UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

FILED
NOV 16 1970
AT O'CLOCK
ELBERT A. WAGNER, JR.
CLERK

UNITED STATES OF AMERICA, Plaintiff,	)	
v.	)	No. 68 C 76
TOPCO ASSOCIATES, INC., Defendant.	)	

OPINION

The Government here seeks an injunction against the defendant, Topco Associates, Inc. (hereinafter "Topco") to prevent the latter from limiting or restricting the territories within which its members may sell Topco-controlled brands, or limiting or restricting its membership on a territorial basis. It urges that the practice, authorized by Topco's by-laws, of granting "exclusive," "non-exclusive" and "co-extensive" memberships constitutes a per se violation of Section 1 of the Sherman Act (18 U.S.C. §1).

Topco, on the other hand, answers that its territorial limitations on membership are necessary to enable its members to compete effectively with the national food chains, the limitations on competition in Topco-controlled brands resulting therefrom are far outweighed by the competitive advantages thereof and, accordingly, on balance are reasonable and not violative of Section 1 of the Sherman Act.

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As the Findings of Fact delineate in some detail, which will not be repeated here, Topco is an association of small or medium sized regional supermarket chains, at the moment 25, who operate stores in some 33 states. Topco's sole function is to serve as a cooperative buying organization through which its members can purchase in excess of 1,000 different items, most of which are sold under brand names owned by Topco. Its members purchase only such items as they desire and Topco does not purchase nationally advertised brands for its members who acquire them through other distribution channels.

Topco's members vary in the degree of market share which they possess in their respective areas from 1-1/2 per cent to 16 per cent, but collectively, their combined retail sales of more than $2 billion are exceeded only by the retail sales of A & P, Safeway and Kroger. Topco procured products represent about 10 per cent of the members' total sales. The Topco members compete in their respective areas not only with one or more national chains but with other regional or local chains as well as with independents.

Topco membership may be either "exclusive," "non-exclusive" or "co-extensive" as its board of directors determines. Most memberships are "exclusive" and the member possesses the exclusive right to sell Topco-controlled brands and Topcoprovided products in the geographic territory defined in its membership agreement. A non-exclusive territory is one in which a member may sell Topco products but not to the exclusion of others who may be licensed. Co-extensive territories are those in which two or more designated members may sell Topco products. Non-exclusive or co-extensive memberships are generally granted only where the member or members are not large enough to cover the area. No member may sell Topco products outside his designated territory which has apparently limited members' expansion on some few occasions although some members operate stores in other members' territories but do not sell Topco products in such stores.

Topco membership is not static. As member chains grow to the point where they can economically maintain their own private label programs, they normally drop their Topco memberships. The level of annual sales necessary to enable a chain to do this appears to be $250 million or more. Other members, of course, withdraw for a variety of reasons. Topco is constantly seeking new members either in areas in which no members now operate or to replace withdrawing members.

Virtually all of the national supermarket chains have extensive private label programs which are now an almost essential element in supermarket competition. Private label products yield higher profits on lower prices than the highly advertised national brands even though the quality of private label products is frequently equivalent to that of the advertised brands. If a supermarket chain establishes with its customers an acceptance of its private label products, it enjoys a customer loyalty which no competitor can exploit since no chain sells its private label products to competitors. If you believe products carrying the brand names Ann Page, Jane Parker, Bokar, Eight O'Clock, Sultana, etc., are the best buys for the price, you must shop at an A & P store to get them. Similarly, customers believing products bearing names such as Topco, Food Club, Elna, Top Frost, etc. are the best buys, must patronize a Topco member.

It is clear from the record that Topco members believe having an exclusivity comparable to that enjoyed by the national chains is an indispensable element of Topco's effectiveness and their interest in membership. Top officers of a number of members testified unequivocally that they would not spend the money, time and energy necessary to establish consumer acceptance of Topco brands in their areas of operation if any of their substantial competitors could likewise sell the same brand names and would not continue as members of Topco but would, to the extent possible, endeavor to develop their own private label programs in which they would have exclusivity.

The government concedes that if Topco, rather than being a buying organization for smaller local and regional chains, were a single, large national chain, none of its practices would be objectionable under the antitrust laws. It also concedes that Topco's private label program enables its members to compete more effectively both with the larger national chains, as well as with other medium or smaller regional or local chains and independents. It contends, however, that competition in Topco controlled brands is diminished and that, in any event, Topco's exclusivity practices constitute a per se violation of Section 1 of the Sherman Act even if the ultimate result of these practices may be an overall increase in supermarket competition.

Consistent with this position, the government offered no live witness. Its case consisted solely of documents obtained from Topco, plus several newspaper advertisements disclosing that in some instances where non-exclusive or co-extensive memberships have been issued, two different local chains advertise Topco private label products in the same newspaper. In defense, Topco also offered a number of documents, as well as the oral testimony of its Executive Vice President and General Manager, executives of six of its members and two experts in supermarket merchandising, all of whom testified to the importance of private label brands in the supermarket field and the importance of exclusivity to private label programs.

In support of its per se contention, the government urges the Supreme Court decisions in three cases arising originally in this district: _United States_ v. _Arnold Schwinn & Co._, 388 U.S. 365 (1967); _United States_ v. _Sealy, Inc._, 388 U.S. 350 (1967); and _United States_ v. _Serta Associates, Inc._, 393 U.S. 534 (1969). The first of these, _Schwinn_, was a vertical arrangement under which Schwinn, a manufacturer of bicycles, granted exclusive representation in identified geographic areas to certain dealers thereby precluding competing dealers from obtaining Schwinn bicycles, one of the leading, if not the best known, brands of bicycles and which imposed certain price and other competitive limitations on its exclusive dealers. Both _Sealy_ and _Serta_ involved exclusive territorial licenses for the sale of Sealy and Serta brand mattresses. The Sealy corporation was owned by the exclusive licensees who agreed not to handle competing brand mattresses and who were given exclusive rights to sell Sealy mattresses in their territories.

Serta Associates, Inc. was a corporation owned by formerly independent regional mattress manufacturers who agreed not to manufacture or sell Serta brand mattresses outside their designated geographic areas although there was no restriction upon the number or class of customers to whom a member-licensee might sell within his territory.

In each instance, it was clear that the effect of the agreements was to substantially eliminate or reduce competition either among manufacturers or dealers who might otherwise compete with each other. The government contends that the Topco exclusive territorial arrangements have the same effect and are therefore per se violative of Section 1. In addition to the foregoing, the government cites United States v. Masonite, 316 U.S. 265 (1942); United States v. Line Material Co., 333 U.S. 287 (1948); United States v. Besser Mfg. Co., 343 U.S. 444 (1952); White Motor Co. v. United States, 372 U.S. 253 (1962); and Northern Pac. Ry. v. United States, 356 U.S. 1 (1958), as authority for the proposition that any agreement for territorial exclusivity is prohibited by Section 1 without regard to its over-all effect on competition. They also quote from Judge Learned Hand in United States v. Aluminum Co. of America, 148 F.2d 416, 427 (C.A. 2, 1945) to the effect that,

> It is settled, at least as to §1, that there are some contracts restricting competition which are unlawful, no matter how beneficient they may be; no industrial exigency will justify them; they are

> absolutely forbidden. Chief Justice Taft said as much of contracts dividing a territory among producers [in Addyston Pipe & Steel, supra.]

The defendant, on the other hand, urges that, from the earliest cases on, the courts have recognized that contracts which have only a remote or incidental adverse effect on competition are not prohibited, citing Hopkins v. United States, 171 U.S. 578 (1898); Standard Oil Co. of N.J. v. United States, 221 U.S. 1 (1911); Chicago Board of Trade v. United States, 246 U.S. 231 (1918); Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933); United States v. Morgan, 118 F.Supp. 621 (S.D.N.Y. 1953); United States v. National Football League, 116 F.Supp. 319 (E.D. Pa. 1953). They quote from Mr. Justice Brandeis in the Chicago Board of Trade case, supra at p. 238, to the effect that,

> In applying this test, a close and objective scrutiny of particular conditions and purposes is necessary in each case. Realities must dominate the judgment. The mere fact that the parties to an agreement eliminate competition between theselves is not enough to condemn it. ... The question of the application of the statute is one of intent and effect, and is not to be determined by arbitrary assumptions. It is therefore necessary in this instance to consider the economic conditions peculiar to the...industry, the practices which have obtained, the nature of defendant's plan of making sales, the reasons which led to its adoption, and the probable consequences of the carrying out of that plan in relation to market prices and other matters affecting the public interest.... 288 U.S. at 360-61.

In addition to the foregoing, the defendant has listed in a 23 page appendix to its brief a large number of cases in which arrangements or agreements resulting in some preclusion or diminution of competition were held not to violate Section 1, including a number in which territorial restrictions were involved. In _Sandura_ _Co_. v. _F_._T_._C_., 339 F.2d 847 (C.A. 6, 1964), the Court concluded that a system of exclusive territorial distributorships promoted inter-brand competition without any demonstrated detriment to intra-brand competition, since the record indicated that the bulk of the expense and effort necessary to develop consumer acceptance had to be borne by the distributors who testified that they would not be interested in Sandura distributorships if they were not exclusive. The Court concluded, p. 859:

> ... The distributors, the dealers and the public will _best_ be served by the continued economic health and competitive existence of Sandura as well as its distributors. We are of the opinion that _on_ _this_ _record_, the only justified conclusion is that elimination of the closed territory arrangement would impair competition, rather than foster it." 339 F.2d 847, 859.

Except for the fact that the Sandura distributorships were conferred by the manufacturer and not, as in Topco, by a board controlled by existing franchisees, the record here is virtually identical.

All of the witnesses for the defendant testified that the cost of developing consumer acceptance for the Topco private brands was borne by each member in its own territory. Every executive of a Topco member who was a witness stated categorically that his chain would not be interested in devoting the time, energy and money to the necessary promotion and would not be interested in Topco membership if one or more of his chain's competitors in the area also offered consumers the same brands and products. All of defendant's witnesses asserted that monopoly of Topco private label products was as essential to Topco members as the monopoly of A & P, National Tea, Jewel and other national chains' private label products was to these chains.

Whether or not the exclusivity practices of Topco result in substantial diminution of intra-brand competition is difficult to determine. The government has introduced evidence indicating that some applications by Topco members to expand into territories assigned to other members have been denied. In some instances, this apparently led to a decision not to expand while in others, the applicant apparently expanded notwithstanding and operated the new store without Topco private label products. In a few instances, the Boston area, for example, two or three local chains, no one of which serves the entire territory, have co-extensive or non-exclusive franchises but, because of the geographic separation of their outlets, there is some question as to whether they actually compete with each other.

One other factor relevant to the possible anti- and pro-competitive effects of the Topco exclusivity practices must be noted. As previously indicated, the products which the members procure through Topco represent approximately 10 per cent of their total sales, though in some lines, such as canned foods, the percentage is much higher. It varies, of course, from member chain to member chain and from store to store depending, in part, on the degree of consumer acceptance of the Topco private brands which has been developed.

In terms of the market share in their respective market areas in which Topco members possess, the average market share of January 1, 1966 was 5.87 per cent, and ranged from 1.4 per cent to 16.3 per cent. While some are obviously significant factors in their particular market areas, all are medium-sized or small regional or local chains, and all compete with outlets of national chains as well as other local and regional chains and independents.

One conclusion which the government urges is not supported by the record, i.e., that Topco is a restrictive organization whose members are primarily interest in keeping new members out and protecting their exclusivity. While there is evidence of some instances in which members have resisted the expansion of other members into their territories or the addition of new members in the same territory, there is other evidence of occasions on which Topco members, in the interest of expanding the membership and strengthening the organization, have agreed to a reduction of their assigned territories or the type of franchise held by them.

The ultimate question here presented is whether the antitrust laws prohibit practices by a cooperative buying organization which may reduce competition between its members or potential members in the sale of private label brands but which enable its members to compete more effectively with national chains whose private label brands are sold exclusively through their own outlets. On the record before us it is clear that the regional and local chains who join Topco do so only because it provides them with a broad source of private label merchandise they could not otherwise obtain and which is essential to their effective competition with the national chains operating stores in their areas. In this connection, as previously noted, the government concedes that Topco, if it were a single national chain rather than a cooperative buying organization for a number of smaller regional or local chains, could restrict sales of its private label brands to its own stores without raising any question of antitrust violation.

We conclude that the Topco practices with respect to the allocation of territories to its members in which they have either exclusive, non-exclusive or co-extensive rights to sell the Topco private label brands is not a per se violation of the antitrust laws. Whatever anti-competitive effect these practices may have on competition in the sale of Topco private label brands is far outweighed by the increased ability of Topco members to compete both with the national chains and other supermarkets operating in their respective territories. Moreover, if the testimony of all the live witnesses at the trial is correct, the elimination of the Topco territorial limitations in the franchises would result in the demise of the Topco organization and its private label program with no benefit to competition in those private label brands and with a substantial reduction in the competition between its members and both the national chains and other supermarkets. Expressed another way, the relief which the government here seeks would not increase competition in Topco private label brands but would substantially diminish competition in the supermarket field. The antitrust laws are certainly not intended to accomplish such a result. Only the national chains and the other supermarkets who compete with Topco members would be benefitted. The consuming public obviously would not.

In the light of all of the foregoing, judgment will be entered for the defendant.

United States District Judge

Dated: November 16, 1970