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Developments in Antitrust Law

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DEVELOPMENTS IN ANTITRUST LAW

I. *Introduction*

In this survey period the Supreme Court affirmed the Court of Appeals for the Tenth Circuit's analysis of vertical nonprice restraints. The Tenth Circuit had ruled in *Westman Commission Co. v. Hobart International, Inc.*[1] that a manufacturer's refusal to grant a dealership to a distributor was not a per se violation of section one of the Sherman Act,[2] even though the refusal came at the urging of a competing distributor. The Tenth Circuit held that " 'in the absence of any evidence of intent to raise prices . . . an agreement whereby a supplier of some good or service refuses, at the behest of one of his distributors, to deal with a competitor of that distributor is not illegal per se.' "[3] This approach to vertical nonprice restraints had been used in the Fifth, Seventh, and Eighth Circuits; it was in contrast to the approach of the Third and Ninth Circuits, which had held that such refusals were per se violations.[4] This conflict between the circuits was resolved when the Supreme Court decided *Business Electronics Corp. v. Sharp Electronics Corp.*[5]

II. WESTMAN COMMISSION CO. V. HOBART INTERNATIONAL, INC.: A SPLIT IN THE CIRCUIT COURTS

A. *Background*

Westman Commission Co. v. Hobart International, Inc. arose out of a distributor's claim that a manufacturer's refusal to grant it a dealership was an illegal restraint of trade.[6] Hobart International, Inc. ("Hobart"), a manufacturer of food service equipment, sells its products through approximately 540 independent dealers in the United States and is considered to be "the preeminent manufacturer" in the industry.[7] Hobart had eight dealers in the Denver, Colorado area at the time it refused to grant Westman Commission Company ("Westman") a dealership.[8]

Westman, a wholesale grocery supplier, had entered the food service equipment supply business in 1973 by purchasing the assets of the WE-4 division of Wilscam Enterprises, Inc.[9] The WE-4 division had dis-

1. 796 F.2d 1216 (10th Cir. 1986), *cert. denied*, 108 S. Ct. 1728 (1988). At the district court level, *Westman* was bifurcated into liability (*Westman I*) and damages (*Westman II*) segments. *Westman I*, 461 F. Supp. 627 (D. Colo. 1978), is discussed in this article.

2. 15 U.S.C. §§ 1-7 (1982).

3. *Westman*, 796 F.2d at 1223 (quoting Products Liability Ins. Agency v. Crum & Forster Ins. Cos., 682 F.2d 660, 663 (7th Cir. 1982)).

4. *See* Cernuto, Inc. v. United Cabinet Corp., 595 F.2d 164 (3d Cir. 1979); Zidell Exploration, Inc. v. Conval Int'l, Ltd., 719 F.2d 1465 (9th Cir. 1983).

5. 108 S. Ct. 1515 (1988).

6. 461 F. Supp. 627, 628 (D. Colo. 1978), *rev'd*, 796 F.2d 1216 (10th Cir. 1986), *cert. denied*, 108 S. Ct. 1728 (1988).

7. *Westman I*, 461 F. Supp. at 628.

8. *Id.* at 629.

9. *Id.* at 628.

tributed Hobart products on an informal basis[10] before it was acquired by Westman. Westman also distributed Hobart products on this basis after it acquired the WE-4 division and attempted to conclude a formal dealership agreement with Hobart.[11] However, after complaints by another Hobart dealer in the area, Hobart ultimately informed Westman that it did not intend to offer Westman a dealership.[12]

Westman brought a private action under section one of the Sherman Act,[13] alleging that Hobart and Nobel, the competing distributor, had conspired to keep Westman out of the food service equipment supply market.[14] Nobel was Hobart's most successful dealer in the area and had urged Hobart to deny Westman a dealership, claiming that the additional dealership would jeopardize Hobart's relationship with Nobel.[15]

The district court determined that the relevant market was "one-stop shopping,"[16] and held that Hobart's refusal to grant Westman a dealership had the effect of excluding Westman from the market.[17] The court held that this refusal to deal, at Nobel's prompting, was a conspiracy in restraint of trade and thus a per se violation of the Sherman Act.[18]

Although the court had found a per se violation, it went on to perform a 'rule of reason' analysis of Hobart's refusal to grant Westman a dealership.[19] In applying a 'rule of reason' analysis, a court must consider what procompetitive benefits are made available as a result of the alleged anticompetitive practice.[20] Hobart claimed that its refusal to grant Westman a dealership was based on several reasons: that it "had doubts about Westman's ability to pay for Hobart purchases," that it

10. "Although Hobart had been accepting orders from the WE-4 division as if it were a formal Hobart dealer, a sales agreement form had never been signed by Wilscam Enterprises." *Id.* at 629.

11. *Id.* at 630.

12. Westman Comm'n Co. v. Hobart Int'l, Inc., 796 F.2d 1216, 1219 (10th Cir. 1986), *cert. denied*, 108 S. Ct. 1728 (1988).

13. 15 U.S.C. § 1 (1982) provides in pertinent 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. Every person who shall make any contract or engage in any combination or conspiracy hereby declared illegal shall be deemed guilty of a felony.

14. *Westman*, 796 F.2d at 1219.

15. *Id.*

16. This is "a recognized distinct market wherein a purveyor can supply a customer in the institutional food service or restaurant business with all requisite equipment and supplies." *Westman I*, 461 F. Supp. 627, 628 (1978), *rev'd*, 796 F.2d 1216 (10th Cir. 1986), *cert. denied*, 108 S. Ct. 1728 (1988).

17. *Id.* at 636.

18. *Id.*

19. *Id.*

20. The 'rule of reason' was first stated by Justice Brandeis in Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918):

> The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable.

Id. at 238.

"had adequate coverage in the [Denver] area," and that it "doubted Westman's loyalty to the Hobart line."[21] The court determined that these reasons for denying Westman the dealership were but a pretext for an anticompetitive purpose.[22]

B. Analysis: The Tenth Circuit Opinion

The district court's opinion was appealed by Hobart to the Court of Appeals for the Tenth Circuit.[23] The Tenth Circuit, in an opinion by Judge Monroe McKay, reversed the lower court without remanding.[24]

At the outset of its opinion the court stated that the purpose of the antitrust laws was "the promotion of consumer welfare"[25] and that it would consider Hobart's refusal to grant Westman a dealership in terms of its effect on consumers rather than competitors.[26] The court examined the district court's conclusion that Hobart had excluded Westman from the market and determined that the lower court had misidentified the relevant product and geographic markets. The product market was not strictly "full-line distribution"; nor was the geographic market limited to the Denver area.[27] The appellate court held that these conclusions were the result of identifying the market from the perspective of the distributor rather than the consumer.[28]

Although Hobart had not excluded Westman from the market, it had terminated Westman as a distributor in response to Nobel's threat that making Westman a dealer would "jeopardize" Hobart's relationship with Nobel.[29] The appellate court thus had to consider the agreement between Hobart and Nobel, and determine whether Hobart's refusal to deal was a per se violation of the Sherman Act.

The court noted that other circuits had split on the question of whether a manufacturer's refusal to deal with a distributor was a per se violation when the refusal came at the urging of a competing distributor. The Fifth, Seventh, and Eighth Circuits had held that refusals to deal were not per se violations; the Third and Ninth Circuits had held that they were.[30] The court stated that it agreed with those circuits that rejected the per se approach.[31]

After reviewing the basis for various circuit rulings, it pointed out that the rationale for applying the per se approach was almost always the

21. *Westman I*, 461 F. Supp. at 637.
22. *Id.* at 636.
23. Westman Comm'n Co. v. Hobart Corp., 796 F.2d 1216 (10th Cir. 1986), *cert. denied*, 108 S. Ct. 1728 (1988).
24. *Id.* at 1228.
25. *Id.* at 1220.
26. *Id.*
27. *Id.* at 1220-22.
28. *Id.* at 1220-21.
29. *Id.* at 1221.
30. *Id.* at 1223.
31. "After weighing the conflicting authorities, we choose to align ourselves with the Seventh Circuit." *Id.* at 1222-1223. The Fifth Circuit had also rejected the per se approach. *Id.* at 1223.

presence of price-fixing motives.[32] The court stated that its rejection of the per se approach was supported by the recent Supreme Court decision in *Monsanto Co. v. Spray-Rite Service Corp.*[33] "In *Monsanto*, the Court held that a plaintiff could not survive a directed verdict by merely establishing that a manufacturer terminated a price-cutting distributor in response to complaints of a competing distributor."[34] Quoting from the Fifth Circuit's decision in *Business Electronics Corp. v. Sharp Electronics Corp.*,[35] the court emphasized that "[n]othing in *Monsanto* suggests that liability can be found without any evidence of a price fixing agreement. Rather the language of *Monsanto* can only indicate the Court's belief that *a price fixing agreement is a requirement for per se liability* in distributor termination cases."[36]

Applying this approach to Hobart's refusal to grant Westman a dealership, the Tenth Circuit stated that "[s]ince the record reveals not the slightest hint of price maintenance or price fixing, Hobart's refusal to deal cannot be illegal per se."[37]

The court then explained why a 'rule of reason' analysis was particularly appropriate to refusal-to-deal cases. It pointed out that "sound economic theory" supported "allow[ing] suppliers wide latitude in selecting their distributors"[38] and that the Supreme Court had recognized this in *Continental T.V. v. GTE Sylvania, Inc.*[39] "[E]ven though these refusals to deal may limit intrabrand competition, they are likely to benefit consumers by increasing interbrand rivalry."[40] Some of the procompetitive effects of refusals to deal are "allowing each distributor to achieve economies of scale and to spread out fixed costs over a large amount of products," "facilitat[ing] the entry of new manufacturers into the market," "encourag[ing] distributors to provide promotional activities, consumer information, and product service," and "reduc[ing] transaction costs . . . ."[41]

III. Business Electronics Corp. v. Sharp Electronics Corp.

In its rationale for rejecting the per se approach to vertical nonprice restraints, the Tenth Circuit cited the Fifth Circuit's "extensive and well-reasoned" opinion in *Business Electronics Corp. v. Sharp Electronics Corp.*[42] *Business Electronics* was ultimately appealed to the Supreme Court and the Court's opinion was dispositive not only of that case, but also of *Hobart*

32. *Id.*
33. 465 U.S. 752 (1984).
34. Westman Comm'n Co. v. Hobart Int'l, Inc., 796 F.2d 1216, 1224 (10th Cir. 1986), *cert. denied*, 108 S. Ct. 1728 (1988).
35. 780 F.2d 1212 (5th Cir. 1986), *aff'd*, 108 S. Ct. 1515 (1988).
36. *Westman*, 796 F.2d at 1224 (quoting Business Elec. Corp. v. Sharp Elec. Corp., 780 F.2d 1212, 1218 (5th Cir. 1986), *aff'd*, 108 S. Ct. 1515 (1988)).
37. *Id.*
38. *Id.* at 1226.
39. 433 U.S. 36 (1977).
40. *Westman*, 796 F.2d at 1227.
41. *Id.*
42. 780 F.2d 1212 (5th Cir. 1986), *aff'd*, 108 S. Ct. 1515 (1988).

and another case.[43]

A. *Background*

Business Electronics Corporation was the sole retailer of Sharp electronic calculators and business equipment in the Houston area until 1972, when Sharp appointed Gilbert Hartwell as a second retailer. After Hartwell had sold Sharp products for a while, he began to complain to Sharp about Business Electronics' price cutting: Hartwell complained that Business Electronics was " 'free riding' on Hartwell's investment in product promotion and other sales-related services."[44] Eventually Hartwell gave Sharp an ultimatum: terminate Business Electronics as a retailer, or Hartwell would cease to sell Sharp products. Sharp terminated Business Electronics.[45]

Business Electronics brought an action alleging that Sharp had violated section one of the Sherman Act[46] by agreeing with Hartwell to terminate Business Electronics.[47] Sharp responded to these allegations by claiming that it had terminated Business Electronics for several reasons not related to any attempt to set resale prices. These included dissatisfaction with Business Electronics' failure to meet sale quotas, as well as its discounting practices.[48]

The issue of liability was submitted to the jury as an instruction that there is a per se violation of the Sherman Act when a supplier agrees to terminate a price cutting dealer at the prompting of another dealer.[49] The jury found that there was an agreement between Sharp and Hartwell to terminate Business Electronics because of its price cutting.[50]

B. Analysis: The Fifth Circuit Opinion

On appeal Sharp presented several issues to the Court of Appeals for the Fifth Circuit. In addition to whether the trial court's application of a per se standard was correct, there were also evidentiary questions and a question regarding the computation of damages.[51] Chief Judge Clark, writing for the court, began this analysis by pointing out that the trial court's finding, "which [did] not require an agreement between

43. McCabe's Furniture, Inc. v. La-Z-Boy Chair Co., 798 F.2d 323, 329 (8th Cir. 1986), *cert. denied*, 108 S. Ct. 1728 (1988).

44. Business Elec. Corp. v. Sharp Elec. Corp., 780 F.2d 1212, 1215 (5th Cir. 1986), *aff'd*, 108 S. Ct. 1515 (1988). "Free riding" is a practice that allows one distributor to take advantage of a competing distributor's expenditures on promotion and services for a product. The free riding distributor is able to sell the product at a lower price because it does not have the cost of the promotion and services it can rely on its competitor to provide.

45. Business Elec. Corp. v. Sharp Elec. Corp., 780 F.2d 1212, 1214-15 (5th Cir. 1986), *aff'd*, 108 S. Ct. 1515 (1988).

46. *See supra* note 13.

47. *Business Electronics*, 780 F.2d at 1214.

48. *Id.* at 1215.

49. *Id.*

50. *Id.* at 1214.

51. *Id.*

Sharp and Hartwell to maintain resale prices, is an incorrect one."[52]

The court noted precedent within the Fifth Circuit and elsewhere that supported its reversal of the district court.[53] It then addressed the fact that two other circuits had taken a contrary view. In *Cernuto, Inc. v. United Cabinet Corp.*,[54] the Third Circuit held that a manufacturer's termination of a dealer in order to protect a requesting dealer was per se illegal.[55] Chief Judge Clark pointed out that the rationale for the *Cernuto* decision was that "if the manufacturer and dealer wish to protect the dealer from price competition then they *must* intend that prices be higher once the price cutting dealer is terminated."[56] Chief Judge Clark then delineated his reasons for disagreeing with this standard. He began by stating that the effect of terminating a price cutter "*may* be to raise prices but this is equally true of the granting of an exclusive dealership, which we have held not to be per se illegal."[57] He next showed how this fit in with recent Supreme Court decisions in *Monsanto Co. v. Spray-Rite Service Corp.*[58] and *Continental T.V. v. GTE Sylvania*.[59]

The court concluded by stating that "in order for a manufacturer's termination of a distributor to be illegal *per se*, it must be pursuant to a price maintenance agreement with another distributor."[60]

IV. The Supreme Court Resolves the Split

The Supreme Court opinion by Justice Scalia began with the Court acknowledging that certiorari was granted to hear *Business Electronics* "to resolve a conflict in the Courts of Appeals regarding the proper dividing line between the rule that vertical price restraints are illegal per se and the rule that vertical nonprice restraints are to be judged under the rule of reason."[61] The opinion then proceeds to draw that line, yet all the while draw away from it.

After recounting the history of the case, the Court stated that the Sherman Act "prohibit[ed] only unreasonable restraints of trade"[62] and that "*per se* rules are appropriate only for 'conduct that is manifestly anticompetitive.' "[63] It pointed out that in its *Continental T.V. v. GTE Sylvania* decision, it had refused to apply a per se rule to a manufacturer's termination of one dealer in connection with an exclusive territory

52. *Id.* at 1215.

53. *See* Borger v. Yamaha Int'l Corp., 625 F.2d 390 (2d Cir. 1980); Aladdin Oil Co. v. Texaco, Inc., 603 F.2d 1107 (5th Cir. 1979); St. Petersburg Yacht Charters, Inc. v. Morgan Yacht, Inc., 457 So. 2d 1028 (Fla. Dist. Ct. App. 1984).

54. 595 F.2d 164 (3d Cir. 1980).

55. *Id.* at 170.

56. *Business Electronics*, 780 F.2d at 1216 (emphasis in original).

57. *Id.* (emphasis in original).

58. 465 U.S. 752 (1984).

59. 433 U.S. 36 (1977).

60. *Business Electronics*, 780 F.2d at 1218 (emphasis in original).

61. Business Elec. Corp. v. Sharp Elec. Corp., 108 S. Ct. 1515, 1517 (1988).

62. *Id.*

63. *Id.* (quoting Continental T.V. v. GTE Sylvania, Inc., 433 U.S. 36, 50 (1977)).

agreement with another dealer.[64] Application of a per se standard was to be "based on demonstrable economic effect rather than . . . formalistic line drawing."[65] In *GTE Sylvania* the Court determined that vertical nonprice restraints did not facilitate cartelization. Rather, "they had real potential to stimulate interbrand competition, 'the primary concern of the antitrust laws.' "[66]

The Court emphasized the importance it gave to the *GTE Sylvania* decision: "We have been solicitous to assure that the market-freeing effect of our decision in *GTE Sylvania* is not frustrated by related legal rules."[67] It then stated that applying a per se rule in the circumstances of *Business Electronics* "would threaten to dismantle the doctrine of *GTE Sylvania*" as well as "discourage conduct . . . recognized as beneficial to consumers."[68] The Court concluded by stating that the Fifth Circuit was correct in applying the 'rule of reason' to refusals to deal when there has been no agreement as to price or price levels.[69]

V. Conclusion

The Supreme Court's decision in *Business Electronics* accomplishes more than the resolution of a split in the Courts of Appeal. Vertical nonprice restraints will now be considered under a 'rule of reason' analysis unless there has been some showing of an agreement as to price or price levels.[70] Along with narrowing the application of per se analysis, the Court has provided a method of analysis for approaching vertical nonprice restraints. This method, as stated in *Business Electronics*, is as follows:

> [T]here is a presumption in favor of a rule-of-reason standard; departure from that standard must be justified by demonstrable economic effect, such as the facilitation of cartelizing . . . interbrand competition is the primary concern of the antitrust laws; and that rules in this area should be formulated with a view towards protecting the doctrine of *GTE Sylvania*.[71]

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64. *Id.*
65. *Id.* (quoting Continental T.V. v. GTE Sylvania, Inc., 433 U.S. 36, 58-59 (1977)).
66. *Id.* (quoting *GTE Sylvania*, 433 U.S. 36, 52 n.19 (1977)).
67. *Id.* at 1520.
68. *Id.* at 1521, 1523.
69. *Id.* at 1525.
70. *Id.*
71. *Id.* at 1520-21.