

1-1-1969

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Thomas Howard Brown

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Recommended Citation

Thomas H. Brown, *Customer Restrictions in Fair Trade Contracts*, 10 B.C.L. Rev. 392 (1969), <http://lawdigitalcommons.bc.edu/bclr/vol10/iss2/10>

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CUSTOMER RESTRICTIONS IN FAIR TRADE CONTRACTS

After a finished product has been sold to a distributor for a profit, its manufacturer is usually not concerned about its subsequent progress through the distribution system. In some circumstances, however, a manufacturer is directly interested in the transactions which follow the sale to the distributor. If a commodity is a prestige product the manufacturer may desire high retail prices to maintain the exalted status of his product. Similarly he may desire to keep his product from those retailers whose establishments are not associated with the sale of high quality products.

To maintain high prices the manufacturer may require the wholesaler or retailer (or both) to resell his product above certain prices. This practice is called resale price maintenance. To prevent his product from reaching the possession of undesirable retailers, the manufacturer may require that his distributors sell only to retailers approved by the manufacturer. This limitation on the distributor is called a vertical customer restriction.

Federal enabling legislation has been passed which allows states to legalize resale price maintenance.¹ A large majority of the states have enacted fair trade laws which permit manufacturers, wholesalers and retailers to enter into contracts establishing minimum or fixed resale prices.² Despite this legislation, a comprehensive fair trade system is not possible where retailers who have not contracted to follow resale prices may obtain the products and sell them at lower prices. Some states have solved this problem by incorporating in their fair trade legislation non-signer clauses which allow the manufacturer to establish retail prices at which *all* outlets must sell if the manufacturer obtains an agreement with *any* retailer in the state.³ In states without non-signer legislation, however, the only means to eliminate retail sales below the manufacturer's established prices is to prevent retailers who are not parties to fair trade contracts from obtaining the goods. This result is usually accom-

¹ The Miller-Tydings Amendment to the Sherman Act, 50 Stat. 693 (1937), as amended, 15 U.S.C. § 1 (1964), and the McGuire Act, 66 Stat. 631 (1952), as amended, 15 U.S.C. § 45 (1964), amending the Federal Trade Commission Act.

These statutes permit only vertical price-fixing contracts. Vertical resale price maintenance contracts are contracts between persons who are on different levels of competition and are not in competition with each other. Thus a contract between a manufacturer and a wholesaler is a vertical resale price maintenance contract. A horizontal price-fixing contract, a contract between persons who are on the same level of distribution and who are in competition with each other, for example, a contract between two wholesalers, is illegal under the Sherman Act.

² Presently 42 states have fair trade laws. 2 Trade Reg. Rep. ¶ 6017 (1967).

³ An example of a non-signer clause is § 56:4-6 of the New Jersey Fair Trade Law, N.J. Stat. Ann. § 56:4-3 to -6 (1964):

Willfully and knowingly advertising, offering for sale or selling any commodity at less than the price stipulated in any contract entered into pursuant to the provisions of section 56:4-5 of this Title [legalizing resale price maintenance contracts], whether the person so advertising, offering for sale or selling is or is not a party to such contract, is unfair competition and is actionable at the suit of the producer or distributor of such commodity or at the suit of any retailer selling such commodity at not less than the price stipulated in any contract entered into pursuant to the provisions of section 56:4-5 of this Title.

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plished by means of a customer restriction on the manufacturer's wholesalers, which prohibits them from selling to non-contracting retailers.

The legality of customer restrictions imposed to implement a comprehensive fair trade program has long been assumed.⁴ However, in *United States v. Arnold, Schwinn & Co.* customer restrictions upon purchasing wholesalers were declared illegal.⁵ The effect of this decision upon the long standing assumption of the legality of customer restrictions in fair trade programs will be examined in this comment.

I. RESALE PRICE MAINTENANCE

The Sherman Antitrust Act declares that every contract, conspiracy or combination in restraint of trade among the states is illegal.⁶ Price fixing establishing fixed or minimum resale prices was held to be illegal per se under the Sherman Act because it was an unreasonable restraint of trade that was lessening competition and constituting an impermissible restraint on alienation.⁷

This absolute prohibition of price fixing, regardless of the circumstances, was considered by some to leave valuable rights unprotected. Resale price maintenance was considered necessary to protect smaller merchants from the competition of larger rivals, such as chain stores and discount houses, and to protect some manufacturers whose products would suffer a loss of goodwill or reputation if they were sold at low prices.

Because of their size, mass merchandisers, such as chain stores and discount houses, have advantages over small merchants. They can sell products at lower prices than the small merchants and still receive a substantial profit because of their high volume of sales. In addition, with the intention of attracting more customers into the store, the mass merchandisers may advertise and sell some well known products at a loss without suffering any economic injury. A product sold at a loss with the intention of attracting customers into the store is called a "loss leader,"⁸ and any loss suffered from the "loss leader" can be absorbed by the large retailers. They alone have a large volume of sales of other products from which they can recoup the loss caused by the "loss leader."

The advent of the chain stores and discount houses during the Depression placed many small retailers in competition with the lower prices and "loss leaders" of these mass merchandisers.⁹ Because the small retailers feared that the mass merchandisers would drive many of them out of business, they sup-

⁴ E.g., *Vornado, Inc. v. Corning Glass Works*, 388 F.2d (3d Cir. 1968), aff'g 255 F. Supp. 216 (D.N.J. 1966). The district court opinion concerning the issue of fair trading and discrimination against certain stamp programs is noted in 8 B.C. Ind. & Com. L. Rev. 376 (1967).

⁵ 388 U.S. 365 (1967).

⁶ 26 Stat. 209 (1890), as amended, 15 U.S.C. § 1 (1964).

⁷ *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

⁸ Schachtman, *Resale Price Maintenance and the Fair Trade Laws*, 11 U. Pitt. L. Rev. 562, 577 (1950). Sales of a product below its costs, such as a "loss leader," may be illegal in certain circumstances under § 3 of the Robinson-Patman Act, 15 U.S.C. § 13(a) (1964) or under § 5 of the Federal Trade Commission Act, 15 U.S.C. § 45(a)(1) (1964) or under a state statute dealing with sales below cost. E.g., N.J. Stat. Ann. § 56:4-8 (1964).

⁹ Comment, *Fair Trade: The Ideal and Reality*, 27 Ohio St. L.J. 144, 147 (1966).

ported introduction of fair trade legislation.¹⁰ The small retailers felt that fair trade would afford some protection against the larger retailers by maintaining at least minimum resale prices. Fair trade would prevent mass merchandisers from taking full advantage of their economies of size through lower prices and would end the use of fair-traded products as loss leaders.

Retailers were not alone in their support of fair trade legislation. Manufacturers of brand named or trademarked products invest large sums of money in advertising their products to familiarize the consuming public with their brand name or trademark. Because of the well known brand name or trademark and because of prices higher than similar competitive products, their products obtain a reputation of high quality in the eyes of the consumer who often associates high prices with high quality.¹¹ This reputation of high quality in these brand named or trademarked goods is known as the goodwill of the product.¹² Some manufacturers feared that the low prices of the chain stores and discount houses injured the goodwill of their products because they prevented the association of high quality with the usual high prices of their brand named or trademarked goods. Thus, in order to maintain the public image of their products, many manufacturers supported the enactment of fair trade legislation.

In the early 1930's some states enacted legislation to protect the small retailers and the goodwill of the manufacturer's products from the consequences of the low prices of the chain stores and discount houses.¹³ These statutes allowed fair trading of products—resale price maintenance. Although these statutes were held constitutional under the Federal Constitution,¹⁴ they proved ineffective because they allowed only contracts that affected prices in intrastate transactions.¹⁵ Since most products traveled in interstate commerce, most brand named and trademarked products could not be fair-traded.

This shortcoming of the state fair trade acts was removed in 1937 when Congress passed the Miller-Tydings Amendment to the Sherman Antitrust Act.¹⁶ The Miller-Tydings Amendment is enabling legislation which exempted from the prohibition of the Sherman Act fair trade contracts for brand named or trademarked products in interstate transactions.¹⁷ There was strong opposition to Miller-Tydings. Some opponents argued that resale price maintenance or fair trading of products is antithetical to the purpose of the Sherman

¹⁰ *Id.* at 147-48; 81 Cong. Rec. 7495 (1937) (remarks of Senator Tydings).

¹¹ Comment, *supra* note 9, at 153-54.

¹² See *Old Dearborn Distrib. Co. v. Seagram-Distillers Corp.*, 299 U.S. 183, 193-95 (1936).

¹³ In 1931 California enacted the first fair trade law. Cal. Bus. & Prof. Code § 16902 (West 1964).

¹⁴ *Old Dearborn Distrib. Co. v. Seagram-Distillers Corp.*, 299 U.S. 183 (1936).

¹⁵ Cf. S. Rep. No. 2053, 74th Cong., 2d Sess. (1936).

¹⁶ 50 Stat. 693 (1937), as amended, 15 U.S.C. § 1 (1964).

¹⁷ The Miller-Tydings Amendment states that contracts establishing resale prices which affect interstate commerce are legal if such contracts are lawful as applied to intrastate transactions, under any statute, law, or public policy now or hereafter in effect in any State, Territory, or the District of Columbia in which such resale is to be made, or to which the [fair traded] commodity is to be transported for such resale. . . .

15 U.S.C. § 1 (1964).

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Act to foster a free economy with unrestricted competition.¹⁸ Another argument against resale price maintenance was that it deprived the purchasing distributor or retailer of the right to alienate freely or sell his property.¹⁹ Proponents of the Amendment countered these criticisms by arguing that, because Miller-Tydings only allowed the fair trading of trademarked or brand named products against which similar products were in competition, there would still be ample competition from competing brands to maintain a free, competitive economy.²⁰ Also, it was argued that small retailers were a vital part of the economic system who must be protected from competition of chain stores and discount houses in order to survive.²¹ Finally, it was argued that the right to free alienation of property was not violated. The goodwill of the product obtained through the identification of the high-priced trademarked or brand named product with quality was considered an important right of the manufacturer in the product, a right worthy of protection although the manufacturer had sold all other interest in the product.²²

Until 1951 the Miller-Tydings Amendment was sufficient to allow substantial fair trading of products. Then, the Supreme Court in *Schwegmann Bros. v. Calvert Distillers Corp.* held that non-signers of fair trade contracts were not bound by the fair trade contracts of others where the brand named or trademarked products traveled in interstate commerce despite state statutes to the contrary.²³ This decision destroyed the effectiveness of resale price maintenance established by the Miller-Tydings Amendment. Most retailers would refuse to sign a fair trade contract where they knew that a competitor who did not sign a fair trade contract could obtain and resell the products at lower prices. The risk of being undersold by non-signers prevented any comprehensive fair trade system. Moreover, a non-signing retailer by selling the product at low prices could defeat the purposes of the fair trade acts, protection of the small retailer and of the goodwill of the product.

To revitalize fair trade, Congress enacted the McGuire Act in 1952.²⁴ The Act permits the enforcement of fair trade contracts for interstate goods against non-signers who had notice of such contracts in those states which held non-signers bound by fair trade contracts.²⁵ For no apparent reason, the

¹⁸ H. Toulmin, *Anti-Trust Laws* § 9.2 (1949).

¹⁹ See *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 404 (1911).

²⁰ S. Rep. No. 2053, 74th Cong., 2d Sess. (1936).

²¹ H.R. 1516, 82d Cong., 2d Sess. 10-14 (1952). This report was given prior to the passage of the McGuire Act, but it gives the reasons for resale price maintenance.

²² See *Old Dearborn Distrib. Co. v. Seagram-Distillers Corp.*, 299 U.S. 183, 193-95 (1936).

²³ 341 U.S. 384 (1951).

²⁴ 66 Stat. 631 (1952), as amended, 15 U.S.C. § 45 (1964).

²⁵ Nothing contained in this section or in any of the Antitrust Acts shall render unlawful the exercise or the enforcement of any right or right of action created by any statute, law, or public policy now or hereafter in effect in any State, Territory, or the District of Columbia, which in substance provides that willfully and knowingly advertising, offering for sale, or selling any commodity at less than the price or prices prescribed in such contracts or agreements whether the person so advertising, offering for sale or selling is or is not a party to such a contract or agreement, is unfair competition and is actionable at the suit of any person damaged thereby.

15 U.S.C. § 45(a)(3) (1964).

McGuire Act also re-enacted the provisions of the Miller-Tydings Amendment with a few additions.²⁶ One of these additions allows fair trade contracts to require a purchaser to enter into fair trade contracts with his own vendee.²⁷ This latter addition is an aid to establishing fair trade in states which do not enact non-signer legislation, since it allows a manufacturer to insure that his distributors sell only to retailers who have agreed not to sell below the manufacturer's fixed prices.

II. VERTICAL CUSTOMER RESTRICTIONS

A customer restriction is a restriction limiting the persons to whom a seller may resell his product.²⁸ Where the customer restriction exists between parties who are on a different level of distribution and who are not in competition with each other, the limitation is considered a vertical customer restriction.²⁹ For example, a vertical customer restriction is imposed if a manufacturer limits the persons to whom his wholesalers or retailers may resell his products. Until recently the legality of vertical customer restrictions was tested under the "rule of reason"³⁰ and they were generally upheld unless they were ancillary to an illegal price-fixing scheme³¹ or unless the price fixing was an integral part of the distribution system in which they were present.³² Since the decision in *United States v. Arnold, Schwinn & Co.*,³³ the standard of reasonableness no longer appears to be the appropriate test for the legality of vertical customer restrictions.

In *Schwinn*, the manufacturer sold its products to distributors, all of whom had agreed to resell only to retailers who had been approved by the manufacturer. In turn, the retailers were permitted to sell only to consumers and not to other retailers. Schwinn also executed fair trade contracts with its retailers where such contracts were permitted and it suggested retail prices for its bicycles in non-fair-trade states. Thus both the distributors and the franchised retailers were limited by vertical customer restrictions and some retailers were further restricted by fair trade prices.³⁴ The United States brought suit in the District Court for the Northern District of Illinois alleging that Schwinn and its distributors were involved in a conspiracy to fix prices and to confine distribution of Schwinn's products to certain dealers in violation of Section 1 of the Sherman Antitrust Act. The district court found that there was no basis in fact for the charge of price fixing and, upon application

²⁶ 15 U.S.C. § 45(a)(2), (5) (1964).

²⁷ 15 U.S.C. § 45(a)(2) (1964).

²⁸ See, e.g., *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); *United States v. General Motors Corp.*, 384 U.S. 127 (1966).

²⁹ E.g., *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967).

³⁰ *White Motor Co. v. United States*, 372 U.S. 253 (1963).

³¹ *Id.* at 260.

³² *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707 (1944).

³³ 388 U.S. 365 (1967).

³⁴ Schwinn also restricted the territories in which the purchasing distributors could resell the bicycles. Another aspect of Schwinn's distribution method at issue in the district court was the practice of limiting the territories and customers of distributors who did not purchase the bicycles, but who distributed them as an agent of Schwinn or on consignment. 237 F. Supp. 323 (N.D. Ill. 1965).

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of the rule of reason, that the customer restrictions were not illegal.³⁵ On direct appeal to the Supreme Court, the Justice Department did not contest the finding that there was no basis for the charge of price fixing but sought review of the finding that Schwinn's customer restrictions were reasonable. The Supreme Court reversed the lower court and held that it was a *per se* violation of the Sherman Act for a manufacturer to limit the customers to whom the purchaser of his products could resell.³⁶ In holding these vertical customer restrictions illegal the Court used broad language:

Once the manufacturer has parted with title and risk, he has parted with dominion over the product, and his effort thereafter to restrict . . . persons to whom the product may be transferred—whether by explicit agreement or by silent combination or understanding with his vendee—is a *per se* violation of § 1 of the Sherman Act.³⁷

III. CUSTOMER RESTRICTIONS IN FAIR TRADE CONTRACTS

To establish a comprehensive fair trade program in states where there is no non-signer legislation, a manufacturer must prevent retailers who are not bound by his resale prices from obtaining his products. He can accomplish this objective either by requiring the wholesaler to sell only to the retailers who are bound to follow the resale prices or by bypassing the distributor and selling directly to the retailer. Since the latter alternative is usually impractical, vertical customer restrictions are often the only means by which manufacturers can institute effective fair trading in states without non-signer legislation.

The McGuire Act specifically allows one kind of vertical customer restriction: the manufacturer may require the wholesaler to sell only to the retailers who sign fair trade contracts with the wholesaler. However, many manufacturers apparently desire more direct control than this kind of restriction offers. Rather than leave to the discretion of the *wholesaler* the choice of which retailers are to be offered fair trade contracts, these manufacturers prefer to impose customer restrictions on their wholesalers which would allow them to sell only to retailers approved directly by the *manufacturer*. These "manufacturer-retailer" restrictions require the wholesaler to sell only to retailers who have signed fair trade contracts with the manufacturer.

Although the sweep of *Schwinn's* prohibition seems to be so broad that it makes all customer restrictions illegal wherever they appear, the decision in

³⁵ The district court held also that the territorial restrictions on the purchasing distributors were illegal *per se* under the Sherman Act, but that the customer and territorial restrictions on the distributors who handled the bicycles as agents or on consignment were not illegal under the Sherman Act. *Id.*

³⁶ The Supreme Court held also that it was a *per se* violation for a manufacturer to limit the territories in which the purchaser of his product may resell. But the Court held that where the distributors did not receive title, dominion and the risk of loss from the manufacturer and handled the bicycles as agents or salesmen of the manufacturer, the customer and territorial restrictions upon these distributors were not illegal upon the application of the "rule of reason." 388 U.S. at 379-82. For a discussion of the Supreme Court decision in *Schwinn* see Comment, Restricted Distribution After "Schwinn," 9 B.C. Ind. & Com. L. Rev. 1032 (1968).

³⁷ 388 U.S. at 382.

Schwinn did not resolve the issue whether certain customer restrictions are legal when present in fair trade contracts. There was fair trading of products in *Schwinn*, but the customer restrictions there were not linked closely to the fair trade program. The manufacturer did not attempt to justify them as necessary features of their fair trade program and imposed them even where fair trading was not allowed.

In *Schwinn*, therefore, the Court was not called upon to decide the narrow issue of the legality of customer restrictions which are ancillary to a fair trade program. Moreover, the McGuire Act specifically allows fair trade contracts with vertical customer restrictions which require the wholesaler to sell only to retailers who have signed fair trade contracts with the wholesaler.³⁸ These restrictions are clearly exempted from *Schwinn's* broad prohibition of vertical customer restrictions because the McGuire Act exempts fair trade contracts with these specific restrictions from all antitrust laws.³⁹

It is less clear, however, whether customer restrictions which require the wholesalers to sell only to retailers who have signed fair trade contracts with the manufacturer are immune from *Schwinn's* rule of per se illegality when they are present in fair trade contracts. This restriction is not expressly permitted in fair trade contracts by the McGuire Act, but it is similar in wording and, at least superficially, in effect to the restriction permitted by the McGuire Act. The legality of the customer restriction at issue depends upon whether the federal fair trade statutes impliedly permit fair trade contracts with such restrictions. If the contracts with such restrictions are not permitted by the Miller-Tydings Amendment or the McGuire Act both the contracts and the customer restrictions therein lose their immunity from the antitrust laws. Unless the restriction at issue is exempted from the antitrust laws by Miller-Tydings or McGuire, they are probably illegal under *Schwinn's* broad prohibition.

A. *The Arguments for the Manufacturer-Retailer Restriction*

There are two arguments for the position that fair trade contracts with the manufacturer-retailer restriction are permitted by the federal fair trade statutes. The first argument is that the language of the fair trade statutes impliedly allows them. This interpretation rests upon two cases which were decided immediately subsequent to the passage of the McGuire Act and upon the apparently identical effect of the manufacturer-retailer restriction and the restriction explicitly allowed by the McGuire Act. The second argument is that fair trade contracts with these restrictions are permitted by the fair trade statutes because the restriction is a necessary ancillary restriction to an effective fair trade program and because without such a restriction the implementation and maintenance of a fair trade program would not be possible.

Neither argument is sufficient to establish that fair trade contracts with

³⁸ The McGuire Act specifically allows fair trade contracts that require "a vendee to enter into [fair trade] contracts. . . ." 15 U.S.C. § 45(a)(2) (1964). This phrase may be interpreted as requiring the wholesaler to sign fair trade contracts with retailers or, in other words, as requiring the wholesaler to sell only to retailers who have signed fair trade contracts with the wholesaler.

³⁹ 15 U.S.C. § 45(a)(2) (1964).

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the restriction at issue are permitted by the Miller-Tydings Amendment or the McGuire Act. The first argument fails because the two cases relied upon did not apply the strict interpretation always used in the construction of the fair trade statutes. Also, there is one important distinction between the effect of the manufacturer-retailer restriction and the effect of the restriction permitted by the McGuire Act. The former restriction allows the manufacturer to violate an important antitrust policy reinforced in *Schwinn*, the freedom of the trader, specifically the freedom of the wholesaler to choose his own customers. The second argument fails not only because the manufacturer-retailer restriction is not always necessary for the implementation of a fair trade program, but also because it may be a means by which the purposes of the fair trade statutes are defeated. Thus, it is submitted, fair trade contracts which require the wholesaler to sell only to retailers who have signed fair trade contracts with the *manufacturer* are not permitted by the Miller-Tydings Amendment or the McGuire Act and they are illegal under the Sherman Act.

The argument that the Miller-Tydings Amendment and the McGuire Act can be interpreted as permitting fair trade contracts with the manufacturer-retailer restriction is grounded partly upon two cases, *Masters, Inc. v. Sunbeam Corp.*⁴⁰ and *Sunbeam Corp. v. Payless Drug Stores*.⁴¹ Both cases were concerned with the legality of Sunbeam's wholesale fair trade contracts under the Miller-Tydings Amendment. These contracts contained the manufacturer-retailer restriction. The contracts required the wholesaler to sell Sunbeam's products only to retailers who had signed fair trade contracts with Sunbeam, the manufacturer. In *Masters*, the court held that, because the fair trade contracts placed another condition upon the resale of products in addition to the minimum resale prices, they were not permitted by the Miller-Tydings Amendment.⁴² The court interpreted the Amendment to allow only contracts which placed the single condition of minimum prices upon the resale of the products.⁴³ In *Payless*, the court held that the Miller-Tydings Amendment permitted fair trade contracts with Sunbeam's restriction because the contracts fell within the Amendment's phrase which made lawful contracts prescribing minimum resale prices.⁴⁴ The contracts were viewed as prescribing in essence two minimum resale prices, one wholesale and one retail.⁴⁵

In both cases, the Miller-Tydings Amendment governed the legality of the contracts, but the courts consulted the McGuire Act as an aid to its interpretation of Miller-Tydings. In both cases, the McGuire Act was interpreted to permit Sunbeam's resale price maintenance contracts with the restriction requiring the wholesaler to sell only to retailers who had signed fair trade contracts with the manufacturer.⁴⁶ The two courts placed different significance upon the fact that the McGuire Act contained other additions to the Miller-

⁴⁰ 112 F. Supp. 268 (S.D.N.Y. 1952).

⁴¹ 113 F. Supp. 31 (N.D. Cal. 1953).

⁴² 112 F. Supp. at 270-71.

⁴³ *Id.* at 270-72.

⁴⁴ 113 F. Supp. at 38-39.

⁴⁵ *Id.* at 39.

⁴⁶ 113 F. Supp. at 37; 112 F. Supp. at 271. In both cases the McGuire Act was inapplicable because it was enacted after the initiation of the actions.

Tydings Amendment beside the provision allowing enforcement of fair trade contracts against non-signers. In *Masters*, the court concluded that because of these other additions the McGuire Act did not merely clarify the protection afforded by the Miller-Tydings Amendment.⁴⁷ Thus the Act could not be considered as a basis for declaring the Sunbeam contracts legal under the Miller-Tydings Amendment. Despite these other additions to the Miller-Tydings Amendment, the court in *Payless* considered the McGuire Act as a mere restatement of what the Amendment stated less explicitly.⁴⁸ Thus the court in *Payless* held that the Sunbeam fair trade contracts with the customer restriction requiring the wholesaler to sell only to retailers who signed fair trade contracts with Sunbeam were permitted by the Miller-Tydings Amendment because they were allowed by the McGuire Act, the statutory clarification of the Amendment.⁴⁹

The conclusion of *Payless* concerning the Miller-Tydings Amendment and the conclusion of both cases concerning the McGuire Act were based on a liberal interpretation of the fair trade statutes. But the Supreme Court has consistently applied a strict interpretation to these statutes. For example, in *Schwegmann Bros. v. Calvert Distillers Corp.*,⁵⁰ the Supreme Court applied a strict construction of the Miller-Tydings Amendment and held that the Amendment permitted no enforcement of fair trade contracts against non-signers. The Court here gave the words of the Amendment their normal and customary meaning⁵¹ and refused to read the non-signer provision into the statute although the destructive effect of the decision on resale price maintenance was obvious prior to the decision.⁵² Similarly in *United States v. McKesson & Robbins, Inc.*⁵³ the Supreme Court applied a strict interpretation of the Miller-Tydings Amendment and the McGuire Act. There the Court explicitly stated that the resale price maintenance exemption of antitrust acts is to be construed strictly because it "is a privilege restrictive of a free economy."⁵⁴ In other instances the courts have similarly refused to give the fair trade acts a loose or liberal interpretation.⁵⁵

When the Miller-Tydings Amendment is strictly interpreted, it must be concluded that the statute does not permit customer restrictions which require the wholesaler to sell only to retailers who have signed fair trade contracts with the manufacturer. There are no words in the statute whose ordinary and customary meaning could possibly lead to a contrary conclusion.

A strict interpretation of the McGuire Act would produce the same result. The McGuire Act specifically allows fair trade contracts which require "a

⁴⁷ 112 F. Supp. at 271.

⁴⁸ 113 F. Supp. at 39-40.

⁴⁹ *Id.*

⁵⁰ 341 U.S. 384 (1951).

⁵¹ *Id.* at 388.

⁵² *Cf. id.* at 397 (dissenting opinion).

⁵³ 351 U.S. 305 (1956).

⁵⁴ *Id.* at 316.

⁵⁵ *E.g., Eastman Kodak Co. v. FTC*, 158 F.2d 592 (2d Cir. 1946), cert. denied, 330 U.S. 828 (1947), where the court, in refusing to interpret that a manufacturer's camera film which produced color photographs was in "free and open competition" with non-color film, stated that the Miller-Tydings Amendment should not be interpreted so broadly as to defeat its purpose. *Id.* at 594.

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vendee to enter into contracts or agreements prescribing minimum or stipulated prices. . . ."⁵⁶ This phrase may be interpreted as permitting the manufacturer to require his wholesaler to sell only to retailers who sign fair trade contracts with the wholesaler. It is admitted that this phrase may also be interpreted to allow fair trade contracts requiring the wholesaler to sell only to retailers who have signed fair trade contracts with the manufacturer. The latter interpretation is broader than the former because it would permit more exempted activity. It would allow the manufacturer to take vital and active part in the selection of the wholesaler's customers after the manufacturer had apparently sold all of his interest in the product. A court recognizing that the fair trade acts give a limited immunity from the antitrust laws⁵⁷ and applying a strict interpretation would not adopt the interpretation which allows a broader exemption. Rather it would interpret the McGuire Act to permit only contracts which require the wholesaler to sell only to retailers who have signed a fair trade contract with the wholesaler.

B. *The Freedom of the Trader*

Neither can the McGuire Act be interpreted to permit the manufacturer-retailer restriction for the second reason advanced for that construction—that because the effects of this restriction and the effects of the restriction expressly permitted by the McGuire Act are substantially the same, the McGuire Act also permits contracts with the manufacturer-retailer restriction. The effect of both restrictions is that the wholesaler is not contractually free to sell to a retailer unless the retailer is a party to a fair trade contract. There is a difference, however. Under the McGuire Act restriction, the retailer would contract with the wholesaler, whereas under the manufacturer-retailer restriction, the retailer would contract with the manufacturer. In practice this distinction is very significant. Under the latter restriction the manufacturer chooses the wholesaler's customers by signing fair trade contracts with certain retailers. The wholesaler's freedom to trade, specifically his freedom to choose his own customers, is restricted in contravention of the antitrust policy to protect the freedom of the trader. Therefore an interpretation of the McGuire Act as permitting the manufacturer-retailer restriction should not be accepted.

Under the restriction permitted by the McGuire Act all retailers are potential customers of the wholesaler. In relation to the wholesaler all retailers stand on the same footing. To obtain the manufacturer's products they must sign a fair trade contract with the wholesaler. Under the manufacturer-retailer restriction, not all of the retailers are potential customers of the wholesaler. In practice, only the retailers who have signed fair trade contracts with the manufacturer are potential customers unless the wholesaler wishes to breach his contract with the manufacturer and sell to non-contracting retailers. Thus the manufacturer chooses the wholesaler's customers by signing fair trade contracts with certain retailers and the freedom of the wholesaler to choose his customers is greatly curtailed.

The freedom of the trader has long been an important antitrust policy.

⁵⁶ 15 U.S.C. § 45(a)(2) (1964).

⁵⁷ *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 388 (1951).

This policy is an essential aspect of the Sherman Act, the purpose of which was to keep trade free from restraint.⁵⁸ The freedom of the individual trader was expressly protected first in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, where the Supreme Court held that it was illegal per se under the Sherman Act for the manufacturer to establish the resale prices at which his retailers may resell his products.⁵⁹ This protection still exists except for the limited exception created by the fair trade statutes. Also, the individual trader has been protected against horizontal boycotts which prevent him from obtaining products.⁶⁰ And in *Schwinn* the Supreme Court held that the individual trader may not have his selling territories or his choice of customers restricted by the manufacturer.⁶¹ Thus, the freedom of the individual trader has been protected under the antitrust laws and the merchant's freedom to choose his customers has specifically been protected in *Schwinn*.

Because the manufacturer-retailer restriction enables the manufacturer to select which retailers may sell his products, the restriction limits the freedom of the wholesaler to choose his own customers. The restriction explicitly permitted by the McGuire Act produces a similar effect in that the wholesaler's final choice of customers is limited to retailers who are bound by the resale prices, but it does not deprive the wholesaler of his freedom to choose his own customers from all the retailers. Because the fair trade statutes allow restriction upon the freedom of the trader to establish his own prices and do not mention any other restriction upon the trader's freedom, except for the relatively minor limitation caused by the customer restriction permitted expressly by the McGuire Act, it is unreasonable to conclude that the fair trade statutes, specifically the McGuire Act, would allow contracts imposing the manufacturer-retailer restriction. Such contracts would limit the freedom of the trader to fix his own prices and to choose his own customers and were not sanctioned by the fair trade statutes.

Thus, a strict interpretation of the Miller-Tydings Amendment and the McGuire Act precludes the conclusion that fair trade contracts containing the manufacturer-retailer restriction are permitted by the fair trade statutes. Also, the policy of protecting the freedom of the trader, specifically his freedom to choose his own customers, weighs against an interpretation of the McGuire Act as permitting fair trade contracts with the manufacturer-retailer restriction, because contracts with this restriction would limit the wholesaler's freedom far more severely than was intended by fair trade statutes. Therefore, the fair trade statutes cannot be interpreted as authorizing fair trade contracts with a restriction requiring the wholesaler to sell only to retailers who sign fair trade contracts with the manufacturer.

C. *The Necessary Ancillary Restraint Argument*

Finally, the argument that the manufacturer-retailer restriction is a necessary ancillary restriction to a fair trade program and thus is impliedly

⁵⁸ *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919).

⁵⁹ 220 U.S. 373 (1911).

⁶⁰ E.g., *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959).

⁶¹ 388 U.S. at 382.

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permitted by the fair trade statutes is unacceptable. This argument fails to consider the fact that the restriction explicitly permitted by the McGuire Act provides the same protection as the manufacturer-retailer restriction *and*, furthermore, that it prevents the manufacturer from pursuing other practices not envisioned by the fair trade statutes, such as arbitrary exclusion of retailers by the manufacturer.

In states with fair trade statutes that do not contain a non-signer clause, it can be argued that the restriction at issue in a fair trade contract is necessary for the establishment of a fair trade program. If fair trade contracts with this restriction were not permitted in these states, distributors would be able to sell to retailers who failed to sign such contracts with the manufacturer. These retailers would not be bound directly by contract with the manufacturer or indirectly because of a non-signer clause. Thus they would be able to sell the products at any price and thereby defeat the goals of the fair trade statutes. Furthermore, in states without non-signer clauses the manufacturers could probably not initiate a fair trade program at all. No retailer would sign a fair trade contract with the knowledge that his competitors could obtain the goods and sell them below the minimum prices to which he would be bound.

Also it can be argued that the customer restriction at issue is necessary to enable the manufacturer to police and enforce his fair trade program, especially in states with fair trade statutes that contain a non-signer clause. As a condition for continuing its fair trade program a manufacturer is required to police and enforce its program.⁶² In states with non-signer legislation if a manufacturer cannot require his wholesalers to resell only to the retailers who have signed fair trade contracts with him, some of the manufacturer's products could be sold to non-contracting retailers whose possession of them would be unknown to the manufacturer. If these retailers know of the manufacturer's fair trade program, they are bound to follow the resale prices because of the non-signer clauses. Yet it is impossible for the manufacturer to police and enforce his program against these retailers because they are unknown to him. Moreover, the manufacturer will probably not discover that these retailers possessed his products until after their low prices bring them notoriety. But by this time the injury to the goodwill of the product will already have occurred.

It is submitted that neither of these arguments is conclusive, and that the restriction expressly allowed by the McGuire Act is sufficient to permit effective fair trading. The manufacturer-retailer restriction makes fair trading easier, but it is not a necessary ancillary restraint.

The restriction permitted by the McGuire Act will enable a manufacturer to establish an effective fair trade program in states without non-signer legislation. Only retailers who agree to fair trade contracts with the wholesaler can acquire the manufacturer's products and the contracting retailers will have no basis to fear that competitors not bound by the resale prices will obtain the products. Therefore, the manufacturer-retailer restriction is not necessary to establish a program in states without non-signer clauses, because

⁶² 2 Trade Reg. Rep. ¶ 6322 (1965).

the McGuire Act restriction insures an effective fair trade program in these states.

Furthermore, the only advantage of the manufacturer-retailer restriction at issue in states which have non-signer legislation is direct notice to the manufacturer of the retailers who possess his products. This same advantage would ensue for the manufacturer under the restriction at issue in states with no non-signer legislation after the fair trade contracts had been signed. This notice makes policing and enforcing the fair trade program much easier. However, under the restriction expressly permitted by the McGuire Act the manufacturer could easily obtain equivalent notice by requiring the wholesaler to inform him of the retailers who purchase his products. Thus, the manufacturer-retailer restriction is not necessary for policing and enforcing a fair trade program.

The manufacturer-retailer restriction is really necessary only where the manufacturer desires to protect the goodwill of his product by means in addition to resale price maintenance. By signing fair trade contracts only with certain retailers, the manufacturer, through the customer restriction at issue, can limit his wholesaler's customers to retailers whose possession of the products will enhance the goodwill of his product. For example, the manufacturers could sign fair trade contracts only with retailers who have a good reputation or impressive physical facilities. Thus the manufacturer would be protecting the goodwill of his products by a customer restriction on his wholesaler and by established resale prices. The fair trade statutes, however, have as one of their purposes the protection of the goodwill of the manufacturer's products only through the maintenance of resale prices. Also, the restriction expressly permitted by the McGuire Act is sufficient to protect the goodwill through maintenance of resale prices because only retailers who agree with the wholesaler to follow the resale prices, and thereby protect the goodwill of the product by the means envisioned by the fair trade statutes, can obtain those products. Therefore, the manufacturer-retailer restriction is not necessary to protect the goodwill of the manufacturer's product through the maintenance of resale prices.

Because the manufacturer-retailer restriction is not necessary either to implement a fair trade program in states with no non-signer legislation, or to police and enforce a fair trade program or to protect the goodwill of the manufacturer's products by maintenance of resale prices, the restriction is not a necessary ancillary restriction to a fair trade program. Therefore the fair trade statutes should not be considered as permitting contracts with the customer restriction at issue.

CONCLUSION

It has been shown that the fair trade statutes, the Miller-Tydings Amendment and the McGuire Act do not allow resale price maintenance contracts with the customer restriction requiring the wholesaler to sell only to retailers who have signed fair trade contracts with the manufacturer. As a result, fair trade contracts which attempt to impose such a restriction lose their exemption from the antitrust laws. Thus the establishment of resale

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prices is illegal per se under the Sherman Act because it is non-exempted price fixing. Finally, under the *Schwinn* decision the manufacturer-retailer restrictions would be illegal per se under the Sherman Act because the restriction would not fall within the protection of the fair trade exemption.

THOMAS HOWARD BROWN