Franchising + Antitrust = Confusion: The Unfortunate Formula

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FRANCHISING + ANTITRUST = CONFUSION: THE UNFORTUNATE FORMULA

Viewed as a marketing technique, franchising is no novelty to the business world. Automobile, gasoline and oil service industries, and bottling companies have used franchising as a means of distributing goods and services for many years and still comprise the largest percentage of the franchising market. But, since 1960, franchising has mushroomed into an effective method of marketing a wide variety of goods and services and now influences a large segment of the American economy.

Ideally, franchising is a cooperative process of doing big business by small businessmen. It employs a contractual relationship for marketing goods that combines the managerial, marketing, product, and service expertise of the franchise organization with the substantial investment and entrepreneurial efforts of the individual franchisee. Although the franchisee is described as an independent owner, the contract often contains restrictive conditions that seem to violate applicable antitrust legislation.

Initially, the federal judiciary was reluctant to apply the full

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1 For an excellent history of franchising, see H. KURSH, THE FRANCHISING BOOM (1962).
2 The three industries comprise seventy-seven percent of all franchised outlets and eighty-three percent of all sales. These figures were computed from data compiled by the International Franchise Association for the year 1964. See J. CURRY, et al., PARTNERS FOR PROFIT, A STUDY OF FRANCHISING 11, (1966) [hereinafter cited as PARTNERS FOR PROFIT]. These percentages today are undoubtedly lower as other fields of business have flocked to franchising as a means of distribution. See notes 3 & 4 infra.
3 The size and growth rate of franchising generally, and into diversified markets in particular, was described as follows:
[1] In the past few years, franchising has grown rapidly in other industries, and will account for an additional $15 billion [above the $50 billion in goods by automobile, gasoline, and soft-drink companies] in franchised sales this year. The number of companies running franchise networks has grown six fold to nearly 1,200 since World War II, and some 30,000 new franchise outlets will be opened this year, bringing the total to about 250,000. Brayman, Franchises: Boom in Selling Names and Advise, National Observer, Nov. 22, 1965, at 8, col. 3.
4 In 1964, $59.2 billion in sales through the franchised method of distribution accounted for approximately thirty-five percent of the total retail sales in the United States. PARTNERS FOR PROFIT, supra note 2, at 12. By 1966, 330,000 franchisees totalled $65 billion sales and accounted for ten percent of the GNP. Handler, Statement Before the Small Business Administration, 11 ANTITRUST BULL. 417, 418 (1966).
5 PARTNERS FOR PROFIT, supra note 2, at 18.
6 Id.
7 For a discussion of the major contract restrictions see p. 271, and accompanying notes.
8 See note 76 infra.
scope of developed antitrust laws to the relatively new franchise phenomenon, reasoning that they knew too little of the economic and business aspects of these marketing systems. But increasing legal concern began to coincide with the increasing economic importance of franchising, culminating in a series of federal decisions confronting the problem. Ostensibly these recent decisions are consistent with the purpose of the antitrust laws: promoting competition by preventing concentrations of economic power and, concomitantly, preserving the independence and autonomy of smaller competitors. Paradoxically, however, the practical effect of these decisions not only strikes at the heart of franchising as a modern and efficient marketing method, but also produces pressures tending to create vertical integration which destroys the “independence” of the small businessman.

This comment explores the economic and contractual aspects of franchising, and examines some recent antitrust decisions. The presumptive effect of applying antitrust policy is contrasted to the actual impact on franchise operations. The resulting dilemma, presented to the franchisor, is analyzed for possible alternatives open to him, all of which are inconsistent with both the ends of antitrust policy and the beneficial aspects of franchising.

**SOME ECONOMIC CONSIDERATIONS**

As a marketing system, franchising supplies practical business advantages and promotes important economic benefits. From the businessman’s standpoint, the contractual arrangement between the franchisor and his franchisee is reciprocally beneficial to both par-

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9 White Motor Co. v. United States, 372 U.S. 253 (1963). The Government contended that White’s franchise contracts contained price fixing and geographical and customer restrictions that were illegal per se. White did not deny the allegations but contended that it should be allowed to present evidence of the reasonableness of its contracts when considered in their own unique business and economic context. The Supreme Court held that, apart from price fixing, summary judgment was improperly granted and that the legality of the territorial and customer limitations of White’s franchise contracts should be determined only after trial. Speaking of the customer and territorial restrictions in the franchise context, Justice Douglas said, “We do not know enough of the economic and business stuff out of which these arrangements emerge to be certain...” Id. at 263.


11 When the term is used in this comment, vertical integration means ownership rather than contractual integration. If the various operations in the distribution process, such as manufacturing, wholesaling, and retailing, are owned outright by one firm, the company is vertically integrated. Franchising generally forms a chain through vertical integration by contract, whereas a centrally owned chain is termed vertical integration by ownership.
ties. Typically, the franchisee makes a substantial investment for the franchise in inventory, equipment, property, and personnel. Within contractual limits broadly reflecting the marketing scheme of the parties, the franchisee is an independent owner of the business. Thus, the success of that business is directly related to his efforts, dedication, and motivation. Usually he receives a preconceived "package" for marketing the product or service. The package includes an established brand name, initial training and area management counseling, location analysis, financial and developmental aid, and advertising and merchandising resource-pooling. The franchisee is given an instant reputation in an established product or service known and accepted by the public.

In return, the franchisor has a ready-made distribution system for his products or services. Since he can obtain the desired degree of managerial control without assuming full investment responsibility, he is able to employ his capital more profitably elsewhere. Also, in some cases, if a franchisee's operation is a multi-product activity, but the franchisor's is not, then the franchisor has the advantage of marketing his products within a broad "product mix" while retaining some managerial control. In most cases he receives consideration for the privilege of using the franchise. The franchisor also avoids, to a certain extent, local managerial problems and personal service requirements.

In addition to these practical business advantages, modern franchising results in several economic benefits. Franchising has been optimistically labeled as a boon to the small independent businessman, an alternative to increasing "mergeritis," and a hedge against the growing "bigness" of American business.

12 Slater, Some Socio-Economic Footnotes on Franchising, BOSTON U. BUS. REV., Summer 1964, at 23-25, [hereinafter cited as Slater].
13 This is typically the case of a jobber, for example, a manufacturer of one line of well-known products which are sold most advantageously alongside of complimentary products. Car polish, for example, is not effectively sold alone, but is marketed through auto parts stores and other retail outlets where a customer would expect to find all his automotive needs.
14 Various types of charges are levied individually or in combinations according to the nature of the franchise arrangement. Some common costs are: a percentage of the franchisee's gross sales; franchise paid for at the outset of the relationship; rent paid for the location; and a mark-up on initial equipment. Slater, supra note 12, at 25.
15 Hearings on Franchise Legislation before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 90th Cong., 1st Sess., at 513 (1967). The specific phrase used is "the salvation of the small independent businessman."
16 Slater, supra note 12, at 20. Specifically, franchising is the "last stand against the creeping octopus of nationwide mergeritis."
17 Hearings on Distribution Problems Affecting Small Business before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 89th Cong.,
Realistically, the franchise method of operation does have the advantage of enabling large groups of individuals with moderate capital, who might otherwise remain mere employees, to become independent businessmen.\textsuperscript{18} As a self-interested entrepreneur, the franchisee is highly motivated toward personalized service and local good will in contrast to the trend of vast chains toward impersonalized business.\textsuperscript{19} Because the franchisor provides an established product or service and substantial financial and managerial assistance, franchising provides efficient investment opportunities for prospective entrepreneurs from minority groups.\textsuperscript{20}

Franchise operations have a remarkably low business failure rate\textsuperscript{21} and are a profitable way of doing business\textsuperscript{22} as their growth indicates. The Small Business Administration has recently relaxed regulations measuring "independence" requirements conditioning private loans.\textsuperscript{23} Even though the parties are contractually integrated and controls are exercised over the franchisee, this relaxation was a direct result of Small Business Administration hearings establishing the importance of franchising systems to the economy and to small entrepreneurs.\textsuperscript{24} Franchising facilitates entry and expansion into

\textsuperscript{18} In Susser v. Carvel Corp., 206 F. Supp. 636, 640 (S.D.N.Y. 1962), Judge Dawson stated:

The franchise method of operation has the advantage, from the standpoint of our American system of competitive economy, of enabling numerous groups of individuals with small capital to become entrepreneurs. . . . If our economy had not developed that system of operation these individuals would have turned out to have been merely employees. The franchise system creates a class of independent businessmen; it provides the public with an opportunity to get uniform products at numerous points of sale from small independent contractors, rather than employees of a vast chain.

\textsuperscript{19} Slater, note 12 supra, at 26-27.

In the final analysis, franchising is the only logical antidote to a trend to impersonalized business. However much they admire bigness, Americans prefer to do business with those to whom they can talk, and if necessary, complain. The paid manager, unless he rises to the occasion, invariably strikes the customer as a subordinate person 'who follows orders.' Presumably the extra effort of the franchisee would stimulate increased demand for his product or service, thus benefiting the franchise organization and the economy.


\textsuperscript{21} U.S. Chamber of Commerce figures show thirty-five percent of all new businesses fail within one year and ninety-two percent within five years. For franchise operators, the comparable one year figure varies between four and six percent and for five years only twelve percent fail. Stewart, Editorial: The Best Insurance, Modern Franchising, June-July, 1968, at 4.

\textsuperscript{22} Net profits in a well-established franchise may run from fifteen to twenty percent of gross income. The New Look in Franchising, 24 Changing Times, Oct. 1967, at 18.

\textsuperscript{23} Small Business Size Standards, 13 C.F.R. § 121.3-2(a) (1968).

\textsuperscript{24} The Small Business Administration (SBA) held hearings on March 10, & 11, 1966, on the size standards for determining whether a concern operating under a franchise agreement is a small business concern. Philip F. Ziedman, general counsel
industries and markets requiring extensive capital and skilled personnel and, to that extent, promotes interbrand competition between firms. Franchise chains provide individual ownership with the efficiencies attending large scale operations and offer an alternative to centrally owned chains. In short, economic policies as well as business efficiency benefit from the franchise movement.

of the SBA, submitted a letter, dated November 15, 1967, to the Hearings on Franchise Legislation before the Senate Subcomm. on Antitrust and Monopoly of the Comm. on the Judiciary, 90th Cong., 1st Sess., pt. 1 at 431-34 (1967), on the results of the SBA hearings:

It was the consensus of those participating in the hearing ... that franchising contributes significantly to the ability of small concerns to compete effectively with larger organizations; that it offers a relatively safe and promising haven for the small businessman ... that it provides business opportunities, otherwise unavailable, for many persons including members of minority groups, and that it is socially preferable alternative to the further vertical integration of the American economy since it brings to the economy and society most of the benefits and few of the evils thereof. Id. at 432.

Prior to Sept. 1, 1964, franchise agreement provisions limiting the right of a franchisee to make management and business decisions that an “independently operated” business concern ought to be able to make, made the franchisee an “affiliate” of the franchisor and ineligible for SBA benefits. A list was provided of thirty restricting provisions—a substantial number of which gave the franchisor “control” of the franchisee. On August 31, 1964, that list was narrowed to only four. Finally, on Sept. 13, 1966, as a result of the hearings noted above, it was recommended that:

The Small Business Administration should consider franchisees as small business concerns regardless of the nature of the restrictions in their franchise agreements so long as the right to profit, with ownership, and risk of loss is substantially that of an otherwise eligible small business concern. Id. at 432. See also note 23, supra.

25 Intrabrand competition takes place between sellers of the same brand, usually marketed by one firm, whereas interbrand competition exists between sellers of different brands made by competing producers. For a further discussion of this point see note 68 infra and accompanying text.

26 Franchising—Quo Vadis? The Future of Franchising and Trade Regulation, testimony of Professor Jerome Shuman, Hearings on Franchise Legislation before the Senate Subcomm. on Antitrust and Monopoly of the Comm. on the Judiciary, 90th Cong., 1st Sess., pt. 1, 513, 514-15 (1967), takes issue with these concepts. He claims that “Franchising ... is not an industry ... [n]either is it a means of breathing new life into small businesses, nor does it make independent businessmen out of persons who would otherwise be employees, it is [merely] a new form of business organization, an outgrowth of technological evolution.” Id. at 515. He substantiates this statement as follows: 1) The three largest industrial corporations in the world are all franchisors (General Motors, Standard Oil of New Jersey, and Ford Motor Corporation). Moreover, the so called corporate giants are resorting to franchising in increasing numbers. 2) Relatively speaking, even many smaller franchisees are large when compared with the truly independent businesses with which they compete and often displace. The franchisee has an advantage over an independent businessman of comparable capital investment in every area where size is important because of his franchisor’s backing and managerial skills. 3) The commercial ties between the franchisor and the franchisee makes their relationship something less than one of autonomy, giving rise to accusations of “economic serf” as in Goodyear Tire & Rubber Co. v. FTC, 331 F.2d 394, 400 (7th Cir. 1964). 4) Franchising is questionably a deterrent to mergers. A merger results in ownership integration and a franchise in contractual integration; in terms of market power and economic impact, the effect can be the same on the economy and the competitive process. 5) To assert that franchising offers unique opportunities for minority groups to enter the business field is to assert
Contractual Aspects

Franchising utilizes a contractual relationship for doing business between the franchisee and his franchisor and is subject to general contract law. The terms of an agreement can be versatile enough to fit the diverse types of products or services involved and the business or marketing objectives of the parties. Both parties have substantial investments to protect, and, of course, wish to oversee the destiny of that investment. Restrictions, controls, and concessions are exerted contractually upon each other to achieve their respective business goals. The more common of these contractual terms or understandings are: exclusive selling agreements; exclusive buying arrangements which include requirement contracts, exclusive dealing contracts, tie-in arrangements, and full line forcing; territory or customer restrictions; resale price restrictions; and other managerial controls.

that top management and customers will, amongst other considerations, close their eyes to the minority "status" with those with whom they are dealing.

It must be kept in mind, however, that Professor Schuman is favorable towards franchising as a method of doing business but denies the validity of those arguments which stress that it should receive special treatment in the law. "[R]ules and regulations must be devised to accommodate it just as has been done in the past with what are now more traditional forms of business organization . . . ." Id. at 515.

For a list and explanation of the most common types of franchise contracts, see Rothenberg, A Fresh Look at Franchising, J. MARKETING, July, 1967, at 53-54. Briefly, they are distributorship, manufacturing, lease, licensing, conventional, mobile, co-management, and co-ownership.

For a thorough examination of the legal aspects of franchise restrictions listed in this comment, and the business justification advanced for their use, see generally, Averill, Antitrust Considerations of the Principle [sic] Distribution Restrictions in Franchise Agreements, 15 AM. U.L. REV. 28 (1965) [hereinafter cited as Averill]; see also, Covey, Franchising and the Antitrust Laws: Panacea or Problem?, 42 NOTRE DAME LAW. 605 (1967) [hereinafter cited as Covey].

The franchisor agrees not to license another franchisee, and promises not to compete himself within a designated territory, or for a class of customers. This arrangement obviously works to the benefit of the franchisee. Through eliminating intrabrand competition he is provided with a local monopoly for the particular brand of product or service franchised. See Covey, supra note 28, at 609.

The franchisee agrees to handle only the franchisor's products to the exclusion of competitive goods. See Averill, supra note 28, at 39-40.

A franchisee must accept the other products of the franchisor in order to be permitted to carry a major commodity. The major commodity, such as an automobile, is called the tying product, while the other products, such as parts, are called the tied products. Id. at 44.

An exaggerated form of tie-in arrangement whereby a franchisee must carry all, or nearly all of the franchisor's product line. Id. at 50.

Territory restrictions most commonly come in the form of a geographically defined area from which the franchisee agrees not to venture. These are called "closed territories." Id. at 51. Variations on the closed territory are "area of prime responsi-
Even though the franchise operation may be designated as small and marginal within a particular market, the preponderant power and wealth is normally in the hands of the franchisor, vis-à-vis the franchisee.\textsuperscript{37} Illustrative of this point is the fact that of the broad categories of restrictions listed above, only exclusive selling agreements work directly in favor of the franchisee. This dominance of the franchisor may be viewed from opposite perspectives. One view is that the franchisee must give up the inalienable right to mismanage his own business for the privilege of doing business under the franchisor’s aegis.\textsuperscript{38} The other view is that control over his business decisions makes the franchisee an “economic serf” rather than an independent businessman.\textsuperscript{39} To the degree that the franchisee is an “economic serf” and to the extent that the relationship allegedly creates adverse effects on economic competition, the restrictions may come into conflict with the antitrust laws.

\textit{Applicable Antitrust Policy}

Two basic antitrust doctrines are used to determine the legality of a particular trade restraint. The more absolute and stringent, but administratively easier formula, is the per se rule of unreasonableness whereby a restraint having a “pernicious effect on competition and lack of any redeeming virtues” is held to be per se illegal.\textsuperscript{40} This doctrine is easily applied: if a per se label, usually created from precedents, can be applied to the particular case, then no further investigation into the reasonableness of the restraint is necessary. On the other hand, the “rule of reason” requires a greater analysis of the restraint’s actual effect upon the marketplace. A restraint may be reasonable either because trade is not restricted to any significant degree,\textsuperscript{41} or because it is ancillary to and sup-

\textsuperscript{35} The franchisor stipulates the prices at which his products are to be resold. See extended discussion of price-fixing, beginning \textit{infra} at p. 276.

\textsuperscript{36} Quality and service standards, physical appearance standards, performance controls, trade mark protection, promotional activity, standardized record keeping and other managerial considerations may be primarily the domain of the franchisor who contractually imposes his standards on the franchisee. See Averill, \textit{supra} note 28 at 60, 64-65; \textit{See also} Covey, \textit{supra} note 28, at 611.

\textsuperscript{37} Eighty-three percent of vertical restrictions are imposed by the franchisor, J. Curry, \textit{et al.}, \textit{Partners for Profit, A Study of Franchising} 51 (1966).


\textsuperscript{39} Goodyear Tire & Rubber Co. v. FTC, 331 F.2d 394, 400 (7th Cir. 1964).

\textsuperscript{40} Northern Pacific Ry. v. United States, 356 U.S. 1, 5 (1958).

\textsuperscript{41} Board of Trade v. United States, 246 U.S. 231, 238 (1918).
portive of a main lawful purpose. It is then said to have redeeming virtues. The Supreme Court applies these principles under a broad policy favoring the preservation of competition.

Within the classical economic model, "pure" or "perfect" competition is most effective and workable when overbearing restrictions are proscribed and "incipient" trends to oligopoly and economic concentrations are curbed. Competition is also likely to be greatest when there are many sellers, none of whom has any significant market share. The correlative principle is the preservation of the small businessman's autonomy in the market and his freedom from "undue" restrictions. This has long been the Supreme Court's economic policy and is reflected in recent antitrust pronouncements. In the illustrative cases involving franchises that follow, the Supreme Court applied the antitrust doctrines to the facts of each case in an attempt to be consistent with their economic policies.

FRANCHISING AND THE FEDERAL JUDICIARY: SOME RECENT CASES

In Brown Shoe Company v. United States, Brown, the third largest producer of shoes in the United States, attempted to merge with Kinney, the eighth largest shoe seller with over three-hundred retail outlets. Because the effect may have been to substantially lessen competition, thereby tending to create a monopoly, the Court found that such a merger would be a violation of the Clayton Act. Later, in Brown Shoe Company v. FTC, Brown offered valuable services to hundreds of retail shoe outlets in an attempt to maintain control over the retail distribution of its shoes. The contract, however, stipulated that the retailers must obtain their shoe requirements exclusively or primarily from Brown to the exclusion of competitors' lines of shoes. The Federal Trade Commission sued for an injunction against this practice but did not "prove" to the satisfaction of the district court that the practice lessened competition or tended to create a monopoly. The custom of giving free service to those who will buy their shoes is widespread, reasoned the trial court, and is, therefore, a valid requirements contract. The Supreme Court reversed the decision saying that section 3 of the

42 United States v. Addyston Pipe & Steel Co., 85 F. 271, 282 (6th Cir. 1898), aff'd, 175 U.S. 211 (1898).
43 For an excellent discussion of the two rules, see Bork, The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, 75 Yale L.J. 375 (1966).
44 The United States Supreme Court said explicitly, "[c]ompetition is likely to be greatest when there are many sellers, none of which has any significant market share." United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 363 (1963).
46 339 F.2d 45 (8th Cir. 1964).
Federal Trade Commission Act gave the Commission power to arrest trade restraints in their incipiency without proof that the restrictions amount to an outright violation of the antitrust laws.

These cases illustrate the Court's attitude toward "bigness" in the economy. Very large companies in a particular industry, attempting to vertically integrate with other large companies in a different but related market, have an extremely difficult task in justifying the move. Evidence showing the inherent economic efficiency of the integration or other bona fide motives may be irrelevant if a large percentage of the market is affected. An otherwise legal trade custom coupled with "bigness" may also become illegal. Thus, a requirements contract, such as the agreement employed in Brown, becomes illegal even though imposed for the lawful purpose of insuring the franchisee a sufficient supply, or of providing the franchisor with a predictable market for his output.

Two years later the Court directly confronted the problem of restrictive franchise contracts and decided against the producer of Schwinn bicycles. Schwinn is the second largest bicycle manufacturer in the United States, controlling approximately thirteen percent of the bicycle market. Beginning in 1951, Schwinn instigated extensive market research in an effort to more effectively market their product. As a result of this research, Schwinn developed three methods of distribution. First, independent wholesale distributors were assigned specific territories and were instructed to sell only to franchised dealers. Under the second plan, the "Schwinn Plan", bicycles were shipped directly to retailers with Schwinn invoicing the dealers, extending credit, and paying a commission to the distributors taking the order. Finally, bicycles were distributed by means of an agency or consignment arrangement between the distributors and franchise dealers. Each method employed means for controlling the resale of the bicycles consistent with the efficiencies developed from Schwinn's marketing research.

In United States v. Arnold, Schwinn & Company, the Court said that Schwinn's self-interest alone did not invoke the "rule of reason" to immunize conduct if that conduct is unlawful in its impact in the marketplace. Consequently, any sale to independent distributors, or retailing upon any conditions, agreement, or understanding limiting the resale of bicycles was held to be illegal per se. The only method left legally open to Schwinn to exercise any

48 Id. at 331.
50 388 U.S. 365 (1967).
51 Id. at 375.
degree of control whatsoever over its bicycles was through the agency or consignment agreement. However, the latter are not legal in every case because they must still satisfy "rule of reason" standards. Before this method of distribution may be used, a franchisor must retain "title, dominion or control"; no price fixing may be imposed; the unfranchised dealers must have adequate sources of alternate products; and an agency/consignment arrangement must otherwise meet "rule of reason" requirements.\(^5\)

The Second Circuit had already decided a case involving the typical modern franchise operation. *Susser v. Carvel Corporation*,\(^5\) involved a fast growing area of franchising—quick service food and refreshment chains. Carvel deals with over four hundred franchisees operating ice cream stores under its trademark. Carvel bought ice cream ingredients and supplies from a wide variety of suppliers who, in turn, made individual deliveries to the franchise outlets. Carvel set the prices at which these items were sold to the dealers who were foreclosed from obtaining supplies elsewhere. Carvel justified this tie-in arrangement necessitating contractual restraint upon its dealers on grounds of safeguarding the integrity and value of the trademark. Because they had to deal with Carvel alone, competition between suppliers took the form of substantial price concessions.\(^5\) The franchisees received the supplies at considerable savings over what local suppliers could offer them individually.\(^5\)

Carvel failed to sustain the tie-in arrangement with sufficient proof of the necessity for quality controls to protect the trademark, or proof that specifications for products would be so complex and detailed as to make it impractical to establish such specifications.\(^5\) As a consequence, Carvel's economic leverage over suppliers\(^5\) and their contractual restrictions on franchisees\(^5\) were illegal. The court

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52 Id. at 381.
53 332 F.2d 505 (2d Cir. 1964), cert. granted, 379 U.S. 885 (1964), cert. dismissed as improvidently granted, 381 U.S. 125 (1965). Only the tying arrangement and, indirectly, the exclusive-dealing arrangement aspects of the *Susser* case are considered in this comment.
54 Id. at 514.
55 For example, Carvel sold ice cream cones to its franchisees at $4.80 per 600, whereas, independently, the same franchisee would have to pay $5.60 per 600, in lots of twenty-five cases or more. Id. at 514 n.7.
56 See further discussion of tying arrangements at p. 279, infra. See also notes 57 & 58 infra.
57 A tying arrangement is per se unreasonable and unlawful whenever the seller has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product, and a "not insubstantial" amount of interstate commerce is affected. Northern Pacific Ry. v. United States, 356 U.S. 1 (1958). See also, International Salt Co. v. United States, 332 U.S. 392 (1947).
58 To the extent the franchisor enjoys market control, other potential sellers
reasoned that smaller suppliers were unable to effectively compete with larger producers capable of meeting Carvel's price and service demands, thus restricting their outlet sources. The court went on to note that an individual franchisee should not be forced to surrender his right to negotiate with suppliers of his choice even though he may enjoy lower prices from his franchisor.\(^5\) The effect of this rationale is to preserve the smaller supplier's ability to compete in the market with more powerful competitors and to maintain the autonomy of the franchisee to deal with whomever he wishes. Furthermore, a franchisor may not invoke the defense of \textit{in pari delicto} against a franchisee who brings a private antitrust suit even though the franchisee encourages and supports some of the restraints for his own benefit.\(^6\) Presumably, this places the normally smaller franchisee in the favored position of enjoying illegal restrictions granted for his benefit (provided, of course, government agencies do not enter the picture) while receiving treble damages for reciprocal restrictions imposed for the franchisor's benefit.

\section*{The Franchise Industry's Dilemma}

However correct on precedent or laudable in theory the Court's "antibigness" policies may be, its attempt at implementing these policies may work in favor of larger and more powerful franchisors and create pressure tending toward "bigness" rather than independence and autonomy.

An example may be drawn from the prohibition on resale price-fixing. In a recent case,\(^6\) the Supreme Court held that the freedom

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  \item are foreclosed from offering substitutes for the free competitive judgment of the franchisee. When forced to buy the tied product, a buyer abdicates his independent judgment as to the tied products' merits and insulates it from the competitive stress of the open market. If the tied product is superior or less expensive, the buyer should be free to select it over others. Times—Picayune Publishing Co. v. United States, 345 U.S. 594, 605 (1952).
  \item Susser v. Carvel Corp., 332 F.2d 505, 514 (2d Cir. 1964).
\end{itemize}

\(^5\) Plaintiff-franchisees had to purchase all mufflers from defendant-franchisor (Midas Mufflers) and carry the complete Midas line (full-line forcing and tying); refrain from dealing with any of Midas' competitors (exclusive dealing); and comply with a price maintenance scheme. Plaintiffs were given exclusive territories. Plaintiffs made "enormous profits," eagerly sought to acquire Midas franchises with full knowledge of the contractual provisions, and eagerly sought to acquire additional franchises. The exclusive territory and price maintenance scheme worked to the advantage of the franchisees, but the tying, full-line forcing, and exclusive dealing arrangements did not.

\(^6\) Albrecht v. Harold Co., 390 U.S. 145 (1968). The defendant, a morning newspaper distributor, sells at wholesale to independent carriers who sell at retail. The carriers were granted exclusive territories which amounted to an absolute monopoly for morning newspaper service in that area. Defendant advertised a suggested retail price in its newspapers. The franchise agreement was subject to termination if the
of a franchisee to determine his own resale price above a franchisor's imposed maximum may not be impaired. This rule was enforced even though the franchisee enjoyed a complete monopoly by virtue of an exclusive franchise granted by his franchisor, and despite the franchisor's attempts to enforce the maximum by actually competing with the franchisee.

Resale price-fixing, both minimum and maximum in horizontal and vertical market situations, has been a traditional target of antitrust laws.\(^2\) It is used to punish errant franchisees, to drive weaker competitors out of the market, and to generally restrict the flow of competition. Aside from its predatory motives, the effect of which the laws may successfully prevent, vertical price maintenance may have "redeeming virtues" in terms of economic efficiencies. Maintaining price structures can lead to: efficiencies in advertising;\(^{1}\) promotion of pre-sale and post-sale service to customers;\(^{4}\) reinforcement of market division;\(^{6}\) preservation of uniformity in product services;\(^{6}\) and, provide a means of transferring information.\(^{7}\)

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\(^{1}\) Agreements to fix maximum prices "no less than those to fix minimum prices, cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment." Kiefer-Stewart Co. v. Seagram & Sons, Inc., 340 U.S. 211, 213 (1951).

\(^{2}\) "A variety of ... instances in which price fixing is essential to advertising efficiencies is easily imaginable, e.g., the fixing of prices on food items franchised drive-in operations, and the fixing by individual manufacturers of retail prices of nationally advertised consumer goods." Bork, The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, 75 Yale L.J. 375, 461 (1966), [hereinafter cited as Bork].

\(^{3}\) "Where a reseller's price is maintained, he is forced to engage in other forms of competition in order to make a competitive return." Id. at 454.

\(^{4}\) There might ... be instances of sales at low prices and subsequent resale across territorial boundaries which was not intended by the manufacturer. Control of the manufacturer's prices by the group prevents the opportunity for such arbitrage. ... Retailers forbidden to advertise or sell at cut prices will find it more difficult to resell across territorial lines. Id. at 456-57.

\(^{5}\) A large part of the ... franchisor's brand appeal rests upon uniformity of the product sold by each of it's franchisee's ... A ... franchisor wishing to appeal to those consumers who value a high degree of sales effort must establish the uniformity of his product so that consumers can rely upon getting a particular combination of physical product and sales effort at any ... franchisee carrying the brand. Id. at 445.

\(^{6}\) "One reason a ... manufacturer may dictate the retail price ... is the belief that the manufacturer has greater information as well as greater competence to make price decisions." Id. at 457-58. In United States v. Nationwide Trailer Rental Systems, Inc., 156 F. Supp. 800 (D. Kan. 1957), aff'd, 355 U.S. 10 (1957), where a suggested price schedule was used to give information to the far-flung members of a nationwide one-way trailer rental service, Nationwide Trailer Rental System stated:
The franchisor may have sufficient marketing information to determine the optimum price level at which to sell the product in a given area, thus protecting the franchisee from making inept business decisions. Although vertical price maintenance may restrict intrabrand price competition between franchisees, it may also increase interbrand competition within the marketplace. And, as Professor Galbraith maintains, firms with substantial market power legally arrive at advantageous prices amongst themselves, tantamount to fixed prices, despite antitrust laws. Thus, only companies too small or weak to develop sophisticated methods of price-fixing are, in reality, affected by antiprice fixing laws designed to foster competition.

It was essential to the intelligent conduct of a one-way trailer business by the numerous small businessmen ... that they have an estimate of what rates would be profitable and reasonable in areas to which they send trailers. Without this information it is impossible for them to bargain intelligently with their customers. Bork, supra note 63, at 459, citing Defendant's Jurisdictional Statement, p. 11.

68 Professor Bork says that the interbrand versus intrabrand formulation in elimination of competition cases is misleading and proposes that determining the effect of price-fixing or efficiency and restriction of output is superior to the automatic application of the per se rule. Bork, supra note 63, at 472-73. He maintains: [S]uch a formulation leads courts to make judgments that are not properly their business. Vertical ... price-fixing agreements whose legality is proposed in this article usually involve a decrease in intrabrand competition but never involve the likelihood of restriction of output [which is a truer measure of effect on competition]. This means that the parties to each such agreement are motivated by a desire for increased efficiency. The parties ... have already weighed any losses in efficiency due to the suppression of intrabrand competition and found them more than balanced by gains in other efficiencies. [It is improper, therefore, to use] ... the Sherman Act as a license for courts to second-guess business judgments about degrees of efficiency when restriction of output is not a danger. ... Id. at 472.

69 J. K. Galbraith, The New Industrial State 186 (1967). As an illustration of this point, Professor Galbraith says:

[The three majors in the automobile industry, as the result of long and intimate study of each other's behavior within the confines of one city, are able to establish prices which reflect the common interest. And they can do so with precision. ... A group of smaller suppliers of parts ... to the automobile industry will not have the same capacity for estimating each other's needs and intentions. ... Should it become known that in response to their weaker (and more competitive) position that they have come together to discuss prices, and thus win some of the ability to control prices that the automobile majors possess as a matter of course, the law would be upon them like a tiger. It exempts the market power of the strong. And it partly disguises this exemption by attacking efforts by the weak to acquire like power. Id. at 186.

70 The [antitrust] law exempts those who possess the market power and concentrates on those who would try to possess it ... those who, as the result of numbers and weakness, must use crude or overt methods to control their markets and in favor of those who, because of achieved size and power, are under no such compulsion. Id. at 187.

On the whole subject of present antitrust law, Professor Galbraith concludes: There is considerable injustice in the immunity enjoyed by those who have achieved a strong market position as compared with those who, being weaker, seek, by merger or collusion, to win a stronger position. ... [A]ntitrust laws were placed on the statute books to preserve the power of the market against
Yet, even if a franchisor's motives are pure and his business judgment sound, he must tread lightly; otherwise, his overzealous actions to convince his franchisee of the wisdom of his suggested prices will elicit a lawsuit. *United States v. Colgate & Company*\(^1\) established an early principle of antitrust law: that a producer may unilaterally refuse to deal with distributors who do not market products or services in the manner desired by the producer. However, at least where price-fixing is concerned, the Court qualified the *Colgate* doctrine in *United States v. Parke, Davis & Company*.\(^2\) The franchisor is limited to a mere announcement of this pricing policy and a simple refusal to deal.\(^3\) Beyond this, any attempt to enforce the policy is illegal per se. If the *Parke, Davis* rule applies to other franchise restrictions, a franchisor faces probable legal action with any trade restraint that even approaches those condemned by antitrust laws.\(^4\) A literal interpretation of the rule forces the franchisor to draw a fine line between persuasion and coercion. Fear of sanction under such vague standards may not only detract from a franchisor's decision-making efficiency but also deprive the franchisee of the marketing benefits which result from professional management counseling.

The franchisor's difficulty in conformity to the Court's standards may be demonstrated by application of the Court's rules to other contract restrictions. Tying one product to others may be done only when the protection of goodwill necessitates it or when specifications for a substitute would be so detailed that they could not practicably be supplied.\(^5\) Thus, tying arrangements are illegal per...
se if a franchisor's products do not have complicated specifications, or if he cannot justify the need for protecting a patent, a copyright, or a trademark. Other common restrictions are illegal if they tend "to substantially lessen competition."\textsuperscript{76} For example, where a defendant accounted for 6.7 percent of gasoline sales in a seven-state area, the defendant's exclusive-dealing agreement was held to substantially lessen competition.\textsuperscript{77} Whether the "quantitative substantiality" test applies to market shares over 6.7 percent is not clear.\textsuperscript{78} When the test is applied to other restrictions, it may be said, in general, that if the business is small, new, or failing and the restrictions are supported by valid business justifications, they will be upheld. However, large companies or companies in a business which is tending toward an oligopoly, will have an almost impossible burden in justifying any restrictions.\textsuperscript{80}

If anti-competitive restrictions should be condemned, present judicial standards provide franchisors with a dilemma in practical application and compliance even when the "rule of reason" analysis is applied to a legal problem. Ostensibly, the "rule of reason" considers the business justifications that a defendant may raise, along with the effect of the restraint on the market. But if a franchisor contemplates use of a control device in his franchise operation, he would first have to determine what constitutes "protection" of a trademark, and his "relevant strength" in the "relevant market" to protect himself from a possible antitrust suit. Answering such questions and developing guidelines from a case by case study of antitrust principles is almost impossible and probably will be more perplexing and unpredictable than useful. In antitrust law, "it is


\textsuperscript{78} Substantiality was defined as, "[r]elative strengths of the parties, the proportionate volume of commerce involved in relation to the total volume of commerce in the relevant market area, and the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein." Tampa Elec. Co. v. Nashville Co., 365 U.S. 320, 329 (1961).

\textsuperscript{79} Lower court decisions are divided as to whether \textit{Tampa} overrules \textit{Standard Oil Co.} For a discussion of lower court cases since \textit{Tampa}, see Smith, \textit{Vertical Arrangements in Antitrust Law: Exclusive Dealing Arrangements}, 22 ABA \textit{Antitrust Section} 18, 28-30 (1963); see also Bork, \textit{The Tampa Electric Case and the Problem of Exclusive Arrangements Under the Clayton Act}, \textit{Supreme Court Review} 267 (1961).


\textsuperscript{81} See note 75 supra and accompanying text.

\textsuperscript{82} See note 78 supra.
delusive to treat opinions written by different judges at different
times as pieces of a jig-saw puzzle which can be, by effort, fitted
correctly into a single pattern.83 Trends in judicial thinking may be
discerned from a line of antitrust decisions, but these are not firm
rules easily applied to a practical situation. Even if a firm can afford
expert antitrust counsel as well as the proper market research to
determine the "relevant market" and its "relevant strength," the
firm must still provide adequate capital to cover treble damages or
government compliance orders as insurance against the wide vari-
ance of judicial intérpretations. The expense can be prohibitive and
obviously favors the large and powerful.

THE FRANCHISOR'S POSSIBLE ALTERNATIVES

Many of the problems a franchisor must reconcile in attempting
to interpret and follow the Court's rules have been stated. If he con-
tinues the normal franchise relationship of contractual integration
he is faced with a maze of case law that obfuscates which channels
are legally open.84 Commentators have already sought to chart the
franchisor's course through this legal labyrinth.85 Generally, the
franchisor may seek ways to either insure his control over his opera-
tions, or give up control altogether. These alternatives tend to
destroy franchising because they ignore its essence.

Ownership or vertical integration exists when the various oper-
ations in the distribution process, such as manufacturing, wholesaling,
and retailing, are owned outright by one firm. A franchisor can inte-
grate vertically by merging his outlets into the whole organization.
He will then become an integrated chain with complete managerial
control over the destiny of whatever product he is marketing. This,
of course, would require a tremendous outlay in investment, at
least for a franchisor with a distribution system of any consequence
at all. It thus defeats the very purpose of the Supreme Court's
"antibigness" policies in that only larger and economically more
powerful franchisors are in the best position to afford the capital
outlays necessary to integrate. Also, the small independent business-
man becomes a mere employee; he is not preserved in the market
place, and he loses all of his autonomy. Attempts by relatively larger
franchisors to integrate, however, can themselves create antitrust

84 See note 74 supra.
85 See e.g., Pollock, Alternative Distribution Methods After Schwinn, 63 Nw.
U.L. Rev. 595 (1968); Zimmerman, Distribution Restrictions After Sealy and Schwinn,
12 Antitrust Bull. 1181 (1967).
problems under section 2 of the Sherman Act,\textsuperscript{86} or section 7 of the Clayton Act,\textsuperscript{87} or both.\textsuperscript{88}

A franchisor may relinquish control by adopting the "open market system" whereby a producer sells his product to the distributors and no further ownership interest or contractual relationship exists between them. The franchisor may sell his product or service to the franchisee without restricting the franchisee in any significant manner. The Supreme Court favors this method because it is the "usual marketing situation" and "since most merchandise is distributed by means of purchase and sale."\textsuperscript{89} This view, unfortunately, ignores the unique nature of the franchise system—its ability to combine relatively small independent units and the economies of large scale professional management controls, thus providing an alternative to integrated chains.

If, for whatever reasons, a franchisor deems it necessary to maintain vertical controls, the safest way\textsuperscript{90} is probably through the agency/consignment method of distribution, legitimized, with qualifications, in the \textit{Schwinn} decision. In that case franchising was summarily equated with "confinement of distribution,"\textsuperscript{91} but that rationale, by itself, fails to explain why restraints may be legally imposed if "title, dominion, and risk of loss" is retained while the same restraints imposed by contract are illegal per se—a difference, seemingly, in form rather than substance.\textsuperscript{92} Nevertheless, such an

\begin{itemize}
\item \textsuperscript{86} "Every person who shall monopolize, or attempt to monopolize, . . . any part of the trade or commerce among the several States, . . . shall be guilty of a misdemeanor . . . ." 15 U.S.C. § 2 (1964).
\item \textsuperscript{87} "No corporation engaged in commerce shall acquire, . . . stock or other share capital . . . or assets of another corporation engaged also in commerce, where . . . the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18 (1964).
\item \textsuperscript{88} \textit{Trade Reg. Rep.} ¶ 4430 (1968) contains the latest merger guidelines. However, "integration by merger is more suspect than integration by contract, because of the greater permanence of the former." United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 366 (1963).
\item \textsuperscript{89} United States v. Arnold, Schwinn & Co., 388 U.S. 365, 379 (1967).
\item \textsuperscript{90} Agency/consignment arrangements were originally held to be valid, even if they contained resale price restrictions. United States v. General Elec. Co., 272 U.S. 476 (1926). Although not expressly overruling \textit{General Electric}, \textit{Simpson v. Union Oil Co.}, 377 U.S. 13 (1964), held price-fixing consignment agreements illegal, the facts of both cases being virtually indistinguishable. Now \textit{Schwinn} holds that this may be the only method of distribution that will sustain vertical restraints.
\item \textsuperscript{91} United States v. Arnold, Schwinn & Co., 388 U.S. 365, 380 (1967).
\item \textsuperscript{92} Simpson v. Union Oil Co., 377 U.S. 13, 22 (1964). The Court held that the substance or effect of a restraint will be considered, and not the form that it takes or name by which it is called. Union Oil tried to cover an illegal "consignment" to fix prices by calling it an "agency" arrangement, but the Court ignored the labels and considered only the impact of the arrangement on the marketplace as a whole. Union Oil apparently retained "title, dominion, and risk of loss." However, one commentator notes that "[T]he teaching of \textit{Schwinn} is that in antitrust cases form is
arrangement requires the capital necessary to maintain the inventory which a franchisor must now own. It may also require much more time and expense to readjust present marketing systems to comply with the new method of distribution. Again, this works in favor of the richer and more powerful franchisors. Furthermore, a franchisor, considering the Schwinn rule too burdensome, may decide to vertically integrate. For example, the Schwinn Company has announced to its independent dealers the intention of ultimately distributing its bicycles and other products through wholly owned sales subsidiaries. Presumably, complete vertical integration awaits acquisition of adequate capital.

CONCLUSION

Neither the "open market" nor the "vertical integration" systems reconcile the conflict between independent ownership and efficient management control. This conflict is accommodated by the franchise system; however, many aspects of contractual integration are irreconcilable with "the ancient rule against restraints on alienation." The Supreme Court apparently realizes the conflict to some extent. But, to apply verbal expressions of past economic conditions to modern marketing concepts, ignores the overall picture of what is happening to our complex economy. The Court's pronouncement in White Motor Company v. United States, that "we do not know enough of the economic and business stuff out of which these vertical arrangements emerge" may be a more realistic attitude than providing Court decisions for the sake of "guidance,"


95 "All vertical restrictions . . . and all franchising" is not illegal per se, because: Such a rule might severely hamper small enterprises resorting to reasonable methods of meeting the competition of giants of merchandising through independent dealers, and it might sharply accelerate the trend towards vertical integration of the distribution process. Id.

96 "With all deference, 'the ancient rule against restraints on alienation' would appear to be no more relevant to the solution of current distribution problems than the Rule in Shelley's Case would be for solving problems in the merger field." Pollock, Alternative Distribution Methods After Schwinn, 63 Nw. U.L. REV. 595, 601 (1968).


98 Justice Stewart criticized the Schwinn decision, stating:
The Court today is unable to give any reasons why, only four years later, this White precedent should be overruled. Surely, we have not in this short interim accumulated sufficient new experience or insight to justify embracing a rule automatically invalidating any vertical restraints . . . Indeed, the Court does not cite or discuss any new data that might support such a radical change in the law . . . Such a rule ignores and conceals the 'economic and business stuff out of which' a sound answer should be fashioned. United States v. Arnold, Schwinn & Co., 388 U.S. 365, 393 (1967).
if in fact, the trend toward "bigness" continues, and confusion reigns. The Supreme Court appears preoccupied with preserving "ancient rules" rather than adopting new principles to cope with the twentieth century phenomenon of franchising.

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