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TERRITORIAL AND CUSTOMER RESTRICTIONS IN FRANCHISE AGREEMENTS UNDER THE ANTITRUST LAWS

by Donald M. Jenkins*

Introduction—the Development and Significance of Franchising

The growth of franchising as a marketing vehicle in the past decade has been apparent to the American consumer. Several factors have contributed to this growth. This kind of distribution system can be achieved with less capital outlay and in a shorter time span than most other distribution systems require. Some products and services gain greater consumer acceptance if they stand alone in the market place than when they are co-mingled with other products. Wholesalers in certain product lines, such as food and drugs, have found it necessary to form voluntary chains based upon franchise agreements to meet the competition of the big chains. Franchising, particularly in the service field, enables a product or institution to achieve an identity upon which a reputation for quality can be built. These are a few of the reasons for the widespread use of franchising.

Franchising has been described as a system of distribution wherein a market supplier of goods or services grants particular distribution rights to a limited number of selected businesses.¹ The franchise may be granted to promote the marketing of a product, products, or product line or to promote entire business enterprises. This concept of franchising suggests two types of franchising arrangements under which the grant of exclusive territories or customer allocations may be included:

(1) Those that establish an efficient method of distribution for the franchisor’s product, such as those for cars or bicycles.

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Those that establish manufacturing or processing plants, such as those for soft drink bottlers and mattress manufacturers.²

The essence of franchising is the marketing of goods and services through quasi-independent businesses that are subject to various controls respecting their business operation. Two such controls commonly included in franchise contracts are provisions limiting the territory in which the product or service can be distributed by the franchisee and designating particular classes of customers to whom the franchisee may sell. The potential anti-competitive effects of these provisions produce antitrust complexities. The Supreme Court of the United States in United States v. Arnold, Schwinn and Company³ expressed its position on these restrictions in June of 1967. This article will review the development of pre-Schwinn antitrust law affecting these restrictions, will evaluate the Schwinn decision, and will examine proposed legislation concerned with territorial restrictions.

To get some perspective of the importance of the antitrust law in this area, one must consider the significance of franchising in our economy. The International Franchise Association, a Chicago-based trade group, estimates that in 1966 franchises, including service stations and automobile dealerships, accounted for a retail value of seventy billion dollars worth of goods and services. In addition, approximately eight billion dollars worth of franchises were sold. These estimates suggest that franchised distribution accounts for about eleven percent of the Gross National Product.

Perhaps the significance of franchising can be better perceived by examining specific industries and goods or services utilizing the franchise method of distribution. The reports of Professors Lewis and Hancock are revealing in this regard:

Since the beginning of the automobile business the major proportion of all passenger cars and trucks have been sold through franchised dealers. Practically all the major brands of gasoline and oil are distributed through leased (franchised) service stations. In addition to gasoline, these service station operators sell vast amounts of the oil companies' auto parts and accessories. Approximately 40 percent of the nation's food is sold through food stores affiliated

² Chadwell, Antitrust Aspects of Dealer Licensing & Franchising 63-64 (1966). These are two of three classifications discussed in this article.
with wholesalers by means of a franchise agreement. A major proportion of agricultural machinery and its allied lines are distributed through dealers selected and franchised by farm machinery manufacturers. Tool and equipment rental and auto and truck leasing fields have been and are presently dominated by franchised dealers. The soft ice cream business and many roadside light refreshment businesses are dominated or were originated by franchised organizations. Several well known home services, such as carpet, rug and furniture cleaning were pioneered by franchisors and today they have a sizable share of the market. The recent development and growth of the coin operated laundry and drycleaning field is almost entirely attributable to franchising. Bottling companies are franchised businesses and have been since the inception of the soft drink industry. Splendid growth and expansion, all of high quality, is in evidence in the hearing aid field, specialized restaurants, inns, and motels and water-conditioning field. Each of these is either dominated by franchised businesses or it has been penetrated by the franchised way of doing business. 4

It is apparent that a substantial part of our economy, represented by a variety of industries, is affected by the interpretation and application of the Sherman Antitrust Act, 5 the Clayton Act, 6 and the Federal Trade Commission Act 7 as they apply to franchising. A factor that should be stressed is that the size and economic power of franchisors and franchisees encompasses a spectrum from the large and financially powerful to the small and marginally financed enterprises. Franchising often serves the market requirements of firms faced with special competitive problems and should therefore, it would seem, be encouraged by federal legislation. However, franchising has sometimes been used to stifle competition and to restrain trade and when so employed obviously should be curtailed. The characteristic of franchising that may promote competition or restrain it is the control exercised by the franchisor over the franchisee. This control can extend from mutually beneficial cooperation to unlawful conspiracy.

Thus, franchising involves certain restrictions and a potential for anti-competitive activities. The issue then is how much franchise control is desirable and necessary from an antitrust

4 Lewis and Hancock, supra note 1, at 86.
point of view. This issue received the attention of the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee in 1965-1966.\textsuperscript{8} Subcommittee hearings culminated in the summer of 1966 with consideration of a proposed amendment\textsuperscript{9} to the Sherman Antitrust Act permitting exclusive territorial franchises under limited circumstances. This legislation was proposed when the legal status of exclusive territorial franchises was in a greater state of uncertainty than it is today.

**Case Background**

Attention will now be given to the case background of vertically imposed territorial and customer restrictions. The earliest United States Supreme Court case directly touching on the issue of territorial and customer restrictions was *White Motor Company v. United States*,\textsuperscript{10} which was decided in 1963. In that case White Motor Company was charged with violating Sections one and three of the Sherman Act by imposing territorial restrictions on distributors and dealers as well as limitations on the persons to whom the distributors could sell.\textsuperscript{11} White’s marketing plan gave an exclusive right to its distributors to sell White trucks in a specified territory and prohibited the distributor from selling (or authorizing any dealer to sell) to any department or political subdivision of the federal or state government unless expressly permitted to do so by the Company. The government contended that these restrictions were per se violations of the Sherman Act. The District Court for the Northern District of Ohio agreed with the government’s position and granted a summary judgment for the government. White argued that the territorial provisions of its franchise were necessary to encourage initiative and that the territorial security granted the distributor tended to enhance rather than reduce inter-brand competition. White also contended that it was doing nothing through its franchise arrangements that it could not do

\textsuperscript{8} Hearings before the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee, United States Senate, 89th Congress, 1st Session, Part 1 (1965), Parts 2 & 3 (1966). Hereinafter this will be cited as “Hearings before the Subcommittee on Antitrust and Monopoly, 89th Congress”.

\textsuperscript{9} Hearings before the Subcommittee on Antitrust and Monopoly, 89th Congress, Part 3 (1966).


by setting up its own retail outlets. The company defended the customer restrictions by urging that the reserved customers were large volume customers located where competition was keen, that the volume purchased by these customers encouraged discounting which only the manufacturer could afford, and that its distributors were not competent to service such large accounts. The Supreme Court, by a majority of five to three, held that there was insufficient evidence in the record to sustain the District Court’s decision that these vertically imposed restrictions were illegal per se and directed the District Court to inquire into the effect upon competition of the particular restraints in issue and of the particular sanctions by which they were enforced.

In a concurring opinion, Justice Brennan suggested guidelines to aid the District Court in making its inquiry into the legality of the restrictions. Significantly, Justice Brennan indicated that justification may exist for vertical territorial restrictions. For example, a manufacturer starting out in business or marketing a new or risky product requiring close control may have to insulate territories to gain effective access to the market. Justice Brennan then stated that assuming justification can be found for the restraint, the next step is to determine whether the operation of the restrictions reasonably relates to the needs that brought them about. Finally, inquiry should also proceed into the availability of less restrictive alternatives.

Justice Brennan viewed customer restraints as the most inherently dangerous of the two kinds, since they serve to suppress all competition between the supplier and the distributor and lack any countervailing tendency to foster competition between brands. He suggested that the crucial test of this type of restraint is whether the distributor could, absent the restriction, compete with the manufacturer for the reserved outlet. If not, there would be no tendency to lessen competition if the restraint were employed. Of course, if such were the case, there would be much less incentive to use the customer restriction.

Addressing himself to White’s attempts to justify the restraint on customers, Justice Brennan found White’s arguments quite shallow. Commenting on White’s contention that the distributors were not competent to service the reserved accounts without many months of specialized training, the Justice said that less restrictive methods could accomplish the same end, e.g. improved supervision and training of the distributors or a
special manufacturer's warranty to protect the purchaser against unsatisfactory distributors or servicing.

White's argument that the reserved large volume accounts enabled it to compete more effectively with other brands impressed Justice Brennan as constituting a reason why the restrictions were unjustified. If the distributor is not in a position to compete, the restraint can only be explained as being used to protect a noncompetitive pricing structure.

Justices Clark and Black and Chief Justice Warren dissented. They viewed the business-necessity justification advanced by White as invalid. The net effect of the restraint, in their view, was to destroy competition between White and its distributors as to a given class of customers and to lessen competition among White's distributors as to other accounts. They also felt that such vertical restraints were as destructive of competition as price fixing agreements and perhaps more effective than the latter, since territorial restraints are easier to police. The dissenting justices viewed the White franchise agreement as having the intention of eliminating competition and likened it to horizontally imposed territorial restraints, which are illegal per se.12

The significance of the White case was that it disclosed that a majority of the Supreme Court were not ready to declare vertically imposed territorial or customer restrictions illegal per se. The majority gave the impression that the test of legality would be the reasonableness of the restraint and its effect on competition. However, upon return of the case to the District Court, White Motor signed a consent decree eliminating customer and territorial restrictions from its franchise agreement, and so a legal test for these restrictions was not clearly enunciated.

Following the White decision, two cases concerning vertically imposed restraints were decided at the Circuit Court level, Snap-On Tools Corporation v. Federal Trade Commission13 and Sandura Company v. Federal Trade Commission.14

In the former case Snap-On Corporation assigned to its dealers a non-exclusive franchise for the sale of its product within a

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14 339 F.2d 847 (1964).
described territory. The corporation’s dealers distributed from walk-on mobile trucks to customers in their territory. There were approximately 900 dealers selling exclusively to the “mechanics trade” and non-exclusively to the “industrial trade,” certain of these latter accounts being reserved to the company. The Federal Trade Commission charged that Snap-On corporation was guilty of unfair acts and methods of competition in violation of Section five of the Federal Trade Commission Act. The Commission issued a cease and desist order embracing both the territorial and customer restraints. The company elected to appeal. In considering the case, Circuit Judge Swygert referred to the opinion of the Supreme Court in the White case, which he interpreted as meaning that vertical allocations of dealer territories were not per se violations of the Sherman Act; hence an inquiry into the reasonableness of the arrangements was necessary. A review of the characteristics of the pertinent market revealed that regular calls on the “mechanics trade” were a necessity. Also, in this market over eighty competing concerns were engaged in a “bitter and bloody” interbrand competition, and sound business judgment could not ignore this fact in deciding whether to limit competition among intrabrand competitors. Accordingly, the Circuit Court held that the territorial and customer restrictions were reasonable, promoted interbrand competition, and being vertically imposed, were not unlawful.

Turning to the latter case, Sandura Company was also cited by the Federal Trade Commission for engaging in unfair methods of competition under Section five of the Federal Trade Commission Act. The condemned conduct consisted of making resale price fixing arrangements and imposing territorial restraints on distributors, which created closed territories. The Commission found both practices illegal and Sandura appealed that part of the order relating to the territorial arrangements, which the Commission asserted restrained intrabrand competition among Sandura’s distributors. The Sixth Circuit Court, again citing the White case, refused to find the territorial restrictions illegal for eliminating intrabrand competition without examining into the restrictions’ actual effect on competition and the facts offered to justify the restraint. The court’s evaluation of these factors led to the conclusion that Sandura’s methods were reasonable. One consideration influencing the court was that
Sandura was a relatively small concern losing business generally to the "giants" of the floor-covering industry—Armstrong, Congoleum-Nairn, and Pabco. Also participating in the market were large diversified firms such as Johns-Manville, Goodyear, and Goodrich as well as several small firms. Another influential consideration was the fact that Sandura had not devised the closed territory system until a series of events placed the company on the edge of bankruptcy. Sandura had experienced product difficulties in the early nineteen-fifties. Its annual sales dwindled from seven million dollars to three million dollars and its distributors fell into a state of low morale. The closed territories program was created to aid distributors, and after it was instituted sales climbed back to a high of twenty-four million dollars in 1959. As part of the franchising program, the distributors were made prominent participants in Sandura's promotional program, and they contributed to the sales success. Given this dependence upon the distributors for much of Sandura's advertising program, and given the distributors' unwillingness to cooperate without a quid pro quo of closed territories, the court found sufficient justification for the territorial restraints, especially since the effect was to increase competition in the industry.

An evaluation of the above cases indicates that the courts are reluctant to find territorial and customer restrictions illegal per se. This is of special significance in view of the Justice Department's long-maintained position that territorial restrictions are illegal per se. The courts' position as of 1964 amounted to a "rule of reason" approach to the restrictions and a willingness to approve them as long as they were in fact: (1) vertically imposed; (2) justifiable by a sound business reason, such as the need to achieve and maintain a market position, to enable a company to enter a market, or to provide greater interbrand competition and; (3) not unduly restrictive of competition in the particular industry.

Quite apparent in these cases is the difference in the positions of the Justice Department and the Federal Trade Commission. In the White case the Justice Department proceeded under its announced policy that territorial restrictions are illegal per se, whereas the Federal Trade Commission in the Snap-On Tool case and the Sandura case attacked the restraints on the basis of their anti-competitive effect and assumed the burden of proving the same, rather than asserting per se illegality.
TERRITORIAL AND CUSTOMER RESTRICTIONS

The consequences to the business community of the law operative in this area should be noted. In the period 1956-1965 the government instituted twenty-seven suits involving restrictions upon territories or customers pursuant to franchise agreements. Nineteen defendants signed consent decrees eliminating the restrictions; two were fined twenty-five thousand dollars; two were dismissed without prejudice; and four reached the decisional stage at the Supreme Court level, of which only the Schwinn case, discussed below, centered directly upon the vertically imposed territorial and customer restrictions. The cost of this litigation was emphasized by Judge Joseph Sam Perry, who wrote the District Court opinion in the Schwinn case. Judge Perry observed that Schwinn, as a pilot case, would cost in excess of one million dollars, about one-half of which cost would be incurred by the defendants. The Snap-On Tool litigation, according to Robert L. Grover, Executive Vice President of the Company, consumed four years and cost the company a quarter of a million dollars. Monte E. Pendleton, President of Sun-X International, a franchisor, asserted before the Senate Subcommittee that if his company were challenged by the government it would simply have to relinquish the keys to its business, since it could not afford to defend such charges. Obviously, clarification of the law in this field has been urgently needed.

Proposed Legislation

In June of 1966, the Senate Subcommittee held hearings on Senate Bill Number 2549, known as the Executive Territorial Franchise Bill. This legislation was introduced to amend the Sherman Antitrust Act to provide that exclusive territorial franchises would not be deemed to constitute a restraint of trade or commerce or a monopoly or attempt to monopolize, under limited circumstances. The text is set forth below:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, that the Sherman Antitrust Act (15 U.S.C. 1 et seq.) is amended by adding immediately after section 8, the following new section as section 9 thereof:

Sec. 9. For the purposes of the Act of July 2, 1890, as amended, commonly referred to as the Sherman Antitrust

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15 Hearings before the Subcommittee on Antitrust and Monopoly, 89th Congress, Part 3.
16 Id. at 1123-26.
17 Id. at 65 (of Part 1).
Act (15 U.S.C. 1 et seq.) and for the purposes of the Federal Trade Commission Act (15 U.S.C. 41 et seq.) a contract or agreement between a purchaser and a supplier restricting the right of the purchaser to the distribution of the supplier's product within a clearly delineated territorial area shall not in and of itself be deemed to be an unfair method of competition or a contract, combination or conspiracy in restraint of trade, or an unfair or deceptive act or practice in commerce or a monopolization or attempt to monopolize where the product or products which is or are the subject of such exclusive territorial franchise agreement or contract are in free and open competition with products of like grade and quality produced by persons other than the supplier, and where the purchaser under such exclusive territorial franchise agreement or contract is in free and open competition with other vendors of like or similar merchandise within the territorial area defined by such agreement or contract and is not inhibited by the terms of such agreement or contract from dealing in like or similar products of persons other than the supplier.18

Donald F. Turner, Assistant Attorney General, speaking for the Department of Justice, opposed the bill, asserting that it would lead to damaging restrictions on competition, would legalize many harmful competitive agreements, and would significantly increase the burden of enforcement agencies in attacking insidious agreements in court.19

A shortcoming of the bill was pointed out by the Chief Counsel for the Subcommittee, S. Jerry Cohen who observed that if the act were taken literally a court might well reason that if there is not free and open competition with products of like grade and quality, a per se violation would result. To illustrate, in the Sandura proceedings, Sandura had argued that its floor covering was unique and, therefore, competition was not lessened by the franchise provisions. Under the proposed bill this circumstance might well have resulted in Sandura losing the same case it won without the bill.20

Interestingly enough, the International Franchise Association found the bill defective, for the following reasons: First, the bill limits its exemption to franchise agreements under which the franchisee is not inhibited "from dealing in like or similar products of persons other than the supplier." This seems to deny the exemption to agreements wherein the franchisor requires its

18 Id. at 58 (of Part 1).
19 Id. at 1090 (of Part 3).
20 Id. at 1031 (of Part 3).
franchisees to sell only its trade-marked product or service. Such franchising agreements are necessary where uniformity of quality and appearance is required. Second, the phrase "restricting the right of the purchaser to the distribution of the supplier's product within a clearly delineated territorial area" might not be interpreted in the same manner as section three of the Clayton Act, commonly found in franchise agreements. The purpose of this restriction is to disallow peripheral business outlets (in an assigned territory) which would encroach on the business of adjacent franchisees. Thirdly, the language specifically covers "products" and does not mention "services." If this language is interpreted in the same manner as section three of the Clayton Act, which also refers exclusively to "products," territorial franchising of "services" would not be exempted.\textsuperscript{21}

This legislation was pending when the Supreme Court, in \textit{United States v. Arnold, Schwinn and Company},\textsuperscript{22} considered for the first time a case directly raising the issue of the legality of vertically imposed territorial and customer restrictions.

\textbf{The Schwinn Decision}

The \textit{Schwinn} case was decided in June, 1967. Filed on June 30, 1958, the case initially came to trial in the United States District Court for the Northern District of Illinois, Eastern Division. The United States brought the civil antitrust action against Arnold, Schwinn and Company (a bicycle manufacturer), The B. F. Goodrich Company, and the Schwinn Cycle Distributors Association, alleging violation of section one of the Sherman Act in that the defendant engaged in an unlawful combination and conspiracy. The specific franchise agreements under attack were the following:

\begin{itemize}
  \item [(1)] Schwinn franchised a limited number of retailers in each market area for its products, and the Schwinn distributor in a particular market area confined its sales by agreement to these retailers.
  \item [(2)] B. F. Goodrich promised to confine its sales of Schwinn products to B. F. Goodrich outlets only.
  \item [(3)] The franchised dealers agreed to adhere to retail prices fixed by Schwinn.
\end{itemize}

\textsuperscript{21} \textit{Id.} at 1077-79 (of Part 3).
\textsuperscript{22} 388 U.S. 365, 87 S. Ct. 1856 (1967).
(4) The contracts provided that franchised retailers and B. F. Goodrich outlets that failed to adhere to said prices would be refused future deliveries of Schwinn products.

(5) The franchised retailers agreed to purchase Schwinn products only from the authorized Schwinn distributor in their market area and to sell only from the franchised location.

The challenged marketing program was begun in 1952 when Schwinn enjoyed approximately 22.5 percent of the domestic bicycle market. By 1961, its share had dropped to 13 percent although its unit sales and dollar volume had increased substantially. In 1962 nine bicycle manufacturers in the United States supplied 70 percent of the market. Murray Incorporated, the leading producer, supplied 23 percent of the domestic market. Of the total domestic sales, 40 percent of the bicycles were distributed by national concerns which operated their own stores and franchised others. Another 20 percent were sold by giant chain stores, such as Sears-Roebuck and Montgomery Ward. About 30 percent were sold by cycle jobbers, and the balance were marketed by hardware and general stores. Although Schwinn sold only under its name, the company's policy did not prohibit its distributors or retailers from handling other lines, and most did deal in multiple lines. The government did not contend that there was any restraint on interbrand competition but rather that the agreements restricted intrabrand competition. In essence the complaint asserted that this arrangement, which affected but one-seventh of the market, constituted an unreasonable restraint of trade.

Schwinn's channels of distribution were as follows:

(1) Sales were made directly to distributors, to B. F. Goodrich, and to hardware jobbers.

(2) Sales were made to franchised retailers under the so-called "Schwinn Plan." Schwinn would ship directly to the retailer, invoice him directly, extend credit, and pay a commission to the distributor taking the order.

(3) Sales were also made to retailers by means of consignment or agency arrangements with their distributors.

In the 1952-1962 period approximately 50 percent of the company's sales were made under the "Schwinn Plan." By the time the Supreme Court considered the case about 75 percent of all Schwinn's sales were made under this plan.
The Schwinn retail franchisees were required to promote Schwinn bicycles and to give them at least equal prominence with other brands. The number of outlets in a given area were limited and the retailer was franchised only as to a designated location. His sales were restricted to consumers.

The District Court rendered its judgment in a lengthy opinion on December 29, 1964, almost two years after the Supreme Court's decision in the White case. The Court found that the government had failed to prove that the company was guilty of a price fixing scheme, and this charge was dropped on appeal. Further, the court held that the Schwinn franchising system was fair, reasonable and good business procedure under all the circumstances existing in the bicycle industry and that the company should be allowed to continue developing more efficient territorial zones and to continue allocating specific territories to distributors for prime responsibility.23 However, the court held the defendants in violation of Section one of the Sherman Act to the extent that territorial restrictions were placed on distributors who purchased outright Schwinn products (as opposed to distributors who acted as agents or consignees). Such restrictions were characterized as illegal per se. The company did not appeal this decision. The District Court did not declare unlawful the customer restrictions.

The government elected to appeal the upholding of territorial and customer limitations under consigned and agency distribution:

23 Judge Perry stressed the dilemma of the relatively small business organization as it views a market place dominated by giants:

"To put it bluntly, if Schwinn were Sears, Roebuck & Co., its largest bicycle competitor, or if it were General Motors Corp., it would be able to do exactly what it has done in franchising retail dealers with no penalty attached, either through its own retail stores and salesmen as Sears, Roebuck & Co., does or through direct franchising on a nationwide scale as General Motors and other giant corporations do.

And penalized for what? Being a pygmy, compared to its giant bicycle competitors, Sears, Roebuck & Co., and Montgomery Ward & Co.? . . .

Now it appears to this court that if General Motors, Sears, Roebuck & Co., Montgomery Ward & Co., Ford Motors Co., and other international corporations can rely upon a sound and long-established principle of common law and safely choose its customers, deal, and refuse to deal, with whomsoever it will, and wherever it will, so can a small business firm such as Schwinn. There is another rule of law laid down and established at common law just as firmly as the aforesaid principle, and corollary to it: That is the rule of common law that generally what one may do himself he may likewise do by or through an agent. As a matter of fact and law that is how General Motors acts—by an officer. Now that is also what Schwinn has done. In place of acting through a vice president, it has acted through a distributor." 339 F.2d at 112.
arrangements. However, it did not contend in the Supreme Court that such distribution methods were illegal per se but argued that in the light of the "rule of reason" the limitations constituted an unreasonable restraint of trade. It urged that such restraints should be proscribed regardless of the technical form in which the goods were transferred.

_Schwinn_ was argued before the Supreme Court in April, 1967. The _White, Sandura, _and_ Snap-On Tool_ decisions indicated that the restrictions under consideration would be tested against a criteria of reasonableness and not condemned as illegal per se. As expected, the Supreme Court examined the specifics of the challenged practices and their impact on the market place to determine the reasonableness of the restraints. The company maintained that it evolved the distribution system to enable it and the small independent merchants, represented by their franchisees, to compete more effectively. The court discounted as a basis for reasonableness Schwinn's "good business practice" arguments and asserted that the point in inquiry was whether, assuming non-predatory motives and blameless business purposes, the effect on competition in the market place was substantially harmful.

The government argued that it was illogical to forbid territorial limitations on the resale activities of distributors and at the same time to condone arrangements which require distributors to confine the resale of goods to franchised retailers. Such an agreement includes a combination or understanding that violates the Sherman Act. The Supreme Court agreed with this argument and held that upon remand the decree should be modified to enjoin any such limitation on resale by the distributor.

In addition, the government argued that to effectively control such practices the decree should encompass the agency and consignment arrangements used by Schwinn in their distribution system. The Supreme Court, however, distinguished these distribution practices by viewing the restraints achieved as being purely unilaterally and vertically imposed by Schwinn, the title-holder of the goods. The issue, as expressed by the court, was the extent to which a manufacturer may choose his customers, allocate territories for resale, and confine access to his goods to selected, franchised retailers. Hence, a distinction was made between a distribution system wherein the manufacturer parts
with title, dominion over the goods, and risk of loss and a system under which the manufacturer retains ownership and risk of loss.

The District Court, therefore, was upheld in its holding prohibiting as illegal per se territorial limitations where distribution is accomplished through purchase and sale. The Supreme Court extended the per se doctrine to cover the restricting of outlets with whom a distributor may deal and to cover the designating of classes to whom retailers may sell after the franchisor has parted with title to the goods. In effect, the Court stated that if a manufacturer parts with dominion and control over his product or transfers the risk of loss to another, he may not thereafter reserve control over the product's destiny or the conditions of resale. Any such attempt is illegal per se.

As to agency and consignment methods that effect territorial and customer restrictions, it was held that such restraints are not per se violations but may be prohibited by the Sherman Act if their impact is "unreasonably" restrictive of competition. Regarding Schwinn specifically, the Court held that, absent the price fixing issue, which was not a subject of appeal, the restraints were unobjectionable, since: their anti-competitive effects were negligible; the defendant was faced with intense competition by mass merchandisers; and adequate supplies of similar products were available to non-franchised dealers.

The main points advanced by the Supreme Court in support of its opinion were these:

1. Competitive bicycles were available to distributors and retailers.
2. Schwinn's distributors and retailers could handle other brands of bicycles.
3. The restrictions imposed by Schwinn were found by the trial court to be no more confining than necessary to meet competitive pressures. Thus the net effect of the plan was to promote competition.

Judges Stewart and Harlan dissented in the ruling that the restrictions concerning items of purchase and sale were a per se violation. They cited the White case and its formulation of the "rule of reason" test of territorial and customer restraints. They argued that facts peculiar to the business, the competitive factors before and after the restraint, the nature of the restraint and its effect, actual or probable, the history of the restraint, and the reasons for adopting a particular restraint are all factors
to be considered. In their opinion, the finding of a per se violation in this case ran counter to the Court's pronouncement in the White case and ignored the fact that the restrictions did not appear to suppress competition. The dissenters were especially critical of the majority's position that the restrictions violated the "ancient rule against restraints on alienation." Ancillary restraints on alienation, they emphasized, were recognized as legitimate as early as 1711 under the common law, and in any event the vast change in society's economic life since the "ancient rule" was pronounced vitiates this argument.

The Need for Territorial and Customer Restraints

In order to properly evaluate the impact of the antitrust laws under discussion one must be aware of the trend toward concentration of economic power in our society. Mergers have occurred at a rapid rate in the past ten years with relatively little interference from the federal agencies. To cite two examples involving popular consumer products, the brewing industry has experienced a fifty percent decrease in the number of operating breweries since 1950. Distributors in the industry have decreased approximately 32 percent in the same period. In 1965, the five leading breweries supplied 41 percent of the market. The top twenty breweries provided beer for 84 percent of the market, leaving the remaining 16 percent of the market place to approximately 180 breweries. 24 Another industry evidencing this concentration is the cigar industry, where the number of manufacturers decreased from 1,821 in 1950 to 336 in 1965, with the top eleven manufacturers supplying eighty percent of the market. 25 These examples illustrate the trend towards greater concentration. The significant factor is the tremendous market power that is being achieved through this concentration of economic power. For the smaller, financially weaker firms to meet this competition is becoming increasingly difficult. At present there is no reason to believe that the federal agencies will take any significant steps to deter further concentration or to eliminate existing economic concentration. As indicated earlier, many businesses have selected the franchise system of distribution simply to survive the competition offered by the "giants" in their

24 Hearings before the Subcommittee on Antitrust and Monopoly, 89th Congress, p. 4 of Part 1.
25 Id. at 511 (of Part 2).
industry. Market control is an essential element of their competitive program. Territorial and customer restrictions, when so employed, may have pro-competitive effects, as illustrated in the Sandura case. If territorial and customer restrictions are deemed illegal per se where distribution is through purchase and sale, a franchisor is foreclosed from showing that a system of closed territories is a necessary inducement to obtain loyal distributors who will enable him to compete effectively against the "giants" in the industry. Eugene P. Foley, Administrator of the Small Business Administration, highlighted this point in his testimony before the Senate Judiciary Subcommittee on Antitrust and Monopoly:

"Over the years the courts have developed the doctrine that certain practices are so pernicious in their effects on competition, and so lacking in any redeeming virtue, that they are conclusively presumed to be illegal. Among the practices so condemned are agreements among competitors to fix prices; to establish production or sales quotas; or to allocate territories or customers. Where all or most of the participants to such practices are large concerns, the per se approach seems to make sense. But does it make sense where a group of small businesses in an industry resort to such practices for the purpose of strengthening their position against the two or three firms, say, which dominate the market? Should we refuse even to consider the possibility that the net result was to increase, rather than decrease, competition in the industry? That it was beneficial, rather than injurious, to the economy? . . .

. . . In particular I am concerned with the argument, sometimes heard, that it is per se illegal for a franchisor to allocate exclusive territories to his franchisees and to prohibit each from invading the area of another." 26

An undesirable effect of the decision in the Schwinn case is its encouragement of vertical integration, which generally is only within the capability of the better financed organizations. If franchisors are frustrated in their attempts to control their franchisees even where there is no significant adverse effect on competition, their most rational alternative course of action is to integrate forward—to the detriment of their small competitors. Justice Douglas, in Standard Oil of California v. United States,27 predicted such a result if unrealistic limitations on trade restrictions were imposed.

26 Id. at 985 (of Part 3).
27 337 U.S. 293, 69 S. Ct. 1051 (1949).
It is difficult to justify the sanctioning of vertical restraints where distribution is by agency or consignment arrangements and the simultaneous condemnation of such restraints where distribution is by purchase and sale. When they deem such control advisable the large manufacturers will simply integrate forward or else employ an agency arrangement and willingly assume the heavy financial burdens and risks associated with ownership of the products. Neither of these alternatives is available to the small manufacturer. Furthermore, the formal distinction made between these two methods of distribution appears to constitute a very tenuous basis upon which to condone or outlaw these restrictions. The Supreme Court itself rejected such a formal distinction in 1964 in Simpson v. Union Oil Co.\textsuperscript{28}

**Conclusion**

Today the imposition of territorial or customer restrictions by the franchisor is illegal per se if distribution of the product is by purchase and sale. However, if the franchisor retains title to the goods through the channels of distribution by employing agency or consignment agreements, such restrictions will be judged by the "rule of reason," and will be deemed unlawful only if the proscribed adverse effect on competition is apparent.

One questions whether the present law gives due consideration to the realities of the market place. The major advantage of the illegal per se concept in judging trade practices is, of course, the ease with which it can be applied. This is helpful to the government and provides definite guidelines to business. On the other hand it obviously can be too exclusive. It is submitted that the wide spectrum of business entities in our economy and the avowed purpose of the antitrust laws to encourage competition preclude applying the per se concept to territorial and customer restraints. Even the Justice Department, which has had an inflexible attitude toward these restrictions, has acknowledged that under certain circumstances such restraints may be lawful.\textsuperscript{29}

Besides making possible the entry of new firms and the introduction of new products territorial and customer restrictions can also be useful in circumstances involving unusually high risk or prolonged business reverses. The use of these restraints

\textsuperscript{28} 377 U.S. 13, 84 S. Ct. 1051 (1964).
enabled the Sandura Company to escape from the edge of bankruptcy. Companies such as Schwinn and White Motor, engaged in unequal competition with commercial giants, may withstand intense interbrand competition by employing customer and territorial limitations. Snap-On Tools found them necessary to avoid the waste and destructiveness of intrabrand competition in an already extremely competitive market place.

It appears that a return to the current of the law before the Schwinn decision would be in the best interest of society. The Sherman Act proscribes attempts to monopolize and to establish unreasonable restraints of trade. It is these criteria that should be applied in determining the legality of territorial and customer restrictions. This was the conclusion reached in 1955 by the Attorney General's National Committee to Study the Antitrust Laws. If it is found that the restraint is merely ancillary to a legitimate business purpose it should be upheld unless its effect is to unreasonably stifle competition. To the argument that such legal guidelines are too indefinite one can reply that a degree of indefiniteness is preferable to the outright prohibition of rational trade practices that often promote competition. In brief, territorial and customer restrictions should be tested by the "rule of reason."

20 Donald F. Turner, Assistant Attorney General in Charge of the Antitrust Division, declared, in an address to the New York Bar Association Antitrust Symposium in 1966:

"Without pretending to be exhaustive or definitive, let me deal briefly with the question 'Are territorial restrictions more restrictive than necessary to achieve any legitimate purpose?' We have been studying this matter for some time, and I am frank to say that so far I am not convinced that territorial restrictions are reasonably necessary to any legitimate purpose save for one case, that involving the entry of new firms and/or the introduction of new products. These are commonly associated with relatively high degrees of risk and uncertainty, and it is not unreasonable to suppose that territorial restrictions may be necessary in many of such cases to induce dealers to make the investment necessary to get the manufacturer's new product effectively introduced . . ."

Hearings before the Subcommittee on Antitrust and Monopoly, 89th Congress, pages 1021-22 (of Part 3).