January 1982

Dual Distribution Systems—Manufacturer-Imposed Restraints on Distributors Require Rule of Reason Analysis

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RECENT DEVELOPMENTS

ANTITRUST LAW—Dual Distribution Systems—Manufacturer-Imposed Restraints on Distributors Require Rule of Reason Analysis. Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001 (5th Cir.), cert. denied, 102 S.Ct. 119 (1981). Liquid Carbonic Corporation (Liquid) manufactured industrial gas products and distributed such products through independent distributors and direct sales.¹ Red Diamond Supply (Red Diamond), one of Liquid's independent dealers, brought suit under federal² and state³ antitrust statutes, alleging that Liquid had conspired with its independent distributors⁴ to maintain territorial and customer restrictions on the sale of Liquid's products in New Orleans. In addition, Red Diamond alleged that its failure to abide by these restrictions caused its termination as a Liquid distributor.⁵ The district court instructed the jury that territorial and customer restraints imposed by a dual distributor are horizontal market allocations because the manufacturer sells its prod-

¹. Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001, 1002 (5th Cir.), cert. denied, 102 S. Ct. 119 (1981). A marketing network using two separate distribution channels is a dual distribution system. Dual distribution systems operate in many different forms, including those in which the manufacturer distributes products through independent distributors and company-owned distributors (branch outlets), distributors in separate markets (sale of home appliances to retail outlets and to home builders), and two competing product lines (sale under trademarked name and under a private brand name). See Slowey, Dual Distribution: Definition, Legislative Background And Specific Attempts At Regulation, 48 ANTITRUST L.J. 1799 (1981).

². Red Diamond alleged violations of §§ 1 and 2 of the Sherman Act. Section 1 of the Sherman Act, 15 U.S.C. § 1 (1976), provides: "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." Section 2 of the Act, 15 U.S.C. § 2 (1976), provides: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of trade or commerce among the several States, or with foreign nations, shall be deemed guilty . . . ." Id.

³. The primary state claim arose under LA. REV. STAT. ANN. § 51.122 (West 1965), which is similar to the provisions of § 1 of the Sherman Act. See note 2 supra. Section 51.122 provides: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce in this state is illegal . . . ." Red Diamond alleged also that Liquid's practices violated the Louisiana Unfair Trade Practices and Consumer Protection Law, LA. REV. STAT. ANN. § 51.1405 (West Supp. 1982).

⁴. 637 F.2d at 1002. Red Diamond named two of Liquid's independent distributors, Acme Welding and Supply Company (Acme) and Avisco Corporation, as co-defendants. Prior to its jury trial in the district court, Red Diamond settled its claims against Liquid but continued to press its claims against the other co-defendants. Id. at 1003.

⁵. Red Diamond alleged that Liquid had conspired with Acme to terminate Red Diamond's distributorship agreement. Id. at 1003.
ucts in direct competition with its independent distributors.² The jury ruled in favor of Red Diamond, but the district court granted judgment n.o.v. for Liquid on the ground that the evidence failed to support a finding of conspiracy.⁷ On appeal,⁸ the Fifth Circuit affirmed on different grounds and held: When the manufacturer is the source of territorial or customer restraints, those restraints result in vertical market allocations regardless of whether the manufacturer is a dual distributor.⁹

In Continental T.V., Inc. v. GTE Sylvania, Inc.¹⁰ the Supreme Court held that although restrictive trade agreements among competitors are patently anticompetitive and deserve per se treatment,¹¹ some trade ar-

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² Id. at 1004.
³ Id. at 1003. Earlier in the case, the district court had directed verdicts for the defendants on the claims under § 2 of the Sherman Act and the Louisiana Unfair Practices Act. Although the jury ruled in favor of Red Diamond on the Louisiana counterpart to § 1 of the Sherman Act, it ruled for the defendants on the Sherman Act § 1 count, a seemingly inconsistent result.
⁴ Red Diamond’s sole appeal was from the district court’s judgment n.o.v. on the Louisiana counterpart to § 1 of the Sherman Act, LA. REV. STAT. ANN. § 51.122 (West 1965).
⁵ 637 F.2d at 1004.

A per se violation of the antitrust laws is an activity that is so blatantly anticompetitive in intent and "pernicious" in effect that a court need not inquire into the reasonableness of the activity or its actual effect on competition. The Supreme Court in Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958), said:

There are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of per se unreasonableness not only makes the type of restrictions 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.

For a perceptive discussion of the per se rule, see ABA ANTITRUST SECTION, MONOGRAPH No. 2, VERTICAL RESTRICTIONS LIMITING INTRABRAND COMPETITION 31 (1977); Bork, The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, 74 YALE L.J. 775 (1965); Stewart & Roberts, Viability of The Antitrust Per Se Illegality Rule: Schwinn Down, How Many To Go?, 58 WASH. U.L.Q. 727 (1980); Note, supra. In Sylvania, the Court reasoned that horizontal trade agreements exhibit blatant pernicious effects and thus deserve per se treatment. 433 U.S. at 585.
rangements between manufacturers and distributors\(^1\) are procompetitive\(^2\) and require analysis under a rule of reason approach.\(^3\) Because

\(^2\)The \textit{Sylvania} decision merely affirmed the Supreme Court's earlier ruling in \textit{United States v. Topco Assoc., Inc.}, 405 U.S. 596 (1972) (holding agreements among an association of grocers a horizontal restraint and therefore \textit{per se} illegal).

12. In the typical situation, manufacturers and distributors operate on different levels of the distribution chain. When parties stand on different distribution levels, agreements between them are vertical. Dual distribution systems present a unique problem because the manufacturer and the distributor operate on the same level of the distribution chain. \textit{See} notes 18-21 \textit{infra} and accompanying text.

13. The \textit{Sylvania} Court recognized that vertical restrictions often enabled a manufacturer to compete more effectively on the interbrand level, that is, with other manufacturers marketing similar products. Because vertical restrictions reduce competition between its distributors at the intrabrand level, manufacturers can force their distributors to concentrate their efforts on inter-brand sales. \textit{433 U.S. at 583.} Examples of procompetitive vertical restraints include exclusive distributorships and area of primary responsibility clauses. The appeal of using vertical restraints to improve a distributor's interbrand sales efforts is exemplified \textit{by} profit passover clauses. A profit passover clause induces a distributor to concentrate his sales efforts in an assigned location by requiring him, when he sells outside of his primary location, to compensate the distributor in the area he invaded. This payment compensates the invaded dealer for his goodwill. Because the distributor will receive a greater profit on sales inside his assigned location, he will benefit by improving his interbrand competitiveness, thereby increasing his sales within his assigned location. For cases dealing with the validity of such clauses, \textit{see} Eiberger \textit{v. Sony Corp.}, 622 F.2d 1068 (2d Cir. 1980); \textit{Ohio-Sealy Mattress Mfg. Co. v. Sealy, Inc.}, 585 F.2d 821 (7th Cir. 1978); \textit{Response of Carolina, Inc. v. Leasco Response, Inc.}, [1976-2] Trade Cas. (CCH) \textit{\textbf{61},045} (S.D. Fla.), \textit{aff'd}, 557 F.2d 1307 (5th Cir. 1976); \textit{Superior Bedding Co. v. Serta Assoc., Inc.}, 353 F. Supp. 1143 (N.D. Ill. 1972). For a general discussion on the procompetitive aspects of vertical restraints, \textit{see} Schildkraut, \textit{Areas of Primary Responsibility And Other Territorial Restrictions In Channels of Distribution Under The Antitrust Laws: A Legal And Economic Analysis}, \textit{11 COLUM. J.L. SOC. PROB. 509} (1975).

14. The classic formulation of the rule of reason was articulated by Justice Brandeis in \textit{Chicago Bd. of Trade v. United States}, 246 U.S. 231, 238 (1918):

\textit{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. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.}

Although the \textit{Sylvania} Court advocated a rule of reason approach to the legality of vertical restraints, it offered little assistance in applying the rule of reason to actual market situations. \textit{See generally} Pitofsky, \textit{The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions}, \textit{78 COLUM. L. REV. 1, 11} (1978); Posner, \textit{The Rule of Reason and The Economic Approach: Reflections on The Sylvania Decision}, \textit{45 U. CHI. L. REV. 1, 13-16} (1977); Stewart & Roberts, \textit{supra} note 11, at 728 n.6. The confusion generated by \textit{Sylvania} centers on the Court's statement that in determining the validity of a vertical non-price restraint under the rule of reason, a court must balance the competitive effects of the restraint on interbrand and intrabrand competition. Although the \textit{Sylvania-
the *Sylvania* Court distinguished horizontal and vertical restraints, characterization of the restraints is a critical inquiry in analysis under section 1 of the Sherman Act. Although characterization is relatively simple in most instances, dual distribution systems present a dilemma. On the one hand, because the manufacturer acts as a supplier to the independent distributor, the relationship is vertical. On the other hand, because the manufacturer, through its branch outlet, competes on the same distribution level as the independent distributor, the relationship is also horizontal. Consequently, the legality of dual distributor imposed restraints is dependent on a court finding that a vertical relationship exists between the dual distributor and independent distributors.

Prior to *Sylvania*, the courts uniformly advocated a horizontal analysis for determining the legality of dual distribution restraints. The

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15. See note 11 supra.

16. See note 12 supra.

17. After *Sylvania*, courts must judge vertical restraints under the rule of reason, although they still treat horizontal restraints as per se illegal. If the court finds a particular restraint is horizontal, then it simply stops the inquiry and invalidates the restraint. On the other hand, if the court finds that the restraint is vertical, it then must inquire into the reasonableness of the restraint.

18. The basic distribution system involves a manufacturer who distributes his goods solely through a series of independent distributors. Because the manufacturer operates on a different level than its distributors, the relationship with distributors is vertical.

19. For a definition of dual distribution, see note 1 supra.

20. The term "branch outlet" refers to the manufacturer's wholly-owned distributor.

21. Dual distribution alone is not a violation of the antitrust laws. The existence of such a system, however, will subject any accompanying restraint to careful scrutiny.

Any action taken by a supplier engaged in dual distribution that affects the prices at which its customers resell its products, or inhibits the ability of those customers to compete with the supplier, has the potential of being judged as a violation of Section 1 of the Sherman Act, unless the supplier can convince the trier of fact that the decision was motivated solely by legitimate business reasons, and not by a desire on the part of the supplier to restrain competition. Bondurant, *Legal Risks Posed By Sherman Act Section I; Favoritism of Owner Outlets; And Strategic Pricing*, 48 ANTITRUST L.J. 1815, 1816 (1981). For a discussion of the legal risks of dual distribution under § 2 of the Sherman Act, see Brett, *Legal Risks For Dual Distribution Under Sherman Act Section 2*, 48 ANTITRUST L.J. 1820 (1981).

early cases relied upon *United States v. Arnold Schwinn & Co.*,\(^{23}\) in which both horizontal and vertical territorial and customer restrictions imposed by a manufacturer were *per se* violations of section 1.\(^{24}\) The pre-*Sylvania* courts consequently approached the characterization problem rather simplistically, focusing solely on whether the restraint restricted competition between the independent distributor and the wholly-owned distributor.\(^{25}\) Courts used this approach to invalidate national account programs,\(^{26}\) area of primary responsibility clauses,\(^{27}\) and exclusive dealing arrangements.\(^{28}\)

Decisions since *Sylvania* have moved away from horizontal treatment of dual distribution restraints. Although the cases immediately following *Sylvania* did not expressly sanction a vertical approach, they

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24. 388 U.S. 365, 372-73. Because the legality of the restraints in *Schwinn* did not turn on their classification as horizontal or vertical, subsequent cases prior to *Sylvania* did not make precise or accurate distinctions in classification. Pre-*Sylvania* decisions, consequently, are of dubious authority. *See* Altschuler, *supra* note 22, at 82; *Note, supra* note 11, at 1494.

25. *The Fifth Circuit's* opinion in Hobart Bros. *v. Malcolm T. Gilliland, Inc.*, 471 F.2d 894 (5th Cir.), *cert. denied*, 412 U.S. 923 (1973), typifies the pre-*Sylvania* cases. Hobart involved a distribution system that restricted the manufacturer's distributors from selling to certain reserved markets and required distributors to concentrate their sales efforts in designated areas. Characterizing Hobart and its independent distributors as co-distributors, the court classified the distribution system as a horizontal agreement among competitors to eliminate competition. *Id.* at 899.


noticeably failed to mention the possibility of horizontal treatment.\textsuperscript{29} One of the first cases to adopt expressly a vertical analysis for dual distribution restraints was \textit{H \& B Equipment Co. v. International Harvester Co.}\textsuperscript{30} Relying on \textit{Schwinn}, the Fifth Circuit in \textit{H \& B Equipment} determined that conspiracies are horizontal restraints only when they are carried out by a combination of distributors.\textsuperscript{31} The court held that the conspiracy was vertical because the manufacturer and the wholly-owned distributor were the only parties involved.\textsuperscript{32} Because the conspiracy did not involve any independent distributors, the possibility of a horizontal agreement to restrain trade was absent.

The \textit{H \& B Equipment} test resembles the simplistic approach of the pre-\textit{Sylvania} era.\textsuperscript{33} In contrast, the Federal District Court for the Central District of California in \textit{Krehl v. Baskin-Robbins Ice Cream Co.}\textsuperscript{34} adopted a more systematic approach. The court analyzed dual distribution restraints through a three part inquiry, focusing on the relative position of the manufacturer in the distribution chain, the purpose of the restraint, and the ability of the distributors to control marketing decisions.\textsuperscript{35} Under the \textit{Krehl} test, the restraint is vertical if the manufacturer and its distributors are only treated as horizontal when the source of the conspiracy is a combination of distributors.\textsuperscript{36} Although \textit{Schwinn}'s per se rule was overruled by \textit{Sylvania}, see note 23 supra, this aspect of \textit{Schwinn} remains intact. See, e.g., \textit{Donald B. Rice Tire Co. v. Michelin Tire Corp.}, 638 F.2d 15 (4th Cir.), cert. denied, 102 S. Ct. 324 (1981); \textit{Red Diamond Supply, Inc. v. Liquid Carbonic Corp.}, 637 F.2d 1001 (5th Cir.), cert. denied, 102 S.Ct. 119 (1981); \textit{Westpoint Pepperell, Inc. v. Rea}, [1980-2] Trade Cas. (CCH) ¶ 63,341 (N.D. Cal.); \textit{Krehl v. Baskin Robbins Ice Cream Co.}, [1979-2] Trade Cas. (CCH) ¶ 62,806 (C.D. Cal.).

32. According to the court, "the asserted originator of the plan to eliminate H \& B was the manufacturer, which allegedly established the company store for that purpose. Consequently, antitrust law treats the conspiracy as a vertical restraint, and those restrictions are now judged under the rule of reason." 577 F.2d at 245-46.

33. \textit{See} notes 22-28 supra and accompanying text.
34. \textit{[1979-2] Trade Cas. (CCH) ¶ 62,806 (C.D. Cal.).}
35. In finding a vertical relationship, the Court in \textit{Krehl} stated:

On the facts, the Baskin-Robbins arrangement differs decidedly from other arrangements proclaimed horizontal... In all instances, the evidence shows that the appoint-
facturer can unilaterally dictate marketing decisions\textsuperscript{36} and the restraint is designed to improve interbrand competition.\textsuperscript{37} In \textit{Westpoint Pepperrell, Inc. v. Rea}\textsuperscript{38} the Federal District Court for the Northern District of California took an approach similar to \textit{Krehl}, focused on the manufacturer's behavior, and stated that it would not treat a manufacturer like a competitor as long as the manufacturer did not act like one.\textsuperscript{39} \textit{Westpoint Pepperrell} signifies that in the post-\textit{Sylvania} era the courts are inclined to treat dual distribution restraints as vertical restraints.\textsuperscript{40} Pre-\textit{Sylvania} courts found horizontal relationships when the restraint merely restricted competition between the manufacturer and its distributor.\textsuperscript{41} The \textit{Westpoint Pepperrell} decision suggests, however, that a vertical relationship exists unless the restraint com-

\textsuperscript{36} The \textit{Krehl} court was concerned with the situation presented in United States v. Topco Assoc., 405 U.S. 596 (1972), in which a group of grocery store owners formed an association to buy products at lower prices. In \textit{Topco} the true owners or manufacturers were not the association “acting from the top” but the individual grocers acting together as competitors in a horizontal relationship. \textit{Accord}, United States v. Sealy, Inc., 388 U.S. 350 (1967).

\textsuperscript{37} In \textit{Krehl} the Court reasoned that a per se violation of § 1 is justifiable only if the questioned restraint has an adverse effect on interbrand competition. If the restraint improves interbrand competition, it has no anticompetitive effect and therefore is not a violation. [1979-2] Trade Cas. (CCH) ¶ 62,806, at 78,705 (C.D. Cal.).


pletely eliminates competition in the market.\textsuperscript{42}

Although many courts have accepted vertical treatment of dual distribution restraints, some courts\textsuperscript{43} and commentators\textsuperscript{44} have been reluctant to rule out horizontal treatment in certain situations. In \textit{Donald B. Rice Tire Co. v. Michelin Tire Corp.}\textsuperscript{45} the Fourth Circuit refused to adopt the lower court’s\textsuperscript{46} suggestion that \textit{Schwinn} mandated per se vertical treatment for dual distribution restraints imposed by a manufacturer.\textsuperscript{47} The court stated that proper characterization depended upon the restraint’s purpose rather than its source.\textsuperscript{48} Like the \textit{Krehl} court, the \textit{Rice Tire} court indicated that restraints imposed to improve inter-brand competition are vertical; restraints imposed to promote price fixing, however, are horizontal.\textsuperscript{49}

In \textit{Red Diamond Supply, Inc. v. Liquid Carbonic Corp.}\textsuperscript{50} the Fifth Circuit expanded the class of restraints subject to the rule of reason with its sweeping proposition that all restraints imposed by a dual dis-

\begin{notes}
\textsuperscript{42} [1980-2] Trade Cas. (CCH) ¶63,341, at 75,743.
\textsuperscript{43} See, e.g., Sherman v. British Leyland Motors, Ltd., 601 F.2d 429 (9th Cir. 1979); Dougherty v. Continental Oil Co., 579 F.2d 954 (5th Cir. 1978), vacated and dismissed by stipulation, 591 F.2d 1206 (5th Cir. 1979).
\textsuperscript{44} One commentator has suggested that vertical restrictions imposed by a dual distributor who “retains an exclusive area or category of customers and prevents dealers from engaging in what otherwise would constitute substantial intra-brand competition with the manufacturer” are illegal per se or at least carry a strong presumption of illegality. Pitofsky, supra note 14, at 28. Pitofsky states that “where a supplier retains an area or class of customers exclusively for itself, it is in effect agreeing horizontally with distributors in adjacent territories that they will not compete.” \textit{Id.} at 32.
\textsuperscript{46} 483 F. Supp. 750 (D. Md. 1980).
\textsuperscript{47} The Fourth Circuit said:

We must reject, however, any implication arising from the district court’s discussion of \textit{Schwinn} that a restraint may always be regarded as vertical if it is imposed by the manufacturer. Although the Supreme Court did emphasize in \textit{Schwinn} that the source of the restrictions in that case was the manufacturer, it went on to distinguish the restrictions under consideration from “horizontal restraints in which the actors are distributors with or without the manufacturer’s participation.” . . . [I]t is important to distinguish between a conspiracy among dealers and their supplying manufacturer for the purpose of retail price maintenance that would benefit the dealers and one involving the same parties but redounding primarily to the benefit of the manufacturer as a result of increased interbrand competition. A restraint imposed by the former conspiracy would be horizontal in nature and \textit{per se} illegal, while one imposed by the latter would be vertical and analyzed under the rule of reason.

638 F.2d at 16.
\textsuperscript{48} \textit{Id.} See note 47 supra.
\textsuperscript{49} 638 F.2d at 16. See notes 34-37 supra and accompanying text.
\textsuperscript{50} 637 F.2d 1001 (5th Cir.), \textit{cert. denied}, 102 S. Ct. 119 (1981).
\end{notes}
tributor are per se vertical.\textsuperscript{51} Rejecting the lower court's horizontal characterization,\textsuperscript{52} the Fifth Circuit relied on \textit{Schwinn} and held that trade agreements between a manufacturer and its distributors are horizontal only when the agreements involve a combination of distributors.\textsuperscript{53} The court interpreted \textit{Schwinn} and \textit{H & B Equipment} as mandating per se vertical treatment of all restraints imposed by a manufacturer on its distributors.\textsuperscript{54} Consequently, Red Diamond's allegation that Liquid had imposed territorial and customer restraints upon its distributors required that the Fifth Circuit hold the restraint to be vertical.\textsuperscript{55}

Citing \textit{Schwinn} and \textit{H & B Equipment}, the court specifically rejected Red Diamond's contention that Liquid's dual distributor status required a horizontal characterization.\textsuperscript{56} The court reasoned that in a dual distribution system the distributors are not the manufacturer's competitors; rather, they act as its agents in pursuit of a common purpose, the efficient marketing of the manufacturer's product.\textsuperscript{57} The Fifth Circuit warned that if the distributors own and control the supplying entity, their relationship, although it may appear vertical, is actually horizontal.\textsuperscript{58}

In \textit{Red Diamond}, the Fifth Circuit fell into the trap that the Fourth Circuit carefully avoided in \textit{Rice Tire}.\textsuperscript{59} Although the Fourth Circuit

\textsuperscript{51} Id. at 1004.

\textsuperscript{52} See note 6 supra and accompanying text.

\textsuperscript{53} 637 F.2d at 1004. See note 31 supra.

\textsuperscript{54} After reviewing \textit{Schwinn}, see note 31 supra, the \textit{Red Diamond} court quickly concluded that "when the manufacturer is the source, the conspiracy is vertical." 637 F.2d at 1004. See notes 30-32 supra and accompanying text.

\textsuperscript{55} 637 F.2d at 1004.

\textsuperscript{56} Id. The court distinguished its earlier decision in \textit{Hobart Bros. Co. v. Malcolm T. Gilliland, Inc.}, 471 F.2d 894 (5th Cir. 1973), on the ground that Gilliland, a Hobart distributor, also manufactured its own products that directly competed with certain Hobart products, thereby making the competitive nature of their relationship more pronounced. \textit{Id.} at 1005. The \textit{Hobart} court, however, also declared that Hobart's relationship with its other dealers that did not manufacture competing products was horizontal. \textit{Id.} at 899. Consequently, the Fifth Circuit's attempt to distinguish \textit{Hobart} in \textit{Red Diamond} is imprecise. See note 25 supra for further discussion of \textit{Hobart}.

\textsuperscript{57} 637 F.2d at 1005.

\textsuperscript{58} Like the court in \textit{Krehl}, the Fifth Circuit was concerned with the \textit{Topco} situation. See note 36 supra.

After concluding that Liquid's relationship with its dealers was vertical, the court analyzed the agreements under the rule of reason. Because Red Diamond failed to prove any anticompetitive effect, the court found no violation. 637 F.2d at 1007.

\textsuperscript{59} See notes 45-49 supra and accompanying text.
correctly interpreted *Schwinn* as a purpose-oriented test, the Fifth Circuit, misled by its earlier decision in *H & B Equipment*, failed to perceive *Schwinn*'s limitations. Although the *H & B Equipment* court also relied on *Schwinn* for the proposition that restraints are horizontal only when imposed by a combination of distributors, it did not interpret *Schwinn* as mandating per se vertical treatment for manufacturer imposed restraints. Instead, the *H & B Equipment* decision proposed that unilateral marketing decisions carried out by a manufacturer without the involvement of its distributors are vertical restraints. Because the restraints in *Red Diamond* involved both the manufacturer and distributors, the court’s reliance on *H & B Equipment* was misplaced.

The Fifth Circuit’s perception of the distributors’ role in a marketing system fails to recognize the realities of the market place. Although distributors are concerned with efficient marketing of the manufacturer’s product, they are concerned also with their own success. These two interests do not always coincide. The courts in *Rice Tire*, *Westpoint Pepperrell*, *Krehl*, and *Schwinn* recognized that although certain arrangements between a manufacturer and distributor are nominally vertical, they are simply attempts by competitors to divide markets horizontally and fix prices. In *Rice Tire* the Fourth Circuit recognized that although exclusive territorial restraints can improve interbrand competition, they also permit distributors to charge monopolistic prices. Manufacturers attract distributors by offering exclusive

60. See notes 47-48 supra and accompanying text.

61. See notes 30-32 supra and accompanying text.

62. See note 32 supra and accompanying text.

63. Although the decision to eliminate the dealer in *H & B Equipment* required no cooperation between the manufacturer and other dealers, see note 32 supra, the vitality of the alleged restraints in *Red Diamond* did depend upon such cooperation. 637 F.2d at 1002. Therefore, unlike the manufacturer in *H & B Equipment*, Liquid was acting in concert with its independent distributors. This distinction indicates that restraints imposed by a manufacturer are not always unilateral conduct under *Schwinn*. See note 31 supra and accompanying text.

64. See note 51 supra and accompanying text.

65. A distributor is concerned with maximizing his profit. One method of increasing one’s profit margin is inflating the price. Such activity, however, often results in less demand for the manufacturer’s product.

66. See notes 34-49 supra and accompanying text.

67. See note 49 supra and accompanying text. Because exclusive distributorships eliminate intrabrand competition, distributors, absent intense interbrand competition, are free to maintain their prices at artificially high levels. See generally Schildkraut, *supra* note 13, at 342.
distributorships. If the purpose of the exclusive distributorship is to facilitate price inflation, then such arrangements are horizontal restraints under Rice Tire and Schwinn. The Fifth Circuit’s test fails to accommodate the horizontal nature of these situations.

The Red Diamond court’s failure to require an inquiry into the purpose or effect of the restraint is a radical departure from previous case law. Such an inquiry is essential to proper characterization of dual distribution restraints. Krehl’s three part inquiry offers the most flexible approach because it focuses on the individual conditions of a manufacturer’s marketing system. In contrast, the Red Diamond per se approach is wholly inadequate.

By adopting a per se approach to characterization in Red Diamond, the Fifth Circuit has intensified the conflict surrounding the legality of dual distribution restraints. In the wake of Red Diamond a host of divergent precedents remain, ranging from per se horizontal treatment to per se vertical treatment. Until the Supreme Court addresses the issue, this conflict will persist.

B.S.M.

68. Manufacturers attract unwilling distributors to market their product by promising them the larger profit margins guaranteed by exclusive territories.
69. See notes 47-49 supra and accompanying text.
70. Although the Fifth Circuit recognized the horizontal aspects of the Topco situation, see note 58 supra, it failed to recognize that a manufacturer and an independent distributor as competitors can agree to restrain trade.
71. See notes 34-37 supra and accompanying text.
72. The Fifth Circuit per se vertical rule is as simplistic as the pre-Sylvania horizontal rule.