Developments in the Law of Vertical Nonprice Restrictions: A Welcome Return to The Rule of Reason

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Developments in the Law of Vertical Nonprice Restrictions: A Welcome Return to The Rule of Reason

PAUL A. KOCHES*

The Supreme Court of the United States reversed a prior holding and ruled that nonprice restrictions on competition among distributors are not a per se violation of section 1 of the Sherman Act. In so doing, the Court placed significant reliance on the economic implications of the challenged marketing arrangement. The author explores the Court's increased sensitivity to marketplace realities in its decision to return to a more flexible standard of gauging the illegality of vertical restriction schemes. The business planner is cautioned on possible antitrust pitfalls resulting from the newly engendered economic efficiency guidelines. In conclusion, the reinstatement of a reasonableness approach is welcomed.

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I. HISTORICAL BACKGROUND

A. Early Developments

For almost fifty years after Congress enacted the Sherman Act, 1

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   Every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States . . . is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars, or by imprisonment not exceeding three years, or by both . . . .
the legality of vertically restrictive distributional arrangements was uniformly upheld in private antitrust actions. Not until the post-World War II period did the Department of Justice and the Federal Trade Commission begin to challenge such marketing schemes. In these early actions, brought against a variety of industries, the cases normally terminated in consent decrees rather than fullscale trials. In 1961, the government was initially successful in its attack on a closed territory distribution grant in United States v. White Motor Co. The district court, holding customer as well as territorial restrictions imposed by manufacturers per se illegal, entered a sum-


4. In United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944), the Supreme Court held that the Sherman Antitrust Act was violated by a price fixing arrangement whereby wholesalers were required to sell only to retailers licensed by the distributors, who in turn were bound to sell only to the public at locally prevailing prices. While the Court stated that price fixing was "unlawful per se," it was indefinite as to whether the per se rule was applicable to the customer restrictions embodied in the illegal arrangement. Id. at 812. In 1949, the Department of Justice, relying upon Bausch & Lomb, adopted a position opposing vertical restrictions including restrictions on territories and customers. L. SULLIVAN, ANTITRUST 402 (1977).


7. Territorial sales restrictions prevent a distributor from selling to customers outside a geographic area. In contrast, customer restrictions prevent a distributor from selling to certain customers or specific classes of customers irrespective of the area in which the customer is located. In White Motor, territorial sales restrictions permitted distributors and dealers to sell White trucks only to individuals, firms or corporations having places of business and/or purchasing headquarters within the territory assigned to the distributor or dealer. The customer restrictions precluded distributors and dealers from selling trucks to any federal or
mary judgment against the defendant. On appeal, the Supreme Court of the United States acknowledged that the vertical nature of the territorial restrictions presented a case of first impression and candidly admitted not knowing "enough of the economic and business stuff out of which these arrangements emerge." Accordingly, the case was reversed and remanded for trial. Justice Douglas, speaking for the Court, noted: "We need to know more than we do about the actual impact of these arrangements on competition to decide whether they have such a 'pernicious effect on competition and lack . . . any redeeming virtue' . . . and therefore should be classified as per se violations of the Sherman Act."

B. The Schwinn Doctrine

The next opportunity for Supreme Court review of the legality of restrictions on product distribution arose in United States v. Arnold, Schwinn & Co. Schwinn, a bicycle manufacturer, experienced substantial deterioration of its leading market position. Within a decade, Schwinn's firm hold on close to twenty-five percent of the bicycle market had slipped to less than a thirteen percent share, weakened as a result of stiff competition from other manufacturers and mass merchandisers. In an effort to compete more effectively, Schwinn overhauled its marketing strategy and developed a complex new distribution network: (1) direct sales to twenty-two independent wholesale distributors whose resales were restricted to exclusively allocated territories and only to Schwinn franchised retailers therein; (2) sales to retailers by means of consignment or agency arrangements with distributors; and (3) sales to retailers under the so-called "Schwinn Plan" which involved direct shipment by Schwinn to retailers, with Schwinn invoicing the retailers and extending credit and paying a commission to the distributor taking the order. Dealers were franchised with respect to specifically des-
ignated locations and were authorized to sell Schwinn products only to consumers and not to unfranchised competing bicycle retailers. LEASES.

The government brought a civil antitrust action against Schwinn. After a trial lasting seventy days, the district court concluded that the territorial restraints were unlawful per se when imposed on distributors purchasing products from Schwinn, but not unlawful insofar as they were incident to sales by the manufacturer itself to franchised retailers where the distributor acted as an agent or consignee. An injunction was granted enjoining those distribution practices held to be unlawful.

Schwinn appealed directly to the Supreme Court, which reversed. Expressing the views of five members of the Court, Justice Fortas perceived the issue as one raising the fundamental question of the degree to which a manufacturer may not only select the customers to whom he will sell, but also allocate territories for resale and confine access to his product to selected, or franchised, retailers. We conclude that the proper application of § 1 of the Sherman Act to this problem requires differentiation between the situation where the manufacturer parts with title, dominion, or risk with respect to the article, and where he completely retains ownership and risk of loss.

The Court, finding a material distinction between the two situations, accordingly judged them under different standards. The rule of reason was applied in upholding Schwinn’s territorial and customer restrictions imposed on distributors acting in the capacity as Schwinn’s agents and consignees because Schwinn retained all indicia of ownership of the products (e.g., title, dominion and risk of loss). In contrast, with respect to restrictions on customers to whom, or territories within which, either distributors or retailers could resell products purchased outright from Schwinn, the Court apparently found a per se violation. In what was to become oft-quoted language, Justice Fortas wrote: “Under the Sherman Act, it

16. Id. at 370-71. A breach of this requirement would cause a “communicated danger of termination” by Schwinn to the offending franchisee. Id. at 372.
18. Id. at 343.
20. Id. at 378-79.
21. The Court stated: “When we look to the product market as a whole, we cannot conclude that Schwinn’s franchise system with respect to products as to which it restrains ownership and risk constitutes an unreasonable restraint of trade.” Id. at 382.
is unreasonable *without more* for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it.”

II. THE RESPONSE TO Schwinn: A CRITIQUE OF THE MEANING AND WISDOM OF THE PER SE RULE

Considerable legal commentary ensued, raising doubts as to the meaning and scope of the mandate of the Schwinn Court, as well as impugning its wisdom. Indeed, one rancorous observer bluntly characterized the Schwinn decision as “the most egregious error in all of antitrust.”

The controversy focused primarily on the issues of (1) whether Schwinn did, in fact, stand for a strict per se rule against vertical restraints imposed by manufacturers without title, and, more fundamentally, (2) if so, whether the application of a per se standard in such a market context was justified.

As to the first point, the specific debate had seized upon the significance of Justice Fortas’ phrase “without more.” It had been suggested that rather than creating a blanket per se prohibition, this language merely invalidated vertical restraints of the Schwinn genre absent an acceptable business justification. In addition, a degree of contextual ambiguity had been inferred from the juxtaposition in the opinion of the “without more” language to multiple references to a classic rule of reason analysis.

Nevertheless, a reading of certain unequivocal passages elsewhere in the Schwinn opinion should have resolved any ambiguities

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22. Id. at 379 (emphasis added). The rationale stated by Justice Fortas to support this conclusion was that such a practice would violate “the ancient rule against restraints on alienation” of property. Id. at 380. As one might expect, this reasoning was severely criticized as irrelevant to antitrust regulation. See notes 34-36 and accompanying text infra.


in favor of a strict per se interpretation. For instance, the sentence immediately succeeding the "without more" phrase forcefully states: "Such restraints are so obviously destructive of competition that their mere existence is enough." Of more importance is the Court's concluding language, reiterating the holding of Schwinn:

Once the manufacturer has parted with title and risk, he has parted with dominion over the product, and his effort thereafter to restrict territory or 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.

Despite the apparent per se mandate of Schwinn, lower courts had resisted following it. Instead, the opinion was construed as requiring a demonstration of "firm and resolute" enforcement by the manufacturer of the challenged territorial or customer restriction as an "element" of the per se violation. Other decisions contrived dubious factual distinctions in an effort to circumscribe the Schwinn holding to its allegedly "unique" circumstances. In short,
the force of the Schwinn doctrine was partially eroded by the courts, but not without committing judicial acts of violence to logic and intellectual integrity.

The second, and perhaps more essential problem posed by Schwinn was not so much interpreting the meaning of its language, but rather accepting the validity of its proposition.33

Under the Schwinn rationale, the factor determinative of legality was the form of the transaction in the vertical marketing chain. In the event manufacturers sold their products to the distributors, the former had no defense to antitrust liability for any restraint imposed on the distributor's ability to resell. On the other hand, where distributors acted as agents or consignees, manufacturers would be permitted to present legitimate business justifications for limitations on resales. Thus, the Schwinn doctrine produced sharply contrasting results depending upon the role played by the distributor within the marketing system.

The curious distinction between agency/consignment and independent sale transactions was expressly premised on "the ancient rule against restraints on alienation"34 of property. Indeed, Justice Fortas' position had been widely assailed as both entirely unrelated to the competitive effects of the restraint as well as irrelevant to the proper purposes of the antitrust laws.35 For example, in Professor Posner's critique of Schwinn, he wrote:

[T]he common law of restraint of trade was not a product of concern with promoting competition and was not enacted into federal law by the Sherman Act; there is no occasion to consider what a nineteenth-century judge interpreting a confusing body of English precedents would have done if confronted by methods of distribution unknown in his time.36

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35. The rule was described in Justice Stewart's dissent in Schwinn as a "wooden and irrelevant formula." Id. at 394. See, e.g., Handler, The Twentieth Annual Antitrust Review—1967, 53 VA. L. REV. 1667, 1684-86 (1967); Pollock, The Schwinn Per Se Rule: The Case of Reconsideration, 44 ANTITRUST L.J. 557 (1975); Robinson, supra note 23, at 270-71.

36. Posner, supra note 2, at 296; accord, Eastex Aviation, Inc. v. Sperry & Hutchinson Co., 522 F.2d 1299, 1306 (5th Cir. 1975) (applying Schwinn per se rule, but stating: "Ancient rules of property law should not be made the basis for determining the application of modern rules of antitrust law.")
III. THE RESURRECTION OF THE RULE OF REASON

A. Continental T.V., Inc. v. GTE Sylvania Inc.

Against this background, a case arose which would ultimately put in issue the continuing vitality of the Schwinn doctrine. GTE Sylvania Inc., a manufacturer of television sets, adopted a new franchise plan in 1962 which limited the number of franchises granted in any given geographic area and imposed a requirement upon each franchise to sell Sylvania products only from the location or locations at which it was franchised. Continental T.V., Inc., a retailer, prospered under the Sylvania plan, but later cancelled a large order in protest of Sylvania's proposed new franchise which was to be located in close proximity to one of Continental's retail outlets. A general deterioration of business relations ensued, culminating in Sylvania's termination of Continental's franchise.

Subsequently, Continental brought an antitrust suit against Sylvania predicated upon the vertically restrictive franchise system. The cross-complaint alleged that "Sylvania had violated § 1 of the Sherman Act by entering into and enforcing franchise agreements that prohibited the sale of Sylvania products other than from specified locations." At trial, Sylvania introduced evidence demonstrating that its franchising policy of selective distribution was absolutely essential to Sylvania's survival as a viable competitor in the television industry. The case was submitted to the jury by

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38. The plan was prompted by a decline in Sylvania's market share to an insignificant one to two percent of national television sales. Id. at 38.
39. An acknowledged purpose of the change was to decrease the number of competing Sylvania retailers in the hope of attracting the more aggressive retailers which was thought necessary for the improvement of the company's market position. The plan yielded positive results during the time period at issue. By 1965, Sylvania's market share increased to five percent and the company ranked as the nation's eighth largest manufacturer of color television sets. Id. at 39.
40. Hereinafter referred to as "Continental." In fact, there were four corporate petitioners: Continental T.V., Inc.; A & G Sales; Sylpac, Inc.; and S.A.M. Indus., Inc. All four conducted business under the trade style of "Continental T.V." Id. at 39 n.5. Continental was one of Sylvania's most successful dealers in the San Francisco area. Id. at 39.
41. Among other things, Sylvania's credit line was withdrawn. This precipitated Continental's withholding of payments due to a finance company handling credit arrangements between Continental and Sylvania. Id. at 39-40.
42. Actually, the antitrust issues were raised in cross-claims brought by Continental against Sylvania in a diversity action filed by Sylvania's finance company against Continental seeking recovery of money owed and secured merchandise. Id. at 40.
43. Id.
44. GTE Sylvania Inc. v. Continental T.V., Inc., 537 F.2d 980, 982 n.2 (9th Cir. 1976) (en banc).
special interrogatories with instructions virtually precluding the jury from finding in favor of Sylvania on the critical issue of whether the location clause constituted a per se violation of the Sherman Act under the Schwinn rule. Consequently, Continental prevailed and the court assessed treble damages against Sylvania.

On appeal to the United States Court of Appeals for the Ninth Circuit, an en banc panel reversed the judgment below. The appellate court distinguished Schwinn on a number of factual grounds in a strenuous effort to circumvent a per se condemnation of the Sylvania plan. Writing for the majority, Judge Ely contrasted the nature of the restrictions imposed by Schwinn with those imposed by Sylvania, their resultant economic effects, and each manufacturer's respective market power, concluding that Sylvania's distribution practices did not pose the same anticompetitive potential as did those condemned in Schwinn. Accordingly, the panel held "that the just result in the present controversy is not absolutely foreor-

45. See id. at 985 n.6. Interestingly, the trial judge in the case was the late Associate Justice Tom C. Clark (Ret.), sitting by designation in the district court. Scrutinizing his jury instructions which were assigned as error on appeal, the Ninth Circuit observed: "Justice Clark apparently adopted some of his own dissenting comments in White Motor Co. v. United States . . . . There, the majority of the Court, against the will of Mr. Justice Clark, declined to establish a broad per se rule regarding all vertical territorial restraints." Id. at 987 n.10 (citations omitted).

46. Pursuant to 15 U.S.C. § 15 (1976), the district judge entered judgment of treble damages against Sylvania in the amount of $1,774,515 and awarded Continental attorney's fees in the sum of $275,000. 537 F.2d at 986.

47. 537 F.2d at 1004. The majority and dissenting opinions of the first panel hearing the appeal, unofficially reported in 1974-1 Trade Cas. ¶ 75,072 (9th Cir. 1974), were withdrawn pending the rehearing en banc. 537 F.2d 982 n.1.

48. 537 F.2d at 989-92. See also notes 30-32 and accompanying text supra.

49. "Schwinn involved a restriction on the location and types of permissible vendees, while Sylvania only imposed restrictions on the permissible locations of vendors." 537 F.2d at 990 (emphasis by the court).

50. In Schwinn a wholesale distributor was foreclosed from selling Schwinn products to any purchaser located outside his exclusive territory; thus, intrabrand competition (i.e., competition between sellers of the same brand) was wholly destroyed. A potential purchaser of Schwinn products at the wholesale level could look to only one source of the product—the authorized dealer for his territory. No other wholesaler could compete by offering a lower price or better service to the same purchaser. In marked contrast, Sylvania franchised at least two dealers in the major markets and each Sylvania dealer was free to sell to any buyer he chose—preserving intrabrand competition and allowing to every potential purchaser of Sylvania products a reasonable choice between several competing dealers.

Id. (emphasis by the court).

51. "Schwinn had an extremely large share of the bicycle market. Sylvania's market share, however, was so small when it adopted its locations practice that it was threatened with expulsion from the television market." Id. at 991. See also text accompanying note 44 supra.
dained by Schwinn, and that a rule of reason analysis should have been applied."^52

On certiorari review, the Supreme Court affirmed in a six to two decision.\(^53\) The Court, however, rejected the Ninth Circuit’s strained distinctions, finding the language of Schwinn “clearly broad enough to apply to the present case.”\(^54\) Justice Powell, author of the majority opinion, set the tone for the Court’s analysis: “Unlike the Court of Appeals, however, we are unable to find a principled basis for distinguishing Schwinn . . . .”\(^55\) Indeed, Sylvania had urged the Court that if Schwinn could not be distinguished then it should be critically reconsidered. The Court agreed, convinced of the need for clarification of the antitrust law of distributional restrictions.\(^56\)

Mindful of the great weight of scholarly and judicial indictments of the Schwinn doctrine,\(^57\) Justice Powell premised his review of the case before the Court on the observation that the rule of

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52. 537 F.2d at 1003. In so holding, the majority sought to further what it construed to be the congressional intent behind the Sherman Act—the promotion of consumer welfare through a competitive economy. Id. at 1003-04. In contrast, Judge Browning’s dissent interpreted Schwinn as a proper prohibition of restrictions upon the autonomy of independent businessmen. As such, Browning argued, Schwinn was consistent with a principal concern of antitrust regulation. Id. at 1018-22. For a more detailed discussion of the conflicting policy considerations under the antitrust laws, see notes 116-27 and accompanying text infra.

53. Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977). Justice White filed a separate opinion, in which he concurred with the judgment of the other five members of the majority. Id. at 59. Justice Brennan, with whom Justice Marshall joined, filed a brief dissenting opinion. Id. at 71. Justice Rehnquist took no part in the consideration or decision of the case. Id. at 59.

54. Id. at 46.

55. Id. Comparing the focus of the marketing practices in Schwinn with that in Sylvania, the majority agreed with the Ninth Circuit that the former system was intended to limit available retail customers, whereas the latter dealt with territorial restraints. See also note 49 and accompanying text supra. That distinction was found to be without a real difference and, in the words of the majority, “irrelevant to functional anti-trust analysis.” 433 U.S. at 46. Significantly, the Court deferred to the enlightened phraseology of Chief Justice Hughes in Appalachian Coals, Inc. v. United States, 288 U.S. 344, 360, 377 (1933): “Realities must dominate judgment. . . . The Anti-Trust Act aims at substance.” 433 U.S. at 47.

56. Id. at 47. Of course, Schwinn was supported by, if nothing else, the principle of stare decisis. Later in the opinion, however, Justice Powell made the following comment about the value of precedent:

The importance of stare decisis is of course, unquestioned, but as Mr. Justice Frankfurter stated in Helvering v. Hallock . . . “stare decisis is a principle of policy and not a mechanical formula of adherence to the latest decision, however recent and questionable, when such adherence involves collision with a prior doctrine more embracing in its scope, intrinsically sounder, and verified by experience.”

Id. at 58 n.30 (citations omitted). It is noteworthy to contrast the position taken by Justice White, who refused, in his concurrence in judgment, to endorse the overruling of Schwinn, arguing that “considerations of stare decisis are to be given particularly strong weight in the area of statutory construction.” Id. at 60. See also text accompanying note 77 infra.

57. 433 U.S. at 48-49 nn.13 & 14. See also notes 23-36 and accompanying text supra.
reason is the prevailing standard of analysis under the Sherman Act. In so doing, the Court expressly reaffirmed its earlier position that per se rules are appropriate only in circumstances where the conduct complained of is "manifestly anticompetitive." Finding the reasoning in Schwinn fatally erroneous in a number of respects, its per se rule was overturned. For those academicians still debating the meaning and wisdom of the Schwinn doctrine, the dispute was finally resolved simply and authoritatively in GTE Sylvania. Schwinn had indeed stated a per se rule against territorial and customer restrictions but, as such, it was wrong.

B. The Court's Economic Analysis

The Court prefaced its economic analysis with the general observation that the potential market effect of any restrictive distributional system is the simultaneous reduction of intrabrand competition and stimulation of interbrand competition. In a significant footnote, the Court added that "interbrand competition is the primary concern of antitrust law." Criticizing Schwinn for its inept treatment of economics, the GTE Sylvania Court noted the conspicuous absence of "even an assertion in the [Schwinn] opinion that the competitive impact of vertical restrictions is significantly affected by the form of the transaction." Elaborating, Justice Powell

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58. 433 U.S. at 49. The Court at this juncture footnoted to what is perhaps the broadest statement of the rule of reason:

The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.

Id. at 49 n.15 (quoting Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918)).

59. 433 U.S. at 50. The classic expression of the per se rationale is found in Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958): "There are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they caused or the business excuse for their use."

60. 433 U.S. at 59.

61. Id. at 51-52. Stated simply, interbrand competition is competition among the manufacturers of the same generic product, for example, television sets. In contrast, intrabrand competition is competition among the distributors, either at a wholesale or retail level, in marketing the product of a particular manufacturer.

62. Id. at 52 n.19 (emphasis supplied).

63. Id. at 54.
observed incredulously that Schwinn supported its exclusion of non-sale transactions from its per se mandate "not because of a greater danger of intrabrand harm or a greater promise of interbrand benefit, but rather because of the Court's unexplained belief that a complete per se prohibition would be too 'inflexible.'" 64

The Court's analytical focus, then, was clear from the outset. Actual competitive effect in the interbrand marketplace was deemed the essential touchstone for antitrust scrutiny of distributional plans imposed by manufacturers. This approach was applied even though vertical restrictions naturally tend to reduce intrabrand competition by limiting the number of sellers of a given product competing for the business of a given aggregate of buyers. 65 The potential exploitative power of retailers, however, within their assigned geographic market is always checked by consumer mobility, specifically, the ability of buyers to travel to other franchised territories to purchase the same brand at a competitive price. 66 In addition, the existence and availability of reasonable substitute products, depending on cross-elasticity of consumer demand and the absence of a manufacturer's outright product market, serves as a check on retailer market power. 67

Nevertheless, under the GTE Sylvania rule of reason, the distributional system's adverse impact on intrabrand competition, if any, must be balanced against the benefits accruing to interbrand competition; if the scale tips in favor of the latter, the system is legal under section 1 of the Sherman Act. Plainly, vertical restrictions may significantly stimulate interbrand competition by facilitating certain efficiencies in distribution which are otherwise unfeasible in a purely competitive intrabrand market. 68 Among these is the incen-

64. Id. (citing United States v. Arnold, Schwinn & Co., 388 U.S. 365, 379 (1967)).
65. 433 U.S. at 54.
66. Id. The Court's observation is basically sound, with one minor qualification. The prices of territorially restricted dealers could indeed exceed the competitive level, but only by an amount equal to or less than the additional costs incurred by consumers in traveling to the nearest competitively priced dealer.
67. Id. at 52 n.19. The Court also mentioned that neither of these variables—consumer mobility or substitute products—is affected by the form of the transaction between any of the links in the chain of distribution. Id. at 54.
68. Id. at 54, 55 (citing Preston, Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards, 30 Law & Contemp. Prob. 506, 511 (1965)). Although the analysis of GTE Sylvania is extensively couched in economic terms, the Court also footnoted various noneconomic reasons supporting vertical restrictions. For example, a manufacturer may wish to exert control over the manner in which his product is sold and serviced because of a concern for the safety and quality of the product. Furthermore, beyond its own notions of public responsibility, federal and state laws impose stringent requirements upon producers in this regard. E.g., Consumer Product Safety Act, 15 U.S.C. §§ 2051-81 (1976); Consumer Product Warranties Act, 15 U.S.C. §§ 2301-12 (1976); Cal. Civ. Code §§ 1790-96 (West 1973).
tive for new entrant manufacturers to use restrictive systems "in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer."\textsuperscript{69}

In the case of established producers, the Court pointed out that distributional efficiency is enhanced by vertical restraints because they operate to foster competition at the retail level in the "special services" market. Manufacturers can seek to include in their franchising agreements, such as the Sylvania plan, provisions requiring that retailers provide service and repair facilities or engage in promotional and advertising campaigns. Promotional and repair services, the Court observed, may be vital to the successful marketing of certain products in a competitive industry.\textsuperscript{70} As Justice Powell aptly stated: "The availability and quality of such services affect a manufacturer's goodwill and the competitiveness of his product."\textsuperscript{71}

A concurrent benefit of territorial or customer restraints in a marketing scheme is the effective elimination of the "free-rider" syndrome. This effect is seen where, in a purely competitive intrabrand market, a certain proportion of competing dealers are inclined to forego providing services, with the obvious purpose of saving money. The result is a two-fold market imperfection: (1) those recalcitrant dealers get the benefits of the service-enhanced goodwill of the franchised trademark without undertaking the costs; and (2) this group may also cut prices to attract purchasing customers away from the service-competitive franchisees while directing the same consumers to the competitors for repairs, exchanges, etc.\textsuperscript{72} Thus, such incentives are minimized when only a limited number of dealers were franchised in a given location.

The Court further assumed, in support of presumptive legality of vertical restraints, that there is a general interest on the part of manufacturers in maintaining optimal levels of intrabrand competition in both services and price.\textsuperscript{73} One could expect that the lower the retail price, the greater the volume of sales and the higher the total amount of manufacturer revenues.\textsuperscript{74}

\textsuperscript{69} 433 U.S. at 55.
\textsuperscript{70} Id. The Court suggested that service and repair are essential when marketing such products as automobiles and major household appliances and, apparently included within the latter group, television sets. Id.
\textsuperscript{71} Id.
\textsuperscript{72} Id. See generally Posner, supra note 2, at 285.
\textsuperscript{73} That is, to the extent consistent with the efficient distribution of their products. 433 U.S. at 56 (citing Bork, supra note 2, at 403 and Posner, supra note 2, at 283, 287-88).
\textsuperscript{74} See Note, Vertical Restraints: Enforcement of Resale Location Is a Per Se Violation of Section One of the Sherman Act, 88 HARV. L. REV. 636, 641 (1975).
Summarizing his discussion of the economics of distributional restraints, Justice Powell reiterated: "[T]here is substantial scholarly and judicial authority supporting their economic utility. There is relatively little authority to the contrary."

In short, the almost universal disparagement of the Schwinn per se doctrine was, in GTE Sylvania, accorded the ultimate judicial sanction. Justice Powell sounded the death knell for Schwinn with the following forceful language:

Certainly, there has been no showing in this case, either generally or with respect to Sylvania's agreements, that vertical restrictions have or are likely to have a "pernicious effect on competition" or that they "lack . . . any redeeming virtue." Accordingly, we conclude that the per se rule stated in Schwinn must be overruled. In so holding we do not foreclose the possibility that particular applications of vertical restrictions might justify per se prohibition under Northern Pac. R. Co. But we do make clear that departure from the rule-of-reason must be based upon demonstrative economic effects rather than—as in Schwinn—upon formalistic line drawing.

Concurring in the result, Justice White argued that Schwinn should be distinguished rather than overruled. His opinion adopted many of the distinctions offered by the Ninth Circuit majority below. Most significantly, he contended that the potential for enhanced interbrand competition coupled with Sylvania's insubstantial market power sufficiently differentiated the two cases to permit the Schwinn rule to stand.

IV. Conclusion: The Implications of GTE Sylvania

Ironically, the sweeping GTE Sylvania decision may well spawn an even greater volume of commentary than did Schwinn. Clearly, GTE Sylvania stands as a watershed in the law of vertical relationships. Perhaps most interesting are the theoretical implications of GTE Sylvania for future developments in antitrust law, as well as the practical ramifications of the decision for antitrust litigation and for business planning.

A. Business Planning

Prior to GTE Sylvania, business counselors could offer confident advice to their clients concerning the effect of vertical location

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75. 433 U.S. at 57-58.
76. Id. at 58-59 (emphasis supplied) (citations omitted).
77. Id. at 59-60.
and customer restrictions under the clearly delineated boundaries of the \textit{Schwinn} doctrine. Now, in the wake of \textit{GTE Sylvania}, business advisors tread in unchartered waters, guided only by a single buoy of "reasonableness." Moreover, \textit{GTE Sylvania} teaches that reasonableness is determined primarily by the net benefit to interbrand competition. Such determinations are difficult to predict for a manufacturer contemplating the adoption of a radically different restrictive distributional plan.

Thus, in order to minimize the risk of antitrust liability, manufacturers considering such plans should prudently consider and document legitimate marketing reasons for doing so. They should focus on goals of increased efficiency, meeting interbrand competition in the special services area, or inducing investment on the part of retailers. As such, should the restriction come under antitrust attack, the competition-minded manufacturer would be in a better position to demonstrate a "redeeming virtue" justifying his marketing practices.\footnote{78. \textit{Id.} at 54. Justice Powell noted that "[t]hese 'redeeming virtues' are implicit in every decision sustaining vertical restrictions under the rule of reason." \textit{Id.}}

It is crucial, therefore, that the manufacturer clearly and explicitly record evidence demonstrating that the restraint is necessary but ancillary to some legitimate business purpose, designed with the ultimate objective of promoting competition.

Business planners would be well advised to conduct empirical studies on the nature of intrabrand, and more importantly, interbrand competition in the particular product market.\footnote{79. After \textit{GTE Sylvania}, courts should consider all forms of competition, including pricing, advertising, promotional campaigning and providing services. In addition, an analysis of the structural factors which facilitate competition in a market might be helpful, notably seller concentration, buyer concentration, product differentiation and barriers to entry. \textit{See generally} J. \textit{Bain, Industrial Organization} 7 (2d ed. 1968).} At the outset, the manufacturer should consult expert economic advice to assess the competitive ramifications of any distributional plan under consideration. After effectuation of the plan, the actual responses in terms of competitive effects should be closely monitored in the initial stages of its implementation. All relevant data demonstrative of fluctuations in interbrand competition should be diligently recorded. Of course, in the eventuality of a significant decline in competition, the utility of the plan might be reconsidered in light of potential antitrust scrutiny.

Most importantly, manufacturers must be careful not to impose restrictions on distribution in response to concerted dealer pressures. Vertical restraints imposed at the behest of a group of
retailers will not be accorded any justification in rebuttal to a section 1 attack. Rather, *GTE Sylvania* expressly reaffirmed the per se prohibition of horizontal agreements dividing markets or restricting competition among competitors. Finally, to forestall possible allegations of a dealer cartel, vertically restrictive manufacturers should bargain adamantly for clauses in their franchise agreements providing for rigorous enforcement of the location and customer limitations imposed on dealers.

**B. Litigation: Effects on Volume and Strategy**

The overruling of the *Schwinn* per se rule and the substitution of the *GTE Sylvania* rule of reason invites speculation as to its impact on the nature of litigation and the number of cases that will follow.

The most obvious change for litigants is the change in focus to the market effects test. To what degree this shift will affect the net volume of antitrust litigation, however, is presently unclear. On one hand, such proceedings will inevitably involve a balancing of complex economic factors probative of competitive reasonableness. The use of economists and other expert witnesses at trial will certainly increase. Problems of discovery and proof under rule of reason litigation will certainly mushroom, becoming more costly and complex, and thus requiring stricter court supervision. The end result might be massive and protracted trials, aggravating already crowded court dockets.

On the other hand, the number of antitrust attacks launched against distribution-restricting manufacturers may decline following *GTE Sylvania*. Prior to this decision, a simple prima facie case showing the mere existence of a restraint satisfied the *Schwinn* requirement for liability. Antitrust plaintiffs are naturally attracted to the per se cases where the alleged offense has been previously established as a "pernicious act." This is because the application of a per se standard significantly lightens their burden while the potential recovery of treble damages provides a tempting incentive to litigate.

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80. 433 U.S. at 58 n.28. See also United States v. Topco Assoc., Inc., 405 U.S. 596 (1972); United States v. General Motors Corp., 384 U.S. 127 (1966). For a critical analysis of *Topco* which concludes that the rationale in *Topco* is totally obliterated by the teachings of *GTE Sylvania*, see text accompanying notes 87-100 infra.

81. Of course, plaintiffs always had to prove standing and injury. Standards imposed on plaintiffs in these two respects have become increasingly more rigorous as a result of recent antitrust decisions, the subject of which is neither crucial to nor within the scope of this comment.
GTE Sylvania fails to distribute the burdens of proof between the plaintiff and the defendant, thus creating a great deal of uncertainty. Until it is resolved, the prudent plaintiff should be prepared to prove affirmatively the illegal purpose and effect of the restraint or, at bare minimum, to rebut contrary contentions of the defendant.

In short, while GTE Sylvania provides a certain disincentive for plaintiffs to litigate, those cases which are inevitably brought under its purview are likely to involve complicated questions of fact and consequently will engender greater costs to litigants and to courts. Additionally, GTE Sylvania suggests new strategic considerations in the prosecution of distributional cases. To reiterate, the GTE Sylvania Court expressly limited its rule of reason holding to non-price vertical restraints. Mindful of the still viable per se prohibition against pricing maintenance, plaintiffs might be inclined to allege that the underlying purpose of the manufacturer's distribution plan is simply to fix prices. Where a preponderance of the evidence demonstrates such an objective, an otherwise apparently reasonable territory or customer restraint may well be rendered indefensible.

Alternatively, plaintiffs could argue, even in the absence of the manufacturer's illegal intent, that the effect of the restrictions was nevertheless a stabilization of prices. This position is problematical, however, since GTE Sylvania is silent regarding the extent to which a reasonable distributional restraint may tangentially affect prices before crossing the line into the realm of illegality, per se or otherwise.

82. 433 U.S. at 51 n.18.


84. Other significant questions remain open as well. For instance, under the newly fashioned standard of reasonableness against which locations and customer restrictions are to be measured, it is unclear to what degree a manufacturer must establish a "redeeming virtue" justifying the restraint. The specific factors to be considered were not delineated in the GTE Sylvania opinion. Normally, the purpose and nature of the restraint, the business context in which it was imposed and the market impact which results are all important. For a classic expression of the rule of reason, see Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918), quoted in note 58 supra.

Manufacturers no doubt would want to demonstrate that the restraints enhance distributional efficiencies, but it is uncertain whether such a showing, standing alone, could justify any given restraint. Does the burden, thereafter, shift to the plaintiff to prove adverse interbrand market effect? Or should the defendant, rather, carry the burden of demonstrating a net benefit to interbrand competition?

Additionally, the GTE Sylvania Court apparently accorded no independent significance to the market power of the challenged firm. The anxiety expressed by Justice White in his concurring opinion concerning the Court's failure to analyze the effect of relative market
C. Antitrust Analysis in the Future

Apart from the specific message of *GTE Sylvania* to the business community and to antitrust litigants, the case provides instructive insight into the Court’s philosophical and methodological perspective of antitrust jurisprudence. *GTE Sylvania* stands, economists would hasten to say, as a prelude to the further refinement of judicial economic analysis of Sherman Act cases incorporating economic maxims into functional legal rules. Perhaps the greatest significance of the decision then, lies in the Court’s pronouncement of the “functional antitrust” analytical framework. Underlying this approach, the Court premised its holding on the philosophy of economic realism and resolved the problem before it without regard to the artificial labelling of formalism, but rather with a real concern for the impact on actual competition in the market place.

The extension of the rule of reason analysis in *GTE Sylvania* indicates a fresh willingness by the Supreme Court (as well as a directive to lower courts) to consider economic evidence in adjudicating antitrust claims. As such, the case marks a fundamental shift in position from that taken by the Court not so long ago in *United States v. Topco Associates, Inc.*

Topco was a cooperative association consisting of twenty-three small and medium sized regional supermarket chains and two retailer-owned wholesale facilities which operated in thirty-three states. Each store was independently run under its own name. Topco’s only function was that of purchasing agent. The cooperative procured and distributed various food items to members, most of which were sold under the brand name which it owned. The joint

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strength suggests that such was indeed not considered by the majority in reaching the result; nor is it, therefore, relevant to the rule of reason. 433 U.S. at 64. Nonetheless, one wonders, in the event restraints are imposed by market giants wielding near monopolistic market shares, whether an evaluation of the independent effect of market dominance on interbrand competition is proper under those circumstances, or whether the preferred tactic is an action under § 2 of the Sherman Act for monopolization or attempted monopolization. See 15 U.S.C. § 2 (1976).

In connection, one matter that *GTE Sylvania* does resolve, at least implicitly, is the irrelevancy of any degree-of-restrictiveness considerations with respect to location or customer clauses and rule of reason scrutiny. See 433 U.S. at 58 n.29. Therefore, a plaintiff will probably not be heard to argue unreasonableness grounded on the availability of a less restrictive distributional restraint than the one adopted by the manufacturer, even if it could have achieved the same efficiencies.

85. 433 U.S. at 46. See also note 55 and accompanying text supra.
86. 433 U.S. at 47-59; see notes 61-77 and accompanying text supra.
87. 405 U.S. 596 (1972).
88. Id. at 598.
89. Id. Only 10% of the total goods sold by members carried the “Topco” brand mark. Id. at 600.
venture buying and distribution scheme thus enabled member-chains to achieve significant cost economies. At least part of these savings were passed on to customers in the form of lower prices. Unfortunately, as Topco members would soon discover, the fatal error in the program was the association’s exclusive division of geographic markets. Specifically, the joint venture called for the assignment of an exclusive district to each retailer through a system of territorial licensing.  

The district court upheld the restrictions under a rule of reason analysis, concluding that the anticompetitive effects of the territorial restraints were outweighed by the enhanced ability of Topco members to compete with the larger, burgeoning national chain supermarkets.  

On direct appeal, the Supreme Court reversed, finding the per se principle in United States v. Sealy, Inc. controlling for self-imposed territorial restraints by firms at the same level of production. Topco held that any horizontal division of geographic markets is per se illegal.  

In so holding, the Supreme Court enumerated three reasons for rejecting the rule of reason: (1) the inability of the judiciary to weigh the destruction of intrabrand competition against the promotion of interbrand competition; (2) the desirability of leaving to Congress the task of making such complex balancing judgments; and (3) the need to provide the business community with a rule enabling it to predict with certainty what courses of conduct are impermissible.  

Interestingly, in a terse and inconspicuous footnote, GTE Sylvania reaffirmed the Topco rule, coupled with an unconvincing attempt to distinguish and cast aside the horizontal market division situation. One doubts, however, the viability of the tripartite per se rationale of Topco in light of the GTE Sylvania market-effect analysis.  

First, the GTE Sylvania Court obviously demonstrates an ability, if not an eagerness, to do precisely that which the Topco Court declined to do—to sift through complex economic evidence in bal-

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90. Id. at 601-03.
92. 388 U.S. 350 (1967). Coincidentally, Sealy was decided on the same day as Schwinn.
94. Id. at 609-10.
95. Id. at 612.
96. Id. at 609 n.10.
ancing the costs and benefits of territorial restrictions. Second, the
GTE Sylvania decision explicitly refutes the contention that bal-
ancing intrabrand and interbrand competitive effects is not a proper
function of the judicial process, ironically enough citing Schwinn. Third, responding to the policy argument that per se jurisprudence
provides certainty and guidance to the business community, GTE
Sylvania astutely counters: "Those advantages are not sufficient in
themselves to justify the creation of per se rules. If it were otherwise,
all of antitrust law would be reduced to per se rules, thus introduc-
ing an unintended and undesirable rigidity in the law." 100

Potential ramifications upon horizontal marketing arrange-
ments aside, GTE Sylvania also sheds new light upon vertical re-
straints not specifically presented by Sylvania's distribution
scheme. The familiar problem of resale price restraints, 101 hereto-
fore uniformly struck down by courts as per se illegal, 102 is now ripe for
reconsideration under the Court's "new economics of vertical rela-
tionships." 103 Here again, however, GTE Sylvania made clear that
price maintenance was excepted from its rule of reason penumbra,
distinguishing price controls on the basis of precedent and policy.
The Court footnoted: "The per se illegality of price restrictions has
been established firmly for many years and involves significantly
different questions of analysis and policy." 104

Nonetheless, in a concurring opinion, Justice White character-
ized the "purported" distinction as being "as difficult to justify as
that of Schwinn under the terms of the majority's analysis." 105 Not-

98. Id. at 50-59.
99. Id. at 57 n.27.
100. Id. at 50 n.16.
101. Price restraints imposed on distributors or retailers can take two forms: (1) mini-
mum price maintenance, whereby the ultimate seller is prohibited from selling the product
at a price lower than that set by the manufacturer; and conversely (2) maximum price
restraints, whereby price ceilings are set by the manufacturer. See generally Cassady,
Maintenance of Resale Prices by Manufacturers, 53 Q.J. Econ. 454 (1939).
102. The rule is well established. Dr. Miles Medical Co. v. John D. Park & Sons Co.,
220 U.S. 373 (1911) (minimum resale prices per se illegal); accord, Schwegmann Bros. v.
Calvert Distillers Corp., 341 U.S. 384 (1951); United States v. A. Schraders Son, Inc., 252
U.S. 85 (1920). The per se prohibition was later extended to maximum price restraints.
104. Id. at 51 n.18. The court continued: "Resale price maintenance is not designed to,
but almost invariably does in fact, reduce price competition not only among sellers of the
affected product, but quite as much between that product and competing brands." Id.
Compare the articles and comments cited by the Court, 433 U.S. at 51 n.18 with Posner, The
L. Rev. 1, 8 (1977).
105. 433 U.S. at 70.
ing the trend in contemporary economic thought,\textsuperscript{106} he pointed out that the precise justification for nonprice vertical restraints relied upon in the majority opinion are equally applicable to price restraints.\textsuperscript{107} Justice White concluded:

Indeed, the Court has already recognized that resale price maintenance may increase output by inducing "demand-creating activity" by dealers (such as additional retail outlets, advertising and promotion, and product servicing) that outweighs the additional sales that would result from lower prices brought about by dealer price competition . . . . These same output enhancing possibilities of nonprice vertical restraints are relied upon by the majority as evidence of their "social utility and economic soundness," . . . and as a justification for judging them under the rule of reason. The effect, if not the intention, of the Court's opinion is necessarily to call into question the firmly established \textit{per se} rule against price restraints.\textsuperscript{108}

Consequently, the continued viability of the \textit{per se} rule against maximum resale price maintenance, as recently reaffirmed in \textit{Albrecht v. Herald Co.}\textsuperscript{109} is especially tenuous in the aftermath of \textit{GTE Sylvania}. In \textit{Albrecht}, the Herald Company, publisher of the \textit{St. Louis Globe-Democrat}, sold newspapers to independent carriers for distribution in exclusive territories.\textsuperscript{110} The newspapers were not to be resold at a price higher than the suggested maximum.\textsuperscript{111} Herald, responding to one carrier's price hike above the suggested limit, hired another firm to solicit that carrier's customers at the lower price.\textsuperscript{112} The carrier, in turn, brought an antitrust action against Herald. The district court found for the defendant, and the Eighth Circuit affirmed.\textsuperscript{113}

The Supreme Court reversed. It reasoned that maximum as well as minimum price fixing substitutes the perhaps erroneous judgment of the seller for the competitive market forces.\textsuperscript{114} In a persuasive dissent, however, Justice Harlan argued that price ceilings, unlike price floors, present possible justifications that should be explored and not avoided by a mechanical \textit{per se} rule. For

\textsuperscript{106} Id. Justice White cited as examples: Posner, \textit{supra} note 2, at 292-93; Bork, \textit{supra} note 2, at 391-464.
\textsuperscript{107} 433 U.S. at 70.
\textsuperscript{108} Id. (citations omitted).
\textsuperscript{109} 390 U.S. 145 (1968).
\textsuperscript{110} Id. at 147.
\textsuperscript{111} Id.
\textsuperscript{112} Id.
\textsuperscript{114} 390 U.S. at 152.
example, market forces might resuscitate a territorial monopoly, thus price ceilings would be justified to prevent gouging.\textsuperscript{118}

Clearly, even if the per se case against minimum price maintenance were still accepted (which of course is subject to debate as well),\textsuperscript{116} maximum price setting, as Justice Harlan pointed out, is an altogether different matter. Maximum price fixing limits profits rather than competition among retailers. While an individual retailer may lose his freedom to set prices, there is no corresponding damage to price competition. Furthermore, if \textit{GTE Sylvania} accurately reflects the Court's new antitrust policy priorities by subordinating the "autonomy of independent businessmen"\textsuperscript{117} to economic efficiency,\textsuperscript{118} the logical foundation of \textit{Albrecht} now rests on quicksand.

Indeed the Court's extended economic analysis does suggest, at least implicitly, a clarification of the fundamental priorities of antitrust policy. To this end, perhaps, the Court has moved closer to a resolution of the confusion over the principal purpose of antitrust regulation.\textsuperscript{118} Observers have discovered a basic dichotomy of values competing for judicial sanction\textsuperscript{119}—the split occurring between efficiency and nonefficiency considerations.\textsuperscript{121}

Substantial authority exists supporting the notion that the antitrust laws were primarily intended to protect and to preserve the

\begin{enumerate}
\item[115] Id. at 156-68.
\item[116] \textit{See, e.g.}, Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. at 69 n.10; \textit{Posner, supra} note 2, at 292-98.
\item[117] 433 U.S. at 53 n.21.
\item[118] Id. "Efficiency" is used in this context to mean resource allocation unencumbered by monopoly or other market distortions. Distribution of income considerations are not taken into account. Justice Black has articulated this view:
\begin{quote}
The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions.
\end{quote}
\item[120] \textit{Id.} at 979.
\item[121] These are sometimes referred to as socio-political goals (in contradistinction to efficiency considerations), such as the preservation of small business units and economic liberty. \textit{See United States v. Topco Assoc., Inc.}, 405 U.S. 596, 610 (1972) (dubbing the antitrust laws the "Magna Carta of free enterprise," designed to ensure protection of small businessmen); \textit{Scherer, supra} note 119, at 980-81.
\end{enumerate}
small business unit.\textsuperscript{122} Of course, the Sherman Act was enacted during a period of great public anxiety over the concentration of wealth and power in the hands of a few businessmen and small trusts.\textsuperscript{123} It has been contended that the construction of the antitrust laws should embody a basic Jeffersonian philosophy—that is, the preservation of the diverse, locally-competing, small-scale businesses.\textsuperscript{124} Another legitimate antitrust policy consideration which has been suggested\textsuperscript{125} is the primacy of individual freedom of action and economic liberty. Such was the underlying rationale of Schwinn which incorporated into antitrust analysis a form of the ancient rule against restraints on the alienation of property.\textsuperscript{126}

There can be no question that, to a degree, such nonefficiency values remain integral and laudable goals of antitrust policy. However, to the extent that efficiency considerations conflict with nonefficiency values, \textit{GTE Sylvania} states a clear preference for the former. By expressly and unequivocally proclaiming that "interbrand competition . . . is the primary concern of antitrust law,"\textsuperscript{127} the
GTE Sylvania Court holds that fostering a competitive economy, in the interest of consumer welfare,\footnote{128. For an excellent analysis of the social costs of monopoly, see R. Posner, Antitrust Law, An Economic Perspective (1976).} is the principal purpose of antitrust regulation. Irrespective of one's views regarding the primacy of allocative efficiency over other socio-political concerns, there is certainly a desirable predictive value in the consistency of judicial interpretation. To the extent that GTE Sylvania signals a clear priority among competing policy choices, the sometimes inconsistent ratio decidendi running through much antitrust jurisprudence may now be cured. Courts, therefore, should accept GTE Sylvania as a mandate for enforcing the antitrust statutes in a fashion which ultimately strengthens and promotes our nation's economic welfare through a healthy and competitive free enterprise system.