3 (1936).

37 *Id.* at 644.

38 267 F.2d at 14.

39 250 U.S. 300 (1919). The Sherman 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 concerning parties with whom he will deal." *Id.* at 307.

40 See, e.g., *Allied Equipment Co. v. Weber Engineered Products*, 237 F.2d 879 (4th Cir. 1956) (refusal to continue to deal); *Nelson Radio & Supply Co. v. Motorola, Inc.*, 200 F.2d 911 (5th Cir. 1952), *cert. denied*, 345 U.S. 925 (1953) (refusal to deal). See also, Barber, *Refusals to Deal Under the Federal Antitrust Laws*, 103 U. PA. L. REV. 847 (1955); 28 N.Y.U. L. REV. 1170 (1953); 53 COL. L. REV. 874 (1953). This doctrine was criticized in Comment, 64 YALE L. J. 581 (1955). There the author proposed that the conspiracy doctrine under Section 1 of the Sherman Act be applied to embrace the exclusive dealer and all parties who enter into contracts with such a dealer knowing that he is imposing exclusive arrangements on his distributors.

41 167 F. Supp. 949 (W.D.S.C. 1958). The courts have distinguished between contracts binding a party to deal exclusively with another and merely refusing to deal with an uncooperative party. See generally, Draper, *Unilateral Refusals to Deal Under the Sherman Antitrust Act*, 4 ANTITRUST BULL. 785 (1959).

42 269 F.2d 332 (4th Cir. 1959).

43 See *United States v. Parke, Davis & Co.*, 362 U.S. 29, 46 (1960).

44 See ATT'Y. GEN. NAT'L. COMM. ANTITRUST REP. at 135-36 (1955).

in violation of Section 3. This possibility is enhanced by the Fourth Circuit's remand in *McElhenny*.

Attitude of the Federal Trade Commission Under Section 3

Initially, under Section 3 of the Clayton Act, the Commission's position seemed to be that "quantitative substantiality" was the appropriate test in determining the validity of exclusive dealing contracts.⁴⁵ However, the dissenting opinion of Justice Frankfurter in *FTC v. Motion Picture Advertising Service*⁴⁶ was apparently quite pronounced on the Commission — thereafter the Commission demanded that hearing examiners accept evidence relating to the actual effect on competition in the market resulting from the exclusive dealing arrangement. This resulted in the Commission adopting a "qualitative substantiality" test to determine whether there has been foreclosure in fact, even in instances where the complaint was brought under Section 3 of the Clayton Act.⁴⁷ This is to be contrasted with court decisions where satisfaction of the "quantitative substantiality" test almost invariably establishes an antitrust violation.

However, Commissioner Kern, in *Mytinger & Casselberry, Inc.*,⁴⁸ "muddied the waters" by indicating that an appraisal of economic data is not necessary to establish a Section 3 violation, expressly rejecting the *Maico*⁴⁹ case and its "qualitative substantiality" test. According to the Commission, the courts have made it clear that the plain language of Section 3 makes economic considerations irrelevant, so it used a "quantitative substantiality" test (volume of business and share of market) to strike down the agreements in question. This case does not, by itself, completely overrule the "qualitative substantiality" test at the Commission level, but at least, it is an indication that the trend toward "qualitative substantiality" has been reversed.

In a quite significant decision, *Rural Gas Service, Inc.*,⁵⁰ the FTC indicated a lower boundary to the "quantitative substantiality" test. By upholding the exclusive dealing arrangement in question, the Commission determined that a percentage of the market being tied did *not* result in illegality. The facts showed that Rural Gas Service sold liquified petroleum gas in the New England States and in New York. In this market area, it was ranked about eighth in such gas sales, accounting for approximately 3% of the total sales. However, in the states of Massachusetts and New Hampshire, it accounted for 8% of the total sales. Rural made approximately 40% of its sales to distributors while the remaining 60% were made directly to consumers. The agreements with the distributor required such distributors to purchase all their requirements of LP gas from Rural along with prohibitions against (1) purchasing or selling any

45 See *Dictograph Products v. FTC*, 217 F.2d 821 (2d Cir. 1954), *cert. denied*, 349 U.S. 940 (1955); *Anchor Serum Co. v. FTC*, 217 F.2d 867 (7th Cir. 1954).

46 344 U.S. 392 (1953).

47 See *Maico Co.*, 50 F.T.C. 485 (1953); *Harley Davidson Motor Co.*, 50 F.T.C. 1047 (1954).

48 1960-1961 TRADE REG. REP. Transfer Binder, ¶ 29,091, Dkt. 6962.

49 50 F.T.C. 485 (1953).

50 Docket 7065, October 24, 1961.

LP gas except that purchased from Rural and (2) purchasing, selling or using any gas service equipment except that furnished by Rural.⁵¹

In dismissing the complaint alleging that the requirements contracts with Rural's distributors violated Section 3 of the Clayton Act as well as Section 5 of the FTC Act, Commissioner Elman indicated that the requirements contracts only affected 40% of 8% of Rural's market share in the states where it transacted its largest share of business. In *Standard Stations*, the individual distributors affected by requirements contracts accounted for only about 6.7% of the market — which was sufficient foreclosure to meet the Section 3 requirements. Since *Standard Stations* gave no indication as to the minimum market share sufficient in another case, the Commission concluded that it would not infer competitive injury solely from the market share foreclosed in *Rural Gas Service*.

Possibly of greater significance than the indication of what market percentage fails to constitute "quantitative substantiality" is the Commission's inference that a "qualitative substantiality" test must be met where a "quantitative" test is not satisfied. That is, where foreclosure is so small, further evidence of competitive effect is required. The FTC required information concerning the structure of the industry: the relative size of Rural's competitors along with the methods adopted by them to sell their gas. The latter factor was particularly important to the Commission, because it felt if these competitors sold their gas directly to consumers, competition could not be injured by their being foreclosed from possible sales to Rural's distributors. This last conclusion is subject to question. Unless Rural's competitors had no desire to use these distributors in their sale of gas, the fact remains that these distributors are foreclosed from handling the competitors' products — a result which certainly might have an undesirable effect on competition.

Rural Gas Service failed to allude to any dollar amounts involved in the exclusive dealing arrangements. This would seem to indicate that the Commission's view of "quantitative substantiality" encompasses only consideration of market percentage, the dollar volume figures utilized in *Standard Stations* having no more real significance in decisions involving exclusive dealing. This complete disregard of dollar volume could be considered as the ultimate extension of *Tampa Electric* because here the dollar volume was apparently removed from consideration altogether.⁵²

Section 5 of the Federal Trade Commission Act

While the FTC may initiate action under either Section 5 of the FTC Act or Section 3 of the Clayton Act, exclusive dealing contracts are generally tested under Section 5 only when Section 3 of the Clayton Act is inapplicable.⁵³

⁵¹ Consumer agreements were also involved. They required consumers to use only the LP gas and equipment furnished by Rural, whether the sales were made directly by Rural or through one of its distributors.

⁵² Compare text at note 30 *supra*.

⁵³ See generally, Oppenheim, *Guides to Harmonizing Section 5 of the Federal Trade Commission Act with The Sherman and Clayton Acts*, 59 MICH. L. REV. 821 (1961). Rahl, *Does Section 5 of the Federal Trade Commission Act Extend the Clayton Act*, 5 ANTITRUST BULL. 533 (1960); Howrey, *Utilization by the FTC of Section 5 of the Federal Trade Commission Act as an Antitrust Law*, 5 ANTITRUST BULL. 161 (1960).

Since the Clayton Act applies only to arrangements involving commodities and leases,⁵⁴ it is often necessary to resort either to the Sherman Act, or Section 5 of the FTC Act where exclusive dealing involves, for example, services. Section 3 is probably also inapplicable where exclusive dealing is imposed by a supplier with respect to a third party's products.

The appropriate test for determining the legality of exclusive dealing arrangements under Section 5 of the FTC Act has not been crystalized by the Supreme Court. In *FTC v. Motion Picture Advertising Co.*,⁵⁵ the principal case in this area, the Court struck down contracts providing that a theatre owner would display only those advertising films furnished by the defendant. Justice Douglas' opinion relied on the Commission's finding that the "exclusive contracts have limited the outlets for films of competitors and have forced some competitors out of business because of their inability to obtain outlets for their advertising films."⁵⁶

Unfortunately, *Motion Picture Advertising* specified no test to be applied to determine the legality of exclusive dealing arrangements under Section 5. Since the court made no reference to the earlier *Standard Stations* case, it is doubtful whether "quantitative substantiality" is intended to be the appropriate test.

Justice Frankfurter, who wrote the majority opinion in *Standard Stations*, dissented in *Motion Picture Advertising*. While he agreed with the majority's position that the Commission should investigate the industry and analyze the practices therein to facilitate a determination of the standards of illegality, he objected to the fact that the majority never showed that the practices in question, "if full blown" would violate either the Sherman or Clayton Acts.⁵⁷ In other words, to Justice Frankfurter, the FTC Act was designed to prohibit incipient Clayton Act violations.⁵⁸ He indicated that the Commission should base a finding that there was a shutting off of the market on an economic analysis.

Justice Frankfurter's dissent calls for a "qualitative substantiality" test, based on the relevant economic factors, to be applied to determining the legality of exclusive dealing arrangements under Section 5. Of significance is his apparent deviation from the *Standard Stations* case which propounded the original "quantitative substantiality" test.⁵⁹ However, this dichotomy might be explained on his interpretation of the purpose of the FTC Act — "to enable the Commission to nip in the bud practices which, when full blown, would violate the Sherman or Clayton Act."⁶⁰ This dissenting opinion seems to be

54 Section 3 refers to goods, wares, merchandise, machinery, supplies, or other commodities. Cf. *Fleetway, Inc. v. Public Service Interstate Transp. Co.*, 72 F.2d 761 (3d Cir. 1934) where the court stated that transportation of passengers by a bus company was not a commodity within the meaning of Section 3, but rather a service.

55 344 U.S. 392 (1953).

56 *Id.* at 394.

57 *Id.* at 401. (Dissenting opinion.)

58 It has been pointed out that there is a compounding of the doctrine of incipency violations if Section 5 of the FTC Act is utilized to restrain incipient Clayton Act offenses, since the latter are themselves incipient violations of Sherman Act. See, e.g., Oppenheim, *supra* note 40; Howrey, *supra* note 40; Butler, *Federal Trade Commission Jurisdiction Under the Incipency Doctrine*, U. MICH. INST. FED. ANTITRUST LAWS 154 (1953).

59 See 344 U.S. at 401-403. (Dissenting opinion.)

60 *Id.* at 400-01.

the only judicial authority for the adoption of a "qualitative substantiality" test under Section 5.

Some recent FTC hearings indicate that a few of the examiners have adopted the "qualitative substantiality" test, although it will be interesting to see whether this trend will continue in light of the opinion in the *Mytinger* case decided under Section 3.

In 1959, Hearing Examiner John Lewis decided a group of consolidated cases where it was alleged that ice cream manufacturers were imposing exclusive dealing contracts on their distributors in violation of Section 5.⁶¹ Besides a showing of express exclusive dealing agreements, it was contended that supporting practices⁶² all tended to induce the exclusive handling of the manufacturer's products.

After a thorough economic analysis, Mr. Lewis concluded that there was no violation of Section 5. Despite the presence of statistics which could have supported a finding of illegality under the "quantitative substantiality" test, Mr. Lewis evaluated the relevant evidence to determine whether competitors were foreclosed in fact as a result of the agreements and practices in question.⁶³ Through reference to testimony, Mr. Lewis showed that switches by dealers from one manufacturer to another were almost never induced by any of the alleged unfair practices. He placed particular emphasis on the fact that changes from one manufacturer to another were rarely induced by an offer of refrigeration equipment, and that furnishing such equipment was a common industry practice for the manufacturer's benefit to prevent a loss of good will that would result if his products spoiled.

It was also pointed out that the financing of dealers through loans was not done on a substantial scale, and that the bulk of the assistance was to the manufacturer's existing accounts rather than to new ones. The latter practice would tend to result in the retention of business, as opposed to the acquisition of new business. Mr. Lewis was particularly impressed with the great degree of mobility among the dealers in switching from one manufacturer to another upon becoming dissatisfied with the manufacturer's product or service, even in instances where there were express exclusive dealing arrangements—an indication that the effect of such contracts on competition was negligible. Mr. Lewis' approach was based on a qualitative analysis of the relevant economic factors to ascertain the legality of the operations and agreements. If he had mechanically applied

61 Carnation Co., Dkt. No. 6172 (1959); The Borden Co., Dkt. No. 6173 (1959); Beatrice Foods Co., Dkt. No. 6174 (1959); National Dairy Products Corp., Dkt. No. 6175 (1959); Pet Milk Co., Dkt. 6176 (1959); Fairmont Foods Co., Dkt. 6177 (1959); Arden Farms Co., Dkt. 6178 (1959); Foremost Dairies, Inc., Dkt. 6179 (1959); H. P. Hood & Sons, Inc., Dkt. 6425 (1959). All these companies were combined in the initial decision of the hearing examiner. See 1959-1960 TRADE REG. REP. Transfer Binder ¶ 28,139 for initial orders dismissing the complaints in these cases.

62 The practices consisted of: (1) furnishing refrigeration facilities and other types of equipment, generally without cost; (2) making loans to dealers; (3) performing valuable services for dealers; and (4) granting discounts to dealers.

63 The examiner pointed out that there was a lack of quantitative figures in any particular market affected to apply the "quantitative substantiality" test. He further questioned whether such a test may be applied where there is an attempt to show actual injury, rather than an inference of injury. Evidence of actual competitive conditions in the market tend to negate an inference of injury.

the "quantitative substantiality" test, an opposite conclusion could have been reached.⁶⁴

Hearing Examiner Earl Kolb recently decided two cases where exclusive dealing practices were alleged in violation of Section 5. In the first case, a complaint was dismissed against the Firestone Tire & Rubber Co. while the other defendant, Shell Oil Co., was found to have violated Section 5.⁶⁵ In essence, Shell and Firestone agreed that Shell would receive a sales commission on sales of Firestone TBA by Shell outlets. Shell, in order to promote the sales of Firestone TBA, engaged in the following practices, among others: (1) It assisted Firestone in TBA advertising and participated in promotional activities on behalf of such TBA; (2) Its dealers were authorized to sell Firestone TBA on Shell credit cards on either regular or extended credit terms without any carrying charge to either the dealer or the motorist; (3) It recommended that its dealers carry Firestone TBA and threatened some dealers with lease cancellation, the loss of the franchise, or other action if such dealers did not discontinue the purchase or display of nonsponsored TBA.

Although Mr. Kolb concluded there was no evidence of a conspiracy by Firestone with Shell to restrain competition in the sale or distribution of TBA products, nor was there any evidence that Firestone participated in any acts or practices to force Shell dealers and distributors to purchase Firestone TBA,⁶⁶ he found that Shell coerced its dealers to purchase substantial quantities of Shell sponsored TBA by threats of lease cancellation or other action which violated Section 5.⁶⁷ In other words, Shell was imposing a type of exclusive dealing contract upon its dealers. Since he did not go into a detailed factual analysis to indicate how the acts in question constituted unfair competition,⁶⁸ the test used to determine the illegality of the acts was not enunciated.

This case was reviewed by the FTC and Mr. Kolb's decision was upheld.⁶⁹ Chairman Kintner held that the sales commission method also violated Section 5. The Commission felt that Shell was exploiting its economic power as a major

64 Upon appeal, the Commission reversed the examiner's decision and the dismissal order. 1960-1961 TRADE REG. REP. Transfer ¶ 29,459. The Commission directed that further evidence be received on whether the ice cream manufacturers used exclusive dealing arrangements to sell their frozen products. Although the initial report of the examiner seemed quite conclusive in establishing that there had been no foreclosure in fact, he was directed to take further evidence on this aspect. Thus, the Commission, by its remand, stipulates that the "quantitative substantiality" test is controlling. The result of this is that even the lack of evidence indicating any actual foreclosure will fail to immunize parties from antitrust violations if the "quantitative substantiality" test is satisfied.

65 In the matter of The Firestone Tire & Rubber Co. and the Shell Oil Co., Dkt. No. 6487 (1959). See 1959-60 TRADE REG. REP. Transfer Binder ¶ 28,381 for initial cease and desist order.

66 In the matters of The Firestone Tire & Rubber Co. and the Shell Oil Co., Dkt. No. 6487 at pg. 12 (1959).

67 *Id.* at 13.

68 See, *e.g.*, FTC v. R. F. Keppel & Bro., 291 U.S. 304 (1934); FTC v. Gratz, 253 U.S. 421 (1920); Sinclair Refining Co. v. FTC, 276 F.686 (7th Cir. 1921); Hastings Mfg. Co. v. FTC, 153 F.2d 253 (6th Cir. 1946) for statements labeling those types of practices that are considered within Section 5 prohibitions against unfair methods of competition. Even though there is no definite formula to determine what constitutes unfair methods of competition, exclusive dealing which adversely affects competition clearly is encompassed by Section 5.

69 The Firestone Tire & Rubber Co. and Shell Oil Co., Dkt. 6487, 1960-1961 TRADE REG. REP. Transfer Binder ¶ 29,427. See also the companion case, The Goodyear Tire & Rubber Co. and the Atlantic Refining Co., Dkt. 6486, 1960-1961 TRADE REG. REP. Transfer Binder, ¶ 29,426.

distributor of gasoline and as a lessor of numerous distributing facilities to cause its dealers to purchase TBA as a condition of retaining their status as a lessee or distributor of Shell. Chairman Kintner stated that the foregoing, along with Shell's market position and the volume of TBA affected, brought the case within the tie-in doctrine of *Northern Pacific Railroad v. United States*⁷⁰ and *Osborn v. Sinclair Refining Co.*⁷¹ He felt Shell exhibited sufficient economic power in the tying product (gasoline) to be within the standard imposed by *Osborn* resulting in "*per se*" illegality.

Chairman Kintner explained, however, that the decision was not based on a mere mechanical application of *Northern Pacific* and *Osborn*, because the principal issue was the legality of a specific distribution method involving TBA. This statement illustrates the most interesting aspect of the case. The Commission apparently decided that the tying of TBA to the purchase of gasoline could be most effectively prevented by attacking the prime stimulus to the tying, the sales commission arrangement between Firestone and Shell. The Commission took the position that the cause of the tie-in (Firestone's agreement with Shell) was illegal. Thus, the Commissioner's refusal to decide this case on the basis of "*per se* illegality" of tie-in arrangements appears prudent, because the tie-in aspect of the operation is apparently not the principal object of attack.

The Commissioner further supported the decision by stating that the sales commission method which was employed foreclosed effective competition from the smaller tire manufacturers competing with Firestone because they lacked the distribution facilities which could blanket the entire marketing areas of the major oil companies. The evidence tended to show that Firestone TBA was sold by the Firestone wholesale dealers to Shell retail outlets principally as a result of the sales commission plan, rather than any excellence of the products, and these dealers expressed apprehension that they would not be successful in selling Firestone TBA to such outlets if the sales commission plan were eliminated. Because Shell profited by the sale of Firestone TBA by its retail dealers, it was encouraged to and thus did enter into a course of conduct to eliminate the sale of competing brands of TBA by these dealers. This plan eliminated the competitive rivalry among local TBA dealers and resulted in injury to the public: service station owners were hampered in obtaining price savings which might be passed on to the public but for the elimination of this competition. Since the opinion was based on a multitude of factors, it is difficult to determine whether there was one controlling basis for the decision — which is unfortunate — but there is clear approval of the "*per se* illegality" doctrine which is attendant with tie-in arrangements.

The second case decided by Earl Kolb also involved Shell Oil Co.⁷² The complaint alleged that Shell was leasing and selling major lubricating equipment to car dealers who were allowed to amortize the cost thereof by crediting from 5 to 15 cents per gallon of oil they purchased from Shell against such cost.

70 356 U.S. 1 (1958).

71 286 F.2d 832 (4th Cir. 1960).

72 In the matter of Shell Oil Co., Dkt. No. 7044 (1959).

Under the formula used, the lease or sale agreement would extend from 4 to 10 years, with provisions for extension if necessary. By such an arrangement Shell was effectuating at least a partial requirements contract through the tying of oil purchases to the purchase or lease of its lubricating equipment. Mr. Kolb concluded, however, that there was no violation of Section 5. Although the contracts were designed to assist in the sale of oil, the dealers, because of customer preference, were required to maintain a substantial stock of "Premium" oils. He pointed out that the records showed that competitors did take over some of Shell's dealers under the questioned agreements by paying the amount due on the contract or lease to Shell.⁷³ He also indicated that there was no evidence that competitors as a whole suffered any loss of business as a result of this practice.

This decision appears to be reached by an application of a "qualitative substantiality" test to show there was no actual foreclosure. The examiner ignored the quantitative figure of gross sales of over one billion dollars.⁷⁴ However, he indicated that Shell's share of the lubricating equipment market was very small. This latter factor admittedly raises some doubt as to whether he utilized a qualitative rather than a quantitative approach, but his analysis involving the acquisition of Shell dealers by its competitors is a qualitative one showing that there was no foreclosure in fact.

Another significant decision was rendered by Hearing Examiner Everett F. Haycraft in *Murray Shoe Corp.*⁷⁵ In this case the respondent entered into agreements with chiropodists, podiatrists and retailers which contained clauses restricting them from dealing in the molded shoes of other manufacturers. The evidence showed that from 1941 through 1953, the respondent was the only manufacturer of molded shoes of any consequence in the United States. In the following 5-year period, the number of molded shoes sold by the respondent varied from about 5,000 to 12,000 pairs. As the popularity of these shoes increased, many of its customers who were trained in its techniques began to manufacture shoes for themselves, in violation of the restrictive clauses contained in the agreements in question. The evidence showed that competition definitely increased, because not only did new competitors appear on the scene, but, in 1958, one of these competitors replaced the respondent as the largest manufacturer in the industry. The hearing examiner concluded that a substantial lessening of competition would not result from the restriction under consideration, and no antitrust violation had occurred.

It is interesting to note that Examiner Haycraft utilized a "qualitative" test in determining the legality of the agreements in question. His findings establish that there was no danger that competition would be substantially lessened by these exclusive dealing provisions. However, were a strict "quantitative" test utilized, it is entirely possible that the opposite conclusion would have been reached.

⁷³ Again, the mobility of distributors in changing suppliers was an important factor to support the conclusion that the exclusive dealing agreements did not foreclose competitors.

⁷⁴ Perhaps it would be improper to use this figure. There is no indication as to what fraction of this figure was applicable to the furnishing of lubricating equipment.

⁷⁵ 1960-1961 TRADE REG. REP. Transfer Binder, Dkt. 7476, ¶ 29,137.

This last decision illustrates a very undesirable situation — opposite conclusions may be reached depending upon the test employed. In all fairness to business, as well as to the public whom the antitrust laws were designed to protect, there should be one test applied, and one test only. If the Commission were to make an economic analysis and a careful scrutiny of the past and present effects to determine the legality of an agreement or practice — application of the qualitative test — only then would it be acting consistently with the purposes of the antitrust laws.

At the present time, there has been no unequivocal statement by the FTC that it adopts either the “qualitative” or the “quantitative” test to the exclusion of the other, although Commissioner Kern, in *Mytinger*, calls for the “quantitative substantiality” test.

Sections 1 and 2 of the Sherman Act

Exclusive dealing arrangements under the Sherman Act have generally involved the utilization of the tying device. These tying arrangements have been generally regarded as “unreasonable *per se*,”⁷⁶ serving “hardly any purpose beyond the suppression of competition.”⁷⁷ In *Times-Picayune Publishing Co. v. United States*,⁷⁸ two major tests were devised for testing the legality of tying devices. The Court, speaking through Justice Clark, stated that under the Sherman Act, a tying violation required the finding of monopolistic power in the tying product *and* a substantial amount of commerce restrained in the tied product.⁷⁹ If *both* of these conditions are met, the tying device is unreasonable *per se*. On the other hand, Section 3 of the Clayton Act and Section 5 of the FTC Act were said to be transgressed when *either* of the two conditions was found.⁸⁰

Just five years later, the Supreme Court in *Northern Pacific Railway Co. v. United States*⁸¹ modified the tests established by *Times-Picayune*. The majority, this time speaking through Justice Black, stated that the language of *Times-Picayune*, being general, was to be construed to require nothing more “than sufficient economic power [in the tying product] to impose an appreciable restraint on free competition in the tied product”⁸² rather than requiring a

76 See, e.g., *Times-Picayune Pub. Co. v. United States*, 345 U.S. 594, 608 (1953); *United States v. Griffith*, 334 U.S. 100, 107 (1948); *United States v. Paramount Pictures*, 334 U.S. 131, 158 (1948); *International Salt Co. v. United States*, 332 U.S. 392, 396 (1947). See generally, Turner, *The Validity of Tying Arrangements Under the Antitrust Laws*, 72 HARV. L. REV. 50 (1958). For a criticism of the application of “*per se* illegality” see Comment, 45 VA. L. REV. 1165 (1959). The author suggests that utilization of the “*per se* illegality” doctrine is not a substitute for inquiry as to the effects on competition.

77 See *Standard Oil of California v. United States*, 337 U.S. 293, 305 (1949); *Times-Picayune Pub. Co. v. United States*, 345 U.S. 594 (1953). See also Schueller, *The New Antitrust Illegality Per Se: Forestalling and Patent Misuse*, 50 COL. L. REV. 170 (1948); Bowman, *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19 (1957); and Burstein, *A Theory of Full-Line Forcing*, 55 NW. U.L. REV. 62 (1960).

78 345 U.S. 594 (1953).

79 *Id.* at 609.

80 *Id.* at 608-09.

81 356 U.S. 1 (1958). For discussions of this decision see 56 MICH. L. REV. 1214 (1958); 58 COL. L. REV. 887 (1958); 27 FORDHAM L. REV. 272 (1958).

82 *Id.* at 11.

finding of monopolistic power in the tying product.⁸³ The dissenters, Justices Harlan, Frankfurter, and Whittaker, stated that *Times-Picayune* made it clear that dominance in the tying product was needed to show *per se* illegality under the Sherman Act.⁸⁴

Because of the general view that "tying arrangements rarely serve any purpose other than the suppression of competition,"⁸⁵ the less stringent *Northern Pacific* test, requiring the showing merely of sufficient economic power in the tying product, might be preferable. However, because tying devices are generally invalidated as being *per se* unreasonable, perhaps a better approach would be to require *dominant power* in the tying product. This test, suggested by the dissent in *Northern Pacific*, would indicate whether the tying product actually caused a coercive effect upon the tied product. Certainly, if the party imposing the tying arrangement merely has sufficient economic power in the tying product to restrain an appreciable amount of business in the tied product, the availability of substitutes for the tying product would oppose the automatic conclusion that the acceptance of the tied product was in fact coerced. In such an instance, determination of the actual effect of the power seems appropriate.

The Fourth Circuit recently held in a private antitrust suit that an illegal tie-in arrangement was being enforced by Sinclair Refining Company in the marketing of Goodyear TBA.⁸⁶ Basically, the agreement entered into between Sinclair, the defendant, and Goodyear, was the same as the one involved in the *Shell Oil* case decided by Hearing Examiner Earl Kolb — a commission arrangement whereby Sinclair would receive a commission on the sales of Goodyear TBA by Sinclair dealers. In ruling that an illegal tie-in existed, the court rejected Sinclair's attempt to bring the case within the *Colgate* doctrine,⁸⁷ that is, a legally valid refusal to deal.

The lower court in the Sinclair case had sustained the lease cancellation, and had found that there was no agreement that the plaintiff abstain from buying TBA products other than Goodyear as a condition of keeping either the lease or the Sinclair franchise.⁸⁸ The Circuit Court found the existence of such an agreement and reversed.

An interesting aspect of the Circuit Court opinion lies in its affirmation of the "*per se* illegality" doctrine, even though the buyer was not obligated to obtain all of his requirements in the tied product from the seller, but rather, was obligated to purchase substantial quantities of the tied product. The court stated that "to insist upon such exclusivity in a tie-in would be inconsistent with the trend of the decisions in this area."⁸⁹ The court felt if a substantial amount

83 It would be anomalous to require only sufficient economic power in the tying product under the Sherman Act, and then require dominance over the tying product under the Clayton Act, since the latter provides for incipient Sherman Act violations. The proper test to determine the legality of tying clauses under the Clayton Act or FTC Act should be sufficient economic power to restrain an appreciable amount of commerce in the tied product.

84 356 U.S. at 13-14.

85 See authorities cited note 77 *supra*.

86 *Osborn v. Sinclair Refining Co.*, 286 F.2d 832 (4th Cir. 1960).

87 See, *e.g.*, *United States v. Parke Davis & Co.*, 362 U.S. 29 (1960).

88 171 F.Supp. 37 (D. Md. 1959).

89 286 F.2d at 838. See also Comment, 12 SYRACUSE L. REV. 175 (1960) where the author discusses full line forcing in the setting of less than full requirements contracts and the "per se" illegality doctrine.

of commerce is restricted by such arrangements, the standard of illegality would seem to have been met. This decision is consistent with *Sun Oil* which struck down partial requirements contracts as a violation of Section 3 of the Clayton Act. Even if a purchaser is required to obtain from the seller only a very small percentage of his requirements of the tied product, the courts, because of their dislike of tying arrangements, will probably strike down any and all tie-ins that come before them.

In denying a Motion for Rehearing, the Fourth Circuit in the *Sinclair* case restated its view of the standard applicable to tie-in agreements. In so doing, the court further reduced the amount of power required in the tied product:

The standard in *Northern Pacific* is a quantitative one. Just so the seller is of sufficient size to exert some power and the amount of commerce restrained is not insignificant, the standard is met. If all of the industrywide economic data had to be shown for which *Sinclair* argues, it would convert tie-in cases to "rule of reason" cases with the requirement of public injury. When facts, as here, reveal a *per se* restraint of trade, it is not necessary for the plaintiff to prove, by voluminous economic data, that the public generally has been injured. *Klors v. Broadway-Hale Stores* 359 U.S. 207 (1959). What the Court in *Northern Pacific* sought to point out is demonstrated by the illustration given: it is simply that a *de minimis* restraint on competition would not constitute an unlawful tie-in. There must be some not insubstantial restraint. However, to make this modest showing it is not necessary to make out a "rule of reason" case.⁹⁰

Despite the general illegality of tying devices, the Fourth Circuit recently affirmed dismissal of a treble damage action alleging violations of Sections 1 and 2 of the Sherman Act in *Nelligan v. Ford Motor Co.*⁹¹ The charge was based on the tying of dealer contributions of \$25 a car to the Lincoln-Mercury Dealers Association (LMDA), a nonprofit group of dealers engaged in cooperative advertising, to the right of the dealer to maintain his Ford franchise.⁹²

The court distinguished the Ford case from *United States v. General Motors Corp.*,⁹³ where dealers were required to use GMAC financing exclusively as a condition for maintaining a General Motors franchise. The court further stated that the arrangements were "entirely different from tying arrangements held to be 'unreasonable *per se*'"⁹⁴ in the *International Salt*⁹⁵ and *Northern Pacific*⁹⁶ cases. Despite the tying feature in the arrangement, the court displayed a sophisticated approach in analyzing the features of the arrangement. It recognized that the arrangement was merely intended to implement Ford's good will and that Ford did not intend to go into the advertising business, nor did Ford intend in any way to restrain its dealers from using other advertising which they deemed expedient. It should be noted that this case was tried under

90 *Id.* at 841.

91 262 F.2d 556 (4th Cir. 1959).

92 See also *Miller Motors, Inc., v. Ford Motor Co.*, 252 F.2d 441 (4th Cir. 1958); 44 VA. L. REV. 765 (1958).

93 121 F.2d 376 (7th Cir.), *cert. denied*, 314 U.S. 618, *rehearing denied*, 314 U.S. 710 (1941).

94 262 F.2d at 558.

95 *International Salt Co. v. United States*, 332 U.S. 392 (1947).

96 *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958).

the Sherman Act; perhaps Ford could have been found guilty of violating Section 5 of the FTC Act, which requires only the showing of incipient Sherman Act violations.

An almost forgotten doctrine in the area of tie-in devices was recently given judicial revival in the case of *United States v. Jerrold Electronics Corp.*⁹⁷ This doctrine, first alluded to in *General Talking Pictures Corp. v. American Telephone & Telegraph Co.*,⁹⁸ is that tie-in devices are permissible, when used at the inception of a new business which has an uncertain future, to attempt to insulate the business from the risks of failure. In *Jerrold*, the defendant initiated the business of furnishing television reception to communities which had experienced difficulty in obtaining adequate reception. Jerrold required that in conjunction with the sale of the television system to be installed, the purchaser was to enter into a service contract to utilize Jerrold's technical services in connection with the layout, installation and operation of the system. The basic part of the Jerrold system consisted of certain electronic equipment, and Jerrold additionally required that the purchaser obtain a full system, precluding purchasers from obtaining various individual items of equipment from other manufacturers. Jerrold was charged with a violation of Section 1 of the Sherman Act, on a tying device theory. Assuming that the relevant market constituted community television systems in the United States, Jerrold, by August of 1954, had installed 80% of these systems in the United States. Thus, there seems to be no doubt that Jerrold had sufficient economic power in the tying product to substantiate a violation on the basis of an illegal tying clause.

The district court rejected an automatic application of the "*per se* illegality" doctrine with regard to tying clauses, and stated that "while the *per se* rule should be followed in almost all cases, the court must always be conscious of the fact that a case might arise in which the facts indicate that an injustice would be done by blindly accepting the *per se* rule."⁹⁹ Thus, the court recognized the legality of the tying device utilized by Jerrold at the time of its inception. The court recognized that: the equipment sold was extremely sensitive; many people had no technical experience to install, operate and maintain the system; most of Jerrold's resources were tied up in the development of the system; and the success of the business from both a short range and a long range view depended on the success of the first systems which were installed. The court concluded that the service contracts involved were justified, and stated that this was particularly true for Jerrold, which "had put most of its eggs in one precarious basket to open up this new field."¹⁰⁰ This last statement casts doubt as to the real impact of the court's conclusion that the tie-ins were justified because they were used to institute the launching of a new business with a highly uncertain future. Whether the tie-in would have been upheld had the defendant been R.C.A. or Philco for example is not clear in view of this last

97 187 F. Supp. 545 (E.D. Pa. 1960), *affd. per curiam*, 365 U.S. 567 (1961). See 70 YALE L.J. 804 (1960) for an analysis of this case.

98 18 F. Supp. 650 (D. Del. 1937). See also *Standard Stations*, 337 U.S. at 308 where the Court indicates that whether the exclusive dealer is an established competitor or a newcomer is significant.

99 187 F. Supp. at 556.

100 *Id.* at 557.

pronouncement. However, it seems improper to even consider this distinction. The previous success of different business operations has no relation to the risks of a new venture which would suffer great losses if the equipment and operations were not satisfactory. A court, drawing such a distinction to strike down similar tie-ins where a powerful and diversified business is involved, would be condemning size alone.

Jerrold was also attacked under Sections 1 and 3 of the Clayton Act for its full system sales policy, which prevented the purchaser from obtaining competing equipment. The court upheld these restrictions at their inception. It pointed out that Jerrold could not render the service it promised and deemed necessary if customers had an unrestricted choice of equipment. The newness of the field would make a requirement that any competing equipment purchased conform to certain specifications an impractical alternative. Thus, it was concluded that the full system sales policy was a necessary adjunct to the compulsory service agreements, as long as the conditions which necessitated the use of service contracts existed.

Unfortunately for Jerrold, it was held to have violated both Section 1 of the Sherman Act and Section 3 of the Clayton Act by its failure to abandon the compulsory service contracts and full system sales policy when conditions could no longer justify their existence. This result illustrates the extreme difficulty of adopting tie-in policies, even at the inception of a business, because it is strictly a business judgment as to when conditions have changed so that the tie-ins are no longer protected.¹⁰¹ In *Jerrold*, there was an abandonment of the condemned policies, but the court concluded that this was not accomplished quickly enough. This result seems quite unfair. The policies are justifiable in the initial business phase and may even be *necessary* to successfully establish the business. To then penalize one for not abandoning his policies sooner because conditions have changed, without giving any type of warning that the policies are no longer appropriate, could conceivably tend to stifle the advent of new business. The court went so far as to place the burden of proving the reasonableness of its policies on Jerrold.

The business justification theory propounded in *Jerrold* was later applied in *Dehydrating Process Co. v. A.O. Smith Corp.*¹⁰² In that case a treble damage action was brought against the defendant, which was a national manufacturer of a storage silo and an unloading device used in connection with the silo. From 1951 through 1957, the defendant sold its unloader separately from its silo. In 1958, allegedly because of complaints by customers who had purchased separate unloaders, the defendant adopted a policy of refusing to sell unloaders unless they were to be installed in privately purchased or already owned silos of its own manufacture. The plaintiff contended that this was a tie-in sale in violation of Section 3 of the Clayton Act, but the lower court directed a verdict in favor of the defendant at the close of the evidence.

¹⁰¹ *Id.* at 558, where the court admits that on the record it is a matter of speculation as to when Jerrold's policy is no longer justified in various areas of the country. The court did indicate that a party may be allowed a reasonable time to recognize and adjust its policies to changing conditions, but left unanswered the question of what constitutes a reasonable time. The time span is measured from the time when conditions have changed.

¹⁰² 292 F.2d 653 (1st Cir. 1961), *cert. denied*, 368 U.S. 931.

The First Circuit cited with approval the *Jerrold*¹⁰³ case, concluding from the decision in that case that a proper business reason may justify what might otherwise be an unlawful tie-in. The court concluded that the trial court was justified in deciding the question of business justification as a matter of law, where the uncontroverted evidence was demonstrably reasonable. The facts of this case give a somewhat limiting effect to this decision: the court reasoned that half of the customers were dissatisfied over a 7-year period, during which time unloaders were purchased and defendant's silos were not used in connection therewith; and testimony of the plaintiff's own engineer indicated that unloading the plaintiff's product presented special difficulties. Because of these limiting factors, this decision probably will not be extended beyond a similar factual situation, such as one involving previous experience without restrictions.

GENERAL CONCLUSION¹⁰³

The trend of judicial thinking has generally followed the "quantitative substantiality" test in decisions involving an alleged violation of Section 3 of the Clayton Act by virtue of exclusive dealing arrangements.

However, *Tampa Electric* must be considered as a retreat from the "quantitative substantiality" test. Not only has dollar volume been removed as a significant factor for determining the legality of exclusive dealing arrangements, but also, the Court gave new emphasis to the relevant market and the appropriate line of commerce as important factors to be used in analyzing an arrangement in this area.

Unfortunately, the Federal Trade Commission still has not crystallized the test to be relied upon when the legality of exclusive dealing arrangements is tested under Section 5 of the FTC Act. Indications are that both the quantitative and the qualitative tests are being applied by the examiners. It is clearly undesirable that defendants may have to meet different tests before the same agency to establish their innocence of illegal arrangements.

In fairness to all, the "quantitative substantiality" test should be discarded and the one test of "qualitative substantiality" adopted. The "quantitative substantiality" test merely seems to be a very easy way to strike down an arrangement without undertaking to make sure that the anticompetitive effects of the practice exist. There is no real justification for the quantitative test because, as long as a qualitative analysis reveals market foreclosure, the public is protected. However, in those instances where foreclosure cannot be established on a qualitative analysis, condemnation of the exclusive dealing arrangement on quantitative factors alone not only fails to serve the public interest, but may even be inimical to the public interest, for it disrupts legitimate business relationships and thus hinders the business operations of the concerns involved.

With respect to the "tying device" area, as distinguished from the general area of exclusive dealing, the "per se illegality" doctrine has remained substantially unchanged. While *Nelligan*, *Dehydrating Process*, and *Jerrold Electronics* reflect slight inroads in the doctrine, possibly the most significant pro-

¹⁰³ See 47 VA. L. REV. 675 (1961) for a survey of exclusive dealing arrangements with emphasis on recent cases.

nouncement in the area came from Chairman Kintner in *Firestone Tire and Rubber Co. and Shell Oil* where he indicated that the mechanical application of the "per se illegality" doctrine is inappropriate where the facts are not basically similar to previous cases where the doctrine has been applied. This opinion, while hardly of great precedent value to the courts, nevertheless may stimulate thinking in the area which could result in the modification of the present doctrine.

Probably the most unfortunate decision in the area was *Jerrold Electronics* which permitted the utilization of a tie-in device at the inception of a new business with an uncertain future. Although the motivation for the tie-in was to attempt to insulate the business from risk of failure, the court struck down the tie-ins for failure to abandon them when they were no longer justified. Certainly, the requirements that such tie-ins be abandoned when business conditions have changed is not unreasonable, but where there are no clear guidelines to determine when such change has occurred, imposing sanctions on the failure to abandon such a policy soon enough is clearly unfair. It would seem equitable to have the federal agencies issue a warning to businesses which are utilizing tie-in devices before beginning prosecution in order that they may abandon their tie-ins without suffering any penalties. Such a policy would protect both the public and business which is the ultimate goal of our antitrust laws.

It is arguable that the "per se illegality" doctrine should be modified. Once again, a quantitative analysis would seem appropriate to determine whether the "tied product" was in fact foisted on the public due to the tying product or rather, the tied product would have been purchased anyway. Of particular significance in this area is the price because very possibly, despite the failure to utilize the tying device, the lowering of the price for the tied product would make it marketable without the leverage afforded by the tying product. It should be recognized that if the tying product has enough economic acceptance to coerce a consumer to accept an unwanted product, it is certainly arguable that the seller could raise his price and still obtain approximately the same profit which he makes by utilization of the tying device. If this is the case, then it becomes very doubtful if there is real injury to the public from the utilization of the tying device.

It seems that substantial public injury from the utilization of the tie-in device only occurs (1) when the tied product has almost no consumer acceptance *and* (2) when the tying product's price could not be raised sufficiently to offset the loss in revenue if either the tied product were not sold or the price allocable to it had to be substantially lowered. Good sense dictates that a thorough economic analysis of the competitive effects of a practice in a particular factual setting cannot be replaced by judicial doctrines which are evolved from fact situations which may be substantially dissimilar to the facts presented.