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# The Standard Oil Exclusive Contracts Case - A Retreat from Flexible Antitrust Law

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benefit and local interest when other safety or health considerations are not present. The fact that destructive competition might be present in the foreground does not help the cause of the statute in such an instance. The court in each case balances the facts on the side of the public welfare and safety on one side and, on the other, the advantages to be gained from the free flow of interstate commerce. To the side that has the greatest weight on the scales, so goes the favorable decision. *Edward R. Holland.*

## THE STANDARD OIL EXCLUSIVE CONTRACTS CASE—A RETREAT FROM FEXIBLE ANTITRUST LAW?

SECTION 3 of the Clayton Act[1] provides:

> "It shall be unlawful for any person . . . to lease or make a sale of goods, wares, merchandise, machinery, supplies or other commodities . . . 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 . . . seller, where the effect of such lease, sale or contract . . . may be to substantially lessen competition or tend to create a monopoly in any line of commerce."

The section was aimed at two basic types of contracts. One was the tying agreement in which a vendor leases or sells a machine to a vendee only on the condition that the vendee use therein a second product usually produced by the vendor. The other was the requirements (or exclusive) contract wherein the vendee agrees to buy all his requirements of specified goods exclusively from the vendor. Section 3 does not purport to render all such contracts unlawful, but only those contracts the effect of which *may be to substantially lessen competition or tend to create a monopoly.* The problem, then, becomes one of determining which contracts substantially lessen competition or tend towards a monopoly.

1 38 Stat. 731, 15 U. S. C. A., § 14.

Where, under Section 3 of the Clayton Act, the court has found that the tying agreement or the exclusive contract results in dominance of the market no difficulty has been experienced in declaring the agreement or contract illegal.[2] But where dominance of the market could not be established the courts seem to have applied two standards which have been called the comparative test and the quantitative test.[3] By the comparative approach the court has noted the complete competitive effect of the contract on the industry as a whole; whereas under the quantitative standard the court has considered only whether the amount of business removed from competition is "substantial," evidence as to effect on competition being held irrelevant. The early case of *Standard Fashion Co. v. Magrane-Houston Co.*[4] indicated that in spite of the Clayton Act's particularistic approach[5] all of the specified contracts were not forbidden, but only those which *probably* would result in a substantial lessening. A mere possibility was not enough.

Prior to the 1947 decision of the Supreme Court in *International Salt Co. v. United States*[6] the court seems generally to have applied the comparative test in cases in which dominance of the market was not evident.[7] That case involved a tying agreement in which as a condition to the lease of a patented salt machine the lessee contracted to buy salt exclusively from the lessor. The court indicated that the actual effect of the tying clause upon competition was irrelevant, concluding that

[2] Fashion Originators Guild of America v. Federal Trade Commission, 312 U. S. 457 (1941); United Shoe Machine Corporation v. United States, 258 U. S. 451 (1922).

[3] Comment, *Section 3 of the Clayton Act—Coexisting Standards of Legality?* 49 Col. L. Rev. 241, 247 (1949).

[4] 258 U. S. 346 (1922). The Court notes that the Clayton Act operates before the Sherman Act, seeking to catch the objectional contracts in their incipiency.

[5] As contrasted with the Sherman Act, which is more general, 26 Stat. 209, 15 U. S. C. A., §1.

[6] 332 U. S. 392 (1947).

[7] *See* Federal Trade Commission v. Sinclair Refining Company, 261 U. S. 463 (1923); Pick Manufacturing Co. v. General Motors Corporation, 299 U. S. 3 (1936) (semble).

> ". . . it is unreasonable, per se, to foreclose competition from any substantial market."[8]

That decision thus seemed to introduce the quantitative test in cases involving tying agreements. Left unanswered was the question whether the court was prepared to adopt such test with respect to exclusive contracts.

That question has now been answered in the affirmative by the Court in the recent decision in *Standard Oil of California v. United States*.[9] Standard—the largest seller of petroleum products in a seven state West Coast area—had exclusive contracts with independent retailers. In 1946 Standard accounted for 23% of the gasoline sold in the area, but only 6.7% was sold by the retailers under exclusive contracts. The use of such contracts was prevalent in the industry; only 1.6% of the retail outlets sold the gasoline of more than one supplier.[10] The government brought suit under the Sherman and Clayton Acts to enjoin Standard from enforcing its present contracts, or entering into subsequent ones. The lower court granted such an injunction, considering a showing of substantial outlets and value enough to satisfy the qualification to Section 3, regardless of evidence "on a comparative basis" as to actual effect on competition.[11]

On appeal a bare majority of the Court through Justice Frankfurter affirmed the lower judgment, holding "that competition has been foreclosed in a substantial share of the line of commerce affected" while "evidence that competitive activity has not actually declined is inconclusive."[12] Justice Jackson, joined by the Chief Justice and Justice Burton, dissented, desiring to apply the

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[8] 332 U. S. 392, 396.

[9] 337 U. S. 293 (1949). (Finding the Clayton Act violated, the Court did not consider the Sherman Act.)

[10] The balance was sold through company owned stations or to industrial users. Of the total gallonage sold in addition to Standard's 23%, 42.5% was sold by Standard's six major competitors, the remaining 34.5% being divided among more than seventy smaller companies. The Court concedes this is not a dominance case.

[11] United States v. Standard Oil of California, 78 F. Supp. 850, 874 (1948).

[12] 337 U. S. 293, 314.

comparative standard.[13] Justice Douglas in a special dissent noted that the probable effect of the majority opinion would be to cause the large oil companies to establish vast company-owned chains of retail outlets in place of the independents—the "clerk" would arise in place of the "resident proprietor"—and this was more to be condemned than the exclusive contract.

Since the *International Salt* case concerned a tying agreement, the court had to decide whether the same rule should apply to the exclusive contract. As the majority conceded, there are significant differences between the two. A tying agreement is inherently monopolistic, benefiting few other than the vendor, and with little excuse for its existence other than a desire to restrain trade.[14] Even without the Clayton Act such a clause is generally illegal.[15] On the other hand an exclusive contract can be highly beneficial to buyer, as well as seller, and capable of satisfying legitimate economic needs.[16] As a buyer the contractor is assured a reliable source of supply; he may protect himself against price fluctuations, and can avoid storage costs and risks. The seller may minimize his expenses (in particular, salesmen's salaries) in addition to being able to forecast his market.[17] So pronounced are the differences between the two contracts that it has been suggested that different standards of legality be applied to each.[18] Nevertheless

[13] Conceding that the number of outlets and value of their sales "was sufficient to be substantial," he contended that "proof of quantity does not prove that they had this forbidden quality." *Id.* at 332.

[14] It has sometimes been contended that tying clauses are necessary to preserve good will: the reasoning being that the vendee might use defective materials and impair the vendor's good will, or increase the vendor's duties if he were forced to repair. This the courts usually reject by noting that adequate specifications could be drawn. International Salt case, *supra*, note 6.

[15] Motion Pictures Patents Company v. Universal Film Manufacturing Company, 243 U. S. 502 (1917); Rose, *Federal Trade Commission Enforcement of Section 3 of the Clayton Act*, 8 GEO. WASH. L. REV., 639, 658 (1940).

[16] Stockhausen, *The Commercial and Anti-Trust Aspects of Term Requirements Contracts*, 23 N. Y. U. L. Q. REV., 412 (1948).

[17] *Id.* at 413.

[18] See comment, *supra*, note 3. As the author notes, an exclusive contract covering more than one product could be equivalent to a tying agreement. A case with such a contract should be examined to determine whether the seller has such extensive control of one of the products as to be able to impose his will on the buyer.

the majority in the principal case applied the quantitative standard on two grounds: (a) conceding such contracts to be economically honest, Standard and its major competitors were in the field first, and could collectively, even if not collusively, keep out the newcomer; (b) at the most any judicial determination of the economic effect of the contracts would be pure speculation. Since there seems to be little reason for not considering the collective economic effect of the major sellers under the comparative standard which the court declines to follow, tedious and indefinite though that consideration would be, it would seem the first reason is embraced in the second, *i.e.* that a result would be only a judicial guess.

For many years now our highest court has dwelt among such phrases as "restraint of trade," "tend to create a monopoly," not to mention the judicially added "rule of reason." Created in times when single firms or groups of men controlled vast segments of an industry, having reached their position generally by ruthless means, the antitrust laws were designed to have lasting effect.[19] This prompted one judge to look upon the Sherman Act as a quasi-constitution, a "charter of freedom" having "a generality and adaptability comparable to that found to be desirable in constitutional provisions."[20] Thus the single, ruthless monopolist felt its sting and has in large measure disappeared.[21] In his place we have the several mammoth firms, formed in "gentlemanly ways" as Douglas would say, bound together indirectly by considerations of mutual interest.[22] It would seem that to this pattern also, and to subsequent patterns of trade restraint, our antitrust laws were designed to apply.

Yet every decision which strikes down a trade practice as illegal

[19] Rostow, *Monopoly Under the Sherman Act: Power or Purpose?* 43 ILL. L. REV., 745, 790 (1949).

[20] Appalachian Coals, Inc. v. United States, 288 U. S. 344, 359-360 (1933). See also Chief Justice White in Standard Oil v. United States, 221 U. S. 1, 62 (1910) where he notes the flexible provision of the Sherman Act: "...was expressly designed not to unduly limit the application of the act by precise definition...."

[21] Rostow, *supra* note 19 at 792.

[22] *Ibid.* See pages 782 and 783 for an example of this sympathetic response.

*per se,* without assuming the admittedly uncertain task of determining the effect of that practice on competition tends to make the antitrust laws rigid and inadaptable. Certain practices, such as price fixing,[23] can be condemned because of their very nature. Probably the same is true of tying agreements.[24] As conceded by the majority, an exclusive contract is not in the same category, yet such contracts are now, in effect, declared illegal *per se.*[25] While it must be conceded that the Clayton Act requires a different standard from the Sherman Act,[26] the difference is only one of degree. It is to be hoped that the principal case does not represent the beginning of a trend which may impair the flexible structure of our antitrust laws.

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[23] *E.g.,* United States v. Socony Vacuum Oil Co., 310 U. S. 150 (1940).

[24] *See* International Salt Co. v. United States, 332 U. S. 392 (1947). Justice Jackson wrote that opinion, and in his dissent in the principal case, denys it has any application to our problem.

[25] "... I cannot agree that the requirements contract is *per se* an illegal one, and that is the substance of what the Court seems to hold," said Justice Jackson in his dissent, 337 U. S. at 323.

[26] *See* United Shoe Machine Corporation v. United States, 258 U. S. 451, 459. The exclusive contract, in the eyes of Congress, must have been a prima facie objectional thing, and certainly little control coud exist over such contracts under the pre-Clayton Act's "illusive limitation" of public policy. See Rose, *supra,* note 15. As Justice Frankfurter notes, "We are faced ... with ... merely a broadly phrased qualification of an otherwise narrowly directed statutory provision." 337 U. S. at 312.