ANTITRUST LAW—VERTICAL RESTRICTIONS—THE *SCHWINN* PER SE RULE ADJUDGED UNEQUIVOCAL IN ITS REQUIREMENTS

In *Adolph Coors Co. v. FTC,*[1] the United States Court of Appeals for the Tenth Circuit held that once a manufacturer parts with dominion over its product, any effort thereafter "to restrict the territory or persons to whom the product may be transferred . . . is a per se violation[2] of section 1 of the Sherman Act."[3] The court held that it was compelled to apply this rule on the basis of *United States v. Arnold, Schwinn & Co.,*[4] but encouraged the U. S. Supreme Court to graft an exception onto the Schwinn per se rule for a unique product that "requires territorial restrictions to remain in business."[5]

The Adolph Coors Co., which uses the trade name "Coors," is a corporation engaged in brewing, distributing and selling beer. Coors averred that its beer had to be constantly refrigerated during the marketing process or else the integrity of the beer was easily compromised. In view of the delicacy of the product, Coors insisted that its territorial and customer restrictions were an economic necessity.[6] The *Coors* case initially came before an administrative law judge who determined that Coors was guilty of no wrongdoing. The FTC then appealed this initial decision to the five-member FTC board. The Commission board found that Coors had in fact violated section 5 of the Federal Trade Commission Act;[7] the company subsequently brought the case to the court of appeals.[8]

The *Schwinn* per se rule perhaps evolved from an early common law precept[9] that was summarized in *Dr. Miles Medical Co. v. John D. Park*

1. 497 F.2d 1178 (10th Cir. 1974).

2. A business practice becomes a per se violation, *i.e.*, a violation in itself, when after considerable judicial experience it is found that the practice lacks any redeeming virtue and has nothing but a pernicious effect on competition. Northern Pac. Ry. v. United States, 356 U.S. 1 (1957).

3. Section 1 of the Sherman Act provides in part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal . . . ." 15 U.S.C. §1 (1970).

4. 388 U.S. 365 (1967).

5. 497 F.2d at 1187.

6. *Id.*

7. Section 5 of the Federal Trade Commission Act provides in part: "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful." 15 U.S.C. §45(a)(1) (1970).

8. 497 F.2d at 1180-81.

9. In White Motor Co. v. United States, 372 U.S. 253, 265 (1963), the Court said, in citing *Dr. Miles* and referring to the common law, that restraints on alienation were historically and inherently suspect under antitrust laws. For a general consideration of the history and legality of restraints upon alienation, both at common law and under the Sherman Act, see Levi, *The Parke, Davis-Colgate Doctrine: The Ban on Resale Price Maintenance,* 1960 SUPREME COURT REV. 258, 270-78. *See also* A. STICKELLS, FEDERAL CONTROL OF BUSINESS §5 (1972).

& *Sons Co.*,[10] as follows:

> The right of alienation is one of the essential incidents of a right of general property in movables, and restraints upon alienation have been generally regarded as obnoxious to public policy. . . .
>
> "If a man . . . be possessed of a horse or any other chattel, real or personal, and give or sell his whole interest or property therein, upon condition that the donee or vendee shall not alien the same, the same is void, because his whole interest and property is out of him . . . ."[11]

Of course common law rules regarding restraints on the alienation of property in the field of commerce have been generally supplanted by federal antitrust laws.[12]

In applying antitrust laws the courts have dichotomized property alienation restraints as being either horizontal or vertical.[13] Vertical restrictions are those imposed by a manufacturer upon its distributors, and horizontal restrictions are those agreed upon by competitors at the same level of the market structure.[14] Although horizontal restrictions have traditionally been regarded as per se illegal,[15] vertical restrictions have been allowed if they were justified under the "rule of reason."[16] Not until *White Motor Co. v. United States*[17] was it claimed in a case before the Supreme Court that vertical arrangements were illegal per se.[18]

White Motor Co., a manufacturer of trucks, maintained contracts which permitted its dealers and distributors to sell only in specific geographic

10. 220 U.S. 373 (1911). In *Dr. Miles* the manufacturer, through a series of contracts, restricted the prices at which its agents and dealers could sell its products. In addition, retailers could sell only to those buyers, or classes of buyers, expressedly certified by the manufacturer. The Court disallowed both the price-fixing arrangements and the customer restrictions.

11. *Id.* at 404.

12. *See* note 9 *supra.*

13. "[T]his court has distinguished between horizontal and vertical territorial limitations for purposes of the impact of the Sherman Act . . . ." United States v. Sealey, Inc., 388 U.S. 350, 352 (1967). *See also* United States v. Topco Associates, Inc., 405 U.S. 596 (1972); Northern Pac. Ry. v. United States, 356 U.S. 1 (1967); Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951); United States v. National Lead Co., 332 U.S. 319 (1947).

14. One of the classic examples of a per se violation of §1 is an agreement between competitors at the same level of the market structure to allocate territories in order to minimize competition. Such concerted action is usually termed a 'horizontal' restraint, in contradistinction to combinations of persons at different levels of the market structure, *e.g.*, manufacturers and distributors, which are termed vertical restraints. 405 U.S. at 608.

15. *See* notes 13 and 14 *supra.*

16. Courts at an early date recognized that almost all commercial contracts in some way restrained trade or competition. Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918). To determine at what point an antitrust violation occurred on the continuum between a necessary restraint and a restraint violative of the Sherman Act, the "rule of reason" approach was adopted. Standard Oil Co. of New Jersey v. United States, 221 U.S. 1 (1911).

17. 372 U.S. 253 (1963).

18. *Id.* at 261.

areas[19] and only to certain classes of customers.[20] The United States brought suit in the district court claiming that these vertical restrictions were per se violations of the Sherman Act. The district court agreed with the Government and granted summary judgment, but White appealed the holding directly to the United States Supreme Court.[21] The Supreme Court ruled that summary judgment in the district court had been improvidently granted and that the question of whether vertical limitations were per se invalid could be decided only after a full trial. The court said that it needed to know more about the actual impact of vertical arrangements on competition before deciding if they should be classified as per se violations of the Sherman Act.[22] Although the Court did not declare vertical arrangements illegal per se, it did leave open the possibility that it might do so in the future. The *White Motor* case was ultimately settled through a consent decree.[23]

The question of per se illegality regarding vertical territorial or customer restrictions was ultimately decided by the Supreme Court in *Schwinn.*[24]

The Schwinn company manufactured bicycles and distributed them in three ways: (1) final sales to distributors;[25] (2) sales to retailers by consignment;[26] and (3) sales to retailers through agency.[27]

19. In its complaint the government charged that any dealer or distributor who did sell in territory that was reserved to another, had to pay the injured distributor a specified amount for the violation. *Id.* at 271 n.10.

20. White reserved to itself the right to sell to national accounts, fleet accounts, federal and state governments, and political subdivisions thereof. *Id.* at 257.

21. White did not appeal from the district court's ruling that certain price-fixing agreements were unlawful. *Id.* at 256 n.2.

22. *Id.* at 254-64.

23. United States v. White Motor Co., 1964 Trade Cas. ¶71,195 (N.D. Ohio). The decree of the court in part enjoined White

> from entering into, adhering to, maintaining, enforcing or claiming any rights under any contract, combination, agreement or understanding, with any distributor, dealer, or any other person to limit, allocate or restrict the territories in which, or the persons or classes of persons to whom, any distributor, dealer or other person may sell trucks. *Id.*

24. 388 U.S. at 378-79.

25. With this method the distributors took title to the product but they were "instructed to sell only to franchised Schwinn accounts and only in their respective territories which were specifically described and allocated on an exclusive basis." *Id.* at 371.

26. Under the consignment method, Schwinn shipped its bicycles to the distributor's warehouse and they remained there until purchased by a retailer. After the bicycles were sold to a retailer the distributor then paid Schwinn the price previously agreed upon. Title to and right to immediate possession of all consigned bicycles remained in Schwinn as consignor until the distributor paid the agreed upon purchase price. In addition, while the bicycles were in the distributor's warehouse, Schwinn carried them on its books and balance sheet and also insured them. United States v. Arnold, Schwinn & Co., 237 F. Supp. 323, 328 (N.D. Ill. 1965), *rev'd,* 388 U.S. 365 (1967).

27. The distributor offered the retailer the option of buying directly from the Schwinn factory or from the distributor's warehouse. If the retailer elected to buy directly from the factory he chose the "Schwinn Plan." Under this plan Schwinn shipped directly to the

In determining the validity of each of these three distribution schemes, the Supreme Court drew a distinction between "the situation where the manufacturer parts with title, dominion, or risk with respect to the article, and where he completely retains ownership and risk of loss."[28] The Court held that a per se violation of the Sherman Act resulted only when the manufacturer parted with title, dominion and risk and thereafter continued to exercise control over the destiny of the product or the conditions of its resale.[29] The Court said that no per se violation would result, however, if the manufacturer passed the product to a dealer and exercised control while retaining title, dominion and risk, with the position of the dealer being indistinquishable from that of an agent of the manufacturer.[30] The first of these three Schwinn distribution schemes was held to be illegal per se. The manufacturer no longer had dominion over the product but still exercised control over its disposition.[31] Regarding the second and third distribution schemes, the Court said that Schwinn was exercising control through its distribitors who were acting as agents, and further that Schwinn still retained dominion over the product while exercising this control. Therefore schemes two and three were not illegal per se. Their validity or invalidity, the Court said, had to be judged according to the "rule of reason," and in this case, they were found to be reasonable.[32]

The Court stated its holding on vertical territorial and customer restrictions, which has become known as the *Schwinn* per se rule, in the following way:

> Once the manufacturer has parted with title and risk, he has parted with dominion over the product, and his effort thereafter to restrict the territory or persons to whom the product may be transferred—whether by explicit agreement or by silent combination or understanding with his vendee is a *per se* violation of §1 of the Sherman Act.[33]

Before analyzing the Tenth Circuit's rationale for applying the *Schwinn* rule, the factual situation involved requires discussion. The court found that of all the nation's breweries only Coors was a "shipping" brewery.

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retailer, billed the retailer, and then paid the distributor a commission on the sale. If the retailer received the bicycles he purchased from the distributor's warehouse, the purchase price was still remitted directly to Schwinn which in turn paid the cycle distributor for his services including warehouse storage. Primarily, the differences between these two alternatives were speed of delivery and cost, but in both instances the distributor was serving as a Schwinn sales agent or representative. Notice also that under these agency methods Schwinn was being paid by the retailer whereas under the consignment method Schwinn was paid by its distributor. *Id.* at 327-28.

28. 388 U.S. at 378-79.
29. *Id.*
30. *Id.* at 380.
31. *Id.* at 379.
32. *Id.* at 380.
33. *Id.* at 382.

Coors brews all of its beer at one plant in Golden, Colorado, and ships it from that point throughout its eleven state distribution area. Also, Coors alleged that its beer required constant refrigeration during the marketing cycle because of the process by which it is produced. Not only is refrigeration required, the brewer argued, but the beer must also be rotated at intervals, and any Coors beer retained over 90 days must be destroyed. To assure that the beer was properly handled and its quality retained, Coors asserted that it had to require its distributors to distribute Coors beer in assigned territories only.[34]

Coors also prohibited distributors from selling to central warehouse accounts.[35] The reason for this customer restriction, again according to Coors, was to protect the quality of the product. Coors maintained that central warehousers could not be relied upon to use the necessary procedures to assure the quality of the beer, *i.e.*, proper refrigeration and rotation.[36]

In passing upon these customer and territorial restrictions, the court said that the *Schwinn* per se rule should yield where a company producing a unique product must utilize such restrictions to remain in business. The court was of the opinion that in this kind of situation vertical restrictions should be condoned or condemned according to the "rule of reason,"[37] Nevertheless, the court said it felt compelled to put aside the question of "reasonableness" and follow the *Schwinn* per se rule. According to the court, Coors parted with all title and risk to its beer after it was sold and delivered to distributors, and therefore Coors no longer had legal dominion over its product. Consequently, any Coors restrictions as to the territories or persons to whom the product could be transferred were clearly contrary to the *Schwinn* per se rule.[38]

In addition to holding that Coors had violated the *Schwinn* rule, the court also found, *inter alia*, that Coors was guilty of price-fixing and preventing retailers from handling rival draught beers.[39] Although the officially stated policy of Coors was only to suggest the prices at which distributors and retailers could sell, it nevertheless acted to fix and control these prices. Distributors were restricted as to the wholesale prices they could charge, and retailers could not sell at prices below those which Coors specified. If either retailers or wholesalers engaged in price cutting practices, Coors would cut down on the amount of beer it would deliver, it would threaten speedy termination of contract rights, or it would refuse any product deliveries until Coors' pricing policies were adhered to. The

34. Adolph Coors Co. v. FTC, 497 F.2d 1178 (10th Cir. 1974).

35. "Central warehouse accounts are either retailers such as large chain supermarkets who buy for redelivery to their own outlets, or independents who purchase for redelivery to nonaffiliated retail outlets or retailer warehouses." *Id.* at 1182.

36. *Id.* at 1188.

37. *Id.* at 1187.

38. *Id.*

39. *Id.* at 1184, 1187.

Coors court found that such practices violated both section 1 of the Sherman Act and section 5 of the Federal Trade Commission Act.[40] Coors also violated the latter of these acts by maintaining a policy of striving for exclusive draught accounts. Clearly, Coors favored tavern draught accounts, but in handling such accounts Coors required tavern owners to refrain from selling other brands of light draught beer. "If the owner-retailer continued to sell another brand of light draught beer, Coors discontinued its supply of light draught beer to the tavern."[41]

The Tenth Circuit gave only a superficial glimpse into its rationale for finding that its decision was foreclosed by the *Schwinn* rule. In support of its observation that it was foreclosed from deciding contrary to the *Schwinn* rule, the court listed nine cases. All of theze cases, with one exception, concluded as did the Tenth Circuit, that the *Schwinn* rule was unequivocal.[42]

The exception wherein the *Schwinn* rule was not applied was the case of *Tripoli Co. v. Wella Corp.*[43] In that case, Wella Corp., a producer of beauty and barber supplies, was allowed by the Third Circuit to terminate dealings with a wholesaler because the wholesaler refused to adhere to Wella's resale conditions. Wella insisted that some of its products could be sold only to professional beauticians and barbers and absolutely prohibited the sale of these products to the public. The court found that incorrect use of those products on which resale restrictions were placed could cause injuries ranging from blindness to various types of skin irritations. Since the resale restrictions were necessary to protect the public from injury and to protect Wella from liability, the court allowed the restrictions to continue. The court said that resale restrictions which were necessary to protect the public and to guard against products liability were not to be judged according to the *Schwinn* per se rule, but by the standard of reasonableness, and the Wella restrictions were held to be reasonable.[44]

The Tenth Circuit did not consider in its opinion whether the Coors restrictions could have been justified under the *Tripoli* exception. Would consumption of unrefrigerated beer cause personal injury? Would consumption of beer retained over 90 days cause injury? Were the Coors vertical restrictions designed to protect against products liability? These ques-

40. "Price fixing is illegal *per se* under the Sherman Anti-trust Act. . . . Price fixing is also illegal *per se* under Section 5 of the Federal Trade Commission Act." *Id.* at 1184.

41. Id. at 1182.

42. *Id.* at 1187.

43. 425 F.2d 932 (3rd Cir.), *cert. denied,* 400 U.S. 831 (1970).

44. In discussing the *Schwinn* rule the court stated that no considerations other than marketing and competition were advanced in *Schwinn.* The court concluded that if nothing more was involved than the *Schwinn* considerations, then a per se violation in the context of *Schwinn* would result. But the court said that here there was more and that the restraint was of a different order. An intent to protect the public against injury, the court said, furnished a sufficiently lawful purpose to restrict the conditions of product resale. *Id.* at 936, 938.

tions were not addressed by the court, nor is it apparent that Coors raised them. However, if the vertical restrictions imposed by Coors were designed to prevent injury to the public and to protect against products liability, then possibly the Coors territorial and customer restrictions could have been justified according to the *Tripoli* holding.

In addition to *Tripoli,* one other exception to the *Schwinn* rule has apparently been created. In the case of *Janel Sales Corp. v. Lanvin Parfums, Inc.,*[45] an agreement was made wherein it was provided that the retailer would sell only to consumers for use. The court said that the presence of such a clause did not imply a violation under *Schwinn.* The court held that no violation would result unless the manufacturer actively endeavored to enforce such a restriction.[46] The *Janel* exception would not apply to the *Coors* case because Coors did actively endeavor to enforce its restrictions.

Even if the *Schwinn* rule had not existed when the *Coors* case was decided, the *Coors* court would still have been precluded from permitting any continuation of the vertical restrictions practiced by Coors because price-fixing was a ubiquitous feature of the entire Coors distribution system. It has been consistently held that monopolistic practices ancillary to any price-fixing scheme are properly dissolved along with the illegal price-fixing arrangement.[47] If the Federal Trade Commission had directed only that Coors dismantle its vertical restrictions because they were incidents of an illegal price-fixing plan, the *Coors* court would have had difficulty in avoiding such a directive, notwithstanding the *Schwinn* rule. Whenever an antitrust law violation is proven, the FTC becomes vested with wide discretion in its choice of a remedy. Any remedies prescribed are to be upheld by the courts unless there is no reasonable relation between the remedy and the proven violation, and any doubts about the reasonableness of the remedy are supposed to be resolved in favor of the FTC.[48] Unquestionably, Coors' price-fixing and vertical integration schemes were related. Adherence to the Coors pricing scheme was in part maintained through the distribution or non-distribution of the Coors product. If a retailer did not adhere to Coors' prices, Coors would direct the wholesaler to make no further deliveries to the offending retailer. To reiterate, if Coors had been found guilty only of price-fixing, and if no *Schwinn* rule had existed, the

45. 396 F.2d 398 (2d Cir. 1968), *cert. denied,* 393 U.S. 938 (1969).

46. *Id.*

47. "In any price-fixing case restrictive practices ancillary to the price-fixing scheme are also quite properly restrained." 372 U.S. at 260. In *Sealey,* territorial restraints, although horizontal, were found to be a part of a price-fixing scheme and the court said: "[I]ts connection [territorial restrictions] with the unlawful price-fixing is enough to require that it be condemned as an unlawful restraint . . . ." 388 U.S. at 356-57. In *Schwinn* the court said that a per se violation would not result where a manufacturer exercised vertical controls through an agency or consignment system "*absent* price fixing . . . ." 388 U.S. at 381.

48. 497 F.2d at 1189; 321 U.S. at 726.

FTC could still have directed Coors to abrogate its vertical distribution restrictions and the court would have been obliged to acquiesce to such a directive because the restrictions were reasonably related to an illegal price-fixing scheme.

With Coors' vertical restrictions effectively abrogated it would appear that Coors could no longer confine its retail sales to particular geographic areas, but this is not the case. The court in *Schwinn,* besides establishing the per se rule, also stated that exclusive franchises could be created.[49] If Coors decided not to create additional franchises beyond its presently existing eleven state distribution area, it could thereby continue to inhibit any expansion of distribution. Thus Coors could limit retail sales to certain territories through the use of its franchising power. Coors' present franchisees, however, could expand geographical distribution on their own because of the *Schwinn* rule, regardless of any objections by Coors, but increased costs would be a factor. For instance, a distributor of Coors beer in Wyoming wishing to sell in Tennessee where there are no other franchised dealers could do so, but the cost of shipping the beer from the Wyoming distributor to Tennessee would necessarily cause the price of the beer to increase. Already Coors beer is "substantially more expensive than any other beer consumed in the United States,"[50] and it is questionable whether consumers would buy Coors beer at an even higher price which additional shipping costs would dictate. Even if increased costs were not an issue, it is doubtful that Coors would sell its franchisees enough beer to facilitate the expansion of distribution into new territories, if Coors opposed such expansion. The implication here is that encouragement should not be given to those who reside outside the eleven state distribution area that Coors beer might soon be available. In all probability expanded distribution will not be a result of the *Coors* holding.

Grafting an exception onto the *Schwinn* per se rule for a unique product that requires vertical restrictions in order to be marketable is perhaps necessary, but the *Coors* case is not the appropriate forum through which such an exception should be created. The importance of the vertical integration issue in the *Coors* case was mooted when Coors was found guilty of other serious forms of anticompetitive behavior. The additional charges against Coors of price-fixing, of requiring Coors beer to be handled to the exclusion of other light beers, and of enforcing such anticompetitive behav-

49. [A] manufacturer of a product other and equivalent brands of which are readily available in the market may select his customers, and for this purpose he may 'franchise' certain dealers to whom, alone, he will sell his goods. Cf. *United States v. Colgate & Co.,* 250 U.S. 300 (1919). If the restraint stops at that point - if nothing more is involved than vertical 'confinement' of the manufacturer's own sales of the merchandise to selected dealers, and if competitive products are readily available to others, the restriction, on these facts alone, would not violate the Sherman Act. 388 U.S. at 376.

50. 497 F.2d at 1182.

ior through coercion were all supported by substantial evidence.[51] Additionally, if territorial restrictions are actually necessary in order for Coors to successfully market its product such restrictions could be imposed without violating the *Schwinn* rule. Coors could achieve restricted geographic distribution as well through selective franchising as it could through vertical territorial restrictions. With these considerations in mind, the Supreme Court should ignore the Tenth Circuit's invitation to weaken the *Schwinn* per se rule.

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51. *Id.* at 1178.