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Full-Line Forcing of Less Than Requirements by Threat of Refusal to Deal-A Per Se Violation?

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CURRENT COMMENT

FULL-LINE FORCING OF LESS THAN REQUIREMENTS BY THREAT OF REFUSAL TO DEAL—A *PER SE* VIOLATION?

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Veering from its prior course, the Court of Appeals for the Fourth Circuit has, in *Osborn v. Sinclair Refining Co.*,[1] further distended the already bloated class of *per se* violations of the Sherman Act. The plaintiff in the case was the lessee of a filling station carrying petroleum products on a lease and sales agreement with Sinclair. After a continuous twelve-year arrangement, the defendant oil company refused to renew the lease because, the trial judge found, "of the decline in gasoline gallonage [at the station] and because plaintiff was not handling enough Goodyear TBA [tire, battery, and accessory] products."[2] The parties conferred, plaintiff placed an order for over $1,000 worth of TBA, and a new lease was signed. During the next eight years, plaintiff bought some TBA from the defendant (who sold Goodyear products under a commission agreement with that company) but continued to buy more than ten times as much from Firestone with which it had other affiliations. At the end of the yearly lease in the eighth year, Sinclair refused to renew, again because of the failure to sell sufficient amounts of gasoline and the low volume of Goodyear TBA sales. Plaintiff brought a private antitrust damage suit, alleging conspiracy between Goodyear and Sinclair to monopolize the TBA trade in service stations and unreasonably to restrain trade.

The district court[3] found that the commission agreement between Sinclair and Goodyear was not, on its face, violative of the antitrust laws and that plaintiff had failed to prove that it had been illegally applied. While finding a "not insubstantial amount of commerce" affected by the sales of TBA in the area, it found a legitimate business motivation in Sinclair's sales of Goodyear TBA (a desire to have a high quality line available at service stations bearing its name) and concluded that, absent a condition or agreement tying the sale of gasoline to the purchase of TBA, such motivation was sufficient to excuse the cancellation. Following a substantial line of cases, it concluded that a mere refusal to deal was not tantamount to an agreement regardless of the seller's motives.

The Court of Appeals reversed, finding a violation of the first section of the Sherman Act. It held that when plaintiff, in an effort to regain his

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1. TRADE REG. REP. (1960 Trade Cas.) ¶ 69771 (4th Cir. July 11, 1960).
2. Osborn v. Sinclair Refining Co., 171 F. Supp. 37, 43 (D. Md. 1959).
3. Osborn v. Sinclair Refining Co., 171 F. Supp. 37 (D. Md. 1959).

lease, agreed to buy TBA in the interim between the two leases an illegal tying contract was formed. The court was not troubled by the lack of an express agreement, inferring an agreement from the course of dealing. Coupling this agreement with Sinclair's substantial sales of petroleum products and the not insubstantial quantity of TBA sold in the relevant market, it concluded that a *per se* violation of the Sherman Act had been proven, thus making the evidence of legitimate business motivation irrelevant. Nor was it significant that the quantity of the tied product was less than the purchaser's requirements, *i.e.* that, at best, the agreement was one to buy *some* TBA from the petroleum company. The case was remanded to the district court solely for the purpose of ascertaining damages.

THE AGREEMENT AND REFUSAL TO DEAL

A startling aspect of the case is that the opinion was written by Chief Judge Sobeloff who one year before wrote the opinion in *McElhenney Co. v. Western Auto Supply Co.*,[4] and that the opinion in the principal case cites the *McElhenney* case as precedent. McElhenney was an auto supply store, associated with the Western Auto chain, holding a dealership contract which authorized it to use the Western Auto name. The contract, aside from stipulating a required purchase as an opening stock, did not obligate plaintiff to purchase future requirements from defendant or to refrain from the purchase of competitors' goods. It did, however, contain a provision allowing either party to cancel the contract on thirty days written notice. Plaintiff alleged that, from 1950 until the defendant cancelled its contract in 1956, defendant's representatives attempted to coerce it into taking all its requirements of *a line of goods* on threat of cancellation of the contract; that, in fact, as a result, it had purchased some supplies it otherwise would not have purchased, and that, nonetheless, since it refused to deal exclusively in Western Auto distributed television sets, its contract was cancelled. The district court granted a motion to dismiss the complaint on the ground that it failed to state a claim.[5] On appeal, the Court of Appeals for the Fourth Circuit, per Chief Judge Sobeloff, affirmed. The gist of the opinion was that the complaint had failed because it alleged merely a unilateral refusal to deal, and that while an illegal contract could be implied from a course of dealing, the facts alleged were insufficient for that purpose.[6]

The distinction between the two cases, according to the court, is that, as a condition to reinstatement of his lease, Osborn agreed to purchase over $1,000 worth of TBA while McElhenney did not have any pre-contract conferences. It was not the eventual cancellation in *Osborn*, appar-

4. 269 F.2d 332 (4th Cir. 1959).
5. McElhenney Co. v. Western Auto Supply Co., 167 F. Supp. 949 (W.D.S.C. 1958).
6. Since the complaint is not reproduced in the opinion, the assumption is made that the facts discussed in the opinion were, in fact, properly pleaded. Nothing in the opinion suggests otherwise.

ently, that constituted a violation, despite the fact that the theory of the complaint turned on that cancellation.[7]

Viewed in this light, it is difficult indeed to distinguish *McElhenney* from *Osborn*. The plaintiff, in the former case, alleged that there was a contract which was subject to cancellation by either party on short notice[8] and that it was able to keep the defendant from cancelling for six years only by acceding to its purchase demands, consequently buying a line of products. It seems a most untenable distinction that Sinclair cancelled and then renewed on getting an order while Western Auto merely threatened to cancel to get its order. If successful pressure to buy supplies is tantamount to an illegal agreement when coupled with a threat to terminate or not to renew (the two are indistinguishable) a business relationship, such agreement existed in both cases.

Nonetheless, *Osborn* may have reached the appropriate result considering only this aspect of the case. A dealer, acting unilaterally,[9] has a right to refuse to deal with a potential customer for any reason and without regard for the legality or illegality of his objective[10] unless the refusal amounts to monopolization.[11] In the past, courts have deduced from this basic rule the corollary that such a dealer is immunized from private antitrust damages suits in his demands on customers as long as he does not bind them contractually to a restraint of trade.[12] They have refused to find violations while compliance with an illegal distributive plan was obtained merely on threat to cut off future supplies to the offending customer. Why such coerced adhesion to an illegal plan should be distinguished from a literal "condition" or "agreement" to comply, when compliance is accomplished by discussion with the customer, is not clear,[13] especially in light

7. "Plaintiff claims that his service station lease and dealer's sales agreement were cancelled by defendant (Sinclair) in furtherance of an attempt by Sinclair to monopolize the sale of tires, batteries, and accessories (TBA) to its service station dealers in Maryland and/or a combination or conspiracy between Sinclair and Goodyear Tire and Rubber Company (Goodyear) to restrain trade in those products." Osborn v. Sinclair Refining Co., 171 F. Supp. 37, 38 (D. Md. 1959). At page 44 of the opinion, the district judge indicates that the cancellation in question is the cancellation in 1956, *i.e.* the second cancellation. *Id.* at 44.

8. Sixty days written notice was required. McElhenney Co. v. Western Auto Supply Co., 167 F. Supp. 949, 951 (W.D.S.C. 1958).

9. Multilateral agreements to refuse to deal with an offending customer are likely to be treated as *per se* violations under the doctrine of Fashion Originators' Guild of America, Inc. v. FTC, 312 U.S. 457 (1941).

10. United States v. Colgate & Co., 250 U.S. 300 (1919).

11. Individual refusals to deal have been struck down because of monopolistic intent in: Lorain Journal Co. v. United States, 342 U.S. 143 (1951) and Eastman Kodak Co. of New York v. Southern Photo Materials Co., 273 U.S. 359 (1927).

12. *E.g.* Hudson Sales Corp. v. Waldrip, 211 F.2d 268 (5th Cir. 1954); Nelson Radio & Supply Co. v. Motorola, Inc., 200 F.2d 911 (5th Cir. 1952); Shotkin v. General Electric Co., 171 F.2d 236 (10th Cir. 1948). See Barber, *Refusals to Deal Under the Federal Antitrust Laws*, 103 U. PA. L. REV. 847, 857-860 (1955) and cases cited. A recent contrary trend has been initiated: George W. Warner & Co. v. Black & Decker Mfg. Co., 277 F.2d 787 (2d Cir. 1960); A. C. Becken Co. v. Gemex Corp., 272 F.2d 1 (7th Cir. 1959), *cert. denied*, 362 U.S. 962 (1960); Englander Motors, Inc. v. Ford Motor Co., 267 F.2d 11 (6th Cir. 1959).

13. The Attorney General's Committee to Study Antitrust Laws suggests that, at least so far as private suits based on violations of section 3 of the Clayton Act are concerned,

of the fact that the same type of coercion has been found illegal in actions brought by the government.[14] It would seem that the dealer may safely announce an illegal scheme but that he may not obtain assurances of compliance[15] from his customers or elicit their cooperation in making the scheme effective without being guilty of an illegal conspiracy to violate the antitrust laws. There is little reason to distinguish between actions instituted by the government and private actions. The anomaly created by a successful scheme in which customer compliance is achieved without conference must be ascribed to the formulation of the restraint of trade provisions in terms of dual action.[16]

If *Osborn* relies on similar reasoning, the conclusion that there was an "agreement" seems correct, but the *McElhenney* result does not.[17] It also follows that an agreement should be found whether a present customer agrees to future purchases or not. If he agrees, he is a party to an illegal agreement which injures him. If he refuses, assuming only that there are other customers who do not refuse, he is injured by the illegal agreement of the others since it results in the loss of his source of supply. It should not matter that the other customers do not discuss the exclusion of the plaintiff with the supplier since the effect of the discussions is to eliminate noncomplying dealers. If anything, such a customer presents a more appealing case than his sometime-agreeing counterpart.[18]

PARTIAL TYING AS A *Per Se* VIOLATION

A more novel proposition of the court is its finding that the violative "agreement" was a *per se* violation of section 1 of the Sherman Act.

Without considering, for the moment, the fact that Sinclair apparently did not attempt to have its dealers carry its line of TBA exclusively, the application of a *per se* standard to this case seems questionable. True, the

the result might be explained by "the recognition that section 3 of the Clayton Act is fundamentally designed to protect the *seller's competitors* from being foreclosed from the market—an objective which need not comprehend safeguarding an individual buyer incidentally prejudiced by a seller's refusal to deal." ATT'Y GEN. NAT'L COMM. ANTITRUST REP. 136 n.28 (1955). The explanation regards the provisions for private suits to be of compensatory design, while, in fact, the *treble* damage provisions seem to indicate a different purpose: assuring maximum enforcement.

14. Beech-Nut Packing Co. v. FTC, 257 U.S. 441 (1922); United States v. Parke, Davis & Co., 362 U.S. 29 (1960).

15. It would seem immaterial that the assurances were not contractually binding. United States v. Parke, Davis & Co., *supra* note 14.

16. "Every contract, combination . . . or conspiracy. . . ." Sherman Antitrust Act § 1, 26 Stat. 209 (1890), 15 U.S.C. § 1 (1958); ". . . on the condition, agreement or understanding. . . ." Clayton Act, 38 Stat. 731 (1914), 15 U.S.C. § 13 (1958).

17. The two cases may still be reconciled since, in the wake of *Osborn*, the Fourth Circuit reversed the district court's dismissal of an amended complaint filed by the McElhenney Company. McElhenney Co. v. Western Auto Supply Co., TRADE REG. REP. (1960 Trade Cas.) ¶ 69850 (4th Cir. Nov. 2, 1960). This short per curiam opinion, however, expressly avoids the substantive issues.

18. To favor the sometime agreeing party would seem to encourage violation of the law—at least sufficient violation to establish a claim—perhaps more to establish compensable damage.

Supreme Court established a *per se* rule in *International Salt*[19] where the tying product was protected by patent rights and affirmed the rule in *Northern Pacific*,[20] but those cases are founded on what appears to be something more than the quantitative substantiality of the tying product. In *Times-Picayune*,[21] the Court in fact found insufficient market dominance in the control of 40% of the local newspaper circulation. In *International Salt*, the monopoly accorded by the patent supplied the needed dominance. *Northern Pacific*, however, lends more support to the conclusion in the instant case, the *Osborn* court relying on the language in the opinion which states: tying arrangements are ". . . unreasonable in and of themselves whenever a party has sufficient economic power to impose an appreciable restraint on free competition in the tied product and a 'not insubstantial' amount of interstate commerce is affected."[22] It seems that Mr. Justice Harlan's dissenting opinion in *Northern Pacific* was correct in its prediction that that language would ". . . leave courts and lawyers in confusion as to what the proper standards now are for judging tying clauses under the Sherman Act."[23]

Arguably, something like "dominance" in the tying product is still the appropriate standard, though the court prefers to rename it "sufficient economic power." *Northern Pacific* can be read to hold that the district court properly found dominance in the uniqueness of the land holdings, analogizing this uniqueness to patent exclusiveness—a position urged by the Government. The dissent dealt with the case as though the issue were limited to the finding of "sufficient economic power" which it thought was synonymous with finding dominance.

Read most broadly, *Northern Pacific* still retreats from a quantitative substantiality test. A finding of "sufficient economic power" must, at least, be based on some evaluation of the market position of the defendant relative to his competitors. A patent, implying the total exclusion of direct competition, or a unique tying product such as land may settle the issue sufficiently but size alone, where it does not approach dominance in the market, is a poor indicium of *economic* power.

Osborn tried to bring himself within the doctrine of the above men-

19. International Salt Co. v. United States, 332 U.S. 392 (1947) (holding that the leasing of a patented machine on condition that the leasee purchase all supplies for the machine from the lessor a *per se* violation of § 3 of the Clayton Act and § 1 of the Sherman Act).

20. Northern Pacific Ry. v. United States, 356 U.S. 1 (1958) (holding it a *per se* violation of § 1 of the Sherman Act for the railroad to require that lessee of land along its right of way ship their products on Northern Pacific, unless competitive prices are lower or competitive service better, as a condition to granting them the lease).

21. Times-Picayune Publishing Co. v. United States, 345 U.S. 594 (1953) (finding no violation of the Sherman Act in the requirement made by owner of separate evening and morning papers that ads placed in the morning paper be carried also in the evening edition, there being only one other paper in town which paper published only an evening edition).

22. Northern Pacific Ry. v. United States, 356 U.S. 1, 6 (1958).

23. *Id.* at 19.

tioned cases by alleging that Sinclair was using its natural monopoly in its brand-named petroleum products to tie TBA. The district court found: "Sinclair had no . . . dominant position in the petroleum field in Maryland or elsewhere"[24] but also indicated, ". . . this fact might not be important if there were clear restraints in the agreements themselves as there were in *International Salt*."[25] Had the Court of Appeals rested its opinion on the brand-name argument, one might conclude that it was following *International Salt*. It concluded, however, that the issue was determined by the fact that Sinclair had "more than 10% of the gasoline sales and stations in the State of Maryland" and the fact that it was "not disputed" that this amounted to sufficient power in the tying product.[26] It would seem, disputed or not, that resting the finding of economic power on a substantial percentage of the market is an application of the quantitative substantiality test, previously limited to Clayton Act cases.[27]

It may be that in citing the *Standard Stations* case,[28] the court in *Osborn* was deciding the relevant issue under the stricter test of the Clayton Act. If so, and if *Standard Stations*[29] and the dictum in *Times Picayune*[30] are to be taken at face value, since quantitative substantiality is conceded, application of the *per se* standard might only be objectionable on the grounds that the court decided the case on the wrong statute.

Nevertheless, neither the Clayton Act standard nor the looser prohibition of the Sherman Act has previously been applied to a tying contract where the tied product was to be purchased in amounts less than full requirements. The present extension seems difficult to reconcile with *Federal Trade Commission v. Sinclair Refining Co.*[31] In that *Sinclair* case, the court refused to find a violation of the Clayton Act, despite the fact that lessees of gasoline pumps were required to use Sinclair gas exclusively; on the theory that, by acquiring pumps from others, the stations could deal in competitive gasoline, there, consequently, being no agreement

24. Osborn v. Sinclair Refining Co., 171 F. Supp. 37, 46 (D. Md. 1959).
25. *Id.* at 46 n.6.
26. TRADE REG. REP. (1960 Trade Cas.) ¶ 69771, at 77035 (4th Cir. July 11, 1960).
27. The *Standard Stations* case, which authored the "quantitative substantiality" test, decided only the Clayton Act question, declining to consider whether "quantitative substantiality" applied as well to Sherman Act violations. Standard Oil Co. of California v. United States, 337 U.S. 293 (1949). Later cases, dealing with the Sherman Act, applied a more rigorous standard. See discussion, *supra* p. 178-9 and cases cited.
28. Standard Oil Co. of California v. United States, *supra* note 25.
29. *Ibid.* (holding that sufficient control of the tying product was shown, under the Clayton Act standards, by showing that the seller had a substantial percentage of the relevant market without considering whether this gave him economic control of the market).
30. "When the seller enjoys a monopolistic position in the market for the 'tying' product, *or* if a substantial volume of commerce in the 'tied' product is restrained, a tying arrangement violates the narrower standards expressed in § 3 of the Clayton Act because from either factor the requisite potential lessening of competition is inferred. And because for even an unlawful monopolist it is 'unreasonable *per se*, to foreclose competitors from any substantial market', a tying arrangement is banned by § 1 of the Sherman Act whenever *both* conditions are met." Times-Picayune v. United States, 345 U.S. 594, 608, 609 (1953).
31. 261 U.S. 463 (1923).

not to deal in the goods of a competitor. The court was not influenced by the fact that very few gasoline stations operated on a split pump basis. No intervening case would appear to have overturned the *Sinclair* holding.[32] In light of the discussion in *Times Picayune*[33] and in consideration of the fact that section 3 of the Clayton Act was designed to extend the applicability of the Sherman Act, it seems settled that, for acts governed by both statutes,[34] the Sherman Act does not prohibit a broader range of tying contracts than the Clayton Act.

The *Osborn* court is saying that it is a *per se* violation for a seller of substantial economic stature to induce buyers to purchase more than one type of product at the same time, there being in such cases, if both products are offered by competitors, a "not insubstantial" amount of commerce affected because what a buyer buys from one supplier, he will not buy from another. Since, by definition, there can be no inquiry into justification for such tying, the rule is harsh, indeed, harsh far beyond the discussion in *Standard Stations* which suggests that there is *hardly any* justification for tying[35] (a statement one might suppose descriptive of the seller of tied products which requires their exclusive use since only such seller was then under consideration).

What is most troublesome about the opinion, however, is the overall affect. Purchase under threat of termination of dealings is tantamount to an agreement to buy. An agreement to buy some goods with others, assuming the quantitative substantiality in the tied product and an affect on commerce in the tied product, is *per se* illegal. For some sellers this will present a difficult problem.

Consider a retailer-distributor which deals in a line of products such as Western Auto. It is at the mercy of the customer who wants only an item or two from the line, even if such partial service is highly undesirable financially and may jeopardize the reputation of the chain. Its threat to dis-

32. *But see* International Salt Co. v. United States, 332 U.S. 392 (1947), indicating that it was unnecessary for the court to inquire into the availability of competitive salt machines which might allow a buyer the split-pump type of flexibility. To the extent that the salt machine was properly patented, it must, of course, have contained unique features. Perhaps the uniqueness was found to be sufficient evidence of the impracticability of effective competition. Perhaps, also, despite disclaimer of such intent in Northern Pacific Ry. v. United States, 356 U.S. 1 (1958), the court was imposing a stricter standard on patent holders by preventing them from extending the statutory restraint of trade to tie other products. Of course, to the extent that manufacturers were using the salt machines, they were contractually bound to taking *all* their salt for such machines from Mortons; and see Northern Pacific Ry. v. United States, *supra*, which held, in part, that ineffective enforcement of a contractual tying obligation was not a defense, even if it resulted in allowing a measure of competition in the tied product. Since, however, the offense is the *agreement* to restrain trade, such a result should not be surprising.

33. *Supra* note 30.

34. Since section 3 of the Clayton Act is limited to ". . . goods, wares, merchandise, machinery, supplies, or other commodities . . .," Clayton Act, 38 Stat. 731 (1914), 15 U.S.C. § 14 (1958), some tying cases can only be brought under the Sherman Act, *e.g.* Northern Pacific Ry. v. United States, 356 U.S. 1 (1958).

35. ". . . tying agreements serve hardly any purpose beyond suppression of competition . . .," Standard Oil Co. of California v. United States, 337 U.S. 293, 305 (1949).

continue the franchise, even though the buyer was free at all times to buy some competitive products, would be violative of the Sherman Act.

Consider the normal distributor which acts as an intermediary between producers and retail outlets of, for example, food. It could, after this decision, be forced to supply only items selected by customers, whether supplying such customers was economically sound or not.[36]

Consider Sinclair. May it now attempt to sell both high test and regular gas to the same stations, or must it negotiate separately on both? What would happen to the former *Sinclair* case[37] under the new standard? It would seem that the Supreme Court was judicious when it introduced the word *hardly* as a modifier of the proposition that tying contracts do not serve any legitimate purpose.[38] Whether Sinclair was justified in its "tying" practices *vis à vis Osborn,* as the district court found, is another matter. What is important, however, is whether companies are now foreclosed from multiple-product sales without consideration of their economic motivation under a broad rule of *per se* illegality.

36. A barrier to passing on the cost is posed by section 2(a) of the Robinson-Patman Act, 49 Stat. 1526 (1936), 15 U.S.C. § 13 (1959), which prohibits price differentials between competing customers. Cost justification is, of course, a defense to violations of Section 2(a) but the expense of the requisite accounting and uncertainty of the cost standard appears to be a substantial hurdle.

37. FTC v. Sinclair Refining Co., 261 U.S. 463 (1923).

38. *Supra* note 35; see also United States v. Jerrold Electronics Corp., 187 F. Supp. 545 (E.D. Pa. 1960) for an illustration of legitimate purpose.

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