Denver Journal of International Law & Policy

Volume 7
Number 1 *Fall*

Article 8

January 1977

The Antitrust Legality of Territorial Allocations between a U.S. Parent Corporation and Less Developed Country Enterprises

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Keywords
Antitrust

NOTE

THE ANTITRUST LEGALITY OF TERRITORIAL ALLOCATIONS BETWEEN A U.S. PARENT CORPORATION AND LESS DEVELOPED COUNTRY ENTERPRISES

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Laws developed to address the common and ordinary business situation frequently fail to serve the economic realities of new or different circumstances. A case in point is our body of antitrust laws well-tuned toward limiting the powers of large corporations to restrict competition among themselves, but ill-suited to meet the needs of small enterprises attempting to break into industries dominated by such giants.[1]

This discrimination against small businesses arises from the per se rules of antitrust liability. The purpose of the antitrust laws is to promote competition. Based on this premise the customary test of legality for a given restraint is whether under the circumstances it unreasonably impacts on competition.[2] This rule of reason test, however, can require sophisticated economic judgments. In order, thus, to avoid such unpleasantly complex economic issues the courts developed per se antitrust rules.[3] Rather than examine in detail the economic impact of all restraints, the courts designated certain restraints

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1. *See* Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282 (1975); Note, *Territorial Restrictions and Per Se Rules—A Reevaluation of the Schwinn and Sealy Doctrines*, 70 MICH. L. REV. 616 (1970)(arguing that territorial restrictions should be permitted where the effect is to increase competition in the marketplace). *But see* Louis, *Vertical Distributional Restraints under Schwinn and Sylvania: An Argument for the Continuing Use of the Per Se Approach*, 75 MICH. L. REV. 275, 286-87 (1976); Note, *International Joint Ventures and Section One of the Sherman Act: Per Se as the Meaningful Standard*, 23 AM. U.L. REV. 689 (1974) [hereinafter cited as *International Joint Ventures*].

2. Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918).

3. "The fact is that courts are of limited utility in examining difficult economic problems." United States v. Topco Assocs., Inc., 405 U.S. 596, 609 (1972).

as having such a "pernicious effect on competiton [that they] are conclusively presumed to be unreasonable and therefore illegal . . . ."[4] Consequently, once a per se practice has been so identified, the court need no longer analyze the competitive effects of the restraint in order to determine if such a practice should be permitted; per se restraints are conclusively illegal.[5] Although the per se rules ease the analytical burden on the judiciary,[6] the practical effect can be to deny small enterprises the use of certain "anticompetitive" devices, which can greatly aid their efforts to enter new markets thereby increasing competition in the industry.[7]

Perhaps the grossest and most inequitable example of the harmful effect of United States per se rules on small enterprises is their impact on less developed countries (LDCs) seeking technology and investment from the United States.[8] For example, developing nations offer low labor costs and in some instances proximity to foreign markets that would aid U.S. manufacturers seeking to enhance their share of the U.S. or world market.[9] However, most developing nations also require, or at least strongly encourage, that enterprises established by for-

4. Northern Pacific Ry. v. United States, 356 U.S. 1, 5 (1958).

5. The strict per se rules of modern antitrust law establish a conclusive presumption that a particular kind of action has improper anticompetitive effects, and this presumption governs regardless of whether the particular conduct has been proved to have those consequences.

Moraine Products v. I.C.I. America, Inc. 538 F.2d 134 (7th Cir. 1976), *cert. denied,* 429 U.S. 941 (1976).

Consequently, "for the purposes of determining the existence of a *per se* antitrust violation, market analysis and questions of evil or laudatory motive are irrelevant." *In re* Yarn Processing Patent Validity Litigation, 541 F.2d 1127, 1134 (5th Cir. 1976).

6. In fact the simplifying features of the rule is its principal appeal:

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

Northern Pacific Ry. v. United States, 356 U.S. 1, 5 (1958). *See* Jacobi v. Bache & Co., Inc., 520 F.2d 1231 (2d Cir. 1975), *cert. denied,* 423 U.S. 1053 (1976).

7. *See* note 1 *supra. See also* Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Divison,* 75 YALE L.J. 373 (1966); Note, *Horizontal Territorial Restraints and the Per Se Rule,* 28 WASH. & LEE L. REV. 457 (1971).

8. Friedmann, *Antitrust Law and Joint International Business Ventures in Economically Underdeveloped Countries,* 60 COLUM. L. REV. 780 (1960).

9. *See* Rose, *Why the Multinational Tide is Ebbing,* FORTUNE, Aug. 1977, at 112.

eign technology be controlled by local interests.[10] Consequently, a U.S. firm seeking to establish a manufacturing branch in a less developed nation generally must face the prospect that its investment, although yielding short term profits, may also create a potential competitor.[11] A partial solution is for the parent and its offspring to agree not to compete by allocating sales territories between each other. Unfortunately, despite the apparent reasonableness of this territorial market allocation, the scheme would violate the per se rules of U.S. antitrust liability,[12] if the restraint substantially affects the foreign commerce of the United States.[13]

This article examines the legality of territorial market allocations between a U.S. parent and partially owned subsidraries in LDCs. The primary thesis is that, although all market allocations were illegal per se in the past, a logical extrapolation of the recent Supreme Court *Continental T.V., Inc. v. GTE Sylvania, Inc.*[14] decision to the international arena would permit territorial market allocations restricting the exports of newly created LDC businesses where the effect of the restraint is to enable these new enterprises to be formed in the first place. Although *Continental TV* only stands for the limited

10. *See, e.g., Friedmann, supra* note 8, at 781, 786; MacDonald, *Recent Legislation in Nigeria and Ghana Affecting Foreign Private Direct Investment,* 6 INT'L L. 548 (1972); Ness, *Brazil: Local Equity Participation in Multinational Enterprises,* 6 L. & POL. INT'L BUS. 1017 (1974); Zamora, *Andean Common Market—Regulation of Foreign Investments: Blueprint for the Future?,* 10 INT'L L. 153 (1976).

11. Goekjian, *Legal Problems of Transferring Technology to the Third World,* 25 AM. J. COMP. L. 565, 568 (1977).

12. *See* the discussion of illegal market restraints in Joelson & Griffin, *Multinational Joint Ventures and the U.S. Antitrust Laws,* 15 VA. J. INT'L L. 487 (1975); *International Joint Ventures, supra* note 1. *See also* note 18 *infra.*

13. Because of the jurisdictional requirement that an international market restraint have a substantial impact on the foreign commerce of the United States, the narrow issue for review is the legality of the market division insofar as it affects imports into and exports from the United States. Timberline Lumber Co. v. Bank of America, 549 F.2d 597 (9th Cir. 1976); United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945); Rahl, *Foreign Commerce Jurisdiction of the Antitrust Laws,* 43 ABA ANTITRUST L.J. 521 (1974). A market division between foreign companies which does not include the United States would lack sufficient impact on U.S. commerce to warrant jurisdiction. Timberlane Lumber Co. v. Bank of America, 549 F.2d 597 (9th Cir. 1976); MEMORANDUM OF THE DEPARTMENT OF JUSTICE CONCERNING ANTITRUST AND FOREIGN COMMERCE, [1977] 5 TRADE REG. REP. (CCH) ¶ 50,129, at 55,209-10 (1972); Fugate, *International Distribution Agreements,* 43 ABA ANTITRUST L.J. 540, 542 (1974).

14. 97 S. Ct. 2549 (1977).

rule that a franchisor can allocate territories among his franchisees, the rationale of the opinion supports this international exception to the rule against territorial restraints.

In order to focus the analysis the following hypothetical fact situation is posited: Alpha Company manufactures and exports machine tools from the United States. Alpha has 20% of the United States domestic market, 30% of the U.S. export market, and 10% of the world export market. Because of increasing labor and material costs, Alpha wishes to establish Betas, related companies in LDCs that would manufacture and export machine tools under the Alpha brand name. Alpha would maintain some equity interest in each new company, would receive fees for management services provided to each company, but as required by local law would not control either the management or the voting stock of any of the newly created Betas. To protect itself from the competition of its Betas, and to protect the Betas from competition between themselves, Alpha proposes an allocation of markets between Alpha and its progeny, limiting the sales of each to a specific geographic market. Disregarding the effect of patent laws[15] and other laws relating to industrial property rights,[16] would such a scheme survive an attack based on a violation of the Sherman Act?[17]

THE TIMKEN PRECEDENT

If the Alpha/Beta agreement involved domestic commerce alone, there would be little doubt that the agreement would not survive the per se rule against territorial market allocations.[18] Does the same conclusive presumption of illegality apply to international commerce as well? Some have argued that it should not.[19] Whereas the anticompetitive effects of domestic

15. *See* note 139 *infra*.

16. *See* notes 131 & 139 *infra*.

17. 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).

18. United States v. Topco Assocs., Inc., 405 U.S. 596 (1972). *See* United States v. Sealy, Inc., 388 U.S. 350 (1967).

19. Among those arguing for such a distinction are Carlston, *Antitrust Policy Abroad*, 49 Nw. U.L. REV. 713, 717-21 (1955); *Friedmann, supra* note 8, at 789-90; REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 77-83 (1955).

market allocations are known and predictable, the challenges of competing in international markets may present unique demands on enterprises requiring market divisions in order that these enterprises might successfully compete. Since market allocations could have a net procompetitive impact when utilized in international commerce, per se rules of conclusive illegality are inappropriate to judge these restraints of foreign trade. Unfortunately, however, no court has yet to adopt the thesis that foreign commerce requires a relaxation of domestic per se rules.[20] The rule appears to be that *all* market divisions, including international market divisions, are conclusively illegal.[21] Presumably, the Alpha/Beta agreement as structured above is therefore illegal as well.

The *Continental TV* decision, however, may permit a contrary result—at least as applies to the Alpha/Beta model. *Continental TV* creates two possible avenues by which the Alpha/Beta allocations can avoid the per se ban and survive antitrust attack. First, the rationale of the opinion supports the broad hypothesis that the per se rule against domestic market allocations is inappropriate when considering international commerce. Second, and perhaps more useful, *Continental TV's* limited exception to the per se territorial rule, when considered along with other precedent, may itself be broad enough to exempt the Alpha/Beta agreement from per se analysis. Once the rule of reason test is applied, presumably the procompetitive impact of the agreement will justify the market allocations.[22]

Before addressing these escapes, however, one must first inspect the per se prison. *Timken Roller Bearing Co. v. United*

20. *International Joint Ventures*, *supra* note 1, at 706-07.

21. Essentially the argument is that a per se restraint such as market allocation is irrefutably anticompetitive; therefore, the setting in which it is employed is irrelevant. *Id.* at 713-28.

When judging the propriety of efforts to cartelize an industry, the argument against relaxing antitrust rules in international commerce is persuasive. However, when judging restraints employed to gain a foothold in the market, the same per se standards should not be applied. An international market, particularly one dominated by a cartel outside of U.S. antitrust jurisdiction, poses far greater barriers to entry than exist domestically. Restraints designed to facilitate entry into new markets therefore should be permitted. The existing per se rules, however, permit no distinction between territorial restraints aimed at creating a cartel and restraints aimed at competing with that cartel.

22. *See* text accompanying notes 50-52 *infra* and note 21 *supra*.

States[23] perhaps best exhibits the general rule that the per se territorial allocation ban applies equally to international commerce.[24] In *Timken,* British, French, and American Timken, through a combination of market allocations and price controls, effectively divided the world market. Although the Court found "an aggregation of trade restraints,"[25] the principal purpose of these restraints was to effect a division of territories between the three competitors.[26] The Court held this division to be plainly illegal.[27] In so ruling the Court rejected the notion that antitrust standards are different in foreign commerce, at least when industry leaders are involved:

> [T]he provisions in the Sherman Act against restraints of foreign trade are based on the assumption, and reflect the policy, that export and import trade in commodities is both possible and desirable. Those provisions of the Act are wholly inconsistent with appellant's argument that American business must be left free to participate in *international cartels,* that free commerce in goods must be sacrificed in order to foster export of American dollars for investment in foreign factories which sell abroad.[28]

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23. 341 U.S. 593 (1951).

24. Among the first indications that the antitrust rules were to be applied to foreign and domestic commerce with equal vigor was the Second Circuit's discussion of import restraints in United States v. Alcoa, 148 F.2d 426 (2d Cir. 1945). In finding a violation of the Sherman Act the court made but two inquiries: (1) Were there sufficient effects on U.S. commerce to invoke jurisdiction, and (2) did the restraints violate U.S. antitrust laws? At no time did the court indicate that more flexible standards were to be applied because the alleged violation was international in character. *Id.* at 443, 444. *See* W. FUGATE, FOREIGN COMMERCE AND THE ANTITRUST LAWS 182, 185-86 (1973).

25. 341 U.S. at 598.

26. *Id.* at 596.

27. *Id.* at 598.

United States v. General Electric Co., 82 F. Supp. 753 (D.N.J. 1949), presaged the *Timken* holding. *General Electric* also involved an exchange of licenses designed to maintain a territorial market division in the incandescent lamp industry. First having labelled the agreements as elements of a cartel arrangement, the court found the market allocations to be "entirely unreasonable insofar as the interest of the public is concerned," and therefore illegal. *Id.* at 847.

28. *Id.* at 599 (emphasis added).

The New York district court in United States v. National Lead, 63 F. Supp. 513 (S.D.N.Y. 1945), had faced a similar defense and had reached the identical result. In *National Lead* the court concluded that defendants, through territorial and cross-licensing agreements, conspired to monopolize titanium. As a defense to liability defendants argued that "American producers cannot do business successfully in a cartelized world except on cartel terms; and that, to abstain from such business, would amount to a greater restraint on trade than is involved in joining the cartel . . . ." *Id.* at 526. The court dismissed the argument, stating that such an immunity from the antitrust laws could only be granted by statute. *Id.* Defendants' scheme "[c]overing

Timken's rejection of the international cartel is evident; the specific rule to be derived from *Timken* is not, however. Despite the Court's vigorous censure of territorial schemes designed to cartelize international commerce, the Court in *Timken* stopped short of explicitly condemning all international territorial allocations as illegal per se.[29] The omission of the words "per se" leave open the possibility that *Timken,* even today, can be limited to its facts. Specifically, it could be argued that the Court's reference to international cartels limited *Timken* to those instances where the miscreants dominated the relevant world market.[30] Absent such market dominance, market allocations may not necessarily be illegal as being designed "to avoid all competition among themselves or with others."[31]

Admittedly the better view construes *Timken's* cartel language as unnecessary judicial hyperbole.[32] Subsequent Supreme Court decisions have cited *Timken* as standing for the rule that territorial market allocations are illegal per se.[33] Indeed, *United States v. Imperial Chemical Industries* specifi-

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an entire industry, and embracing a division of the world into exclusive territories" was unlawful as an unreasonable restraint of trade. *Id.* at 527. *See also id.* at 531, where many of the same arguments are repeated and the court reaches the same conclusion.

29. Although not expressly stating that *all* territorial market allocations in international commerce are per se illegal, the district court did state that Timken's cartel agreements were illegal per se. United States v. Timken Roller Bearing Co., 83 F. Supp. 284, 308-9 (N.D. Ohio 1949). *See International Joint Ventures, supra* note 1, at 705-06 (arguing that the Supreme Court focused on the illegality of the aggregation of trade restraints in *Timken,* whereas the district court was more prone to adopt a stricter per se approach).

30. Friedmann, *supra* note 8. *Cf.* R. FALK, THE STATUS OF LAW IN INTERNATIONAL SOCIETY 289-90 (1970) (arguing that absent an unlawful purpose *Timken* restraints may be permissible, *i.e.,* when they are designed in overall impact to promote competition).

The district court indeed did find that, given the percentage of the market of the conspirators, "[c]ommand of such volume of business spells out the dominant position of defendant, British Timken and French Timken, both in the tapered and antifriction bearing industry." 83 F. Supp. at 289.

31. 341 U.S. at 597-98; *see* R. FALK, *supra* note 30.

32. *See* W. FUGATE, *supra* note 24, at 175-86; *International Joint Ventures, supra* note 1, at 711-12 (both arguing that *Timken* stands for the rule that territorial restraints are equally illegal when employed in international commerce as when they are employed in domestic commerce).

33. United States v. Topco Assocs., Inc., 405 U.S. 596, 608 (1972); Citizen Publishing Co. v. United States, 394 U.S. 131, 135 (1969); Perma Life Mufflers, Inc. v. International Parts Co., 392 U.S. 134, 142 (1968); White Motor Co. v. United States, 372 U.S. 253, 259 (1963); United States v. DuPont & Co., 351 U.S. 377, 387 n.10 (1956).

cally rejected the notion that dominance must be shown in order to strike an international territorial allocation.[34] Nonetheless, the extent to which *Timken* applies to *non*cartel international market allocations has yet to be fully tested. To date, *Timken* rules have been enforced only against major enterprises with substantial shares of the world market.

Although factually distinguishable from *Timken, United States v. Minnesota Mining & Mfg. Co.*[35] exhibits the judiciary's concern with cartels more than with the specific restraint of international market allocation. The government charged 3M and a number of other domestic producers with restraint of the export trade in coated abrasives. As the government complained, the companies accomplished this result by establishing joint venture companies to manufacture and distribute abrasives in those areas that in the past had been the export markets in which the companies competed.[36] The court held that this scheme violated the Sherman Act.[37]

34. United States v. Imperial Chemical Indus., 100 F. Supp. 504 (S.D.N.Y. 1951), addressed the legality of joint venture arrangements between DuPont and ICI which the partners established in territories not already assigned to one or the other via a patent license. The court found that these agreements represented a conspiracy to divide markets. "In the face of this finding, the law is crystal clear: a conspiracy to divide territories, which affects American commerce, violates the Sherman Act." *Id.* at 592. Drawing no distinction between foreign and domestic commerce, the court reasoned that the market allocation of defendants was no different legally from price fixing. Consequently the court reached the further conclusion that the defendant's liability was not barred by the government's failure to allege market dominance by the defendants:

> There is no intimation in any decision that elimination of competition is to be given a more favorable judicial consideration when achieved by the route of territorial division rather than by way of price fixing, or that proof of industry domination is required in one case though not required in the other.

Id. at 593.

Despite this strong language, even *Imperial Chemical* can be viewed as barring only market allocations by cartels. Even though the court disdained an examination of market dominance, there is little question that such dominance did in fact exist. Thus in considering the proper remedial order a later court stated:

> Although no charge has been made of monopolization and no evidence presented to sustain such a charge, we find that the principal defendants are potent factors in the fields in which they have engaged.

105 F. Supp. 215, 221 (S.D.N.Y. 1952). Moreover, the court made careful note that the agreements at issue were not between newly formed enterprises but rather between existing competitiors. There was no doubt that the overall impact and design of the allocation was to restrain competition. 100 F. Supp. at 557.

35. 92 F. Supp. 947 (D. Mass. 1950).

36. *Id.* at 952-54.

37. *Id.* at 962-64.

Because of worrisome dicta,[38] some commentators view *3M* for the extreme proposition that virtually all foreign joint venture arrangements between U.S. companies are illegal.[39] In fact *3M*, like *Timken*, was only aimed at curtailing international cartel arrangements.[40] Three factual prerequisites for the *3M* holding stand out. First, the joint venture was between existing, competing domestic enterprises;[41] second, these cooperating firms dominated the U.S. export market in coated abrasives—4/5ths to be exact;[42] and, finally, the court found that it was profitable for the firms to export independently to these overseas markets.[43] Although the joint ventures in *3M* lacked the explicit territorial restrictions employed in *Timken* and proposed in the Alpha/Beta agreement, the practical territorial impact was virtually the same.[44] On the other hand, the Alpha/Beta allocation contains none of the cartel/monopoly overtones which the *3M* court found objectionable, and therefore remains distinguishable from both *3M* and *Timken*.

Scholarly analysis of foreign territorial arrangements not only tends to confirm the hypothesis that the *Timken* rule has been applied only against monopolies,[45] but singles out *3M* as the most restrictive of the foreign joint venture cases.[46] To re-

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38. It may very well be that even though there is an economic or political barrier which entirely precludes American exports to a foreign country, a combination of dominant American manufacturers to establish joint factories for the sole purpose of serving the internal commerce of that country is a *per se* violation of this other clause of the Sherman Act. The intimate association of the principal American producers in day-to-day manufacturing operations, their exchange of patent licenses and industrial know-how, and their common experience in marketing and fixing prices may inevitably reduce their zeal for competition *inter sese* in the American market.

Id. at 963. Significantly, the court seems to be more concerned with domestic competition than with the potential restraint on foreign commerce.

39. Note, *Joint Ventures Abroad and Per Se Antitrust Violations*, 1 CAL. W. INT'L L.J. 95, 107-9 (1970).

40. *See* Joelson & Griffin, *supra* note 12, at 512; *International Joint Ventures*, *supra* note 1, at 709-10 (both explaining the factual determinations required before the *3M* per se analysis could be applied. *See also* R. FALK, *supra* note 30, at 291-95.

41. 92 F. Supp. at 952, 953, 963.

42. *Id.* at 961.

43. *Id.* at 962, 963.

44. That is, the primary purpose of the entire scheme was to eliminate competition in exports. *Id.* at 961.

45. Friedmann, *supra* note 8, at 782-84. *See also* W. FUGATE, *supra* note 24, at 158-61; *International Joint Ventures*, *supra* note 1, at 704.

46. *Friedmann*, *supra* note 8, at 786-87; Joelson & Griffin, *supra* note 12, at 510-

peat, the better view is that *Timken* did indeed bar territorial allocations between international competitors regardless of their share of the market. However, only *Imperial Chemical* has explicitly ruled to that effect,[47] and no court has yet to apply the *Timken* rule in a case which did not in fact involve a cartel arrangement.[48] The Justice Department itself has implicitly followed the noncartel exception to *Timken* by limiting

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11; *International Joint Ventures, supra* note 1, at 709-11.

47. *See* the discussion of *Imperial Chemicals* at note 34 *supra*.

48. United States v. Bayer Co., 135 F. Supp. 65 (S.D.N.Y. 1955), illustrates the courts' continuing failure to close the noncartel loophole. Although the *Bayer* court noted that a division of world markets was a per se restraint on U.S. commerce, thereby invoking the jurisdiction of the antitrust laws, *id.* at 70, the court neglected to make the same statement with respect to the illegality of the agreement itself. Rather, the court noted that at the time at issue Bayer and its co-conspirator, I.B. Farben (then Leverkusen), were "majors" in the world market. "Indeed, no issue [was] raised by the defendant on this score." *Id.* at 68. The court noted that the agreements amounted to the "usual form of international cartel arrangement." *Id.* at 69, *quoting* General Aniline & Film Corp. v. Bayer Co., Inc., 188 Misc. 929, 930, 64 N.Y.S.2d 492, 494 (1946). Consequently in determining liability the court concluded:

> The allocation of the world markets of the defined pharmaceutical products amongst Bayer, I.G. Farben and Bayer Products Limited *is so all pervasive* as to constitute a per se violation of § 1 of the Sherman Act . . . .

Id. at 70 (emphasis added). Although undoubtedly the court noted the pervasiveness of the arrangment in order to distinguish the conspirators use of trademark licenses, arguably the pervasiveness requirement could apply to the presence or absence of market dominance as well. Other cases barring territorial allocations in situations where the conspirators dominated the relevant market include: United States v. United States Alkali Export Ass'n, 86 F. Supp. 59 (S.D.N.Y. 1949); United States v. General Dyestuff Corp., 57 F. Supp. 642 (S.D.N.Y. 1944).

See also Foundry Services Inc. v. The Beneflux Corp., 110 F. Supp. 857 (S.D.N.Y. 1953), *rev'd on other grounds*, 206 F.2d 214 (2d Cir. 1953), which held that *Timken* did not apply to an ordinary exclusive license of a secret process. In validating the accompanying territorial limitation the court noted:

> It is not shown or even claimed that this license agreement was used either alone or in combination with related agreements to achieve a monopoly in the business of fluxes generally or in any other industry.

Id. at 860-61. Of course *Foundry Services* can be distinguished from the pure territorial allocation being examined here in the context of the Alpha/Beta agreement in that *Foundary Services* involved a trade secret. *See* note 139 *infra* and the discussion of *DuPont* at text accompanying notes 136-39 *infra*. *See also* United States v. Holophane Co., 119 F. Supp. 114 (S.D. Ohio 1954), *aff'd*, 352 U.S. 903 (1956), which judged a worldwide market allocation to be illegal according to the following rule of reason test:

> The evidence establishes that the restrictive agreements were designed to eliminate competition between the parties and with outsiders in all markets of the world, and were neither measurable by, limited to, nor subordinate to the reasonable necessities of the sale.

Id. at 119. *See generally* E. KINTNER & M. JOELSON, AN INTERNATIONAL ANTITRUST PRIMER 74-78 (1974).

their prosecutorial efforts to monopolistic situations, agreements between dominant parties where the territorial restraint has no rationale beyond limiting competition between the parties.[49] Consequently, the *Timken* territorial holding remains readily subject to judicial redefinition.

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49. For example, in assessing the validity of territorial restraints imposed on foreign licenses of know-how, the Department will examine the general availability of the know-how and the market dominance of the contracting parties:

> Territorial restrictions would not be permissible if unreasonable in light of the know-how involved or part of a larger illegal plan to cartelize the market . . . .
>
> Thus . . . the restrictions could be upheld if the know-how being transferred is of substantial value, the territorial restrictions are limited to a reasonable period and the agreement is not part of a larger plan to divide markets between dominant firms.

MEMORANDUM OF THE DEPARTMENT OF JUSTICE, *supra* note 13, at 55,209.

Similarly, recent consent decrees and their accompanying competitive impact statements filed by the Justice Department exhibit the same concern for attacking territorial restrictions that lack a competitive rationale. In United States v. Norman M. Morris Corp., 41 Fed. Reg. 5365 (1976), the Department attacked an agreement restricting import and resale of Omega and Tissot Swiss watches. The Department noted that in 1972 55% of all watches purchased in the U.S. were manufactured in Switzerland and that a substantial number of these were the above-named brands. The Department further noted that Switzerland is the world's largest exporter of watches.

In United States v. Addison-Wesley Publishing Co., 41 Fed. Reg. 32617 (1976), the Department attacked a network of exclusive licensing agreements which in effect prohibited exports from America to Britain of English language books and vice versa. The vehicle used to enforce this restraint was the Publishers Association, "a British organization whose membership includes virtually all major United Kingdom publishing houses . . . ." *Id.* In effect, the licensing requirements of the Association restrained virtually all traffic in English books between the two countries.

Finally, and perhaps most directly on point, United States v. Foote Mineral Co., 40 Fed. Reg. 59,358 (1975), outlawed a worldwide territorial allocation of lithium products. The agreement was between Foote, which produced lithium in its raw state, and Metallgesellschaft, who purchased its materials from Foote and absent the market allocation would have competed with Foote in the sale of lithium products. In banning the territorial division, the Department noted that Foote was one of only five enterprises worldwide which recovers lithium in its natural state and that Foote accounted for 45% of U.S. natural state production.

Significantly, the Department did not disturb an agreement which in effect prevented Foote from underselling Metall in Europe. The Department commented that given the long term supply contracts involved. Metall required such protection in order to retain incentive to compete with Foote in other markets. Otherwise Foote could undercut Metall in its home territory in response to any competition by Metall in other geographic areas.

Department officials themselves have further noted their own focus on cartels of dominant parties. *See* Address by Donald I. Baker, Antitrust Division, Department of Justice, New York State Bar Ass'n, Antitrust Law Section Annual Meeting, Jan. 24, 1973, *quoted in International Joint Ventures, supra* note 1, at 704.

To conclude this discussion one caveat must be expressed. Although the Justice Department may tacitly recognize a noncartel exception, that "authority" is of little

As alluded to above, the rationale for a noncartel international exception to the territorial rule derives from the potential procompetitive impact of allocations between small international businesses. For example, although restraining competition between themselves, the Alpha/Beta allocation permits the creation of the new Beta enterprises, thereby permitting the group to compete more effectively in more world markets.[50] Without the help of Alpha, native LDC investors would lack the technological and financial resources necessary to launch such enterprises as the Betas. The "restraint" permits the creation of new businesses that otherwise would not be financially feasible. The procompetitive impact of the market allocation almost certainly satisfies the demands of the rule of reason.[51] Consequently, by employing a noncartel exception to relieve international market allocations between small enterprises from the per se impact of *Timken,* arrangements such as the Alpha/Beta agreement can escape antitrust liability by satisfying the less stringent rule of reason requirement.[52]

The importance to the Alpha/Beta agreement of creating such a noncartel exception to the *Timken* rule becomes more evident when one considers that host country laws typically preclude the use of the principal "end around" to the *Timken* territorial rule: practical market division through corporate integration. Section 1 of the Sherman Act requires a conspiracy between competitors.[53] Thus, an enterprise can avoid *Timken* through internal expansion, so that the "competitors" with which one plans to divide territories will in fact be but parts of one single corporate entity. Absent such unity an enterprise will be potentially liable for antitrust violations. Thus,

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use if the courts do not recognize the exception as well. If the courts stick to an absolute per se approach, a contracting party will be able to use the antitrust illegality of the agreement as a defense to an action on the contract. *See* the discussion of *Continental TV* at text accompanying notes 93-94 *infra.* Even if one avoids this problem through arbitration and/or choice-of-law clauses, there is the additional prospect of suits by "injured" consumers, state attorneys general representing those consumers, or even suits on behalf of foreign consumers. *See* Caplan, *Parens Patriae Antitrust Suits by Foreign Nations,* 6 DEN. J. INT'L L. & POL'Y 705 (1976).

50. *See generally* text accompanying notes 140-42, 144 *infra.*

51. *See* text accompanying notes 80-82 *infra.*

52. Standard Oil Co. v. United States, 221 U.S. 1, 60 (1911) (possibly representing the original statement of the rule of reason test).

53. *See* note 17 *supra.*

> the central message of the Sherman Act is that a business entity must find new customers and higher profits through internal expansion—that is, by competing successfully rather than by arranging treaties with its competitors.[54]

In other words, a corporation cannot illegally conspire with itself;[55] therefore, completely integrated parts of one enterprise can "divide" territories with other integrated parts of the same enterprise.

However, host country local control laws prevalent in LDCs prevent an international company from meeting this single business entity test, at least as the term has been interpreted by the courts to date. Unfortunately for LDC enterprises, the courts narrowly construe what represents an integrated business entity for the purposes of "exemption" from the Sherman Act. The Supreme Court has stated "that even commonly owned firms must compete against each other, if they hold themselves out as distinct entities."[56] In *Timken* the Court imposed liability despite the fact that American Timken owned thirty and fifty percent of British and French Timken respectively.[57] Quite plausibly *Timken* presented no "conspiracy" in restraint of trade. The Court, however, determined that the three Timkens were separate entities and therefore subject to liability for allocating territories. "The fact that there is common ownership or control of the contracting corporations does not liberate them from the impact of the antitrust laws."[58]

The apparent harshness of *Timken's* approach to intracorporate conspiracy is somewhat diminished by the district court's earlier determination that American Timken and British and French Timken were in fact two independent enterprises.[59] Nonetheless, a number of subsequent decisions have eschewed the district court's concern for practical independence in favor of a more formalisitc separate incorporation test of conspiracy.[60] Thus, citing *Timken,* the Supreme Court in

54. United States v. Citizens & Southern Nat'l Bank, 422 U.S. 86, 116 (1975).
55. Cliff Food Stores, Inc. v. Kroger, Inc., 417 F.2d 203, 206 (5th Cir. 1969).
56. 422 U.S. at 116.
57. 83 F. Supp. at 292, 294.
58. 341 U.S. at 598.
59. 83 F. Supp. at 292.
60. Joe Westbrook, Inc. v. Chrysler Corp., 419 F. Supp. 824 (N.D. Ga. 1976); Martin B. Glauser Dodge Co. v. Chrysler Corp., 418 F. Supp. 1009 (D.N.J. 1976).

Perma Life Mufflers, Inc. v. International Parts Corp. instructed: "[S]ince respondents Midas and International availed themselves of the privilege of doing business through separate corporations, the fact of common ownership could not save them from the obligations that the law imposes on separate entities."[61]

Regardless of one's approach, the intracorporate conspiracy issue poses a number of controversies: Can commonly owned but noncompeting enterprises be held liable under section 1 of the Sherman Act for conspiring to restrain trade? The general rule appears to be that they can.[62] Although unincorporated divisions of an enterprise cannot conspire,[63] what about wholly owned subsidiaries? The general response is that wholly owned subsidiaries can indeed illegally conspire with each other.[64]

The problem for LDC enterprises is evident. If wholly owned subsidiaries can illegally conspire to restrain trade, how can locally owned and/or locally controlled LDC enterprises hope to claim that their territorial allocations with their U.S. parent do not represent a conspiracy between competitors. Even under a test which examines the restraint in terms of

See also Keifer-Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211 (1951) (finding the separate incorporation test particularly applicable where the enterprises hold themselves out as competitors). *But see* Mutual Fund Investors v. Putnam Management Co., 553 F.2d 620, 625 (9th Cir. 1977). For summaries of many of the cases dealing with intracorporate conspiracies, *see* Annot., 20 A.L.R. Fed. 682 (1974).

61. 392 U.S. 134, 141-42 (1968).

62. Cromar Co. v. Nuclear Materials & Equipment Corp., 543 F.2d 501 (3d Cir. 1976); Battle v. Liberty Nat'l Life Ins. Co., 493 F.2d 39 (5th Cir. 1974), *cert. denied*, 419 U.S. 1110 (1975); T.V. Signal Co. v. American Telephone & Telegraph Co., 462 F.2d 1256 (8th Cir. 1972); Tamaron Distributing Corp. v. Weiner, 418 F.2d 137 (7th Cir. 1969); Joe Westbrook, Inc. v. Chrysler Corp., 419 F. Supp. 824 (N.D. Ga. 1976). *See* Coleman Motor Co. v. Chrysler Corp., 376 F. Supp. 546 (W.D. Pa. 1974), *order vacated*, 525 F.2d 1338 (3d Cir. 1975). *But see* Ark. Dental Supply Co. v. Cavitron Corp., 461 F.2d 1093 (3d Cir. 1972); Call Carl Inc. v. BP Oil Corp., 403 F. Supp. 568 (D. Md. 1975).

63. Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors Ltd., 416 F.2d 71 (9th Cir. 1969), *cert. denied*, 396 U.S. 1062. *See* Cliff Food Stores, Inc. v. Kroger, Inc., 417 F.2d 203 (5th Cir. 1969).

64. Coleman Motor Co. v. Chrysler Corp., 525 F.2d 1338 (3d Cir. 1975); Battle v. Liberty Nat'l Life Ins. Co., 493 F.2d 39 (5th Cir. 1974), *cert. denied*, 419 U.S. 1110 (1975); Minnesota Bearing Co. v. White Motor Corp., 470 F.2d 1323 (8th Cir. 1973); Martin B. Glauser Dodge Co. v. Chrysler Corp., 418 F. Supp. 1009 (D.N.J. 1976). *But see also In re* REA Express, Inc., Private Treble Damage Antitrust Litigation, 412 F. Supp. 1239 (E.D. Pa. 1976).

practical independence,[65] or under the Justice Department's criteria which invokes strictest scrutiny only where ownership by the parent is less than fifty percent,[66] an Alpha/Beta enterprise will not escape antitrust liability under the "one corporation" rule. For per se restraints to be permissible, the U.S. antitrust laws require integrated expansion by the parent; the laws of the host nation require local ownership. The incompatability of the two requirements necessarily subjects LDC enterprises to antitrust restrictions which in more developed nations can be generally avoided through integration. Given the general policy in favor of investment in the poorer nations,[67] one would expect an opposite result.

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65. One practical approach is to determine if in reality there are two distinct functional corporate entities.

> [A]t least where the corporations are horizontally related, separate incorporation may not defeat the need for substance to prevail over form when only a single business unit exists. Separate incorporation, like the lack of intraenterprise competition, is not dispositive of the question, but only one factor in the calculus.

Mutual Fund Investors v. Putnam Management Co., 553 F.2d 620, 625-26 (9th Cir. 1977), *citing* Knutson v. Daily Review, Inc., 548 F.2d 795, 802-03 (9th Cir. 1976), *cert. denied,* 97 S. Ct. 2977 (1977).

Taking a similar approach, another line of cases appears to examine the corporate relationship together with the particular restraint in order to determine if liability should be imposed. United States v. Yellow Cab Co., 332 U.S. 218 (1947). *See* Coleman Motor Co. v. Chrysler Corp., 525 F.2d 1338 (3d Cir. 1975) (holding Chrysler liable for a conspiracy with its factory-owned dealerships to the detriment of independent dealers—almost a monopolization claim); Battle v. Liberty Nat'l Life Ins. Co., 493 F.2d 39 (5th Cir. 1974), *cert. denied,* 419 U.S. 1110 (1975) (holding that insurance company could not utilize a tying arrangement with its wholly owned funeral home subsidiary); Syracuse Broadcasting Corp. v. New House, 319 F.2d 683 (2d Cir. 1963) (holding that it was permissible for a newspaper to grant free advertising to a commonly owned radio station as the practical impact was only a redistribution of corporate profits). *See also* Note, *Intra-Enterprise Conspiracy Under Section 1 of the Sherman Act: A Suggested Standard,* 75 MICH. L. REV. 717 (1977).

66. "The Department of Justice has consistently accepted the view stated in the 1955 Report of the Attorney General's National Committee to Study the Antitrust Laws: a parent corporation may allocate territories or set prices for the subsidiaries that it fully controls." DEPARTMENT OF JUSTICE, ANTITRUST GUIDE FOR INTERNATIONAL OPERATIONS, *reprinted in* [1977] ANTITRUST & TRADE REG. REP. (BNA) No. 799 at E-1 (Feb. 1, 1977). Normally, majority equity control represents the test for avoiding an illegal conspiracy. However, the Department notes that "the same reasoning may apply to a minority position where the U.S. firm maintains effective working control." Moreover, the Department also intimates that some nonmajority, noncontrolled subsidiaries may nonetheless allocate territories; at no point in the example did the Department adopt a per se rule. Significantly, the example used to express these standards assumed that the parent was a multinational who was a worldwide leader in its field. *Id. See* note 49 *supra.*

67. *See, e.g.,* the discussion of economic rights in Starr, *International Protection*

SCHWINN, TOPCO AND THE DEFENSE OF PROCOMPETITIVE IMPACT

The Supreme Court's apparent willingness in *Continental TV* to carve exceptions to the per se rule against territorial restraints thus acquires an added significance for businesses in the general relationship of Alpha and Beta as described above. *Continental TV* seems to offer an opportunity to avoid the single corporate entity paradox by permitting Betas to employ their very poverty and local laws as a defense to an antitrust action attacking territorial agreements with their parent. If Betas can be created only by permitting territorial divisions, presumably the net procompetitive impact of those divisions deserves some form of immunity from per se, conclusive illegality.

However, *Schwinn*,[68] and later *Topco*,[69] previously had barred the use of such a reasonability defense when territorial market allocations were involved. *Schwinn* accomplished the first broad rejection of the procompetitive impact defense. Although a number of restraints were involved in the franchising system set up by Schwinn to market its bicycles,[70] for our purposes the principal restraint prevented distributors from selling bicycles to retailers outside of their designated territories. Schwinn argued that this restraint was required in order for it to survive the competition posed by giant mass retailers such as Sears.[71] The Court agreed to some extent, allowing Schwinn to retain some of the features of its franchise system.[72] However, such arguments of competitive reasonableness were not even considered in relation to Schwinn's territorial restraints.

> Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it.[73]

In distinguishing an earlier line of cases the Court did note that exceptions to the per se rule may apply to a new business

of Human Rights and the United Nations Covenants, 1967 WISC. L. REV. 863, as well as the policy considerations expressed in Nanda, *Selected Legal Issues in the World Population/Food Equation*, published in this issue.

68. 388 U.S. 365 (1967).
69. 405 U.S. 596 (1972).
70. 388 U.S. at 370-71; 237 F. Supp. at 326-27.
71. 388 U.S. at 368-69, 376-77.
72. *Id.* at 379-80.
73. *Id.* at 379.

or a failing company.[74] However, attempting to maintain one's market position does not have such a corresponding exception.

> The promotion of self-interest alone does not invoke the rule of reason to immunize otherwise illegal conduct. It is only if the conduct is not unlawful in its impact in the marketplace or if the self-interest coincides with the statutory concern with the preservation and promotion of competition that protection is achieved.[75]

Thus, the most that can be said for *Schwinn* is that it left the door open for some additional exceptions to the per se rule where a net procompetitive impact clearly results.

Topco closed this door. Topco was an association of small and medium size regional supermarket chains that served as a purchasing agent for its members.[76] The members created the association to permit them to buy items in large quantities, and to foster the development of private label brands which these smaller chains could then use to meet the private label competition of the giants.[77] The Justice Department attacked the association's territorial restriction, which prevented member firms from selling Topco-controlled brands outside their designated marketing territory.[78]

In some respects the motive of the *Topco* territorial arrangement was less reasonable than *Schwinn* in that it flowed horizontally from competing member retailers, rather than having been imposed upon the retailers vertically by a concerned manufacturer.[79] On the other hand, more clearly than *Schwinn*, the net economic effect of the *Topco* territorial arrangement was to promote rather than restrict competition.[80]

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74. *Id.* at 374.

75. *Id.* at 375. For a discussion of the international implications of *Schwinn*, now mooted by the *Continental TV* decision, *see* E. KINTNER & M. JOELSON, *supra* note 48, at 95-97. *See also* United States v. Glaxo Group Ltd., 302 F. Supp. 1 (D.D.C. 1969)(applying *Schwinn* to a British company selling in bulk within the United States).

76. 405 U.S. at 598.

77. *Id.* at 598, 599 n.3.

78. *Id.* at 601.

79. A horizontal market allocation is an agreement between competitors at the same level of the distribution chain. Edwin K. Williams & Co. v. Edwin K. Williams & Co.-East, 377 F. Supp. 418, 424-25 (C.D. Cal. 1974), *modified*, 542 F.2d 1053 (9th Cir. 1976). However, as demonstrated in text accompanying notes 118-21 *infra*, defining a horizontal agreement and proving a horizontal agreement are two completely different tasks.

80. *See* Noble v. McClatchy Newspapers, Inc., 533 F.2d 1081, 1087 (9th Cir. 1975),

The territorial restraints strengthened the Topco Association; and the stronger the association the greater the ability of Topco members to compete with the large national chains. As the district court determined,

> [w]hatever anti-competitive effect these practices may have on competition in the sale of Topco private label brands is far outweighed by the increased ability of Topco members to compete both with the national chains and other supermarkets operating in their respective territories.[81]

Based on a rule of reason analysis, the Topco territorial allocation would have been permissible.[82]

The Supreme Court, however, determined that it was error to apply the rule of reason test; horizontal territorial restrictions require the per se rule of illegality.[83] In so holding the Court refused to consider whether the net impact of the restraint was really procompetitive.

> The fact is that courts are of limited utility in examining difficult economic problems. Our inability to weigh, in any meaningful sense, destruction of competition in one sector of the economy against promotion of competition in another sector is one important reason we have formulated *per se* rules.[84]

Once per se analysis is invoked, the alleged procompetitive impact of the restraint becomes irrelevant.[85]

The practical harshness of the *Topco* holding was subsequently tempered by the court's ruling that Topco would be permitted to retain areas of primary responsibility.[86] However,

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cert. denied, 97 S. Ct. 2966 (1977).

81. 319 F. Supp. 1031, 1043 (N.D. Ill. 1970), *quoted in* 405 U.S. 596, 605-6 (1972).

82. The Topco licensing provisions are not inherently unreasonable and have no substantial adverse effect on competition in the relevant market. They are ancillary and subordinate to the . . . legitimate, procompetitive purpose of the Topco cooperative, reasonable and in the public interest.

319 F. Supp. at 1038.

83. 405 U.S. at 608.

84. *Id.* at 609-10. *But see id.* at 624 (Burger, C.J., dissenting).

85. "In applying these rigid rules, the Court has consistently rejected the notion that naked restraints of trade are to be tolerated because . . . they are allegedly developed to increase competition." *Id.* at 610. *But see* Chief Justice Burger dissent for the argument that precedent required no such rigid rule. *Id.* at 613.

86. United States v. Topco Assocs., Inc., 1973-1 Trade Cas. 93,797 (N.D. Ill. 1973).

Areas of primary responsibility normally invoke price/profit penalties against those who sell outside their areas. If the penalty is too great, the court will declare it

Topco nonetheless clearly indicates that procompetitive impact is not a defense to a charge of territorial market allocation. As a result *Topco* eliminated the principal argument justifying the Alpha/Beta territorial restraint: that the restraint aids market entry by competitively disadvantaged LDC investors, and thereby promotes competition.

THE CONTINENTIAL TV EXCEPTIONS

Domestically, the impact of *Schwinn and Topco* led to some complaints[87] and more than a little subterfuge.[88] For franchise operations the principal avoidance technique was the use of exclusive dealership arrangements, which are considered legal under the antitrust laws.[89] By strategically locating exclu-

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to be an illegal market allocation. *See, e.g.*, Response of Carolina, Inc. v. Leasco Response, Inc., 537 F.2d 1307 (5th Cir. 1976).

87. For example in Adolph Coors Co. v. FTC, 497 F.2d 1178 (5th Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975), the Federal Trade Commission attacked Coors' practice of restricting the territories of its distributors. Coors maintained that the restrictions were required to maintain quality since Coors beer uniquely requires that it be refrigerated until sold to the consumer. The court reluctantly rejected Coors' argument:

> Although we are compelled to follow the *Schwinn per se* rule rendering Coors' territorial restrictions on resale illegal *per se*, we believe that the *per se* rule should yield to situations where a unique product requires territorial restrictions to remain in business . . . . Perhaps the Supreme Court may see the wisdom of grafting an exception to the *per se* rule when a product is unique and where the manufacturer can justify its territorial restraints under the rule of reason.

Id. at 1187.

88. For example, one manufacturer expressly contracted with its distributor that the manufacturer retain title to its product (Green Stamps) in the hope of coming within the maintenance of title exception to *Schwinn*. Finding that the risk of loss had passed to the distributor, the mere contracting to retain title did not exempt the resale restrictions from the *Schwinn* rule. Eastex Aviation, Inc. v. Sperry & Hutchinson Co., 522 F.2d 1299 (5th Cir. 1975).

Other manufacturers assigned territories without expressly limiting sales to those territories. In such instances the court will look to see if the manufacturer enforced a territorial restriction. *See, e.g.*, Pitchford v. Pepi, Inc., 531 F.2d 92 (3d Cir.), *cert. denied*, 426 U.S. 935 (1976); Reed Brothers, Inc. v. Monsanto Co., 525 F.2d 486 (8th Cir. 1975), *cert. denied*, 423 U.S. 1055 (1976); Hobart Brothers v. Malcolm T. Gilliland, Inc., 471 F.2d 894 (5th Cir.), *cert. denied*, 412 U.S. 923 (1973); Fontana Aviation, Inc. v. Beech Aircraft Corp., 432 F.2d 1080 (7th Cir. 1970), *cert. denied*, 401 U.S. 923 (1971) (finding such active enforcement); Knutson v. Daily Review, Inc., 548 F.2d 795, 810 (9th Cir. 1976), *cert. denied*, 97 S. Ct. 2977 (1977); Colorado Pump & Supply Co. v. Febco, Inc., 472 F.2d 637 (10th Cir.), *cert. denied*, 411 U.S. 987 (1973); Janel Sales Corp. v. Lanvin Parfums, Inc., 396 F.2d 398 (2d Cir.), *cert. denied*, 393 U.S. 938 (1968) (failing to find the requisite amount of enforcement by the manufacturer).

89. *See, e.g.*, Universal Brands, Inc. v. Philip Morris, Inc., 546 F.2d 30 (5th Cir. 1977); Williams v. Independent News Co., Inc., 485 F.2d 1099 (3d Cir. 1973); Akron Tire Supply Co. v. Gebr. Hofmann KG, 390 F. Supp. 1395 (N.D. Ohio 1975). *But see*

sive dealers, by limiting the number of dealers, and by requiring dealers to sell only from designated locations one can in practice achieve a territorial allocation. The success of such a scheme depends upon the manufacturer's ability to control the number and location of its exclusive dealers in a given area. Thus, the validity of such schemes came to turn on whether franchise applications are denied because of independent business judgment or the urging of existing nearby dealerships. The latter was of course illegal,[90] while the former apparently was not.[91]

Continental TV, Inc. v. GTE Sylvania, Inc.[92] examined just such a scheme. Sylvania had adopted an exclusive franchising arrangement with its retailers in an effort to boost its sales from the dismal one to two percent of the market to which Sylvania had fallen. An essential element of the plan was the conscious limitation of the number of retail outlets in a given area in the hope that by so limiting competition Sylvania could attract an aggressive group of retailers. "[S]ylvania retained sole discretion to increase the number of retailers in an area in light of the success or failure of existing retailers in developing their market."[93] Licensed retailers could sell only from designated locations.

In a dispute between Sylvania and a former franchisee, Continental TV, the latter raised the illegality of the franchise plan under the Sherman Act as a counterclaim to Sylvania's action to recover goods in Continental's possession.[94] Continental claimed that the franchise plan was an illegal territorial allocation. Sylvania denied that any such market division had occurred.

Justice Powell's opinion cut through the exclusive dealership subterfuge and labelled the locational restraint as func-

also Quality Mercury, Inc. v. Ford Motor Co., 542 F.2d 466, 471 n.6 (8th Cir. 1976) (indicating that a perpetual exclusive dealership may be illegal).

90. Quality Mercury, Inc. v. Ford Motor Co., 542 F.2d 466 (8th Cir. 1976); American Motor Inns, Inc. v. Holiday Inns, Inc., 521 F.2d 1230 (3d Cir. 1975).

91. Salco Corp. v. General Motors Corp., 517 F.2d 567 (10th Cir. 1975); Kaiser v. General Motors Corp., 396 F. Supp. 33 (E.D. Pa. 1975), *aff'd without opinion*, 530 F.2d 964 (3d Cir. 1976). *See also* Sheldon Pontiac v. Pontiac Motor Division, 418 F. Supp. 1024 (D.N.J. 1976).

92. 97 S. Ct. 2549 (1977).

93. *Id.* at 2552.

94. *Id.* at 2552-53.

tionally identical to the territorial allocation held to be illegal in *Schwinn.*[95] However, rather than holding for Continental TV based on the *Schwinn* rule, the Court reexamined and rejected the *Schwinn* per se approach to territorial restraints. The specific reason for the reversal derives from the Court's decision to endorse franchising arrangements in general;[96] the *Schwinn* court had viewed franchising with intense suspicion.[97] The Court determined that many vertical territorial restraints can be on balance procompetitive. Since "*[p]er se* rules of illegality are appropriate only when they relate to conduct that is manifestly anti-competitive,"[98] this finding warranted rejection of *Schwinn's* per se bar to vertical territorial restraints.

The Court's determination with regard to the possible procompetitive impact of such vertical restraints rests on the Court's analysis of the distinction between interbrand and intrabrand competition. "Interbrand competition is the competition among the manufacturers of the same generic product . . . . In contrast, intrabrand competition is the competition between the distributors—wholesale or retail—of the product of a particular manufacturer."[99] An examination of the competitive impact of a territorial allocation must weigh the restraint's effect on both types of competition.[100] Consequently, although territorial restrictions imposed on retailers by a manufacturer will dull intrabrand competition, if these restrictions also assist that small manufacturer to penetrate a market, interbrand competition, and competition in general, may be increased. Often smaller businesses can not grow to the status of a viable competitor without the efficiencies offered by vertical

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95. *Id.* at 2556.

96. *Id.* at 2556-62, 2561 n.26, 2560 n.22. *See* text accompanying notes 122-125 *infra.*

97. The Court in *Schwinn* noted that to permit territorial restrictions once title had passed "would sanction franchising and confinement of distribution as the ordinary instead of the unusual method" of retailing products. 388 U.S. at 379.

98. 97 S. Ct. at 2558.

99. *Id.* at 2559 n.19.

100. In fact the Court criticized the *Schwinn* opinion for failing to examine both aspects of competition: "Significantly, the Court in *Schwinn* did not distinguish among the challenged restrictions on the basis of their individual potential for intrabrand harm or interbrand benefit." *Id.* at 2559. An excellent analysis of the potential varying impacts of vertical restraints on both interbrand and intrabrand competition can be found at Copper Liquor, Inc. v. Adolph Coors Co., 506 F.2d 934, 941 n.5 (5th Cir. 1975).

territorial allocations.[101] It is the restraint's "potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition"[102] which renders inappropriate the per se rule's conclusive presumption of illegality.[103]

A NONCARTEL EXCEPTION FOR INTERNATIONAL COMMERCE?

To assess the impact of *Continental TV* on the Alpha/Beta international agreement initially requires an examination of the broader rationale behind the opinion. The *Continental TV* Court relied on the analysis of *White Motor Co. v. United States*[104] for authority to repudiate the *Schwinn* per se doctrine.[105] *White Motor* had refused to apply per se rules to vertical territorial restraints.

> We need to know more than we do about the actual impact of these arrangements on competition to decide whether they have such a "pernicious effect on competition and lack any redeeming virtue" and therefore should be classified as *per se* violations of the Sherman Act.[106]

Presumably the same analysis can justify additional exceptions to the per se rules.[107]

Specifically, if faced with the opportunity, perhaps the current Court would now draw a distinction between domestic and international commerce when applying the per se rules. As noted earlier, to date the courts have failed to verbalize separate rules for international trade. However, as also noted earlier, the courts have yet to face a fact situation that would

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101. *Id.* at 2561. The Court went on to note that eliminating the per se rule may also benefit small franchisees where the manufacturer is an established entity.

> We also note that *per se* rules in this area may work to the ultimate detriment of the small businessmen who operate as franchisees. To the extent that a *per se* rule prevents a firm from using the franchise system to achieve efficiencies that it perceives as important to its successful operation, the rule creates an incentive for vertical integration into the distribution system, thereby eliminating to that extent the role of independent businessmen.

Id. at 2561 n.26.

102. *Id.* at 2559.

103. "Certainly, there has been no showing in this case, either generally or with respect to Sylvania's agreements, that vertical restrictions have or are likely to have a 'pernicious effect on competition' or that they 'lack any redeeming virtue.'" *Id.* at 2562.

104. 372 U.S. 253 (1963).

105. 97 S. Ct. at 2558.

106. 372 U.S. at 263. *See* note 103 *supra;* 97 S. Ct. at 2558.

107. *See* Chief Justice Burger's dissent in United States v. Topco Assocs., Inc., 405 U.S. 596, 613-24 (1972).

require that such a distinction be made; all of the previous opinions have dealt with cartel-like situations. Arguably these early opinions did not articulate a per se rule at all beyond the statement that monopoly practices are presumptively illegal.

As with the domestic application of the Sherman Act, its international application is designed to promote competition.[108] As was stated in *White Motor*[109] and repeated in *Continental TV*, a given restraint becomes illegal per se only when its known impact on competition is so pernicious that it warrants the conclusive presumption of illegality that a per se rule entails.[110] Surely the financial, technical, and marketing resources required to penetrate international markets may require territorial restraints in some instances; the business judgment underlying the Alpha/Beta agreement aptly illustrated this.[111] Allocations between industry leaders may well be illegal per se as their anticompetitive effects are known. But absent such market dominance, a per se bar to international territorial restraints is not appropriate. In fact the Court's view of tying arrangements provides authority for such a dominance distinction.[112]

Moreover, the courts have at times carved limited exceptions to per se rules where the peculiar circumstances of a particular enterprise or industry warrant such an exception.[113]

108. "[T]he major premise of the Sherman Act is that the suppression of competition in international trade is in and of itself a public injury . . . ." United States v. National Lead Co., 63 F. Supp. 513, 525 (S.D.N.Y. 1945).

109. In *White Motor* the Justice Department attacked White Motor's franchise system which limited the customers and territories to which each dealer would be permitted to sell. White Motor responded that these restraints were entirely reasonable under the circumstances. White Motor was a small truck company competing against the automotive giants. In order to survive the competition of the larger manufacturers, White Motor had to insure that its dealers would actively promote its truck within the territories assigned to each dealer. The only way to insure such intensive customer development is to grant each dealer an exclusive territory. Based on these facts the Court refused to grant summary judgment for the United States.

110. *See* text accompanying notes 104-107 *supra.*

111. *See* text accompanying notes 50-52 *supra.*

112. *See, e.g.*, United States Steel Corp. v. Fortner Enterprises, Inc., 97 S. Ct. 861 (1977); Northern Pacific Ry. Co. v. United States, 356 U.S. 1 (1958); International Salt Co. v. United States, 332 U.S. 392 (1947).

113. Tripoli Co. v. Wella Corp., 425 F.2d 932 (3d Cir.), *cert. denied*, 400 U.S. 831 (1970) (resale restraint needed to insure safe use of the product); Mackey v. National Football League, 543 F.2d 606 (8th Cir. 1976)(football business has unique features of a joint venture which relieve it of the full impact of the per se rules). *But see* Copper

The problems of starting a new business where success or failure is in the balance may permit the use of restraints that would otherwise be illegal per se.[114] In particular, the demands of attempting to penetrate a new international market in the face of substantial competition can justify even horizontal territorial restraints between existing competitors, particularly when one's foreign competitors are attempting to create a cartel among themselves.[115] Aggregating these exceptions, and considering further the greater probability that the international context will create situations invoking such exceptions, a retreat from the per se approach to international territorial restraints seems appropriate under the policies expressed in *White Motor* and *Continental TV.*

THE "FRANCHISING" EXCEPTION OF CONTINENTAL TV

Practical business decisions, however, cannot rest on an as yet unarticulated international noncartel exception. Fortunately, there is sufficient language in *Continental TV* itself to permit the specific market division proposed for the Alpha/Beta group. The trick lies in having the Alpha/Beta restraint construed as a permissible franchising arrangement under the rules expressed in *Continental TV.* Although the language of the Court's opinion focuses predominantly on the distinction between horizontal and vertical territorial restraints, the decision's broader practical impact was to judge territorial *franchising* arrangements by the rule of reason, rather than to condemn such practices as per se illegal. The

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Liquor, Inc. v. Adolph Coors Co., 506 F.2d 934 (5th Cir. 1975)(holding that efforts to maintain quality do not warrant an exception to the per se rule against territorial restraints).

114. United States v. Jerrold Electronics Corp., 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd,* 365 U.S. 567 (1961)(tying arrangement between sales and service permitted during initial stages of business to establish community television antennas). Note the new business and failing company exceptions of *Schwinn* and *see* text accompanying notes 74-75 *supra,* although at least one court has intimated that such exceptions may not be applicable when considering horizontal territorial restrictions. Sulmeyer v. Coca Cola Co., 515 F.2d 835, 846 (5th Cir. 1975), *cert. denied,* 424 U.S. 934 (1976).

115. United States v. Pan American World Airways, Inc., 193 F. Supp. 18, 34 (S.D.N.Y. 1961), permitted two U.S. airlines to divide routes in an effort to penetrate the South American market. The impact of this decision is diminished, however, by the fact that the later creation of the Civil Aeronautics Board provided an administrative mechanism for accomplishing the same result. In fact the Supreme Court reversed the above decision on the grounds that the issues were within the primary jurisdiction of the C.A.B. 371 U.S. 296 (1963).

decision creates a new exception for territorial restraints employed by a functionally unified enterprise.[116] Although the vertical/horizontal distinction constitutes a substantial factor in judging functional unity, that distinction alone is not determinative of the test of illegality to be applied to the restraint. Consequently, although the Alpha/Beta allocation appears to be horizontal in nature,[117] that fact does not in itself prevent the scheme from coming within the *Continental TV* exception.

Admittedly, at least where independent retailers are involved, *Continental TV* expressly preserves the per se bar to horizontal territorial allocations:[118]

> There may be occasional problems in differentiating vertical restrictions from horizontal restrictions originating in agreements among the retailers. There is no doubt that restrictions in the latter category would be illegal *per se* [citations omitted], but we do not regard the problems of proof as sufficiently great to justify a *per se* rule.[119]

Nonetheless, the Court's reservations concerning proof problems expressed in this statement exhibit the Court's concern over employing the horizontal/vertical distinction as the determinative fact in territorial market allocation analysis. The Court's statement implicitly recognizes that in the final analysis all territorial market restraints are horizontal: they all allocate territories between competitors at the same level of the distribution chain. Consequently, if one admits that vertical territorial franchising arrangements can be permissible, then horizontal, territorial franchising arrangements must be potentially permissible as well. Since both schemes have the same final "horizontal" competitive impact, then so must both schemes be judged by the same antitrust test.

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116. The Court rejected the *Schwinn* rule because it may unduly impede the growth and success of franchise operations—and thereby impede an enterprise's ability to compete in the broader interbrand market. 97 S. Ct. at 2560-61.

117. Admittedly the Alpha/Beta agreement allocates territories horizontally on the manufacturing level. However, since these manufacturers all employ technology built by Alpha and since Alpha retains a financial interest in the proper exploitation of this technology, the agreement retains vertical elements. *See* note 128 *infra*.

118. This is further supported by the fact that *Continental TV* relies heavily on *White Motor*, which had noted also in dictum that horizontal territorial limitations "are naked restraints of trade with no purpose except stifling of competition." 372 U.S. at 263. *But see* United States v. Topco Assocs., 405 U.S. 596, 613, 615 (Burger, C.J., dissenting) where the Chief Justice argues that this dicta of *White Motor* is not precedent.

119. 97 S. Ct. at 2562 n.28.

The practical impossibility of proving a horizontal restraint within a legitimate franchising arrangement confirms the hypothesis that the vertical/horizontal distinction alone can not conclusively determine whether the rule of reason or per se rules will judge the territorial allocation in question. Even prior to *Continental TV* the circuit courts' consideration of the vertical/horizontal factual issue hardly inspired confidence.[120] This factual determination becomes virtually impossible now that *Schwinn* has been overruled. Assuming that rule of reason requirements are met, a new manufacturer can now establish explicit territories at the outset of a franchising venture, rendering unnecessary any conspiracy between franchisee retailers. Similarly, established businesses no longer need employ the charade of denying franchise applications in order to maintain an illicit territorial market allocation; they can now explicitly allocate territories among their retailers. How will it be possible to show that this new business structure was prompted by a conspiracy of the retailers and not by the independent business judgment of the manufacturer?[121]

Whereas the superficial horizontal/vertical distinction makes no logical or practical sense, a test addressing the functional unity of the enterprise does. The governing factual issue becomes the intrabrand nature of the restraint, not the horizontal nature of the restraint. As *Continental TV* so carefully pointed out, only the clear anticompetitive impact of a given type of restraint invokes per se rules.[122] Since territorial allocations between franchisees will have the same effect on competition regardless of whether the franchisor or the franchisee first conceived the restraint, the vertical/horizontal distinction serves no meaningful function. The intrabrand test, however, draws a meaningful economic distinction and therefore can serve to differentiate rule of reason from per se restraints. Although noting the vertical character of Sylvania's restraint, the basic rationale behind *Continental TV's* rejection of *Schwinn* was the differing economic impact of interbrand and intra-

120. *See* cases cited in notes 90 & 91 *supra*. Specifically, *compare* Quality Mercury, Inc. v. Ford Motor Co., 542 F.2d 466 (8th Cir. 1976) *with* Salco Corp. v. General Motors Corp., 517 F.2d 567 (10th Cir. 1975). *See also* Sheldon Pontiac v. Pontiac Motor Div., 418 F. Supp. 1024 (D.N.J. 1976).

121. *See* discussion of exclusive franchising in Louis, *supra* note 1, at 286-87.

122. *See* text accompanying notes 98-100 *supra*.

brand territorial allocations.[123] A restraint limited to intrabrand competition can nonetheless enhance interbrand competition and thereby generate a a net procompetitive impact.[124] Presumably a territorial restraint of an interbrand nature could not generate such beneficial results and therefore would still be illegal per se. Since only the intrabrand distinction corresponds to a similar distinction in competitive impact, the intrabrand distinction must afford the test for determining the applicability of rule of reason analysis.[125]

By ignoring the vertical/horizontal issue and focusing instead on the intrabrand/interbrand issue, the *Continental TV* opinion obtains a certain degree of logical coherence. As noted above, it would be absurd in practice to attempt to enforce a total ban against horizontal allocations among franchisees. However, the Court's statement that horizontal restraints between retailers continue to be illegal per se makes sense if viewed as a statement that *existing* competitors cannot use the creation of a brand name as a conduit to validate an otherwise impermissible horizontal market allocation.[126] Similarly, the Court's statement that the intrabrand rule applies only to products from a *particular* manufacturer merely reiterates the Court's desire to prevent combinations between existing competitors, but permit allocations among elements of a functionally unified business enterprise.[127] Therefore, as long as a business employs market allocations only as part of a functionally integrated expansion effort by that business, rule of reason analysis will judge that restraint.

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123. *See* text accompanying notes 99-103 *supra.*

124. 97 S. Ct. at 2560.

125. "[A]n antitrust policy divorced from market considerations would lack any objective benchmarks." *Id.* at 2560 n.21. Note also that the intrabrand distinction will be relatively easy to apply to actual factual controversies.

126. This would essentially cover the scheme employed by Topco. *See* text accompanying notes 76-85 *supra.*

An interesting issue is whether the specific plan struck down in *Topco* would now be condemned by the *Continental TV* Court as well. Although *Continental TV* cited *Topco* with approval, 97 S. Ct. at 2562 n.27 & n.28, the policies expressed in *Continental TV* are quite similar to Chief Justice Burger's dissent in *Topco* and would seemingly call the *Topco* decision into question. 405 U.S. at 613. In fact a basic premise of *Topco* was the Court's inability to weigh "destruction of competition in one sector of the economy against promotion of competition in another sector." *See* text at note 82 *supra.* Since *Continental TV's* intrabrand rule expressly assumes that courts can make such judgment, the basic rationale of *Topco* has apparently been eliminated.

127. *See* text accompanying notes 122-125 *supra.*

COMPLYING WITH THE CONTINENTAL TV EXCEPTION

Whereas the Alpha/Beta agreement could meet a vertical restraint exception only through strained construction of the agreement,[128] the functionally integrated intrabrand exception can be met easily by structuring the agreement according to the intrabrand requirement of *Continental TV.* Three basic integrative features are required:

(1) The contracting parties must all service the same brandname;

(2) the contracting parties must have been created to profitably exploit that brandname; and

(3) the originator of the brand—and of the restraint—must retain a financial interest in the success of the other contracting parties.

By following these rules an enterprise would restrict the territorial allocation to use by a functionally unified business entity that would in turn fall within the economic rationale of *Continental TV's* intrabrand exception. The restraint will be designed to promote competition, not foreclose competition, and therefore warrants rule of reason analysis. These rules deserve a more extensive explanation.

First, the most obvious requirement is that Alpha and the Betas manufacture under the same trademark or trade name. Without creating a single "brand" it will be impossible for the Alpha/Beta group to fall within the intrabrand exception. The restraint would then have to be justified under one of the extraordinary exceptions to the per se rules noted above.[129]

Second, the Betas must be new enterprises. As *Topco* aptly illustrates, and as *Continental TV* implies, the creation of a brand name by existing competitors to enforce territorial arrangements remains illegal per se.[130] As an example, international cartel cases such as *United States v. Bayer* have specifically held that trademark licensing cannot be used as a subterfuge for worldwide territorial allocations among *existing* competitors.[131]

128. The maintenance of an equity interest by Alpha in the Betas may qualify the restraint as vertical in the view of some, as theoretically the equity interest may deter any deleterious impact on output from the actual operation of the restraint. Bork, *supra* note 7, at 424-25. *See* note 117 *supra.*

129. *See* text accompanying notes 113-115 *supra.*

130. *See* text accompanying notes 76-85 *supra* and notes 126-127 *supra.*

131. United States v. Bayer Co., Inc., 135 F. Supp. 65 (S.D.N.Y. 1955). *See*

However, creation of new "competitors" preserves the character of the enterprise as the expansion of a single business. In fact some courts have held that one who receives necessary licensed technology from an alleged conspirator,[132] or one who is permitted to do business at the suffrance of an alleged conspirator,[133] is not in fact a competitor of that conspirator such that an agreement between the two would invoke Sherman Act liability.[134]

Although the validity of such a relaxed definition of competitor is suspect,[135] the policy behind the view is not. *United States v. DuPont*[136] provides an illustration. Among the issues in this famous cellophane case was whether the origin of DuPont's dominating position in cellophane had developed lawfully. A French company, La Cellophane, licensed DuPont to manufacture cellophane in the United States. Incident to this contract the parties agreed to the territories in which each would be permitted to sell the product. The district court held that such territorial restraints were not illegal:

> It is not the purpose of the Sherman Act or the common law of restraints of trade to discourage establishment of a new business in a new territory. Trade secrets have always been considered in the nature of a property right. Among the ancillary restraints which are considered reasonable, both under common law and

Farbefabriken Bayer v. Sterling Drug, Inc., 197 F. Supp. 613 (D.N.J. 1961), *aff'd on other grounds,* 307 F.2d 207 (3d Cir. 1962), *cert. denied,* 372 U.S. 929 (1963). *See also* United States v. Sealy, Inc., 388 U.S. 350 (1967).

132. Foundry Services, Inc. v. The Beneflux Corp., 110 F. Supp. 857 (S.D.N.Y.), *rev'd on other grounds,* 206 F.2d 214 (2d Cir. 1953).

133. Evans v. S.S. Kresge, 544 F.2d 1184 (3d Cir. 1976).

134. *See also* San Francisco Seals, Ltd. v. National Hockey League, 379 F. Supp. 966, 970 (C.D. Cal. 1974): Members of the National Hockey League are not competitors for the purposes of the antitrust laws. "[T]he organizational scheme of the National Hockey League, by which all its members are bound, imposes no restraint upon trade or commerce in this relevant market [professional hockey games in the United States and Canada], but rather makes possible a segment of commercial activity which could hardly exist without it."

135. For example, in discussing restraints between a parent and an independently owned offspring, the Supreme Court noted:

> We may also assume, though the question is a new one, that a business entity generally cannot justify restraining trade between itself and an independently owned entity merely on the ground that it helped launch that entity, by providing expert advice or seed capital.

United States v. Citizens & Southern Nat'l Bank, 422 U.S. 86, 117 (1975).

136. 118 F. Supp. 41 (D. Del. 1953), *aff'd,* 351 U.S. 377 (1956).

> the Sherman Act, are those which limit territory in which the contracting parties may use the trade secret.[137]

In terms of its specific holding *DuPont* is not precedent for the Alpha/Beta agreement. First, *DuPont* involved the transfer of a trade secret, a property right; this essay assumes that the technology transferred to the Betas will not be of such a character to warrant treatment as a property right, trade secret, or patent.[138] Secondly, given the limits which the courts have placed on the scope and extent of trade secret rights, the continued vitality of the *DuPont* holding itself is questionable.[139]

Nonetheless, the policy behind *DuPont* remains appropriate for defining the intrabrand exception. The *DuPont* court focused on the fact that although DuPont and La Cellophane may have been potential competitors, they were not in fact competitors at the time of the agreement. Therefore, rather than viewing the agreement as an anticompetitive restraint, the court applauded "the creation of the American cellophane industry."[140] The agreement was a joint venture, the purpose of which "was the development and exploitation of a new business to function in American markets."[141] Consequently, by creating competitors rather than organizing existing competitors, one attains the aura of expansion of a single enterprise, at least in practical effect. This distinction between creating new competitors and regulating old competitors creates a legit-

137. 118 F. Supp. at 219.

138. Much technology sought by developing countries is not of a nature that would customarily receive U.S. property right protection. *See* Goekjian, *supra* note 11.

139. A patent can support a territorial restraint in foreign commerce. Dunlop Co., Ltd. v. Kelsey-Hayes Co., 484 F.2d 407, 417 (6th Cir. 1973), *cert. denied,* 415 U.S. 917 (1974); Brownell V. Ketcham Wire & Mfg. Co., 211 F.2d 121 (9th Cir. 1954); United States v. L.D. Caulk Co., 126 F. Supp. 693 (D. Del. 1954); American Optical Co. v. New Jersey Optical Co., 58 F. Supp. 601 (D. Mass. 1944). This rule is presumably limited by the domestic rule that the restraint can only extend to the licensee, not his customers. *See* Hensley Equipment Co. v. Esco Corp., 383 F.2d 252, 263 (5th Cir. 1967); American Industrial Fastener Corp. v. Flushing Enterprises, Inc., [1973-2] Trade Cases (CCH) ¶ 74,619 (N.D. Ohio 1973).

However, these permissible restraints derive from the monopoly power expressly granted by statute. A trade secret, lacking that statutory grant, cannot generally be used to enforce restraints of trade. Dr. Miles Medical Co. v. Hohn D. Park & Sons Co., 220 U.S. 373, 400-02 (1911). *See* United States v. Hughes Tool Co., [1958] Trade Cases (CCH) ¶ 69,001 (S.D.N.Y. 1958), where in a consent decree defendant agreed not to restrain the imports of persons to whom it had licensed trade secrets.

140. *Id.* at 220.

141. *Id.*

imate integrated interest, distinguishing the enterprise from an illegal per se *Topco* restraint.[142]

Third, the final requirement to forestall antitrust liability is an equity interest by Alpha in each of the Betas. Preferably, this interest should be to the fullest extent permitted by local law. The *Continental TV* rule applies to products of a "particular manufacturer." By integrating to the fullest extent possible, an enterpise not only enhances its character as a functionally unified business, but also forestalls arguments that the overseas expansion unreasonably absorbs enterprises that would otherwise be potential, if not actual, competitors.[143]

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142. *See* Kestenbaum v. Falstaff Brewing Corp., 514 F.2d 690 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976). In *Kestenbaum* the court refused to judge by a per se rule efforts by a brewer, Falstaff, to establish a price ceiling on the sale of its distributorships:

> Under the particular facts of the case sub judice, where the price fixer must extend the very distribution-rights privilege which gave Kestenbaum's busines its value, any restraint legitimately imposed to safeguard that privilege does not have such a deleterious impact as to create illegality as a matter of law. Rather, this type of situation necessitates an inquiry into the business purpose and reasonableness of the restraint employed, and must be measured under the rule of reason standard.

Id. at 696. The combination of the fact that the rights sold were created by Falstaff, with the legitimate self interest of Falstaff in insuring the success of its franchisees, precluded the per se rule normally applied in price fixing cases:

> It logically follows that Falstaff has a right to restrict the sales price of one of its distributorship franchises to the reasonable value of that franchise in order to insure that the purchaser will have a chance to realize a reasonable return on his investment. Falstaff clearly has a strong interest in the financial vitality of a new franchisee. If the purchaser of a franchise makes a bad bargain when he buys, then he cannot give the distributorship the solid, concerned management which it must have to be successful for him and to enhance Falstaff's image and relative position in the market.

Id. Admittedly the *Falstaff* restraint lacks the clear horizontal implications of the Alpha/Beta allocation; in practical effect the price ceiling benefitted only Falstaff. However, the case nonetheless stands for the willingness of the courts to refrain from per se rules when the restraints are imposed by a parental enterprise seeking to insure the success of the entire multienterprise operation. *See* discussion of *Citizens and Southern Nat'l Bank* at text accompanying notes 145-157 *infra;* Worthen Bank & Trust Co. v. National Bankamericard, Inc., 485 F.2d 119 (8th Cir. 1973), *cert. denied,* 415 U.S. 918 (1974). *See also* Akron Tire Supply Co. v. Gebr. Hofmann KG, 390 F. Supp. 1395, 1402 (N.D. Ohio 1974), which stated that the old *Schwinn* rule applied only to territorial restraints which limited competition between distributors; territorial restraints limiting competition between a manufacturer and its distributors are judged by the rule of reason.

143. United States v. Penn-Olin Chemical Co., 378 U.S. 158 (1964), established the modern rule that joint ventures may violate the merger provison, section 7 of the

As *Timken* aptly illustrates, even a substantial equity interest is not in itself sufficient to certify an enterprise as unified to the extent necessary to avoid antitrust liability. However, when practical or legal considerations prevent expansion by means of a fully integrated company, a lesser standard of unity should be required. *Continental TV* implies as much; when justifying its rejection of *Schwinn,* the Court expressly noted that per se analysis may well bar the entry of smaller enterprises, which would not be able to avoid the rule against market allocations by integrating to the extent required by *Schwinn.*[144]

Perhaps more directly on point, however, is the Supreme Court's holding in *United States v. Citizens & Southern National Bank.*[145] C & S National Bank had tried to avoid a state law which prohibited branch banking. The law limited to five percent ownership of a bank's stock by a bank holding company. In response C & S established a number of "five percent banks," in which C & S owned five percent of the stock, and C & S officers, shareholders, and friends owned substantial portions of the rest. At the time these banks were established

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Clayton Act, when the impact of the joint venture arrangement unduly diminishes potential competition in an industry. Thus, even when one or both of the joint venturers would not in fact have entered the market by themselves, if the enterprises serving the market thought that either or both *might* enter the market, that threat of potential entry will exert a procompetitive impact on the marketplace. If the procompetitive impact of one new competitor cannot outweigh the anticompetitive impact of the elimination of two potential competitors, then the joint venture may violate the Clayton Act. *See* United States v. Falstaff Brewing Co., 410 U.S. 526 (1973).

Applying the same analysis to the Alpha/Beta scheme, Alpha must maintain a substantial equity interest in each of their Betas in order to avoid a potential competition attack. If Alpha maintains only a token equity interest in each of the Betas, then each new Beta, or more specifically the investment capital that formed the Beta, represented a potential competitor of Alpha and the other member of the industry. Since the Alpha/Beta market allocation eliminates this competition—at least as concerns Alpha—Penn-Olin reasoning may apply to strike down the restraint and the joint venture. (Note that one does not already have to be a member of the industry in order for the potential competition rule to apply, *see* FTC v. Proctor & Gamble Co., 386 U.S., 568 (1967)).

On the other hand, by maintaining a major equity interest, Alpha can argue that without its investment capital and without its technology the Betas not only could not have entered the market, but could not have been expected to enter the market. Therefore the Alpha/Beta agreement eliminates no significant potential competition.

144. "Capital requirements and administrative expenses may prevent smaller firms from using the exception" to *Schwinn* where the manufacturer retains title. 97 S. Ct. at 2561.

145. 422 U.S. 86 (1975).

it was understood that they would be acquired by C & S as soon as the law permitted.[146] When the law was indeed changed, C & S sought to acquire its *de facto* branches. The Justice Department challenged the acquisition under section 7 of the Clayton Act, and further alleged that the ongoing cooperative relationship between C & S and its *de facto* branches violated section 1 of the Sherman Act, claiming in part a conspiracy to fix interest rates and prices, as well as an unreasonable amount of cooperation embodied in the bank's service agreements.[147]

Although the Supreme Court was aided by the district court's determination that the alleged price restraints had in fact not occurred,[148] the Court's ruling upholding the C & S *de facto* branch service agreements implied that even price fixing liability would not have been imposed on the conspirators due to the unusual legal constraints under which C & S had to operate. In judging the unreasonable cooperation claim, the Court noted that the banks in question would not have been created but for the impetus of C & S' efforts.[149] As the Court recognized, this fact does not normally immunize restraints between possible competitors from antitrust liability.[150]

> But these general principles do not dispose of the present case. C & S was absolutely restrained by state law from reaching the suburban market through the preferred process of internal expansion. De facto branching was the closest available substitute.[151]

Construing Georgia's banking law as a horizontal territorial market division, per se illegal if done by private parties, the Court found the cooperation between C & S and its branches to be entirely reasonable: "To characterize these relationships as an unreasonable restraint of trade is to forget that their whole purpose and effect was to *defeat* a restraint of trade."[152]

Citizens & Southern is distinguishable from the Alpha/Beta restraint. The services agreement which the above-cited language addressed was already sanctioned in part by the banking laws;[153] the Court was not considering the validity of

146. *Id.* at 91-93.
147. *Id.* at 96-97.
148. *Id.* at 112-15.
149. *Id.* at 111.
150. *See* note 135 *supra; id.* at 117.
151. *Id.* at 117.
152. *Id.* at 118.
153. *Id.* at 114-15.

an alleged per se restraint of trade.[154] However, once again the policy behind the *Citizens & Southern* decision would permit the territorial restaints sought to be employed by the Alpha/Beta group. The Court noted that the C & S *de facto* branching program was procompetitive; it created new outlets in the suburbs thereby increasing consumer choice. Similarly, the Alpha/Beta enterprise is designed to create new manufacturing units toward a procompetitive end. Although the Betas would not compete between themselves, the restraint would generally enhance the group's ability to compete in a greater number of foreign markets. Additionally, one must consider the broader policy incentives of distributing profits and industrial capacity to competitively underprivileged countries.

Because of the ultimate procompetitive impact, unified expansion within the confines of legally imposed equity limits apparently justifies market restraints normally permitted only in fully integrated enterprises. When the government suggested that C & S could have developed less restrictive agreements with its *de facto* branches, the Court responded in part that it would be unrealistic to expect C & S to create new branches that would fully compete with itself.[155] Thus, when local law made internal expansion impossible, it was not only proper to create *de facto* outlets, but permissible as well to limit their competitive impact on the *de facto* parent. If this indeed is the general rule to be derived from *Citizens & Southern National Bank*, then the Alpha/Beta territorial restrictions would apparently be sanctioned as reasonable restraints designed to immunize a parent from the competition of its offspring. Admittedly, sponsorship alone creates no antitrust immunity; "otherwise the technique of sponsorship followed by restraint might displace internal growth as the normal and legitimate technique of business expansion, with unknowable consequences."[156] However, when local law prevents such internal growth, presumably even territorial restraints limiting competition with the parent become valid. Thus the Alpha/Beta restraint also becomes valid where Alpha integrates to the fullest extent permitted by local law.[157]

154. *Id.* at 116.
155. *Id.* at 119.
156. *Id.* at 117.
157. *Citizens and Southern* potentially broadens the impact of the following state-

Even assuming that the *Citizens & Southern* rule cannot by itself legitimize a per se restraint such as a territorial allocation, the analysis of *Citizens & Southern* supports a characterization of the Alpha/Beta scheme as a functionally integrated enterprise within the *Continental TV* intrabrand exception. As noted above, *Continental TV* defines intrabrand competition in terms of the product of a particular manufacturer. Given the Court's analysis of the practical realities behind Citizens and Southern's *de facto* branching program, the Alpha/Beta program of expansion could also be viewed as the expansion of one basic enterprise that would qualify for lenient intrabrand treatment. One might even argue that *Continental TV's* endorsement of franchising limits the *Citizens & Southern* dictum barring sponsorship followed by restraint, at least where the agreement would pose no potential competition problems.[158]

Finally, although perhaps not required, one further step should be taken by the Alpha/Beta group to insure immunity from the per se territorial rule: The territorial allocation agreement should run only for a term of years, preferably no longer than the useful life of the original manufacturing facility to be established by Alpha for the Betas. One of the principal arguments for per se rules is that even though a given restriction may be currently reasonable in its impact, there is nothing to

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ment in *3M:*

> With part of the defendants' argument there can be no legitimate quarrel. It is axiomatic that if over a sufficiently long period American enterprises, as a result of political or economic barriers, cannot export directly or indirectly from the United States to a particular foreign country at a profit, then any private action taken to secure or interfere solely with business in that area, whatever else it may do, does not restrain foreign commerce in that area in violation of the Sherman Act. For the very hypothesis is that there is not and could not be any American foreign commerce in that area which could be restrained or monopolized.

United States v. Minnesota Mining & Mfg. Co., 92 F. Supp. 947, 958 (D. Mass. 1950). This statement in *3M* permits only restraints that are specifically designed to avoid foreign government prohibitions. Presumably, at least in the case of equity restriction, *Citizens and Southern* would also permit restraints ancillary to compliance with those restrictions. Theoretically, in certain circumstances, territorial market allocations would constitute such a reasonable ancillary restraint.

158. In other words, expansion thru sponsorship and restraint would be permissible as long as the new businesses were not potential competitors. The arrangement would increase production in an industry without eliminating any existing competition, real or potential. In fact future courts may wish to employ potential competition analysis as a means of judging the reasonability of intrabrand restraints. *See* note 143 *supra*.

prevent unreasonable use of that restriction in the future.[159] By restricting the duration of the restraint this rationale for imposing per se analysis on the Alpha/Beta restraint is undermined. Certainly the time limitation will also aid justification of the restraint based on a rule of reason test.

CONCLUSION

The *Continental TV* decision, by heralding a reexamination of the per se rules concerning territorial restraints, provides a mechanism whereby the discriminatory impact of the per se rules against LDC enterprises can be redressed. Arguably the rationale of *Continental TV* alone precludes per se analysis in the international arena in noncartel situations. However, even absent such a broad reading, LDC enterprises can now possibly escape the per se bar to territorial allocations by structuring the enterprise as a functionally integrated unit using intrabrand restraints. Although a territorial restraint which concerns only intrabrand competition does not in itself escape per se analysis, one can avoid being characterized as a *Topco* horizontal association by "conspiring" only with newly created enterprises. One further meets the "particular manufacturer" requirement of *Continental TV* by integrating into a single entity to the maximum extent permitted by local law. Consequently, by following these suggestions, and by further limiting the duration of the territorial restraint, a U.S. firm can expand into LDCs thru the form of an Alpha/Beta agreement with reasonably confident expectations that one has complied with the demands of the antitrust laws.

159. United States v. Topco Assoc., 405 U.S. 596, 611 (1972); United States v. Trenton Potteries Co., 273 U.S. 392, 397 (1927).