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Selected Antitrust Problems of the Franchisor: Exclusive Arrangements, Territorial Restrictions, and Franchise Termination

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The rule of reason approach should be used when applying the Sherman Act to foreign commerce because many problems arise that are unknown in domestic commerce. In this manner proper consideration could be given to the relevant market and to the reasonableness of a restraint in light of foreign business conditions. The Declaratory Judgment Act could be used in such cases to determine whether a proposed course of action is legal. If any or all of these suggestions were adopted, the uncertainty surrounding the application of the Sherman Act to foreign commerce would be reduced, and American business could, through private investment, help promote the economic development of the CACM.

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SELECTED ANTITRUST PROBLEMS OF THE FRANCHISOR: EXCLUSIVE ARRANGEMENTS, TERRITORIAL RESTRICTIONS, AND FRANCHISE TERMINATION

Although the modern franchise agreement had its genesis more than one hundred years ago,[1] it has only recently become a significant factor within the domestic economy. Franchised business operations now account for approximately ten per cent of the gross national product[2] and almost twenty-five per cent of all retail sales.[3] In 1967 there were approximately 750 "substantial" franchising operations with a total of 450,000 retail outlets.[4] That franchising is a relatively recent phenomenon is evidenced by the fact that prior to 1966 the Small Business Administration (SBA) refused to classify as small businesses those that were not free from the outside control of a relatively large concern. Since the right to some control over the franchisee is a crucial element in virtually all franchise agreements, the SBA amended its small business size standards to provide that the presence of such control would not preclude the small businessman from receiving SBA benefits if he were otherwise qualified.[5]

1. H. KURSH, THE FRANCHISE BOOM 4-5 (rev. ed. 1968).
2. Senator Philip A. Hart, Chairman of the Senate Subcommittee on Antitrust and Monopoly Legislation, estimates that franchising now accounts for $80 billion of business each year. BNA ANTITRUST & TRADE REG. REP., April 15, 1969, at A-17.
3. Zeidman, *The Growth and Importance of Franchising — Its Impact on Small Business*, 12 ANTITRUST BULL. 1191, 1196 (1967). Senator Hart estimates that franchising involves 20% of all retail sales, *supra* note 2.
4. Zeidman, *supra* note 3, at 1196; New York Times, July 9, 1967, §3, at 1, col. 1.
5. 13 C.F.R. 121.3-2(a) (Supp. 1969), first published in 31 Fed. Reg. 11973 (1966): "[R]estraints imposed on a franchisee by its franchise agreement shall not be considered in determining whether the franchisor controls . . . and, therefore, is affiliated with the franchisee, if the franchisee has the right to profit . . . and bears the risk of loss . . . ." *See* Zeidman, *Small Business Concerns — Franchising and Its Antitrust Problems*, 29 ALA. LAW. 460, 462 (1968).

The term "franchise" embraces an amalgam of marketing or manufacturing concepts or both.[6] However, there are certain common characteristics that serve to illustrate the basic nature of franchise agreements. A franchise, in its simplest terms, is a contract permitting the franchisee to distribute goods or services either produced by the franchisor or embraced within a trademark held by the franchisor. Although franchise agreements can be categorized primarily by the subject matter of the franchise, numerous ancillary provisions, which can be inserted into the franchise contract, preclude a more precise definition. Typically these provisions relate to such matters as the nature of the franchised product or concept and whether the franchisor shall offer continuing assistance to the franchisee, provide training for the franchisee, and sell equipment to the franchisee.[7] Although other classifications have been suggested for various franchise arrangements[8] it seems most suitable, for the purposes of antitrust analysis, to classify franchise systems according to the nature of the subject of the franchise. Considered in such a manner, almost all franchise agreements fall within one of three categories:[9] first, those that establish an efficient method of distribution for the franchisor's product;[10] second, those that establish retail outlets where a franchisor is principally selling a name or method or format of doing business;[11] and third, those franchise arrangements that establish manufacturing or processing plants.[12] Each of these types of franchises is formed with a different objective in mind; each faces distinct business problems; and each poses different antitrust issues that, when resolved, are not necessarily applicable to the other types of agreements.[13]

The origins of the "franchise boom" can be found in the economic and social climate of the period immediately following the Second World War. Returning veterans, backed by business loans guaranteed by the Veteran's Administration,[14] provided the capital and managerial potential necessary to make the franchising concept viable. With the evolution of suburban shopping districts and the perfection of national advertising media in the form

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6. Kintner, *Distribution Restrictions in Franchise Agreements—As Viewed By a Member of the Private Bar,* 12 ANTITRUST BULL. 1211, 1213 (1967), notes the virtually useless breadth of the term.

7. H. KURSH, *supra* note 1, at 24.

8. LeBlanc, *Antitrust Ramifications of Trademark Licensing and Franchising,* 53 TRADEMARK REP. 519, 520 (1963), distinguishes between franchising of manufactured goods and franchising of a product concept; Kintner *supra* note 6, at 1213, distinguishes between manufacturers and retailers, manufacturers and wholesalers, wholesalers and retailers, and service-sponsors and retailers.

9. Covey, *Franchising and the Antitrust Laws: Panacea or Problem?,* 42 NOTRE DAME LAW. 605, 606-07 (1967).

10. United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967); Interphoto Corp. v. Minolta Corp., 295 F. Supp. 711 (S.D.N.Y. 1969).

11. Susser v. Carvel Corp., 332 F.2d 505 (2d Cir. 1964), *cert. dismissed,* 381 U.S. 125 (1965); Engbrecht v. Dairy Queen Co., 203 F. Supp. 714 (D. Kan. 1962).

12. United States v. Sealy, Inc., 388 U.S. 350 (1967).

13. Kintner, *supra* note 6, at 1214.

14. H. KURSH, *supra* note 1, at 6.

of television and radio,[15] the stage was set for a new form of business enterprise geared to the demands of an affluent and mobile society.

The 1946 amendments to the Lanham Trademark Act[16] were the catalytic factors in the ascendancy of franchising. Prior to these amendments, the owner of a trademark had the exclusive right to its use only in the geographical area in which he could reasonably be expected to employ the mark.[17] The amended registration provision conferred on the registrant of the mark national rights that were much more generous than many trade symbol registrants themselves were able to utilize.[18] Since the 1946 amendments, the tremendous expansion in trade symbol licensing has been paralleled by a related increase in the use of franchising as a marketing technique.[19] Other factors inherent in franchising also have contributed substantially to its success. Competitive unitary systems could not be established with the same capital and personnel requirements within so short a time;[20] nor could a unitary marketing or production system generate the managerial enthusiasm found in a franchised operation where each unit was operated and owned by the same individual.[21]

As franchising has attained an increasingly significant role in the American economy, it has come under intensifying scrutiny from the federal antitrust laws. This confrontation has been ultimately defined in terms of the degree of control that the franchisor may exercise over the franchisee. For the franchisor control is the key element of the entire system. Without standardization — which can only be implemented by the franchisor — there is no selling point that can be successfully exploited.[22] In addition to controls on the nature and quality of the end product of the franchise agreement, the franchisor may also seek to control the geographic area in which, and the persons with whom, the franchisee may deal.[23] Because of the breadth of the

15. Zeidman, *supra* note 3, at 1192.

16. 15 U.S.C. §1072 (1964) provides that "[r]egistration of a mark on the principal register provided by this chapter . . . shall be constructive notice of the registrant's claim of ownership thereof."

17. This was the doctrine of concurrent territorial trade symbol rights. *See* United Drug Co. v. Theodore Rectanus Co., 248 U.S. 90 (1918); Hanover Star Milling Co. v. Metcalf, 240 U.S. 403 (1916); Dole, *The Interplay of Trade Symbol Protection and the Antitrust Laws*, 13 ANTITRUST BULL. 1347, 1350 (1968).

18. Dole, note 17 *supra*.

19. *Id.*

20. Covey, *supra* note 9, at 607.

21. Covey, *supra* note 9, at 607; Zeidman, *supra* note 3, at 1210. Additional factors, which have been suggested as relevant to the expansion of franchising, include flexibility of individualized operation when compared with the bureaucratic ineptness of larger corporations, Shuman, *The Future of Franchising and Trade Regulation*, 14 HOWARD L.J. 60, 74 (1968), and the widespread technological revolution of the fifties such as the uniform governmental grading of food products throughout the nation.

22. Covey, *supra* note 9, at 608. *Cf.* United States v. Sealy, Inc., 388 U.S. 350 (1967). Just when and in what manner this standardization should be implemented by the franchisor is, however, unclear. Treece, *Trademark Licensing and Vertical Restraints in Franchising Arrangements*, 116 U. PA. L. REV. 435, 453 (1968).

23. Wilson, *Exclusionary Restraints and Franchise Distribution*, 12 ANTITRUST BULL. 1169, 1169-70 (1967). *See* United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

possible range of control, legitimate concern has been expressed that franchising might "deteriorate into a thinly veiled system of total control over all the essential business decisions that the franchisee is supposed to make on his own."[24]

This concern for the welfare of the small businessman has served as the core of the Supreme Court's rationale in construing the antitrust laws in franchise cases.[25] One commentator noted after the now renowned decision in *United States v. Arnold, Schwinn & Co.*[26] that the Court "would appear to be evolving a doctrine which embraces the freedom of an individual businessman to conduct his business as he sees fit, and which sees as illegal attempts on the part of other businessmen to curtail that freedom unduly."[27] However, another critic has commented that such a formulation is more conducive to *ruining* than *running* a franchised operation.[28] *Schwinn* and other of the Court's decisions emphasizing the importance of the small businessman[29] are, however, particularly confusing when applied to franchising cases. For example, under the facts of the *Schwinn* decision, it is somewhat unclear whether the manufacturer becomes the small businessman of the case when he is contrasted against his competitors, Sears and Montgomery Ward,[30] or whether the small businessmen are actually the retail and wholesale dealers who should then be contrasted with the much larger and more powerful Schwinn manufacturing organization.[31] Whether the franchisee or the franchisor is *the* small businessman, antitrust policy is to that extent indeterminate.

The duality of the franchisee's interest further obscures this area. The relative dominance of the franchisor over the franchisee becomes a source of antitrust concern when one considers that the franchisee owes allegiance both to his own interests and to those of the franchisor. The individual in the unitary system does not have a bona fide interest apart from that of the

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24. Jones, *The Growth and Importance of Franchising and the Role of the Law*, 12 ANTITRUST BULL. 717, 726 (1967).

25. White Motor Co. v. United States 372 U.S. 253, 264 (1963); *see* United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 369-70 (1963); Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962); *cf.* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 380 (1967). *See* Zeidman, *supra* note 5, at 460. However, others have countered that in spite of this language, the antitrust laws have in essence failed because they have not attacked the really large concentrations of economic power, but have only interfered with those that are medium-sized. John Kenneth Galbraith expressed this as "the element of charade in the antitrust laws." *Hearings Before the Subcomm. of the Senate Select Comm. on Small Business*, 90th Cong., 1st Sess. at 7 (1967). Donald F. Turner, in *The Scope of Antitrust and Other Economic Regulatory Policies*, 82 HARV. L. REV. 1207, 1213 (1969), criticized Galbraith's position, and suggested thrusts through which the antitrust laws could become a more effective instrument.

26. 388 U.S. 365 (1967). *See* text accompanying note 157 *et seq. infra* for an analysis of the *Schwinn* decision.

27. Jones, *supra* note 24, at 741.

28. Zeidman, *supra* note 5, at 482.

29. *See* cases cited note 25 *supra.*

30. United States v. Arnold, Schwinn & Co., 237 F. Supp. 323, 334 (N.D. Ill. 1965).

31. *See* United States v. Arnold, Schwinn & Co., 388 U.S. 365, 368-69 (1967).

integrated system;[32] he is an employee. The franchisee on the other hand, is more nearly in the position of an independent businessman. With tying arrangements, that is, conditioning the sale of a sought after product upon the purchase of an accompanying, unrelated product, the point seems to be well taken. Other forms of restraint, such as territorial and customer allocations, may be of benefit to both the franchisor and franchisee, and perhaps in some cases even of more benefit to the franchisee.[33] Central to the interaction of franchising and the antitrust laws is the element of control. The importance of establishing a mutually amenable balance between the competing interests of the franchisee and franchisor is of considerable importance.[34]

> [I]f the attributes of a franchisee's independence – his pride and initiative, his industry and concern for the future of the business – are lost, the problems for the franchisor of supervision and control and of discipline and morale may at this point far outweigh the advantages of conservation of capital and decentralization which the franchise system ideally promises. Moreover, if the franchisee's genuine legitimate independence is lost, his role in our economy as a decision-maker, his imagination as an innovator, the speed with which he can react to and meet whatever the local market and the particular competitive conditions may there require, and his own competitive potentiality will similarly become a nullity.

The focus of this note will be upon the problem of control in terms of decisional and statutory law with a view toward determining the permissible limits within which the franchisor may accomplish his business goals. For purposes of this analysis, the restraints normally employed in franchising shall be classified as exclusive arrangements, customer and territorial restrictions, and termination provisions. Consideration will be given to the special quality control problems encountered with a trademarked product or process, since such problems are particularly relevant in the "format" type franchise.

EXCLUSIVE ARRANGEMENTS

Exclusive arrangements encompass those restraints that are commonly termed exclusive dealing and tying arrangements. Although exclusive dealing can be further subdivided into exclusive selling and exclusive buying, the former category will not be discussed in this section since its effect is primarily territorial.[35]

The proof required to establish that the use of these various methods of control amounts to a violation of the antitrust laws varies considerably.[36] However, when dealing with these restrictions in a franchise context, one

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32. Jones, *supra* note 24, at 727.

33. Jordan, *Exclusive and Restrictive Sales Areas Under the Antitrust Laws*, 9 U.C.L.A.L. REV. 111, 120 (1961).

34. Jones, *supra* note 24, at 725.

35. Covey, *supra* note 9, at 609. *See also* discussion at notes 138, 223 *infra*.

36. *Compare* Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961) (exclusive dealing), *with* Northern Pac. Ry. v. United States, 356 U.S. 1 (1958) (tying arrangements).

should not for evidentiary purposes distinguish too readily between the restrictions. They should be considered together as a part of the same spectrum of ideas because some actions, seemingly exclusive dealing arrangements defensible through a showing that the practices arise from and accomplish valid business goals, will be treated as tying arrangements and subjected to a per se standard of illegality that makes irrelevant any showing of justifications for the restraints.[37] Such a possibility arises particularly in the franchise context because the power of termination of the franchise agreement is in itself viewed as having possible antitrust consequences. A growing awareness of this power and its impact was captured quite aptly in a Senate report:[38]

> From previous hearings held by the subcommittee, there was testimony — although disputed by some — that because of restrictions placed by some franchisors on franchisees, they may be something less than independent businessmen. When these restrictions are coupled with the threat of arbitrary cancellation the franchisor may be able to control decisions of the franchisee with respect to pricing, purchasing, and other competitive business decisions. The result may be that the franchisee's ability to compete effectively in the marketplace is restricted.

This realization has had particular impact in the area of exclusive buying. The courts have interpreted the franchisor's vested power of termination to represent sufficient economic power to justify application of the harsh tying standards of per se illegality to restraints that would normally encounter the less rigorous exclusive dealing standard of the rule of reason.[39]

Exclusive Buying

Exclusive buying agreements require that the franchisee purchase designated supplies only from the franchisor or from other sellers who have been approved by the franchisor.[40] These arrangements, which generally appear in the form of requirements contracts, are quite common in franchising[41]

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37. Wilson, *supra* note 23, at 1175. *See also* Covey, *supra* note 9, at 613; Dillon, *Exclusive Dealing, Requirements Contracts, Tieing Arrangements and Full-line Forcing*, 37 ABA ANTITRUST L.J. 146, 150 (1968). Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958), stated the rationale for the per se rule: "[T]here 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 have caused or the business excuse for their use."

38. SUBCOMM. ON ANTITRUST AND MONOPOLY OF THE SENATE COMM. ON THE JUDICIARY, ANTITRUST AND MONOPOLY ACTIVITIES 1967, S. REP. No. 1226, 90th Cong., 2d Sess. 4-5 (1968).

39. *Compare* Standard Oil Co. of Cal. & Standard Stations v. United States, 337 U.S. 293 (1949), *with* FTC v. Texaco Co., 393 U.S. 223 (1968).

40. Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961). *See* Covey, *supra* note 9, at 609; Note, *Antitrust Problems in Trademark Franchising*, 17 STAN. L. REV. 926, 937 (1965).

41. *E.g.*, Susser v. Carvel Corp., 332 F.2d 505 (2d Cir. 1964), *cert. dismissed*, 381 U.S. 125 (1965); Denison Mattress Factory v. Spring-Air Co., 308 F.2d 403 (5th Cir. 1962); Engbrecht v. Dairy Queen Co., 203 F. Supp. 714 (D. Kan. 1962).

and generally are beneficial to both franchisee and franchisor. A dependable source of supply with relatively stable costs constitutes the primary benefit to the franchisee. In the absence of such factors, he is unable to implement effective long-range planning and must additionally absorb the otherwise unnecessary costs and risks of storage of those items that fluctuate in availability.[42]

The franchisor is better able to establish and maintain goodwill by creating a situation in which the franchisee stocks all of his products rather than having a random selection.[43] Additionally, the franchisor can assure high quality throughout his franchise system without incurring the relatively high costs related to policing numerous independently supplied outlets.[44] Theoretically, the ultimate benefit to the consumer materializes in uniformly high quality in a large array of goods that may be purchased at relatively low costs.[45]

Although the courts have traditionally viewed exclusive buying provisions with suspicion, they have not yet held them to be per se violations of the antitrust laws.[46] This suspicion is manifested in the particular scrutiny given to exclusive buying arrangements when the economic power of the seller far exceeds that of the buyer.[47] Because such an economic imbalance is typical in franchising situations, the courts have treated exclusive arrangements between franchisee and franchisor rather harshly while still applying the rule of reason. In *Standard Oil of California & Standard Stations v. United States*[48] the franchisor had required that the franchisees purchase all petroleum from the franchisor. In some instances the franchisor also required that purchases of tires, batteries, and accessories (TBA) be made through the franchisor. Although the Supreme Court held these restrictions to be in violation of section 3 of the Clayton Act,[49] the focal point of the decision is its emphasis on the economic consequences of the exclusive dealing provisions employed by the franchisor.[50] Rejecting the per se approach espoused in *International Salt Co. v. United States*,[51] the Court conducted a rule-of-reason investigation of the arrangements[52] before finding them to be illegal.

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42. Standard Oil Co. of Cal. & Standard Stations v. United States, 337 U.S. 293, 306 (1949); Covey, *Franchising and the Antitrust Laws: Panacea or Problem?*, 42 NOTRE DAME LAW. 605, 609 (1967).

43. Covey, *supra* note 42, at 609; *cf.* FTC v. Brown Shoe Co., 384 U.S. 316 (1966).

44. LeBlanc, *Antitrust Ramifications of Trademark Licensing and Franchising*, 53 TRADEMARK REP. 519, 540 (1963).

45. Covey, *supra* note 42, at 609.

46. Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 333 (1961); Anchor Serum Co. v. FTC, 217 F.2d 867 (7th Cir. 1954).

47. Zeidman, *Small Business Concerns — Franchising and Its Antitrust Problems*, 29 ALA. Law. 460, 473 (1968).

48. 337 U.S. 293 (1949).

49. 15 U.S.C. §14 (1964).

50. Standard Oil Co. of Cal. & Standard Stations v. United States, 337 U.S. 293, 302 (1949).

51. 332 U.S. 392 (1947).

52. 337 U.S. 293, 307-08 (1949).

In *Tampa Electric Co. v. Nashville Coal Co.*,[53] a requirements contract between a public utility and a small coal producer was upheld. The contract would have been violative of the test announced in *Standard Stations.* The Court in *Tampa Electric* based its decision partially upon a finding that there was not a significant imbalance of economic power between the contracting parties.[54] In emphasizing the equality of the power possessed by the parties, the Court in effect distinguished the case from virtually all franchising situations. It has been suggested that *Tampa Electric* indicates an increased willingness by the Court to acknowledge the significance of certain business purposes for employing requirements contracts,[55] thereby lessening but not at all vitiating the "quantitative substantiality" criterion of *Standard Stations.*[56] Others have pointed out that exclusive dealing arrangements may be more justified in franchising situations where the franchisee operates under the tradename of the franchisor.[57] In such instances the franchisor has an interest, which is somewhat greater than that involved where the franchisee does business under his own name, in overseeing the operation of the franchised enterprise. Accordingly, it is arguable that the standards applied in such cases should make allowances for proof of a valid business justification and lack of anticompetitive intent.[58]

Such comments overlook the significance of the inevitable discrepancies in economic power between franchisee and franchisor, an imbalance that cannot be ignored when attempting to determine the present viability of *Standard Stations.*[59] When one considers the second requirements contract, which dealt with TBA in addition to petroleum products, the impact of this imbalance on the threshold between rule of reason and per se illegality becomes of considerable importance. Although the TBA requirements contract may seem to be no more offensive than the contract that dealt with petroleum products alone, it has less relevance than does the primary requirements contract to the supposed benefits accruing from enjoying a guaranteed source of supply at a stable price level. While the very existence of a service station franchise requires that the franchisee have his basic product, gasoline, available on a continuing basis, his needs for TBA can be more easily satisfied under a short-term or completely independent arrangement. Thus, the summary standard of per se illegality applied to tying arrangements might be held applicable to a case with a factual situation similar to that in *Standard Stations.* With this possibility in mind, an analysis of tying arrangements is in order.

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53. 365 U.S. 320 (1961).

54. *Id.* at 330; Curly's Dairy, Inc. v. Dairy Co-op. Ass'n, 202 F. Supp. 481, 485 (D. Ore. 1962).

55. Rudnick, *The Franchisor's Dilemma: Can He Satisfy the Legal and Commercial Requirements of a Trademark Licensing System Without Exposing Himself to Other Legal Risks,* 56 TRADEMARK REP. 621, 624 (1966).

56. Zeidman, *supra* note 47, at 474.

57. Covey, *supra* note 42, at 620-21; Dole, *supra* note 17, at 1357.

58. Dole, *supra* note 17, at 1357. *See* discussion at note 157 *et seq. infra.*

59. This was the problem of defining the threshold between exclusive dealing and tying arrangements that was alluded to in the discussion, notes 37-39 *supra.*

Tying Arrangements

In *Northern Pacific Railway Co. v. United States*,[60] the Supreme Court succinctly defined tying arrangements:

> [A] tying arrangement may be defined as an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from another supplier.

The traditional justification for tying devices in a franchise context is the franchisor's need to assert an effective form of quality control over the franchisee in order to protect his established goodwill.[61] Lower base costs for both the franchisor and franchisee can be attributed to the use of tying devices in those situations where the economies of scale achieved by the franchisor's purchasing are passed on to numerous franchisees. Furthermore, the franchisor's expenses incurred in quality control are greatly reduced if he is able to inspect supplies passing through a central depository rather than having to make field checks on each individual franchisee.[62] In most instances these savings will be passed on to the consuming public in the form of lower prices and will therefore bolster the volume of sales in an item having an elastic demand curve.[63] The consumer is additionally benefited by the product improvement that a large-scale franchisor is able to accomplish.[64]

Asserting that "tying agreements serve *hardly* any purpose beyond the suppression of competition,"[65] the courts have consistently declared such restraints to be illegal per se.[66] This condemnation is predicated largely upon the realization that the paramount interest in the tying arrangements rests with the franchisor-supplier, who receives the real benefits from the arrangement in the form of higher profits or rebates from his franchisees.[67] Given this motive for the use of a tying agreement, neither the consumer nor the goodwill of the franchised product is benefited;[68] the application of the per se rule is therefore justified.

The creation of a per se rule does not always result in a per se condemnation of the practices proscribed by the rule. The Chief of the Division of

60. 356 U.S. 1, 5-6 (1958); Note, *supra* note 40, at 928. A classic example of a tying arrangement is found in IBM v. United States, 298 U.S. 131 (1936).

61. Wilson, *supra* note 23, at 1173; Note, *supra* note 40, at 933.

62. Note, *supra* note 40, at 931, 933.

63. *Id.*

64. Note, *Quality Control and the Antitrust Laws in Trademark Licensing*, 72 YALE L.J. 1171, 1190, 1192 (1963). However, others have viewed these advantages as short-lived and less beneficial to competition and the consuming public than the complete absence of tying. Note, *supra* note 40, at 933-34.

65. Standard Oil Co. of Cal. & Standard Stations v. United States, 337 U.S. 293, 305-06 (1949) (emphasis added).

66. *See* note 37 *supra*.

67. Note, *supra* note 40, at 928. If the alleged tying arrangement is such that no profits accrue to the alleged violator, no violation of the antitrust laws results. Crawford Transp. Co. v. Chrysler Corp., 338 F.2d 934 (6th Cir. 1964).

68. Note, *supra* note 40, at 929.

Trade Restraints of the Federal Trade Commission has indicated that although the Commission is willing to apply a per se rule in this area, it will nonetheless look for more than the mere presence of a tie-in arrangement. Accordingly, he has suggested that attorneys come before the Commission "with the best possible evidence of why the [challenged] restraints . . . advance the public interest in free, fair and open competition."[69] There are several significant cases that collectively delineate those circumstances in which the restraints can be said to serve such a public interest. In *United States v. Jerrold Electronics*,[70] the manufacturer refused to sell separately any selected components of a recently developed community television antenna system. It further refused to sell its product unless the purchaser agreed to purchase the entire system, which included a service contract. The court approved the limited use of a tie-in, noting that such was necessary to protect the goodwill of an infant industry. In emphasizing that in a newly conceived industry prompt and efficient service is necessary to foster and protect the industry's goodwill, the court noted:[71]

> [A] wave of system failures at the start would have greatly retarded, if not destroyed, this new industry and would have been disastrous for Jerrold, who . . . did not have a diversified business to fall back on but had put most of its eggs in one precarious basket in an all out effort to open up this new field.

However, the court further delineated this policy by noting that although *Jerrold's* policy "was reasonable at its inception," it could no longer be sustained.[72] The industry had lost its "infant" status and had, at the time of trial, obtained its majority.

Jerrold is also relied upon for the proposition that tying is inapplicable in some situations where there is actually only a "single product," that is, a television antenna *system*, rather than a group of related but distinct products.[73] In *Associated Press v. Taft-Ingalls Corporation*,[74] the court interpreted *Jerrold* as enumerating "four criteria of separability" to be used in determining whether the single product defense had been properly established. The court noted that the following factors are of primary significance:[75]

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69. Jones, *supra* note 24, at 734 n.34; Wilson, *supra* note 23, at 1172, 1180.

70. 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961).

71. *Id.* at 557.

72. *Id.* at 558; Note, *Newcomer Defenses: Reasonable Use of Tie-Ins, Franchises, Territorials, and Exclusives*, 18 STAN. L. REV. 457 (1966). *Cf.* Advance Business Sys. & Supply Co. v. SMC Corp., 287 F. Supp. 143, 156 (D. Md. 1968).

73. Note, *supra* note 72, at 559. *See also* International Mfg. Co. v. Landon, Inc., 336 F.2d 723, 730 (9th Cir. 1964); Advance Business Sys. & Supply Co. v. SMC Corp., 287 F. Supp. 143, 156 (D. Md. 1968).

74. 340 F.2d 753 (6th Cir. 1965).

75. *Id.* at 764. This single product defense arose with a slightly different emphasis in Dehydrating Process Co. v. A. O. Smith Corp., 292 F.2d 653 (1st Cir. 1961), where the manufacturer of a silo unloading device required that a glass-lined silo be purchased with the unloader. Earlier abortive attempts to use the unloader with conventional silos had prompted this alleged tying. *Id.* at 654, 656. Although the lack of any satisfactory substitutes in the

(1) the practices of competitors;
(2) the number of products alleged to be a single product;
(3) the method in which the purchaser was charged — for individual items or for the unit; and
(4) the consistency of prior practice with the presently alleged tie-in.

A final defense to an allegation of an illegal tying arrangement can be invoked in those cases in which the specifications for the tied product are so detailed that they cannot practically be made available to the purchaser. However, this defense, which was suggested in the *Standard Stations* decision, has not been very efficacious for the franchisor.[76] In *Teleflex Industrial Products, Inc. v. Brunswick Corporation,*[77] the court noted that even if "technological interdependence" was shown, the tie-in sale might nevertheless be proscribed if competing manufacturers could demonstrate that their instruments could be readily conformed to the tying manufacturer's standards.[78] Some commentators have questioned the ultimate validity of the specifications defense even in cases where virtually unattainable specifications are shown. It is maintained that even at such a point, the harm to competing sellers far outweighs the interest of the franchisor in assuring conformity to minute details.[79]

In *Times Picayune Publishing Co. v. United States,*[80] the Supreme Court upheld a unitary sale of advertising in morning and evening newspapers even though advertisers were compelled to purchase space in both papers, which were owned by the same publishing company, in order to advertise in either one. The Court was unable to determine which edition should be termed the dominant product in order to establish the tying of advertising in one paper to purchasing advertising in the other. Furthermore, the Court failed to find the power necessary to effect an illegal tying arrangement,[81] although subsequent decisions in which power has been inferred from the existence of the tying arrangement seem to be more in line with the Court's current philosophy on this point.[82] The relevant issue in the franchise context then becomes whether the Court will infer the existence of the requisite power to render a tying agreement illegal through the mere existence of a franchise agreement.[83]

market very likely influenced the court's decision, the logical result of such absence is that this silo-unloader combination was for all practical purposes a single product, two parts of an integral system. *Id.* at 656-57. *See also* Covey, *supra* note 42, at 620; Zeidman, *supra* note 47, at 476.

76. Standard Oil Co. of Cal. & Standard Stations v. United States, 337 U.S. 293, 306 (1949).

77. 293 F. Supp. 106 (E. D. Pa. 1968).

78. *Id.* at 110.

79. Note, *supra* note 40, at 928.

80. 345 U.S. 594 (1953).

81. *But see* Kansas City Star Co. v. United States, 240 F.2d 643 (8th Cir. 1957), which said the result in *Times-Picayune* was based on a failure of proof. *Cf.* FTC v. Sinclair Ref. Co., 261 U.S. 463 (1923).

82. *E.g.,* Northern Pac. Ry. v. United States, 356 U.S. 1 (1958).

83. Wilson, *Exclusionary Restraints and Franchise Distribution,* 12 ANTITRUST BULL. 1169, 1175 (1967).

In *Standard Stations,* discussed previously as it bears upon exclusive arrangements,[84] the Court placed strong emphasis on the desirability of a judicial consideration of the proffered business justifications. However, an examination of several recent franchising cases indicates a trend toward an inference of the requisite power arising from the franchise itself. This trend can be interpreted as classifying some activities as tying and therefore subject to a per se condemnation.

In *Atlantic Refining Co. v. Federal Trade Commission,*[85] a sponsorship of Goodyear TBA by Atlantic to its franchised retail outlets was held to be in violation of section 5 of the Federal Trade Commission Act.[86] The Court placed strong emphasis on Atlantic's active involvement in the plan because Atlantic had urged its dealers to carry Goodyear products. Although the Court expressly noted the challenged activity was not a tying arrangement, it emphasized the economic power that Atlantic possessed over its dealers. This control took the form of "lease and equipment loan contracts with . . . cancellation and short-term provisions."[87] The Court further noted that the "central competitive characteristic [of the agreements] was the same" as in tying arrangements.[88]

The Court had previously reached similar conclusions,[89] but with its decision in *Federal Trade Commission v. Texaco*[90] the full import of this trend became evident. In *Texaco* the Court looked only to the short-term leases and other contractual manifestations of unequal bargaining power to find that an arrangement similar to that of *Atlantic Refining* was "inherently coercive." The Court expressly noted that Texaco did not employ the "overt coercive practices" involved in *Atlantic Refining.*[91] *Texaco* did not indicate that its holding was the result of an application of a per se rule analogous to that applied in most tying cases, but the proof of the violation does not seem to amount to more than a showing of the existence of the practices alleged. This is the typical impact of the application of a per se rule.[92] Furthermore, Justice Marshall's dissenting opinion in *United States v. Container Corporation of America*[93] indicates that the *Texaco* decision is an application of a new per se rule.[94]

84. Standard Oil Co. of Cal. & Standard Stations v. United States, 337 U.S. 293, 302 (1949). *See* discussion at note 48 *et seq. supra.*

85. 381 U.S. 357 (1965), *rehearing denied,* 382 U.S. 873. *See also* Shell Oil Co. v. FTC, 300 F.2d 470 (5th Cir. 1966); Broussard v. Socony Mobil Oil Co., 350 F.2d 346 (5th Cir. 1965).

86. 15 U.S.C. §45 (1964).

87. 381 U.S. 357, 368 (1965). *Cf.* Simpson v. Union Oil Co., 377 U.S. 13, 21 (1964).

88. 381 U.S. 357, 368-69 (1965). *See* Wilson, *supra* note 83, at 1174-75; Zeidman, *The Growth and Importance of Franchising—Its Impact on Small Business,* 12 ANTITRUST BULL. 1191, 1203 (1967).

89. *See generally* Simpson v. Union Oil Co., 377 U.S. 13 (1964); Osborne v. Sinclair Ref. Co., 324 F.2d 566 (4th Cir. 1963); United States v. General Motors Corp., 121 F.2d 376, 400 (7th Cir. 1941).

90. 393 U.S. 223, 89 S. Ct. 429 (1968).

91. *Id.* at 228, 89 S. Ct. at 432.

92. BNA ANTITRUST & TRADE REG. REP., March 4, 1969, at B-2.

93. 393 U.S. 333, 89 S. Ct. 510 (1969).

94. *Id.* at 340, 89 S. Ct. at 514.

A case somewhat analogous to *Texaco* is *Federal Trade Commission v. Brown Shoe Co.*[95] Rather than a situation of preexisting power over the retailer-franchisee, *Brown Shoe* involved an offer dealing with certain valuable services[96] to be provided by Brown to the dealer in return for the dealer's agreement to concentrate his sales program upon Brown products. *Brown Shoe* seems to encompass more than *Texaco* in finding a violation of section 5 of the Federal Trade Commission Act (FTCA). Comparing the case with *Atlantic Refining*, one commentator has suggested that the distinction is the difference between employing a stick and a carrot to achieve desired goals.[97] Although the Court was willing to find a violation of the Federal Trade Commission Act, the case does not support the trend culminating in the *Texaco* decision. The *Brown Shoe* language indicating that proof of economic impact need not be shown[98] was based upon the "incipient incipiency" application of section 5 of the FTCA.[99] Departing from the trend represented by *Atlantic Refining*, the Court in *Brown Shoe* analyzed the anticompetitive factor in a manner reminiscent of the *Tampa Electric* approach to exclusive dealing.[100] Lest this analysis seem too encouraging for the potential franchisor, it should be noted that the *Texaco* decision is the Court's latest pronouncement in this area. Furthermore, the relevance of *Brown Shoe* to the more popular forms of franchising is open to some doubt.[101]

Thus, in attempting to solve the problem regarding the viability of the secondary (TBA) exclusive arrangements in *Standard Stations*[102] it would seem justified (and even properly precautionary) to anticipate the application of a per se rule to such arrangements.

Finally, one should not hastily dismiss the foregoing cases as relevant to the economic giants of our financial community but not to the moderately large franchisor. In *Fortner Enterprises v. United States Steel Corp.*,[103] the Court was presented with an alleged tying arrangement foreclosing competition in the tied item to a maximum of 190,000 dollars annually. In holding this arrangement illegal under the Sherman Act, the Court said that sufficient competition had been foreclosed so as "not to be merely 'de minimus.'" By thus lowering the threshold at which an impermissible amount of competition is foreclosed, this case broadens the area in which tying arrangements will be found illegal, and although the meaning of this phrase in a franchising context is uncertain, the increased possibility of liability in much smaller eco-

95. 384 U.S. 316 (1966). *Cf.* Bascom Launder Corp. v. Telecoin Corp., 204 F.2d 331, 333 (2d Cir.), *cert. denied*, 354 U.S. 994 (1953).

96. 384 U.S. 316, 318 (1966) listed the furnishing of architectural plans, merchandising records, services of field representatives, and group insurance.

97. Covey, *Franchising and the Antitrust Laws: Panacea or Problem?*, 42 NOTRE DAME LAW. 605, 616 (1967).

98. 384 U.S. at 321-22.

99. Dillon, *Exclusive Dealing, Requirements Contracts, Tieing Arrangements and Full-line Forcing*, 37 ABA ANTITRUST L.J. 149 (1968).

100. Wilson, *supra* note 83, at 1177. *See* discussion note 53 *et seq. supra*.

101. Rudnick, *supra* note 55, at 626.

102. *See* the discussion note 59 *supra*.

103. 394 U.S. 495 (1969).

nomic units than the Atlantic or Texaco oil combines cannot be ignored. For the prospective franchisor, *Fortner* stands as a portentious omen. And because *Fortner* was decided under the Sherman Act and not merely section 5 of the FTCA, under which *Atlantic, Texaco,* and *Brown Shoe* were decided, the franchisor is further liable for private treble damage suits.[104]

Trademarks and Tying

It has been noted that "[f]or many franchisors, the *Texaco* opinion may mean that they can comply with the law only by avoiding any involvement with their franchisees' purchases from third-party suppliers of products that are not used in close enough association with the franchised mark to make restrictions on their source reasonably ancillary to protection of the mark."[105] There seems to be an unarticulated distinction between those franchise arrangements in which the franchisor agrees to permit the franchisee-licensee to use the mark not only as a trademark but also as a trade name, and those in which the owner licenses only the use of the mark and the franchisee continues to do business under his own trade name.[106] This distinction assumes some importance in an antitrust context, since the legality of employing certain restraints in these different methods of doing business may ultimately turn upon whether the restraints are employed for anticompetitive purposes or are ancillary to the licensing of the trademark and are accordingly employed to protect the goodwill embodied in the mark.[107] Under the scrutiny of the rule of reason, restraints employed in a trade name franchise are more likely to be found to be reasonable than identical restraints where only the use of the trademark is permitted.[108]

From the consumer's point of view, trademarks serve two essential purposes: they reduce the risk in purchasing previously untried products, and they assist in choice reduction when one is faced with a variety of similar products.[109] Trademarks are said to enhance competition because they induce individuals to enter production by giving them an opportunity to take advantage of another's (the licensor's) technological and marketing experi-

104. *See, e.g.,* Siegel v. Chicken Delight, Inc., 271 F. Supp. 722 (N.D. Cal. 1967), *modified sub. nom.,* Chicken Delight v. Harris, 412 F.2d 850 (9th Cir. 1969), which also illustrates the expanded usefulness of the class action under FED. R. CIV. P. 23. Furthermore, the point is now well settled that the franchisee is not barred from suing as being *in pari delicto* with the franchisor. Konfakis v. Carvel, 1968 TRADE CAS. ¶72,343, at 84,933 (E.D.N.Y., Jan. 5, 1968).

105. BNA ANTITRUST & TRADE REG. REP., March 4, 1969, at B-1.

106. *See* Denison Mattress Factory v. Spring-Air Co., 308 F.2d 403 (5th Cir. 1963); Engbrecht v. Dairy Queen Co., 203 F. Supp. 714 (D. Kan. 1962); United States v. Spring-Air Co., 1962 TRADE CAS. ¶70,402 (N.D. Ill. 1962). *See also* LeBlanc, *supra* note 44, at 536-37.

107. Baker v. Simmons Co., 307 F.2d 458 (1st Cir. 1962); Covey, *supra* note 97, at 621.

108. Covey, *supra* note 97, at 622; Kintner, *Distribution Restrictions in Franchise Agreements—As Viewed by a Member of the Private Bar,* 12 ANTITRUST BULL. 1211, 1217 (1967); LeBlanc, *supra* note 44, at 537.

109. Treece, *Trademark Licensing and Vertical Restraints in Franchising Arrangements,* 116 U. PA. L. REV. 435, 438 (1968); Note, *Antitrust Problems in Trademark Franchising,* 17 STAN. L. REV. 926 (1965).

ence;[110] allow small producers to compete against larger ones;[111] and increase customer choice because licensing trademarks stimulates greater production.[112] On the other hand, trademark licensing tends to be anticompetitive because it discourages innovation by licensee and licensor once the mark has become established; discourages entry into a product market where a particular mark is already established; and disrupts local markets when they are invaded by an established mark, thereby forcing local producers out of business.[113]

The individual who possesses a mark that he wishes to license is faced with two basic risks. Under trademark law, a mark owner who allows another to use his mark without retaining a sufficient amount of control over the quality of the product in conjunction with which the mark is employed by the licensee runs the risk of loss of his rights to the mark itself.[114] Additionally, the licensor must consider the fact that the licensee is to a large extent selling the goodwill embodied in the mark. The franchisor thus has legal and practical business reasons for retaining some degree of control over the use of the mark.[115] The second basic risk that the licensor faces, then, is the loss of his rights to the mark for an antitrust law violation occasioned by his attempting to conform to the dictates of trademark law and in so doing exerting a prohibited degree of control over the mark franchisee.[116]

In the relationship between licensor and licensee, the latter must depend upon the former for a determination of minimal product or service standards and for a determination of what amounts to a conformance with those basic standards. Of necessity, the licensee must at least cede to the licensor the right to inspect his production facilities and finished products as well as the right to determine the fate of nonconforming products.[117] It is in attempting to implement alternatives to on-the-spot inspection of franchisees that the trademark or trade name franchisor begins to encounter the prohibitions of the antitrust laws.

The use of tying arrangements in connection with a trademark license is usually traced to the licensor's attempts to insure that the mark will be used only in conjunction with products or services of a quality commensurate with that generally associated with the mark.[118] From a business viewpoint, tying is necessary when used in connection with a mark where the products sold

110. Susser v. Carvel Corp., 206 F. Supp. 636, 640 (S.D.N.Y. 1962); Note, *supra* note 109, at 926.

111. Denison Mattress Factory v. Spring-Air Co., 308 F.2d 403, 413 (5th Cir. 1962).

112. Note, *supra* note 109, at 926.

113. *Id.*; Note, *Quality Control and the Antitrust Laws in Trademark Licensing*, 72 YALE L.J. 1171, 1190-91 (1963).

114. Dawn Donut Co., Inc. v. Hart's Food Stores, Inc., 267 F.2d 358 (2d Cir. 1959); Covey, *supra* note 97, at 611-12; Treece *supra* note 109, at 465-67.

115. Covey, *supra* note 97, at 612.

116. Swizer Bros., Inc. v. Locklin, 297 F.2d 39, 46 (7th Cir. 1961). *See* Timken Co. v. United States, 341 U.S. 593, 599 (1951); Treece, *supra* note 109, at 466-67; Note, *supra* note 109, at 927.

117. Treece, *supra* note 109, at 465.

118. Susser v. Carvel Corp., 332 F.2d 050 (2d Cir. 1964), *cert. dismissed*, 381 U.S. 125 (1965).

under the mark are, for example, derived from a secret formula. In such situations tying is generally permitted.[119] Even in cases where the formula for the product is not secret, the franchisor may attempt to employ tying as an alternative to on-the-spot inspection of each franchisee's production facilities. When employed in such a manner and not primarily as a trade restraint, such arrangements are generally subject to a rule-of-reason standard and are frequently sustained.[120]

Tying arrangements have been held illegal in situations where the supplying party had sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product.[121] The question, which then must be considered, is whether a trademark may be said to be a tying item and if so, whether it can be said to possess the degree of "power" necessary to find such a use illegal.[122] *Brown Shoe, Atlantic Refining,* and *Texaco*[123] seem to indicate that the inquiry should be answered in the affirmative. However, it should be noted that in those cases the tying arrangements were not employed in a manner designed to protect the goodwill embodied in the franchised mark.[124] Additionally, the *Brown Shoe* case does not appear to have involved any of those "singular factors which are so inherent in and distinguish a franchise situation from an ordinary manufacturer-retailer relationship."[125]

The leading case in this area is *Susser v. Carvel Corporation.*[126] There the court noted that "in compelling circumstances the protection of goodwill, as embodied for example in a valuable trademark, may justify an otherwise invalid tying arrangement."[127] The compelling circumstances permitting the tying agreement in *Carvel* included the fact that since the Carvel franchise was a format franchise, all products sold on the premises would be attributable to the franchisor.[128] Additionally, Carvel's primary product, soft ice cream, was noted to be one that would not easily lend itself to advance specifications enabling each franchisee to purchase his own supplies from an independent dealer.[129]

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119. *Id.*; Dole, *The Interplay of Trade Symbol Protection and the Antitrust Laws,* 13 ANTITRUST BULL. 1347, 1356 (1968).

120. Susser v. Carvel Corp., 332 F.2d 505 (2d Cir. 1964); Engbrecht v. Dairy Queen Co., 203 F. Supp. 714 (D. Kan. 1962).

121. Note, *supra* note 109, at 929; *see* discussion note 80 *et seq. supra.*

122. Dillon, *supra* note 99, at 151; Note, *supra* note 109, at 929.

123. *See* discussion note 85 *et seq. supra.*

124. Ward, *Antitrust Aspects of Restrictions To Protect the Integrity of a Trademark and Preserve Goodwill,* 36 ABA ANTITRUST LAW J. 52, 59 (1967).

125. Zeidman, *supra* note 88, at 1204.

126. 332 F.2d 505 (2d Cir. 1964), *cert. dismissed,* 381 U.S. 125 (1965); Comment, *Tying Arrangement With Trademark as the Tying Item Is Not a Per Se Violation of the Antitrust Laws,* 63 MICH. L. REV. 550 (1965).

127. *Id.* at 512.

128. *Id.* at 518-21. *See* Dole, *supra* note 119, at 1354; Zeidman, *supra* note 88, at 1204.

129. 332 F.2d at 520. *Cf.* Standard Oil Co. of Cal. & Standard Stations v. United States, 337 U.S. 293, 306 (1949). Dole, *supra* note 119, at 1354, suggests that if advance standards had been feasible, the tying arrangement would have been unnecessary.

In *Carvel,* the Second Circuit Court of Appeals rejected the contention that for antitrust purposes a trademark should be accorded the same treatment as a patent.[130] However, the court did not reject the contention that a trademark could, in and of itself, constitute a tying item. In a later Federal Trade Commission action,[131] arising from the same facts as *Susser v. Carvel Corporation,* the Commission held a trademark could *not* be a tying item since it cannot be conceptualized as separate and apart from the product that it identifies.[132] Nonetheless, it should be noted that Carvel had numerous competitors and that entry into the soft ice cream market was relatively easy. Both *Carvel* decisions contain clear warnings to franchisors with significant market power and who operate in markets where there are substantial barriers to entry. Such licensors must have "sound business reasons for tying the purchase of goods or services to the license of their trade symbols."[133]

The cornerstone of a successful franchise is a licensed trade name or trade symbol.[134] While it is clear that trademark license agreements do not constitute carte blanché exceptions to the antitrust laws,[135] it is equally clear that antitrust policy does not demand a blanket prohibition of those restrictions necessary for the reasonable operation of a trademark franchising system.[136]

TERRITORIAL RESTRAINTS

Territorial restraints include such devices as exclusive dealerships, dealer location clauses, and area of primary responsibility clauses.[137] Exclusive dealerships, which are the most frequently encountered type of territorial restraints,[138] manifest themselves in one of two basic formats – purely territorial restraints or customer restraints that ultimately have a territorial impact.[139] In the former the dealer is given an area in which he may sell to anyone who is in that area regardless of the buyer's primary business location.[140] In the latter, the dealer is also assigned a territory within which he

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130. The existence of a patent is prima facie evidence of the power necessary to taint a tying arrangement with illegality, Standard Oil Co. of Cal. & Standard Stations v. United States, 337 U.S. 293, 306 (1949). *See also* Rudnick, *The Franchisor's Dilemma: Can He Satisfy the Legal and Commercial Requirements of a Trademark Licensing System Without Exposing Himself to Other Legal Risks,* 56 TRADEMARK REP. 621, 629 n.13 (1966).

131. Carvel Corp. [1965-1967 Transfer Binder] TRADE REG. REP. ¶17,298 (F.T.C. Dkt. 8574).

132. *Id.* ¶22,429. *Contra,* Anchor Serum Co. v. FTC, 217 F.2d 867 (7th Cir. 1954).

133. Dole, *supra* note 119, at 1356.

134. Susser v. Carvel Corp., 206 F. Supp. 636, 641 (S.D.N.Y. 1962).

135. Timken Roller Bearing Co. v. United States, 341 U.S. 593, 599 (1951), indicated that "[a] trademark cannot be legally used as a device for Sherman Act violations."

136. LeBlanc, *Antitrust Ramifications of Trademark Licensing and Franchising,* 53 TRADEMARK REP. 519, 544 (1963).

137. Pollock, *Alternative Distribution Methods After* Schwinn, 63 NW. U.L. REV. 595, 602 (1968). Exclusive dealerships with their territorial impact are to be distinguished from requirements contracts' impact of exclusive dealing.

138. Zeidman, *supra* note 88, at 1197.

139. Covey, *supra* note 97, at 610.

140. Snap-On Tools Corp. v. FTC, 321 F.2d 825, 830-32 (7th Cir. 1963). *See* the discussion note 230 *et seq. infra.*

is to operate but is additionally limited to selling to those customers who reside or have a business operation within his designated territory.[141]

Until fairly recently, vertically imposed territorial restraints were attacked under the antitrust laws as being per se illegal only when they occurred in conjunction with some other restrictive practice such as price fixing.[142] They were viewed in light of traditional legal concepts; that is, as ancillary restraints occasioned by a contractual relationship between buyer and seller or consignor and consignee. But, relying on dictum in a 1944 case, *United States v. Bausch & Lomb Optical Co.*,[143] the Federal Trade Commission and the Department of Justice initiated a vigorous and successful campaign against vertically imposed customer and territorial restraints.[144] The basic premise of the campaign was that such restraints were illegal per se and could not be justified through a rule of reason inquiry.[145]

White Motor Co. v. United States[146] seemed to be the case that would diminish, if not completely curtail, the Government's per se condemnation of vertically imposed customer and territorial restraints. Justice Douglas, in the majority opinion of *White Motor*, acknowledged that while the restraints in question could very well have an injurious impact upon competition and thereby subject the restraints to the sanctions of the antitrust laws, there was in 1963 insufficient understanding of the economic impact of such restraints to justify the application of a per se rule in light of its inherent harshness.[147] Indeed, he noted that such restraints "may be . . . the only practicable means a small company has for breaking into or staying in business. . . ."[148]

While the antitrust bar apparently took *White Motor* to indicate that absent any overtones of a horizontal agreement, a vertically imposed exclusive dealership arrangement would be judged under the rule of reason,[149] the Government evidentially felt otherwise.[150] Nonetheless, two subsequent cases,

141. United States v. Arnold Schwinn & Co., 388 U.S. 365 (1967); Covey, *supra* note 97, at 610; Day, *Exclusive Territorial Arrangements Under the Antitrust Laws—A Reappraisal*, 40 N.C.L. REV. 223, 227 (1962).

142. *E.g.*, White Motor Co. v. United States, 372 U.S. 253 (1964); Dr. Miles Medical Co. v. John D. Park & Sons, 220 U.S. 373 (1911); General Cigar Co., 16 FTC 537 (1932).

143. 321 U.S. 707, 721 (1944): "A distributor of a trade-marked article may not lawfully limit by agreement, express or implied, the price at which or the persons to whom its purchasers may resell . . . . The same thing is true as to restrictions of customers."

144. Note, *Validity of Vertical Restraints*, 51 MARQ. L. REV. 395, 397-98 (1967).

145. *E.g.*, United States v. Lone Star Cadillac, 1963 TRADE CAS. ¶70,739 (N.D. Tex. 1963); United States v. Sperry Rand Corp., 1962 TRADE CAS. ¶70,495 (W.D.N.Y. 1962); Travers & Wright, *Restricted Channels of Distribution Under the Sherman Act*, 75 HARV. L. REV. 795, 796-97 (1962). *See* Stone, *Closed Territorial Distribution: An Opening Question in the Sherman Act*, 30 U. CHI. L. REV. 286, 288 (1963).

146. 372 U.S. 253 (1963).

147. Justice Douglas speaking of the effect on competition reasoned: "We do not know enough of the economic and business stuff out of which these arrangements emerge to be certain." *Id.* at 263.

148. *Id.*

149. McLaren, *Marketing Limitations on Independent Distributors and Dealers—Prices, Territories, Customers, and Handling of Competitive Products*, 13 ANTITRUST BULL. 161, 166 (1968).

150. The Government ultimately prevailed by obtaining a consent decree, United States

Sandura Co. v. Federal Trade Commission[151] and *Snap-On Tool Corp. v. Federal Trade Commission*,[152] which embraced the *White Motor* rationale, served to bolster the confidence of those who relied upon vertically imposed restraints to achieve certain business goals. In some instances, courts granted lost profits to distributors whose exclusive territories had been infringed by another distributor.[153]

White Motor, Sandura, and *Snap-On* were manifestations of a reluctance on the part of the courts to apply a per se rule to vertically imposed customer and territorial restraints. By 1967, this trend had become so firmly established that the Government did not seek an application of the per se rule in the case in which its applicability was finally announced. During the oral argument of *United States v. Arnold, Schwinn & Co.*,[154] Justice Black interrupted government counsel and inquired: "Am I to understand from your argument that the Government does not want to win this case on a per se argument?" Unequivocally, government counsel replied: "That's correct."[155]

Schwinn sold its bicycles primarily to or through twenty-two wholesale distributors, from whom numerous retailers purchased and resold to the public. Schwinn assigned specific territories to each distributor who was then required to sell only to franchised Schwinn retailers and only in territories that had been specifically assigned.[156] Schwinn franchised approved retail outlets, and although the franchise did not prevent the handling of other brands, it required that the retailer promote Schwinn products.

The Supreme Court found illegal per se those restraints imposed upon the bicycles that had been *sold* to the distributors. However, the Court ruled

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v. White Motor Co., 1964 TRADE CAS. ¶71,195 (N.D. Ohio 1964). Even though the restraints were never proved to be unreasonable, the White Motor Company agreed to discontinue its franchising practices completely. *Id.* One commentator indicated that White's agreeing to a consent decree reflects the relative unimportance of territorial and customer restrictions. Zimmerman, *Distribution Restrictions After* Sealy *and* Schwinn, 12 ANTITRUST BULL. 1181, 1187 n.8 (1967) (Mr. Zimmerman was the First Ass't, Antitrust Division, Dep't of Justice). It seems equally if not more likely that the consent decree reflects the high cost of antitrust litigation. Schwinn's expenditures amounted to $500,000 from the time the complaint was filed until the final judgment was entered by the trial court on remand from the Supreme Court. United States v. Arnold, Schwinn & Co., 291 F. Supp. 567, 568 (N.D. Ill. 1968). White's expenses were probably also substantial.

151. 339 F.2d 847 (6th Cir. 1964). The court of appeals reversed the FTC's ruling and refused to find Sandura's arrangement illegal without "examining [its] effect upon competition *and* the facts offered to justify the resulting restraint." *Id.* at 850. Basically, Sandura had imposed the restraint because it had come upon hard times and needed to obtain maximum market coverage for an unmarketable product.

152. 321 F.2d 825 (7th Cir. 1963). "[T]here are certain advantages to a manufacturer . . . in requiring an exclusive territorial arrangement with its dealers which promotes (rather than suppresses) in a broad, meaningful way, competition between it and other manufacturers of similar products, and which therefore justify a minimal curtailment of intrabrand competition among its dealers." *Id.* at 831-32.

153. *E.g.*, Exercycle of Michigan, Inc. v. Wayson, 341 F.2d 335 (7th Cir. 1965).

154. 388 U.S. 365 (1967).

155. 35 U.S.L.W. 3369, 3373 (April 25, 1967) (summary of oral arguments in *Schwinn*).

156. United States v. Arnold, Schwinn & Co., 237 F. Supp. 323, 341 (N.D. Ill. 1965) indicates that the company distributed maps assigning specific territories.

that those restraints applicable to the bicycles that had not been sold to the distributors, but consigned to them, were not subject to the same per se condemnation. In determining that they were not illegal, the Court applied the rule of reason to these restraints.

In reaching this result the Court implicitly rejected a number of justifications put forth in favor of territorial restrictions. These arguments, which favor the use of such restraints and which are equally applicable to customer restraints, are myriad: territorial restraints benefit the manufacturer by insuring him that his product will be marketed in an orderly fashion;[157] their use facilitates his entry into new geographic markets;[158] they serve as a deterrent to vertical integration and horizontal mergers among competitors;[159] such restraints stimulate dealer participation, since dealers soon realize that they are protected from ruinous *intrabrand* competition;[160] they allow a manufacturer to exclude unskilled distributors and retailers in order to avoid tort liability and maintain the reputation of his product;[161] they generally increase efficiency in distribution while insuring maximum market coverage;[162] they enhance servicing where special facilities or knowledge or both are required;[163] and they generally enhance interbrand competition.[164]

The commentators and courts are equally prolific in discovering virtues of territorial restraints when viewed from the position of the franchisee.[165] Generally, their praise is focused upon the fact that such restraints enable the little man to get a slice of the capitalistic pie without really putting himself in economic jeopardy. He is given exclusive rights to market a product within a given area and knows that he alone (as opposed to other distributors) will reap the benefits from all the time and capital he devotes to cultivating his protected market.

The per se rule promulgated in *Schwinn* has been diluted somewhat by later decisions. In *Albrecht v. Herald Co.*,[166] Justice Douglas indicated in his concurring opinion that in *Schwinn* the Court "noted that evidence of record 'elaborately sets forth information as to the total market interaction and intrabrand competition, as well as the distribution practices and plans.' "[167] The case seems to indicate that the Court presently will not apply the

157. Zeidman, *Antitrust Aspects of Franchising*, MICH. ST. B.J., May 1966, at 31.

158. Shuman, *The Future of Franchising and Trade Regulation*, 14 HOW. L. J. 60, 73 (1968).

159. *Id.* at 63.

160. Note, *supra* note 109, at 939. *Contra*, Zimmerman, *supra* note 150, at 1186.

161. Comment, *Restricted Distribution After* Schwinn, 9 B.C. IND. & COM. L. REV. 1032, 1043 (1968).

162. Bork, *The Rule of Reason and the Per Se Concept: Price-Fixing and Market Division*, 75 YALE L.J. 373, 375 (1966); Travers & Wright, *supra* note 145, at 813.

163. Kittelle, *Territorial and Customer Restrictions Through Consignment or Agency* — Schwinn *or Sin?*, 12 ANTITRUST BULL. 1007, 1031 (1967).

164. Covey, *Franchising and the Antitrust Laws: Panacea or Problem?*, 42 NOTRE DAME LAW. 605, 613 (1967); Stone, *supra* note 145, at 311; Travers & Wright, *supra* note 145, at 800.

165. *See* authorities cited notes 155-162 *supra*.

166. 390 U.S. 145 (1968).

167. *Id.* at 155.

Schwinn per se rule with all of its potential. This possibility has been enhanced by the appointment of Chief Justice Burger and the retirement of Justice Fortas.[168]

In *Mississippi Valley Gas Co. v. Federal Power Commission*,[169] a contractual clause providing that the "[b]uyer shall not sell gas . . . to any one industrial customer in excess of 100,000 cubic feet . . . per month except by express written consent of the seller" was alleged to be in violation of the *Schwinn* per se rule.[170] The court acknowledged the existence of the rule, but indicated that it was inapplicable to the subject matter of the case. The restraint in the contract was *reasonable* in light of the unique nature of public utilities and the apparent purpose of the clause to insure the seller that it would not be subject to a demand that would so drain its resources as to render it unable to supply other customers. Although this factor can be said to distinguish the case from *Schwinn*, the decision nonetheless ignores the spirit if not the language of *Schwinn*.

Another significant case interpreting the *Schwinn* rule is *Janel Sales Corp. v. Lanvin Parfums, Inc.*[171] The Second Circuit Court of Appeals stated in *Janel*:[172]

> [T]he existence of such a contractual clause does not necessarily imply a *per se* violation. In [*Schwinn*], the Supreme Court premised its finding of a *per se* violation on the fact that Schwinn had been "firm and resolute" in insisting on compliance.

The disputed clause in *Janel* provided that the " '[r]etailer' will not sell any of the '[c]ommodities' except to customers for use."[173]

Albrecht, Mississippi Valley Gas, and *Janel* seem to indicate a reluctance on the part of the courts to embrace the per se rule of *Schwinn* in situations that differ even slightly from that of *Schwinn*. Perhaps the rule will become so riddled with exceptions that for all practical purposes it will cease to exist. Nonetheless, the *Schwinn* per se rule represents the law as it now stands, and one must frame his actions with that rule in mind.

The position reflected by the lower federal courts in *Janel* and *Mississippi Valley Gas* and the position of Justice Douglas in *Albrecht* may in some part be attributable to criticism of *Schwinn*'s per se rule. Such criticism has centered primarily upon two areas: anticipated vertical integration as a result of the adoption of the rule[174] and the adoption of the rule absent conclusive evidence that the types of restraints employed by Schwinn were so completely without redeeming value as to merit a per se condemnation.[175] The anticipated

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168. Wall Street Journal, May 16, 1969, at 1, cols. 7-8.

169. 398 F.2d 395 (5th Cir. 1968).

170. *Id.* at 396 n.5.

171. 396 F.2d 398 (2d Cir.), *cert. denied*, 89 St. Ct. 303 (1968).

172. 396 F.2d at 406.

173. *Id.* at 400.

174. Keck, *Alternative Distribution Techniques-Franchising, Consignment, Agency and Licensing*, 13 ANTITRUST BULL. 177, 178 (1968).

175. *See* Note, *supra* note 144, at 399; Comment, *supra* note 161, at 1042.

vertical integration becomes particularly undesirable when it becomes apparent that it will occur primarily at the expense of the smaller businessman.[176] To some extent this prediction has been borne out,[177] but whether this is representative of a trend is unclear. Similar prognostications made after the *Standard Stations* decision have failed to materialize.[178] At least one commentator has questioned whether there is enough distinction between the actual operation of a franchised and a unitary system to make the anticipated integration of any moment.[179]

This criticism of the per se rule revolves largely around the Court's unarticulated analysis of the *inter-* and *intra*-brand spheres of competition.[180] The *Schwinn* decision represents a judicial value judgment as to the relative merits of interbrand and intrabrand competition. Upon the suggestion of the Government, the Court considered the relationship of these two types of competition, but referred to the matter only in a cryptic remark after approving the consignment exception: "Application of the rule of reason cannot be confined to intrabrand competition."[181]

Justice Brennan, concurring in the *White Motor* decision, noted that territorial restraints may have an anticompetitive impact on intrabrand competition and then further noted that their impact upon competition was probably far less significant than that of resale price maintenance.[182] He was therefore unable to condemn them at the time. Such reservations in condemning restraints that affect only intrabrand competition are not without merit. Through protecting vast marketing systems from intrabrand competition one may stimulate the rise of stronger manufacturers who would increase the intensity of interbrand competition and perhaps bring about an over-all increase in competition.[183] Accordingly, the removal of intrabrand competition from the scrutiny of the antitrust laws has strong advocates who, because of the interrelationship between intrabrand competition and territorial restraints, offer justifications similar to those discussed above.[184] Obviously, such justifications are irrelevant if the product sold by the franchisee is unique. In such a situation, there can be no interbrand competition and no overriding need to sacrifice intrabrand competition to preserve interbrand competition

176. Keck, *supra* note 174, at 178. *See also* Simon, *Dual Distribution*, 37 ABA ANTITRUST L.J. 168, 170 (1968).

177. Of the twenty-two original Schwinn distributors, nineteen have been absorbed into the company and the other three, which are presently on consignment arrangements, have been notified of the impending termination of their contracts. United States v. Arnold, Schwinn & Co., 291 F. Supp. 567, 568 (N.D. Ill. 1968) (mem. accompanying final judgment).

178. Zimmerman, *supra* note 150, at 1186.

179. Shuman, *supra* note 158, at 63.

180. As with a number of the Court's decisions and as predicted, Zeidman, *The Growth and Importance of Franchising — Its Impact on Small Business*, 12 ANTITRUST BULL. 1191, 1207 (1967), criticism has led to legislative proposals to except territorial restraints from the antitrust laws in some situations. *See* H.R. 3645, 7056, 8866, 91st Cong., 1st Sess. (1969).

181. 388 U.S. at 382.

182. White Motor Co. v. United States, 372 U.S. 253, 268 (1963).

183. Covey, *supra* note 164, at 620.

184. Zimmerman, *supra* note 150, at 1182. *See* note 157 *et seq. supra*.

can be shown.[185] However, in *Schwinn* the Court was faced with a situation that was not as clearly defined as in the above examples. In electing between a per se rule and a rule of reason the Court was actually making a choice between interbrand and intrabrand competition. Had the Court held *all* the restraints illegal per se, intrabrand competition would have been stimulated by allowing previously restricted dealers to invade lucrative markets that had previously been protected under the challenged restraints. On the other hand to have refused to apply a per se rule would have probably permitted Schwinn ultimately to retain the restraints, after a trial on the merits.[186] This would have been detrimental to intrabrand competition, while still allowing Schwinn to compete more effectively against the large unitary systems that were the critical competitive factors in Schwinn's originally adopting the restraints. It would be an understatement to say that the choice has been hotly debated, but one commentator has suggested a cogent reason for refusing to protect intrabrand competition in all but the new and failing company situations allowed by *Schwinn*. He noted that particularly in concentrated industries "the further product differentiation [interbrand competition] which may be encouraged by the restrictions — the alleged benefit — serves largely to help transfer oligopolistic behavior to the distribution level and to encourage intrabrand 'product' competition at the expense of price competition."[187] One of the most persuasive suggestions concerning the underlying reasons for the adoption of the per se rule in *Schwinn* concerns the heavy workload of the federal courts coupled with the inability of the federal judiciary to cope with the complex economic problems presented by most antitrust litigation.[188]

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185. Jordan, *Exclusive and Restrictive Sales Under the Antitrust Laws*, 9 U.C.L.A.L. Rev. 111, 115 (1961). Schwinn argued in the district court that its bicycles were actually a unique product, 237 F. Supp. 326 (1965), but this aspect of the case was not mentioned in the Supreme Court's decision.

186. *But see* Preston, *Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards*, 30 Law & Contemp. Prob. 506 (1966).

187. Zimmerman, *supra* note 150, at 1185.

188. Adoption of a per se rule would reduce considerably the quantum of evidence that would have to be introduced to establish that a challenged restraint was illegal, because there would be no allowance for a showing of any offsetting justifications for the use of the restraint. McLaren, *supra* note 149, at 168. The record filed with the Court in *Schwinn* consisted of twenty-three volumes, which were submitted only sixty days before oral arguments were heard and 113 days before the decision was handed down. *Id.* The Justices themselves have frequently noted the burden imposed upon the Court by complex antitrust litigation, United States v. Singer Mfg. Co., 374 U.S. 174, 175 n.1 (1963); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 362 (1963); United States v. Trenton Potteries, 273 U.S. 392 (1927). Congressional response to the Expediting Act, 15 U.S.C. §§28-29 (1964), which allows antitrust litigations to be appealed directly to the Supreme Court and thus a crucial factor in increasing the Court's burden, has been equivocal. *See* S. 2721, 2806, 90th Cong., 2d Sess. (1968). *See also Hearings on Expediting Act Amendments Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 90th Cong., 2d Sess. (1968). The Nixon administration has urged amendment of the Expediting Act as a partial solution to the problems encountered by the Court in antitrust litigation. 115 Cong. Rec. H5899 (daily ed. July 14, 1969); Wall Street Journal, July 15, 1969, at 4, col. 3.

The correctness of these interpretations is not as significant as their uncertainty. Although the Court noted in *White Motor* that in 1963 there was insufficient knowledge of the economic impact of vertically imposed territorial and customer restraints to justify an application of a per se rule,[189] it failed to indicate that any such information had become available in applying a per se rule to almost identical restraints in *Schwinn*. Indeed, one thorough study of such restraints indicates that their competitive impact varies considerably and is primarily dependent upon the ends sought to be accomplished through their use.[190]

The agency or consignment exception[191] seems to afford considerable leeway to those who would be affected by the *Schwinn* per se rule. However, ranking counsel of the Federal Trade Commission have warned that it is not an open invitation to circumvent the spirit of the per se prohibition against restraints upon products that have been sold to the franchisee. If accomplished solely to take advantage of the consignment exception, any sudden alteration in the structure of a distribution system will be viewed with suspicion.[192] Others have similarly warned that mere form will not insulate a consignment type system from attack.[193] Indeed, the Court seems to indicate that in order to fall under the consignment exception, the consignee must be something very close to a "mere salesman."[194] Furthermore, at least one Federal Trade Commission attorney has indicated that those consignment arrangements that seemingly fall under the *Schwinn* rule may nonetheless be found to violate section 5 of the Federal Trade Commission Act: "Indeed, section 5 was designed to cope with cases like this."[195] This position is supported by a statement of a former Small Business Administration chief counsel, who questioned whether the consignment-sale distinction was a sufficient basis for a significant exception to a per se rule.[196] Finally, there is some concern as to whether the consignment exception is really of any benefit to the small businessman who wants to set up a distribution system, yet who does not have the capital necessary to finance a large inventory.[197]

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189. 372 U.S. 253, 263-64 (1963).

190. Preston, note 186 *supra*.

191. There are other justifications which were alluded to in *Schwinn* and which are solidly entrenched in decisional precedent, dealing with infant industries and failing companies. 388 U.S. at 374. *See* Orrick, *Marketing Restrictions Imposed To Protect the Integrity of "Franchise" Distribution Systems*, 36 ABA ANTITRUST L.J. 63, 69-70 (1967). The impact of these justifications has been observed in the discussion of *Jerrold Electronics* (infant industry) at note 70 *et seq. supra* and in *Snap-On Tools* (failing company) at note 152 *supra*.

192. BNA ANTITRUST & TRADE REG. REP., Feb. 18, 1969, at A-6, A-7.

193. *See* Zeidman, *Small Business Concerns — Franchising and Its Antitrust Problems*, 29 ALA. LAW. 460, 469 (1968), *commenting* on the prerequisites enumerated in *Schwinn*, 388 U.S. at 381-82.

194. 388 U.S. at 381. *See* Zimmerman, *supra* note 150, at 1189.

195. Wilson, *Exclusionary Restraints and Franchise Distribution*, 12 ANTITRUST BULL. 1169, 1176 (1967).

196. Zeidman, *supra* note 193, at 471-72.

197. Jones, *The Growth and Importance of Franchising and the Role of Law*, 12 ANTITRUST BULL. 717, 738-39 (1967).

For franchisees, consignment involves a further question. Although in 1966 the SBA amended its regulations to allow franchisees to qualify for SBA financial assistance, the requirements now indicate that a small businessman (franchisee-consignee) must retain the "risk of loss" in order to qualify for the assistance.[198] This would seem to conflict with the express requirement of *Schwinn* that the risk of loss remain with the franchisor (manufacturer) in order for the distribution system to qualify for the consignment exception. The uncertainty arises from whether the term "risk of loss" means the same thing to the SBA as to the Court in *Schwinn*.

Other commentators have not stopped to question the validity of the consignment exception, but have further questioned the viability of the entire decision.[199] This criticism is based upon the premise that a traditionally per se illegal price-fixing conspiracy can be established from the facts presented in the *Schwinn* decision. Although the Government did not appeal the district court's rejection of its allegation of price-fixing, government counsel attempted to raise a price-fixing contention based on the fact that the territorial and customer restraints had been employed to ameliorate price competition by keeping Schwinn's products out of discount houses and other volume dealers' inventories.[200] The Court's refusal to hear the argument on procedural grounds does not, however, weaken the argument that the activity falls within the standards of *United States v. Socony-Vacuum Oil Co., Inc.*[201] In *Socony* the Court indicated that "[a]ny combination which *tampers* with price structure is engaged in an unlawful activity."[202] To equate the "amelioration" involved in *Schwinn* with tampering does not seem unreasonable, at least in the eyes of the Department of Justice.[203] But in order to establish the requisite price-fixing *conspiracy*, one must turn to *United States v. Parke, Davis & Co.*[204] and related cases. These cases interpret certain reporting and policing activities resulting in refusals to deal between manufacturers and independent wholesalers as conspiratorial. An apt analogy can be made here between the wholesalers and manufacturers and franchisees and franchisors and between refusals to deal and cancellation of a franchise for failure to abide by a territorial restriction.[205] Combining the *Parke, Davis* and *Socony* concepts, it is conceivable that a "potpourri theory . . . might require Schwinn to be

198. *See* discussion note 5 *supra*.

199. Kittelle, *supra* note 163, at 1025-29.

200. *Id.* at 1021.

201. 310 U.S. 150 (1940).

202. *Id.* at 222 (emphasis added).

203. *See, e.g.*, United States v. Gasoline Retailers Ass'n, Inc., 285 F.2d 688 (7th Cir. 1961); Plymouth Dealers' Ass'n, Inc. v. United States, 279 F.2d 128 (9th Cir. 1960).

204. 362 U.S. 29 (1960).

205. This impact was summarized in United States v. General Motors, 384 U.S. 127, 144-45 (1966), where the conspiracy finding was based upon a *Parke-Davis* rationale: "What resulted was a fabric interwoven by many strands of joint action to eliminate the discounters from participation in the market, to inhibit the free choice of franchise dealers to select their own method of trade and to provide multilateral surveillance and enforcement. This process can by no stretch of the imagination be described as 'unilateral' or merely 'parallel.'"

confined to situations where there is not only no price fixing in the sense of stipulated prices, but no amelioration of price competition through a systematic denial of merchandise to discount houses and other price cutters."[206] This position finds further support in the analysis of one commentator who feels that the language in *Schwinn* as to the creation and perpetuation of the territorial restrictions — "[w]hether by explicit agreement or by silent combination or understanding"[207] — has by use of the word "silent" actually extended the rule of *Parke, Davis.*[208] This position, if accepted, would relegate *Schwinn* to an emasculated position similar to that of *United States v. Colgate & Co.*[209]

Trademarks and Territorial Restrictions

The impact of a trademark licensing agreement on vertically imposed territorial and customer restraints is somewhat unclear. Although the Supreme Court has indicated that one may not employ a trademark to legitimize activity that would otherwise be illegal under the antitrust laws,[210] it failed to face squarely this issue in its most recent decision involving all of these factors, *United States v. Sealy, Inc.*,[211] decided on the same day as *Schwinn.* Sealy was an "umbrella corporation" that had been formed by a group of mattress manufacturers.[212] Sealy held the rights to the Sealy trademark and licensed it to each of its founder-stockholders on a territorial basis. The Court disregarded the Government's contention that the territorial agreements were to be condemned as per se illegal, revived the retail price-fixing aspects, which had not been relied upon by the Government on appeal, and held that the territorial arrangements *coupled with* price fixing were illegal.[213]

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206. Kittelle, *supra* note 163, at 1025-29.

207. 388 U.S. at 382.

208. Kittelle, *supra* note 163, at 1022.

209. 250 U.S. 300 (1919). *Compare Colgate, with* United States v. Parke, Davis & Co., 362 U.S. 29 (1960).

210. Timken Roller Bearing Co. v. United States, 341 U.S. 593, 599 (1951); Dole, *The Interplay of Trade Symbol Protection and the Antitrust Laws,* 14 ANTITRUST BULL. 1347, 1352 (1968).

211. 388 U.S. 350 (1967).

212. Kintner, *Distribution Restrictions in Franchise Agreements—As Viewed By a Member of the Private Bar,* 12 ANTITRUST BULL. 1211, 1213 (1967), describes these umbrella corporations.

213. 388 U.S. at 354-57. *See* McLaren, *Territorial and Customer Restrictions, Consignments, Suggested Resale Prices and Refusals To Deal,* 37 ABA ANTITRUST L.J. 137, 141 (1968); Zeidman, *supra* note 193, at 468. Rudnick, *The* Sealy *Case,* 57 TRADEMARK REP. 459, 466 (1967) indicates that: "Both the territorial restrictions and the price-fixing practices, as well as other restraints, could be lawfully reinstated if all or a substantial number of Sealy's shareholder-licensees merged into a single company. Even under the greatly expanded antimerger doctrines currently applicable under the Sherman and Clayton Acts, it is doubtful whether even a merger of all Sealy licensees into a single company would be illegal. . . . [I]t remains an anomaly that partial restraints are condemned per se whereas the total restraints that would follow from a merger would in the very least be appraised in terms of their market impact."

The Court's failure to condemn the territorial allocation of *Sealy* has been taken to indicate that the presence of limited territorial trade symbol licenses was a distinguishing factor between the application of a per se rule in *Schwinn* and the Court's reliance upon a finding of illegal price fixing in *Sealy*.[214] However, it appears that the Court has expressly reserved decision on the effect of territorial allocation among small concerns as incident to a joint common name and common advertising plan absent unlawful price fixing.[215] The Court might have an opportunity to rule on the legality of such an arrangement in the near future. *United States v. Topco Associates, Inc.*,[216] filed in the Northern District of Illinois in January 1968, challenges the validity of limited territorial trade symbol licenses to twenty-five grocers by an umbrella corporation that they control. Apparently, there has been no allegation of illegal price fixing in the case.[217]

Because the Court did not decide *Sealy* on the basis of the territorial restraints imposed upon the licensees of the mark, it should not be concluded that the law respecting trademark licensing in a franchise context has been altered.[218] Accordingly, where such arrangements represent bona fide attempts to protect valuable rights associated with the mark, where the division of territories is not the central purpose of the arrangement, and where no unreasonable restraint of trade results, such arrangements are legal.[219]

Less Restrictive Territorial Restraints

Noting that the restraints employed in *Schwinn* were designed to overcome bona fide business problems, one commentator has indicated that the restrictions were still unnecessarily stringent: "The cure [was] too drastic for the illness. Less restrictive alternatives exist."[220] The purpose of this subsection is to examine those alternatives and the possibilities they hold for the franchisor. Consideration will be given to exclusive selling, areas of primary responsibility, and dealer location clauses – methods of restraint involved in neither *Schwinn* nor *Sealy*.[221]

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214. BNA ANTITRUST AND TRADE REG. REP. Jan. 16, 1968, at A-14. *But see* Dole, *supra* note 210, at 1351-54; Zimmerman, *supra* note 150, at 1187.

215. United States v. Sealy, Inc., 388 U.S. 350 (1967): "It is argued, for example, that a number of small grocers might allocate territory among themselves on an exclusive basis as incident to the use of a common name and common advertisements, and that this sort of venture should be welcomed in the interests of competition, and should not be condemned as *per se* unlawful. But condemnation [of Sealy's] territorial arrangements certainly does not require us to go so far as to condemn that quite different situation . . . ." *Id.* at 357.

216. United States v. Topco Associates, Inc., Civ. No. 68 C 76, 5 CCH TRADE REG. REP. ¶45,068 (N.D. Ill., filed Jan. 15, 1968).

217. BNA ANTITRUST AND TRADE. REG. REP., Jan. 16, 1968, at A-14. Dole, *supra* note 210, at 1352.

218. Jones, *supra* note 197, at 741-42.

219. LeBlanc, *Antitrust Ramifications of Trademark Licensing and Franchising*, 53 TRADEMARK REP. 519, 537-38 (1963).

220. Zimmerman, *Distribution Restrictions After* Sealy *and* Schwinn, 12 ANTITRUST BULL. 1181, 1184 (1967).

221. Pollock, *Alternative Distribution Methods After* Schwinn, 63 NW. U.L. REV. 595, 602

Exclusive Selling. These restraints are agreements that prevent the franchisor's selling the franchised product to anyone other than the franchisee within a specified territory.[222] Many justifications, not surprisingly very similar to those offered in favor of the more strict restraints, are offered for exclusive selling.[223] For the present at least, these justifications are still relevant and properly arguable before a court since no per se rule has been applied in this area.

The only significant cases that directly address the problem, *Packard Motor Car Co. v. Webster Motor Co.*[224] and *Schwing Motor Co. v. Hudson Sales Corp.*,[225] involve unique situations: both dealt with automobile companies with declining financial fortunes. Some commentators have seized upon this factor, articulated it to indicate a lack of market dominance, and thus questioned the relevance of *Schwing* and *Webster* to cases not involving financially doomed companies.[226]

This concern is particularly apropos in view of the possibility of the courts' viewing the existence of a franchise agreement as indicative of the power necessary to render a tying arrangement illegal.[227] Excepting the unique circumstances of *Schwing* and *Webster,* will the franchisor be presumed to have the market dominance in the manner of *Texaco*? The answer at this point is uncertain, but some arguments for not applying a per se rule have been advanced. One of these focuses upon the economic waste that arises in situations where a weak competitor is unable to reduce the selling costs that it encounters by the elimination of superfluous dealers.[228] However, the better argument points out that refusing to examine the business necessities of such companies would only favor their larger counterparts because only the smaller operations really need the restraints.[229] Clearly, a per se rule in such circumstances would be opposed to the enhancement of small business sought by the antitrust laws. Nonetheless, the attorney dealing with exclusive selling should proceed with caution and employ the restraint only where it is absolutely necessary.

Areas of Primary Responsibility. Although the Supreme Court did not allude to the matter in the *Schwinn* decision, the decision of the district court in the same case carefully distinguishes between exclusive territorial restraints and "prime areas of responsibility."[230] The district court found

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(1968). *See also* Recent Decision, 60 MICH. L. REV. 1006 (1962).

222. Covey, *supra* note 164, at 609. *See* discussion at notes 137-141 *supra.*

223. *See* discussion at note 157 *et seq. supra.*

224. 243 F.2d 418 (D.C. Cir. 1957), *cert. denied,* 355 U.S. 822 (1957).

225. 239 F.2d 176 (4th Cir. 1956), *cert. denied,* 355 U.S. 823 (1957).

226. Covey, *supra* note 164, at 619 nn. 70-71; *see* Columbus Coated Fabrics Corp., 55 FTC 1500, 1521 (1959). *But see* E.A. Weinel Constr. Co. v. Mueller Co., 289 F. Supp. 293 (E.D. Ill. 1968).

227. *See* discussion at note 82 *et seq. supra.*

228. Jordan, *supra* note 185, at 139.

229. *Id.* at 155.

230. 237 F. Supp. 323, 340 (N.D. Ill. 1965).

that Schwinn had the right to assign specific areas as dealers' primary responsibilities,[231] and in the final decree on remand from the Supreme Court, Schwinn was expressly authorized to employ this kind of restraint.[232] In so doing, the trial court adhered to the suggestion in Justice Brennan's concurring opinion in *White Motor*:[233]

> [I]t may appear at the trial that whatever legitimate business needs White advances for territorial limitations could be adequately served, with less damage to competition, through other devices – for example . . . an assignment of areas of primary responsibility to each distributor . . . .

The only opinion directly approaching approval of the validity of the use of areas of primary responsibility is *Snap-On Tools*.[234] While prohibiting certain restraints employed by the Snap-On Tool Company, the Federal Trade Commission indicated that it would be permissible for the defendant to employ areas of primary responsibility as an alternate.[235] However, whatever apparent approval might have been intended was ultimately lost because the decision turned on the "reasonable business expectations" of the industry, and the area of primary responsibility concept was relegated to dictum.[236] Nonetheless, the use of this arrangement in the *Schwinn* final judgment, and fact that the Government has consistently urged this form of restraint as a permissible alternative to more strict restraints[237] suggests that they can be employed with relative safety.[238]

The use of areas of primary responsibility presents real possibilities of abuse.[239] One commentator has suggested that this form of restraint, as well as others analogous to it, will suffer the fate of the seemingly more restrictive practices that were the subject of *Schwinn* if the practical result of the restraints is very much like that of *Schwinn*.[240] The impact of these restraints will be similar to that in *Schwinn* only in those areas where customers do not shop around among dealers or where there are few dealers for each brand, as in the heavy equipment field. With the *Parke, Davis* threshold perhaps lowered by *Schwinn*,[241] any attempt to enforce the restraints strictly by reporting and policing activities, even if of a mild variety, might provoke government action. However, anticipation of future government action in

231. *Id.* at 342.

232. 291 F. Supp. 564, 565 (N.D. Ill. 1968); (final judgment); *see* Pollock, *supra* note 137 at 604.

233. White Motor Co. v. United States, 372 U.S. 253, 271 (1963).

234. Snap-On Tools Corp., v. FTC, [1961-1963 Transfer Binder] TRADE REG. REP. ¶15, 546 (FTC Dkt. 7116), *rev'd on other grounds*, 321 F.2d 825 (7th Cir. 1963).

235. Snap-On Tools Corp. v. FTC, 321 F.2d 825, 832 (7th Cir. 1963).

236. *Id.* at 833.

237. Brief for Appellant at 20-21, United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

238. McLaren, *supra* note 213, at 142.

239. Pollock, *supra* note 221, at 602.

240. Zimmerman, *supra* note 220, at 1187-88.

241. *See* discussion notes 204-205 *supra*; Dillon, *Exclusive Dealing, Requirements Contracts, Tying Arrangements, and Full-line Forcing*, 37 ABA ANTITRUST L.J. 146, 153-54 (1968).

the area only obscures the distinction between the territorial restrictions employed in *Schwinn* and the area of primary responsibility concept — a distinction that must be kept clear in order to protect activities under the area of primary responsibility label. It should be emphasized that the latter type of restraint encourages the franchisee to give proper attention to his assigned area, and less emphasis should be placed upon the territorial impact of the restraints. Then if the franchisee does not give adequate attention to his primary area, action, including a refusal to deal (termination), may be taken by the franchisor[242] in the absence of any anticompetitive motive. In situations where the refusal to deal is not motivated by a desire to maintain strict territorial divisions among franchisees, but is for a valid business reason, such as failure adequately to serve an assigned business territory, the problem is not one of antitrust but is a question of contractual interpretation between franchisee and franchisor.[243]

Dealer Location Clauses. This form of restraint is very similar to areas of primary responsibility, and its slightly different terminology — "zones of influence" — seems hardly distinguishable from areas of primary responsibility. As with areas of primary responsibility, there is little applicable case law.

Boro Hall Corp. v. General Motors Corp.[244] appears to have upheld such clauses in franchise contracts. However, the decision turned largely upon the lack of any showing that General Motors had been unfair to the plaintiff,[245] and its reasoning is currently subject to some question. The court noted that the defendant:[246]

> [H]ad the right under its contract to discontinue dealings with the plaintiff on 30 days' notice. Under such circumstances, we can see no reason why it should not be allowed to fix location for the sale of used cars at a place that did not unduly affect other dealers.

Such a result is contrary to the Supreme Court's *Texaco* decision that the power of the franchisor to terminate is sufficient to implement a per se rule in the tying area.[247] However, an argument that the arrangements in *Boro Hall* amounted to a tying agreement seems inapposite. Tying arrangements do not generally involve territorial restrictions; rather, another body of law has evolved to deal with them. Furthermore, one might be able to defeat a charge of tying in this context by arguing a "single product" defense — the franchise and its location are of unitary business significance.

The appropriateness of a *Parke, Davis* thrust as explicated above, as with areas of primary responsibility, depends upon the activities of the dealers in relation to those of the manufacturer in policing the arrangement and the na-

242. *Cf.* United States v. Arnold, Schwinn & Co., 237 F. Supp. 323, 339 (N.D. Ill. 1965).
243. *See* Interphoto Corp. v. Minolta Corp., 295 F. Supp. 711 (S.D.N.Y. 1969).
244. 124 F.2d 822, *rehearing denied,* 130 F.2d 196 (2d Cir. 1942).
245. Jordan, *supra* note 185, at 146.
246. 124 F.2d at 823.
247. *See* discussion note 80 *et seq. supra.*

ture of the restraint. If the location clause were to emphasize the dealer's proper business attention to the area surrounding his location rather than the boundaries that were not to be transgressed, it would probably be held valid. Such a result can be contrasted with *United States v. General Motors Corp.*,[248] which presented an issue to which the Court could have applied a *Parke, Davis* analysis and decided the case on "classical conspiracy" grounds.[249] In *General Motors* the Court found a causal connection between the refusal to deal and the alleged conspiracy between General Motors and some of its dealers. It was directly through the refusals to deal that the illegal results of the conspiracy were accomplished; namely, maintaining minimum automobile prices by refusing to sell to discount outlets.

Again, the franchisor must proceed with caution, but if his demands are unilateral or based on business demands in the context of the latter two less restrictive restraints, his action will probably escape antitrust condemnation.

TERMINATION

Termination of the franchise relationship, usually occurring in the form of a refusal to deal, is an area of significant concern in antitrust law.[250] As discussed above,[251] in *United States v. Parke, Davis & Co.*,[252] the Supreme Court emphasized the ease with which courts may interpret a seemingly unilateral refusal to deal as a conspiracy within the ambit of section 1 of the Sherman Act. The significant impact of this theory of *Parke, Davis* has been evidenced by the continued reliance of the courts upon it.[253]

There are, of course, some legitimate and justifiable unilateral refusals to deal. For example, the courts have upheld terminations brought about in order to preserve a policy of selling only to wholesalers.[254] Similarly dissatisfaction with the business performance of a franchisee,[255] and protection of goodwill[256] have been recognized as proper grounds for refusals to deal.

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248. 384 U.S. 127 (1966).

249. *Id.* at 139-40; Jones, *supra* note 197, at 730. *See also* Osborn v. Sinclair Refining Co., 324 F.2d 566 (4th Cir. 1963).

250. Termination can become significant as a factor in forms of antitrust violations other than refusals to deal. The Supreme Court's condemnation of the "quasi-tying" arrangements in FTC v. Texaco, 393 U.S. 223 (1968) (without explicitly terming them tying arrangements, the Court noted the similarity of their economic consequences to those of more traditional tying arrangements) was based largely on the coercive nature inherent in the power to terminate the franchising arrangement. *See* discussion note 90 *et seq. supra.*

251. *See* text accompanying note 208 *et seq. supra.*

252. 362 U.S. 29 (1960).

253. *Cf.* Broussard v. Socony Mobile Oil Co., 350 F.2d 346, 349 n.5 (5th Cir. 1965); Wulzberg Bros., Inc. v. Head Ski Co., 276 F. Supp. 142 (D.N.J. 1967).

254. Great Atlantic & Pac. Tea Co. v. Cream of Wheat Co., 227 F. 46 (2d Cir. 1915). *See also* Brosious v. Pepsi-Cola Co., 155 F.2d 99 (3d Cir. 1945); E.A. Weinel Constr. Co. v. Mueller Co., 289 F. Supp. 293 (E.D. Ill. 1968).

255. Ampex of Md., Inc. v. Outboard Marine Corp., 380 F.2d 112 (4th Cir. 1967); Hudson Sales Corp. v. Waldrip, 211 F.2d 268 (5th Cir. 1954), *cert. denied*, 348 U.S. 821 (1954).

256. Coca-Cola v. J.G. Butler & Sons, 229 F. 224 (E.D. Ark. 1916).

The principal problem in the area of franchising arises largely from the appreciation of value of the franchise resulting from both the efforts of the franchisor and franchisee.[257] The loss of a considerable investment in establishing and maintaining the goodwill of the franchised operation may occur upon termination. The Court in *Texaco* noted this explicitly: "The average dealer is a man of limited means who has what is for him a sizeable investment in his station. He stands to lose much if he incurs the ill will of Texaco."[258] Largely because of the inequality of bargaining power existing between the franchisor and franchisee in most situations, this loss may occur as a result of rather insignificant actions of the franchisee. Such actions probably would not lead to termination among equals. Congress was made aware of such a problem in the automobile industry[259] and enacted statutory protection for the franchised automobile dealers.[260] Although considerable doubt has been raised concerning the protection afforded franchised automobile dealers under the act,[261] broader legislation contemplating protection of franchisees in general has been proposed.[262]

Mr. Rufus Wilson of the Federal Trade Commission has suggested further protection for the franchisee. Mr. Wilson argues that a franchisee might be able to argue "unconscionability" upon franchise termination in the absence of good cause on the part of the franchisor. Such a tactic, he asserts, would be but a short step from section 5 of the Federal Trade Commission Act.[263] Yet this theory, as well as the proposed legislation, remains speculative. The real threat to the franchisor in the area of termination is that enunciated by *Parke, Davis*.[264]

CONCLUSION

In *United States v. Arnold, Schwinn & Co.*[265] the Supreme Court noted that part of the company's purpose in restricting the territories and customers to whom the distributor could sell was to keep Schwinn bicycles out of discount houses.[266] As one commentator has pointed out, Schwinn did not merely appoint *preferred* dealers, but demanded that its bicycles be sold *only* through those dealers.[267] The question is why Schwinn felt it was necessary to keep its products out of the hands of discount dealers. Prestige is obviously in-

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257. Covey, *Franchising and the Antitrust Laws: Panacea or Problem?*, 42 NOTRE DAME LAW. 605, 612-13 (1967).

258. 393 U.S. 223, 227, 89 S. Ct. 429, 432 (1968).

259. H.R. REP. No. 2850, 84th Cong., 2d Sess. (1956).

260. *Automobile Dealer Franchise Act of 1956*, 15 U.S.C. §1221, *et seq.* (1964).

261. Freed, *Study of Dealers Suits Under the Automobile Dealers Franchise Act*, 41 U. DET. L.J. 245 (1964). *See, e.g.*, Mt. Lebanon Motors, Inc. v. Chrysler Corp., 283 F. Supp. 453 (W.D. Pa. 1968).

262. BNA ANTITRUST & TRADE REG. REP., Jan. 28, 1969, at A-11, A-12.

263. BNA ANTITRUST & TRADE REG. REP., Feb. 18, 1969, at A-7.

264. *See* Interphoto Corp. v. Minolta Corp., 295 F. Supp. 711 (S.D.N.Y. 1969).

265. 388 U.S. 365 (1967).

266. *Id.* at 376-77.

267. Pollock, *supra* note 221, at 599.

volved, but most companies, having fought against discount merchandising of their products for years, have now discovered that they do a large and valuable share of business through discount houses.[268] Several commentators have noted that the manufacturers who still resist such marketing falter when asked for a solid economic rationale for their resistance.[269] The Federal Trade Commission has begun to emphasize achievement of the legitimate benefits of control through the least restrictive practices available.[270] An advisory opinion as to certain requirements contracts in a franchise operation emphasized the impact of a less restrictive device on the arrangement's legality:[271]

> [A]s to those products where uniformity might be necessary, we *cannot* determine whether it could not be achieved by specifications or by some other less restrictive means than that provided for . . . . Accordingly, we cannot give you any opinion as to the lawfulness or unlawfulness of this provision.

The burden is clearly on the franchisor to assure that he implements a nonrestrictive practice, for if the Federal Trade Commission finds later that his legitimate interests could have been achieved through less restrictive means, he may find his practices subject to attack. Accordingly, after a careful legal analysis of what is and what is not permissible under the antitrust laws, one might be wise, in view of the rapidity with which standards of legality in the antitrust field have changed in the last few years,[272] to look not to the boundary of legality but to seek out the least restrictive practice that will accomplish the desired result.[273] In the last analysis, the franchisor must shift his emphasis from what *may* be done under a strict interpretation of the relevant statutes and case law to a balancing of his need for control over the franchisee with society's need to protect the status of the small, independent businessman.

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268. Dillon, *supra* note 241, at 154-55.

269. Zeidman, *Small Business Concerns — Franchising and Its Antitrust Problems*, 29 ALA. LAW. 460, 481 (1968).

270. *Id.* at 475, *quoting* Donald F. Turner, then Assistant Attorney General for the Antitrust Division, Department of Justice.

271. FTC Adv. Op. Digest No. 19, [1965-1967 Transfer Binder] CCH TRADE REG. REP. ¶17,471 (March 23, 1966).

272. *Compare* White Motor Co. v. United States, 372 U.S. 253 (1963), *with* United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

273. Dillon, *supra* note 241, at 155.