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the device of the constructive trust. But, necessarily, the law in this area is still in a nebulous state, since these decisions have set out the law in only two of a myriad of possible fact situations. Inevitably these situations will arise, and even granting that the court will feel justified in applying a constructive trust in every case, a comprehensive statute would seem vastly preferable. The result would be a much more predictable law in this area, relieving the necessity for litigation and for employing such a legal fiction each time an even slightly different set of facts arises.

DAVID M. CLINARD.

Trade Regulation—Exclusive Dealing Arrangements—Effect on Competition Required by Section 3 of the Clayton Act

Congress enacted Section 3 of the Clayton Act¹ in 1914. The intent of Congress was to apply a narrower standard of legality to exclusive dealing arrangements than was employed by the Sherman Act rule of reason approach.² The Act³ was designed to eliminate unreasonably restrictive practices in their incipency.⁴

Section 3 covers both tying clauses and exclusive dealing contracts.⁵

"equitable principles," expressly reserving the question of whether or not N. C. GEN. STAT. § 28-10 (1953) applied.

²⁹ 229 N. C. 160, 47 S. E. 2d 845 (1948). Son killed both parents. This case was clearly not within N. C. GEN. STAT. §§ 28-10, 30-4, or 52-19 (1953).

¹ 38 STAT. 731 (1914), 15 U. S. C. § 14 (1946).

² In *Chicago Board of Trade v. United States*, 246 U. S. 231, 238 (1918), Justice Brandeis stated the rule of reason as follows: "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."

³ 38 STAT. 731 (1914), 15 U. S. C. § 14 (1946). Section 3 of the Clayton Act provides that: "It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods . . . whether patented or unpatented, for use, consumption, or resale . . . on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods . . . of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce."

⁴ *Standard Fashion Co. v. Magrane-Houston Co.*, 258 U. S. 346, 356 (1922): "The Clayton Act sought to reach the agreements embraced within its sphere in their incipency, and in the section under consideration to determine their legality by specific tests of its own which declared illegal contracts of sale made upon the agreement or understanding that the purchaser shall not deal in the goods of a competitor or competitors of the seller, which may 'substantially lessen competition or tend to create a monopoly.'"

⁵ North Carolina has a statute declaring such practices illegal per se, since there is no qualifying clause therein. N. C. GEN. STAT. § 75-5(b) (Supp. 1953). See also Note, 29 N. C. L. REV. 316 (1951).

An example of a tying clause is where a manufacturer leases a tabulating machine to a lessee, and as a condition of the lease, requires the lessee to use in the machine only cards manufactured by the lessor.⁶ On the other hand, an exclusive dealing contract has a direct exclusionary effect in the form of either a total requirements or an exclusive supply contract. A total requirements contract compels a dealer to buy or lease his full requirements of a product from the seller or lessor; the obvious result is that all other competitors are foreclosed from doing business with the dealer. An exclusive supply contract has the same effect by virtue of a specific provision that the dealer will handle certain goods of the supplier only and is forbidden to deal in goods of competitors of that supplier.

Although Section 3 makes no distinction between tying clauses and exclusive dealing contracts, courts have developed different standards of legality for them. The primary purpose of tying restrictions is to suppress competition,⁷ but there are many economic advantages attributed to exclusive dealing contracts.⁸ Consequently, tying restrictions have been held illegal per se,⁹ whereas exclusive dealing contracts have been accorded more liberal treatment.

In applying Section 3¹⁰ the meaning to be given the qualifying clause presents the most difficult problem. The first case involving exclusive dealing contracts to reach the United States Supreme Court was *Standard Fashion Co. v. Magrane-Houston Co.*¹¹ In a private suit by a manufacturer of dress patterns to enjoin a dealer from violating an "agency" contract, the Court found that the contract was an exclusive dealing restriction.¹² In view of the fact that the manufacturer controlled ap-

⁶ *International Business Machines Corp. v. United States* 298 U. S. 131 (1936).

⁷ *Standard Oil Co. of California v. United States*, 337 U. S. 293, 305-306 (1949).

⁸ *Id.* at 306; Stockhausen, *The Commercial and Anti-Trust Aspects of Term Requirements Contracts*, 23 N. Y. U. L. Q. REV. 412, 413-14 (1948).

⁹ *International Salt Co. v. United States*, 332 U. S. 392 (1947).

¹⁰ Generally speaking, there are three methods by which a Section 3 suit arises:

(1) Department of Justice prosecution in a federal district court;

(2) Federal Trade Commission investigation and proceeding with right to appeal from a Federal Trade Commission order direct to the United States Court of Appeals; and

(3) Private suit in the federal courts. A Section 3 case may arise on an injunction petition against a restrictive practice, a defense to a restrictive contract enforcement action, or in a suit for treble damages for injury sustained on account of the restrictive practice.

In the field of private litigation under Section 3 no case has been discovered where treble damages were allowed a small buyer or dealer because of restrictions imposed by an exclusive dealing contract. To allow recovery there must be not only proof of a public injury, but also a causal connection between the violation charged and injury claimed in addition to proof of the nature and extent of that injury. See *Libman v. Sun Oil Co.*, 127 F. Supp. 52 (D. Conn. 1954); *Hudson Sales Corp. v. Waldrip*, 211 F. 2d 268, 274 (5th Cir. 1954).

¹¹ 258 U. S. 346 (1922).

¹² Exclusive agency contracts, vertical integrations, allocations of exclusive territories, and refusals to deal are not covered by Section 3 of the Clayton Act. Also, exclusive buying arrangements that commit the seller to trade exclusively with the

proximately 40 per cent of the 52,000 so-called pattern agencies in the entire country, the Court concluded that such contracts came within the prohibition of Section 3. The Court applied the "dominance" test, which is to the effect that if the degree of domination of the market is sufficient to justify the inference that competition had been or probably would be lessened, then the alleged violator's exclusive dealing contracts are illegal under the qualifying clause of Section 3. Twenty-seven years later came the *Standard Oil of California* case¹³ on a government prosecution,¹⁴ which laid down a narrower rule called the test of substantiality. This test is met when a substantial portion of the industry's business is foreclosed by the restrictive arrangement.¹⁵ Conversely, if the amount of business foreclosed by a restrictive arrangement is insufficient to adversely affect a substantial amount of competition, such arrangement is not a violation of Section 3.

Since the *Standard Oil of California* decision, there has been much uncertainty as to whether exclusive dealing contracts are illegal per se if the defendant is doing a substantial amount of business, or whether the amount of business foreclosed by the contracts is the major factor.¹⁶ There is also a contention that the courts are inconsistent in their holdings. And further, it is contended that the Federal Trade Commission orders are closer to the rule of reason approach than are the court deci-

buyer are not covered by Section 3. See *Federal Trade Commission v. Motion Picture Advertising Service Co.*, 344 U. S. 392 (1953).

¹³ *Standard Oil Co. of California v. United States*, 337 U. S. 293 (1949). Here the defendant corporation had exclusive dealing contracts with 6000 independent dealers representing 16% of the retail gasoline outlets through which \$58,000,000 worth of gasoline was sold in the western area comprising seven states. Defendant, the largest seller in the area, also had 23% of the industry's business although only 6.7% of it was obtained through defendant's exclusive dealing contracts. Six other competitors had similar arrangements which foreclosed a total of 42.5% of the market to more than 70 smaller companies. The length of defendant's contracts varied from specified terms in some cases to year-to-year terms in others. The Supreme Court held that in view of the substantiality of the affected proportion of retail sales and widespread adoption of such contracts by the other large competitors, the contracts created such a potential clog on competition that Section 3 was violated.

¹⁴ An examination of the FTC Docket of Complaints, 3 CCH TRADE REG. REP. (10th ed.) 40,021-406 (1954), reveals the fact that there has been a great increase in Federal Trade Commission activities in this field against major companies in various industries since the decision in *Standard Oil Co. of California v. United States*, 337 U. S. 293 (1949).

¹⁵ For a discussion of the substantiality test applied in *Standard Oil Co. of California v. United States*, 337 U. S. 293 (1949), see Note, 28 N. C. L. REV. 188 (1949).

¹⁶ See Sunderland, *Antitrust Developments: A New Era for Competitive Pricing*, 41 A. B. A. J. 113 (1955); 18 *FORD. L. REV.* 306 (1949); 35 *IOWA L. REV.* 131 (1949); 19 *U. OF CIN. L. REV.* 163 (1950).

But see McLaren, *Related Problems of "Requirements" Contracts and Acquisitions in Vertical Integration under the Anti-Trust Laws*, 45 *ILL. L. REV.* 141 (1950); Schwartz, *Potential Impairment of Competition—The Impact of "Standard Oil Co. of California v. United States" on the Standard of Legality under the Clayton Act*, 98 *U. OF PA. L. REV.* 10 (1949).

sions.¹⁷ A study of the cases reveals that a pattern is developing which tends to show that the substantiality test laid down in the *Standard Oil of California* case is being consistently applied by both the courts and the Federal Trade Commission. That test has been universally adopted even though a bare majority of the Supreme Court adhered to it.¹⁸ In testing for substantiality the inquiry goes beyond an ascertainment of the amount of business done by the alleged violator and includes such matters as a determination of the amount of business foreclosed by the restrictive arrangement. Other economic factors are also of importance on the issue of substantiality.¹⁹

The *Richfield Oil* case²⁰ involved one of the big producers in the western area. In 1950 Richfield did \$36,000,000 worth of gasoline business²¹ plus \$3,650,000 worth of business in tires, batteries, and accessories. Of the 2965 stations involved, there were over 4500 written agreements of indefinite length and 3000 oral stipulations found to have exclusionary effects. First of all, the exclusive dealing arrangements had to be proved before substantiality of foreclosure of competition could be determined. Richfield had two main types of stations which were called leased out (L-O) stations and dealer stations. It was contended that the L-O stations were created by Richfield and therefore were agencies in fact. But the lease provisions containing fifteen clauses were so elaborate and so worded as to make the lessees independent. A legal estate of at least a tenancy at will was found to exist.²² Superimposed upon these leases were oral requirements restrictions which, combined with the leases, had the effect of establishing exclusive dealing arrangements with the 1343 L-O stations. Dealer stations operated under 80 per cent requirements contracts which, without more, would not have been fully exclusive dealing arrangements. Richfield further employed restrictions in the form of painting agreements and restrictions against

¹⁷ Sunderland, *Antitrust Developments: A New Era for Competitive Pricing*, 41 A. B. A. J. 113 (1955); 1 CCH TRADE REG. REP. (10th ed.) ¶4007 (1954).

¹⁸ *Standard Oil Co. of California v. United States*, 337 U. S. 293 (1949). The lower court decision was affirmed by a 5-4 vote.

¹⁹ See, e.g., *Dictograph Products, Inc. v. Federal Trade Commission*, 217 F. 2d 821 (2d Cir. 1954), and *Anchor Serum Co. v. Federal Trade Commission*, 217 F. 2d 867 (7th Cir. 1954). Both cases will be discussed later in this note.

²⁰ *United States v. Richfield Oil Corp.*, 99 F. Supp. 280 (S. D. Cal. 1951), *aff'd per curiam*, 343 U. S. 922 (1952).

²¹ See Kahn, *A Legal and Economic Appraisal of the "New Sherman and Clayton Acts"*, 63 YALE L. J. 293, 315 n. 123 (1954): "This absolute volume probably amounted to less than 3% of the total gasoline sales in the area, though a substantially higher proportion of the sales through service stations alone."

²² *United States v. Richfield Oil Corp.*, 99 F. Supp. 280, 290 (S. D. Cal. 1951): "If we consider the provision for 24-hours' termination as valid, the lessee has, at the worst, a tenancy at will. . . . And I am inclined to think that, because of the conflict of the 24-hours' termination clause with the monthly rental provisions, Courts would consider the tenancy created by the L-O agreements, at least, a month-to-month tenancy terminable only upon the minimum notice required in such cases."

displaying unauthorized signs or operating unauthorized gasoline pumps. These restrictions, together with their rigid enforcement by overwhelming coercion, precluded competitors from trading with the dealer stations. Applying the substantiality test, the court, undoubtedly having in mind that 55 per cent of the industry was tied up by restrictive arrangements of the big producers, relied on the volume of business of Richfield under the exclusive dealing arrangements, the number of such arrangements employed by Richfield, and the coercion practiced in enforcing them, all of which indicated that the objective was to restrain competition. Therefore, the practices involved were held to violate Section 3 of the Clayton Act.

In contrast to the finding of substantiality in the *Richfield Oil* case, *J. I. Case Co.*²³ is an example of a lack of substantiality. The defendant in this case was the nation's third largest producer of farm machinery doing a \$108,000,000 business in 1948, which amounted to 7 per cent of the total business in the industry. *J. I. Case Co.* required its 3738 dealers to handle its complete line of products²⁴ under one year contracts which were renewable. 1050 of the dealers handled *J. I. Case Co.* products exclusively, but it was found that such arrangements were on the dealers' own volition. 108 instances where pressure was applied to restrict the dealers from trading with competitors were reported, but of these only twenty-six instances were reported since 1946 and none in 1948. The court held that on the entire evidence there were no exclusionary restrictions imposed on the dealers.

Thus, many facts had to be considered in both cases to determine whether exclusive dealing practices were employed. In one case exclusive dealing arrangements were proved, whereas in the other there were no exclusionary understandings found except in 108 isolated instances.²⁵

Two recent Court of Appeals decisions from different circuits have applied the substantiality test. In the *Dictograph Products* case²⁶ the court in an opinion by Judge Medina stated that economic inquiry was unnecessary after a finding of substantiality. But in determining the question of substantiality, such facts were relied upon as the volume of

²³ *United States v. J. I. Case Co.*, 101 F. Supp. 856 (D. Minn. 1951).

²⁴ The policy employed by *J. I. Case Co.* and other producers in the farm machinery industry is that of full line forcing; its effect is to require a dealer to handle the complete line of the producer's products as a condition of lease or purchase of any of the producer's goods. Full line contracts are not restrictive under Section 3 unless the dealer is precluded from handling competitors' products.

²⁵ Proof of exclusive dealing agreements in most cases is not so difficult to establish since the exclusionary provisions are usually incorporated in formal written contracts. See *Standard Oil Co. of California v. United States*, 337 U. S. 293 (1949); *Dictograph Products, Inc. v. Federal Trade Commission*, 217 F. 2d 821 (2d Cir. 1954); *Anchor Serum Co. v. Federal Trade Commission*, 217 F. 2d 867 (7th Cir. 1954).

²⁶ *Dictograph Products, Inc. v. Federal Trade Commission*, 217 F. 2d 821 (2d Cir. 1954).

business done under the defendant's written exclusive dealing contracts, its third position in rank in the hearing aid industry, that it is one of three large producers that use these contracts, that it controls 220 of the 1000 prime retail outlets, and that the defendant has maintained its position during the post-war period of growth. Upon consideration of these facts, probable adverse effect on competition was found.

In the other case, *Anchor Serum Co. v. Federal Trade Commission*,²⁷ the court's opinion by Judge Major stated:

"There was no legal issue before the Commission as to whether the contracts were illegal per se; the only legal issue before the Commission, as it is here, was whether the contracts with their restrictive provisions were calculated to have the proscribed effect or consequences. . . . Only contracts which had the proscribed effect were made unlawful [by Section 3]."²⁸

The findings of the Federal Trade Commission were to the effect that defendant had full requirements contracts with sixteen wholesalers, that it was the largest producer of hog cholera serum and virus in the "lay" producing group, and that the dollar volume of business with the sixteen contract holders was substantial. In addition the Federal Trade Commission found that \$1,000,000 worth of business was done annually with its two largest wholesale dealers who were the biggest distributors in the enormous hog producing states of Iowa and Illinois; facts were shown to prove that competition was completely stymied in certain instances after the exclusive contracts were made in 1947. The inescapable inference is that obligation of the dealers under the contracts caused it.²⁹ Here again the decision rests not only on volume of business done under the restriction, but also leadership in the industry and number of outlets foreclosed along with specific instances of eliminating competitors from the market.

The fact that Federal Trade Commission orders are following the substantiality pattern is illustrated by the *Maico Co.* case.³⁰ The Commission remanded the case to the hearing examiner to determine the substantiality of foreclosure of competition because he, in concluding that Section 3 was violated, had found only the following: the petitioner's rank in the hearing aid field, volume of business, and that there were restrictive contracts with 123 distributors. Not a single case discussed has held exclusive dealing contracts invalid on the meager evidence the hearing examiner relied upon in the *Maico Co.* case. The Commission

²⁷ 217 F. 2d 867 (7th Cir. 1954).

²⁸ *Id.* at 870.

²⁹ *Id.* at 873.

³⁰ The *Maico Co., Inc.*, 3 CCH TRADE REG. REP. (9th ed.) ¶ 11,577 (F. T. C. 1952).

requires evidence of the same type as the courts require, except that due to its specialized nature, it is better equipped to probe more deeply into the same complex relevant economic facts that the courts consider in order to determine whether competition has been or probably will be substantially lessened.³¹

From the foregoing it is apparent that the mere doing of a substantial amount of business by an alleged violator is not sufficient to satisfy the requirements of the qualifying clause of Section 3. The major factor in the substantiality test is the amount of business foreclosed by the exclusive dealing arrangements. However, the courts do broaden an inquiry to include such factors as the rank in the industry, practice in the industry, number and per cent of outlets foreclosed, rigidity of enforcement of the restrictive practices, alleged violator's share of the market, length of the contracts, intent of the parties, availability of alternative ways of obtaining an assured market, and the economic power and capacity of the alleged violator to enforce restrictive provisions.

The fact that it is necessary to make an inquiry into the question of substantiality makes it clear that exclusive dealing contracts or arrangements are not legal per se. On the other hand, the fact that such inquiry is made does not mean that the rule of reason is employed. The technique adopted to determine the question of substantiality is similar to that in the rule of reason. But the analogy goes no further. Once substantiality is found to exist, these arrangements may be said to be illegal per se because there is no further inquiry into the reasonableness or beneficial effects that may, in fact, flow from such arrangements in a particular case. But it must be emphasized that the necessity of finding substantiality precludes such contracts from being per se illegal. Thus, it appears that the courts and the Federal Trade Commission have carried out the congressional intent in regard to exclusive dealing arrangements by applying a test of legality that falls between the rule of reason and illegality per se tests.

JAMES R. STRICKLAND.

Trade Regulation—Robinson-Patman Act—Unjustified Price Discrimination—Additional Requirements Necessary to Constitute Violation of Section 2(a).

Section 2(a) of the Clayton Act, as amended by the Robinson-Patman Act,¹ prohibits an interstate seller from making certain price discriminations. The section in part states:

³¹ Cf. Revlon Products Corporation, 3 CCH TRADE REG. REP. (10th ed.) ¶ 25,184, *motion to reopen denied*, ¶ 25,249 (F. T. C. 1954); Beltone Hearing Aid Co., 3 CCH TRADE REG. REP. (10th ed.) ¶ 25,397 (F. T. C. 1955) (Here the order is not a final Commission order, but a hearing examiner's ruling.)

¹ 38 STAT. 730 (1914), 15 U. S. C. § 13 (1946), as amended, 49 STAT. 1526 (1938), 15 U. S. C. § 13 (Supp. 1952).