The Real Thing: Special Antitrust Treatment for the Soft Drink Industry

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On July 9, 1980, President Carter signed into law the Soft Drink Interbrand Competition Act, a law “to clarify the circumstances under which territorial provisions in licenses to manufacture, distribute, and sell trademarked soft drink products are lawful under the antitrust laws.” Enactment of the bill concluded eight years of legislative attempts to clarify

SEC. 2. Nothing contained in any antitrust law shall render unlawful the inclusion and enforcement in any trademark licensing contract or agreement, pursuant to which the licensee engages in the manufacture (including manufacture by a sublicensee, agent, or subcontractor), distribution, and sale of a trademarked soft drink product, of provisions granting the licensee the sole and exclusive right to manufacture, distribute, and sell such product in a defined geographic area or limiting the licensee, directly or indirectly, to the manufacture, distribution, and sale of such product only for ultimate resale to consumers within a defined geographic area: Provided, That such product is in substantial and effective competition with other products of the same general class in the relevant market or markets.

SEC. 3. Nothing in this Act shall be construed to legalize the enforcement of provisions described in section 2 of this Act in trademark licensing contracts or agreements described in that section by means of price fixing agreements, horizontal restraints of trade, or group boycotts, if such agreements, restraints, or boycotts would otherwise be unlawful.

SEC. 4. In the case of any proceeding instituted by the United States described in subsection (i) of section 5 of the Clayton Act (relating to suspension of the statute of limitations on the institution of proceedings by the United States) (15 U.S.C. 16(i)) which is pending on the date of enactment of this Act, that subsection shall not apply with respect to any right of action referred to in that subsection based in whole or in part on any matter complained of in that proceeding consisting of the existence or enforcement of any provision described in section 2 of this Act in any trademarked licensing contract or agreement described in that section.


2. Both houses of Congress voted overwhelmingly in favor of the legislation. The Senate passed S. 598 by a vote of 89-3. 126 Cong. Rec. S5437 (daily ed. May 15, 1980). The House passed H.R. 3567 by a vote of 77-34. 126 Cong. Rec. H5548 (daily ed. June 24, 1980). Rep. Hall, the original sponsor of H.R. 3567, was joined by over 300 of his colleagues as cosponsors. After hearings were held on H.R. 3567, the cosponsors moved to discharge the Judiciary Committee from further consideration of the bill. The requisite number of members of the House signed the discharge petition which resulted in the bill being scheduled for immediate floor action despite lack of Judiciary Committee approval. In the meantime, however, the Committee acted on the bill, reporting it out with amendments.
the application of the antitrust laws to the exclusive territorial restraints used in the soft drink industry.4

Generally, the antitrust laws5 are intended to foster competition by prescribing anticompetitive restraints of trade. To determine whether restraints are unlawfully anticompetitive, courts have used either a rule of reason analysis or a per se approach. The rule of reason requires judicial examination of the reasonableness of the restraint in question in light of all relevant circumstances.6 In contrast, the per se analysis presumes that certain types of restraints of trade are illegal without regard to their reasonableness under the particular circumstances.7

The soft drink industry operates under a distribution system that includes vertical territorial restraints. Under this system, the franchisor allocates an area to which the bottler is limited in distributing the trademarked soft drinks. Because the agreement to restrict distribution to a designated area is made between parties at two different levels of the market structure (manufacturing and distribution), the restraint is considered vertical. At various times, vertical restraints have been held to be unlawfully anticompetitive, depending on whether a rule of reason or a per se approach was applied. In Continental T.V., Inc. v. GTE Sylvania, Inc.,8 the Supreme Court made it clear that the rule of reason would apply in determining the legality of vertical restraints. By passing the Soft Drink Interbrand Com-

4. The exclusive territorial allocation system is utilized throughout the industry. Under this system, a soft drink manufacturer licenses a distributor to bottle the trademarked soft drink in a designated territory. The manufacturer agrees to grant that bottler exclusive sale, distribution, and production rights within the territory and the bottler agrees to sell the product only within the territory.
5. "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal." Sherman Act, 15 U.S.C. § 1 (1976).
6. See notes 53-57 and accompanying text infra.
7. See notes 57-61 and accompanying text infra.
petition Act, Congress attempted to clarify further the application of the antitrust laws to the specific vertical restraints used in the soft drink industry.

Although the legislative history suggests that the Act codifies the rule of reason articulated in *Sylvania*, the Act actually sets forth a new standard, one requiring "substantial and effective" interbrand competition, for scrutinizing territorial agreements in the soft drink industry. By mandating a standard which differs from the established rule of reason, Congress has singled out the soft drink industry for unique treatment under the antitrust laws but has failed to give guidance as to what are the precise requirements of the new statute.

I. THE SOFT DRINK INDUSTRY

The soft drink industry operates on a franchise system in which a franchisor, such as the Coca-Cola Company, provides flavoring concentrate or syrup to franchisee bottlers. The bottlers then manufacture, sell, and distribute both bottled and canned soft drinks. There are about 1,700 bottling companies nationwide operating approximately 2,000 bottling plants. Although many of the bottlers are small, local companies, the syrup manufacturers themselves as well as other large national corporations own a number of bottling franchises. The soft drink industry is financially successful and is generally characterized as an oligopoly because the four largest syrup manufacturers, Coca-Cola, PepsiCo, Seven-Up, and Dr. Pepper, control over sixty-eight percent of all soft drink sales.

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13. In his testimony, Mark Silbergeld, Director of the Consumers Union, listed several large companies, including Liggett & Myers, General Tire & Rubber, and Twentieth Century Fox, as holding soft drink franchises. Soft Drink Interbrand Competition Act: Hearings on S. 598 Before the Subcomm. on Antitrust, Monopoly and Business Rights of the Senate Comm. on the Judiciary, 96th Cong., 1st Sess. 213 (1979) [hereinafter cited as S. 598 Hearings] (testimony of Mark Silbergeld).
14. William S. Comanor, former Director of the Bureau of Economics of the Federal Trade Commission, noted that while the average manufacturer's rate of return over the 15-year period between 1963-1977 was 12%, the average rate of return among leading soft drink manufacturers was 21%. S. 598 Hearings, supra note 13, at 92 (testimony of William Comanor).
15. See Lerner, The Economics of Territorial Restrictions in the Soft Drink Industry, 22
The distribution system used throughout the industry grants bottlers the exclusive right to sell a specific brand in their designated territories and prohibits bottlers from selling outside their areas. Bottlers are not, however, precluded from distributing more than one trademarked brand within their given territories, and, in fact, bottlers commonly "piggyback" franchises for one or more additional trademarked brands.

The rationale for the territorial arrangements used in the industry is that, theoretically, they enable bottlers to provide services to a wide variety of customers within their areas because they face no pressure from competing bottlers of the same brand within that region. If a bottler has no intrabrand competition, he is more likely to pursue every sales opportunity within his territory. Encouraging this effective market penetration would then enhance a bottler's ability to compete against bottlers of other brands. Because the territorial agreements limit competition, their legality under the antitrust laws has been questioned. Recently, however, Congress responded to the questions by outlining criteria for determining the legality of territorial restraints in the soft drink industry.

II. LEGISLATIVE DEVELOPMENTS

Legislation to remove the soft drink industry from the coverage of prevailing antitrust standards was first introduced in 1972, one year after the


16. The territorial restrictions used in the soft drink industry originate from the early days of soft drink distribution when the outlook for successfully distributing soft drinks was uncertain. See Lamer, supra note 15, at 151-53.

17. This arrangement between the trademark-owning company and the bottlers constitutes a system of vertical restraints because the agreements are made between persons on different distribution levels. See note 63 infra.


20. In an early case involving the Coca-Cola trademark, Coca-Cola Bottling Co. v. Coca-Cola Co., 269 F. 796 (D. Del. 1920), the court found the increase in the ability of a franchise to build its business on a solid foundation within its territory to be sufficiently valuable to justify the territorial restrictions. Id. at 808-10.

21. In 1972, the prevailing antitrust precedent with respect to vertical restraints was United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967), where the Court set forth a per se approach for certain vertical territorial restraints. The Court in Schwinn held that in cases where a manufacturer has parted with dominion of his product, it is illegal per se for that manufacturer to impose territorial or other restrictions on distributors or retailers. For a discussion of Schwinn, see notes 66-70 infra.

The effect of the Schwinn rule on the bottling industry was explained by the late Senator Hart in his opening statement for the hearings on Exclusive Territorial Allocation legislation
Federal Trade Commission (FTC) found the industry’s use of territorial arrangements to be anticompetitive and in violation of section 5 of the Federal Trade Commission Act. The FTC had issued complaints charging Coca-Cola Company and Pepsico with frustrating and eliminating competition in the distribution and sale of soft drinks by the use of territorial arrangements. The soft drink industry turned to Congress, citing the economic consequences that the FTC action would have for small, local bottlers. Consequently, legislation was introduced to permit territorial restrictions in the industry as long as there was “free and open” competition among different products and their vendors. In varying terms, sub-

by the Subcommittee on Antitrust & Monopoly of the Senate Judiciary Committee. Senator Hart noted the concern of bottlers in light of prevailing law, categorizing the law “as making exclusive territorial arrangements highly vulnerable to attack by the antitrust enforcement agencies.” Exclusive Territorial Allocation Regulation: Hearings on S. 3040, S. 3116, S. 3133, S. 3145 & S. 3587, Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 92d Cong., 2d Sess. 565 (1972).


23. The potential failure of small businesses in the soft drink industry as a result of the FTC order has been one of the arguments most frequently expressed by proponents of the soft drink legislation. Chain supermarkets use a central warehouse system to which goods are delivered and from which they distribute products to the individual stores in the chain. Soft drink bottlers, however, deliver directly to the stores in their territories rather than to central warehouses. See SOFT DRINK INDUSTRY STUDY, supra note 11. If the territorial arrangements were discontinued, the supermarket chains would presumably contract with one bottler to deliver all its soft drinks to the central warehouse rather than continuing with the current system in which each store contracts separately with the bottler in its territory. Small bottlers fear that a large bottler, located closer to a supermarket chain's warehouse, would be awarded the lucrative account. The accounts of other bottlers would then be limited to the less lucrative small stores, gas stations, etc. See SOFT DRINK INDUSTRY STUDY, supra note 11, at 39. “Without exclusive territories, many small bottlers like myself believe that we would lose the 25 to 30 percent of our business we do with chainstores . . . .” S. 598 Hearings, supra note 13, at 14 (statement of Peter Moore, Pepsi-Cola Bottling Co. of Bend, Oregon). See also S. 3040 Hearings, supra note 21, at 621-23 (prepared statement of National Soft Drink Association). Critics of the bills have cited the positive local impact of the legislation and attributed the bills' congressional support to local political pressure. See 12 Nat'l J., 1013 (June 21, 1980).

24. Some legislation offered on behalf of the soft drink industry would also have applied to food retailers. In United States v. Topco Associates, Inc., 405 U.S. 596 (1972), the Court held that the territorial agreements made by Topco, a cooperative food distribution association composed of 25 supermarket chains, were illegal per se. The Court determined that the agreements, made “between competitors at the same level of the market structure,” were horizontal restraints and thus per se illegal under § 1 of the Sherman Act. Id. at 608. The Court's adverse ruling in Topco prompted food retailers to seek legislative relief from the application of certain antitrust laws. The legislative consideration of the antitrust treatment for food retailers is, however, beyond the scope of this Comment. For a general discussion of this area see Gunther, The Supreme Court, 1971 Term, 86 Harv. L. Rev. 1241 (1972); 22 Cath. U.L. Rev. 684 (1973).

25. S. 3133 and similar bills of the 92d Congress sanctioned exclusive territorial franchise arrangements as long as otherwise "free and open" competition existed. Former
sequent bills\textsuperscript{26} embraced the same original goal — to exempt the bottlers' arrangements from \textit{per se} scrutiny by the courts\textsuperscript{27} and to provide a new test for review that would have sanctioned the absence of intrabrand\textsuperscript{28} competition caused by the territorial arrangements.\textsuperscript{29} While representatives of the bottling industry categorized the legislation as "policy guidance" from Congress in response to confusing Supreme Court rulings,\textsuperscript{30} Department of Justice spokesmen consistently referred to the bills as providing unjustified antitrust immunity for soft drink bottlers.\textsuperscript{31} Because of

\addcontentsline{toc}{section}{Assistant Attorney General Thomas E. Kauper described the standard of "free and open" competition as requiring only that there be similar commodities produced by others which compete on the market with the product in question without being hindered by unlawful trade restraints. \textit{S. 3040 Hearings}, supra note 21, at 565.}

26. Beginning in the 92d Congress, dozens of bills were introduced. They each proposed to permit territorial restraints as long as some other antitrust test would be met. \textit{See}, e.g., S. 3133, 92d Cong., 2d Sess. 1 (1972) (free and open competition); S. 978, 93d Cong., 1st Sess. 1 (1973) (substantial and effective competition); H.R. 4978, 94th Cong., 1st Sess. 1 (1975) (no \textit{per se} rule shall be applied under certain circumstances); and H.R. 5340, 94th Cong., 1st Sess. 1 (1975) (rule of reason applies).

27. H.R. 6684, 94th Cong., 2d Sess. 1 (1975), for example, specifically precluded the application of a \textit{per se} test for bottlers. For a discussion of the \textit{per se} rule, see notes 59-62 and accompanying text \textit{infra}.

28. Intrabrand competition in the soft drink industry is competition between bottlers of the same brand, for example, competition between different Coca-Cola bottlers. Interbrand competition is competition between bottlers of different brands, for example, competition between a Coca-Cola bottler and a Pepsi bottler. The legislation would have provided special treatment for intrabrand competition only.

29. A typical license between a bottler and the soft drink manufacturer would make the bottler "sole and exclusive customer and licensee for the purpose of bottling" the trademarked syrup. The bottler may not use the trademarked name "nor bottle nor vend said product except in the territory." \textit{See} Coca-Cola Co., 91 F.T.C. at 517, 521-22. Because these territorial arrangements are absolute, they are considered "airtight," thus precluding any intrabrand competition within the territories. \textit{See} Pitofsky, \textit{The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions}, 78 \textit{COLUM. L. REV.} 1, 8-9 (1978). Critics of the legislation pointed out the severity of the airtight restrictions condoned in the bills and noted that less restrictive arrangements (such as primary responsibility clauses which require a dealer to focus his primary efforts on securing a designated area but do not specifically limit him to that area) might have served the small bottlers' needs for protection equally well. \textit{See} Letter from Alan Parker, Assistant Attorney General, H.R. REP. No. 1118, 96th Cong., 2d Sess. 11 (1980).


31. \textit{Id.} at 299 (statement of Bruce Wilson, Acting Attorney General). Mr. Wilson referred to H.R. 6684 as "special interest legislation" and an "exception" to the antitrust laws. During consideration of soft drink legislation in the 96th Congress, Assistant Attorney General Alan Parker echoed Mr. Wilson's views, claiming that the legislation "represents an effort by special interests to remove themselves from the application of antitrust rules designed to maximize competition and preserve efficiency." H.R. REP. NO. 1118, 96th Cong., 2d Sess. 12-13 (1980).
these differing interpretations of the legislation's effect, the measures prompted considerable controversy, and extensive hearings were held on the various proposals.\textsuperscript{32} In response to what it considered improper FTC complaints against Pepsico and Coca-Cola, Congress in 1975 considered legislative proposals to grant relief to the bottlers. While these measures were pending, however, an FTC Administrative Law Judge dismissed the agency's complaints.\textsuperscript{33} The judge applied the rule of reason test\textsuperscript{34} to the unique facts of the soft drink industry. He found that, although the territorial restraints eliminated intrabrand competition,\textsuperscript{35} the loss to intrabrand competition was outweighed by the legitimate business purpose that the restrictions served — focusing bottlers' attention on what the judge described as "intense" interbrand competition.\textsuperscript{36}

Shortly thereafter, the bottlers received good news when, in \textit{Continental T.V., Inc. v. GTE Sylvania, Inc.},\textsuperscript{37} the Supreme Court abandoned the \textit{per se} approach which the bottlers had been seeking to avoid. \textit{Sylvania} involved a franchise agreement in which distributors of GTE Sylvania products were barred from selling their products from locations other than those provided for in the agreement. Instead of the \textit{per se} analysis, the Court reinstated the rule of reason test for vertical nonprice restraints and

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  \item \textsuperscript{32} See, e.g., \textit{S. 3040 Hearings}, supra note 21; \textit{H.R. 6684 Hearings}, supra note 30; \textit{S. 598 Hearings}, supra note 13.
  \item \textsuperscript{33} Coca-Cola Co., 91 F.T.C. at 523 (initial decision by Administrative Law Judge Joseph P. Dufresne).
  \item \textsuperscript{34} Under the \textit{Schwinn} rule, if the Coca-Cola Co. had parted with dominion over the syrup, the restraints imposed by Coca-Cola would be considered illegal \textit{per se}. Because Coca-Cola had not parted with dominion over its product, the judge held that the \textit{Schwinn} rule did not apply. In addition the judge opined that the \textit{per se} rule of \textit{Schwinn} was not intended "to apply to restrictions imposed incidental to the grant of a trademark license such as the one 'Coca-Cola' and the other national bottlers use." \textit{Id.} at 518. For a discussion of the rule of reason, see notes 54-56 and accompanying text \textit{infra}.
  \item \textsuperscript{35} 91 F.T.C. at 585.
  \item \textsuperscript{36} \textit{Id.} at 548. In finding "intense" competition, Judge Dufresne was persuaded by the large numbers of brands available to consumers. An average of 30-50 different types of soft drinks are generally available in most localities. The judge concluded that "there is intense competition in the sale of carbonated soft drinks which stems from the fact that there is a large number of brands available to the consumer in the local market." \textit{Id.} at 548. Examination of the number of brands alone as a measure of the level of interbrand competition may be misleading, however, because of the practice of "piggybacking." "Piggybacking involves the production and sale by a bottler of soft drink brands trademarked by two or more syrup companies. Each syrup company generally grants the bottler an exclusive territory for its brands." \textit{Id.} at 636. As a result of extensive "piggybacking" in the soft drink industry, many bottlers are multi-brand bottlers. \textit{See} \textit{Katz}, supra note 18, at 266. \textit{See also} Coca-Cola Co., 91 F.T.C. at 637.
  \item \textsuperscript{37} 433 U.S. 36 (1977).
\end{itemize}
overruled its holding in United States v. Arnold, Schwinn & Co.\textsuperscript{38} In \textit{Schwinn} the Court had required the application of a \textit{per se} test to certain vertical restraints.\textsuperscript{39} Notwithstanding that \textit{Sylvania} seemed to operate in the soft drink industry's favor, a subsequent ruling by the Federal Trade Commission set back the bottlers by mandating a rule of reason test for industries entering into nonprice vertical arrangements.

In a two-to-one decision, the full Commission vacated the Administrative Law Judge's dismissal of the original complaints and ordered Coca-Cola and Pepsico to eliminate most of their territorial restraints.\textsuperscript{40} Applying \textit{Sylvania}, the Commission concluded that interbrand competition in the soft drink industry was not sufficient to outweigh the loss of intrabrand competition caused by the system of territorial restraints. The Commission examined the potentially legitimate purposes\textsuperscript{41} of promoting interbrand competition. One of the justifications advanced by Coca-Cola for limiting intrabrand competition was that territorial exclusivity was necessary to encourage bottlers to invest in local price advertising. Coca-Cola claimed that, without the territorial arrangements, a local distributor would be reluctant to spend money on advertising when competing Coca-Cola distributors in that locality would be "free riders," reaping the benefits of his advertising without paying for it.\textsuperscript{42} Although the Commission acknowledged that local price advertising helped stimulate competition, it

\textsuperscript{38} 388 U.S. 365 (1967). In \textit{Schwinn} the Court held that in those cases where the restraint was imposed by a manufacturer after he had parted with dominion and control, the restraint was \textit{per se} illegal.

\textsuperscript{39} 433 U.S. at 58. In \textit{Schwinn} the passage of title from the manufacturer to the distributor was the key factor in determining whether a \textit{per se} or rule of reason approach was required. The \textit{Sylvania} court rejected this distinction, noting that it was "essentially unrelated to any relevant economic impact." \textit{Id.} at 56. "We conclude that the distinction drawn in \textit{Schwinn} between sale and nonsale transactions is not sufficient to justify the application of a \textit{per se} rule in one situation and a rule of reason in the other." \textit{Id.} at 57.

\textsuperscript{40} Coca-Cola Co., 91 F.T.C. at 675. Under the antitrust laws and rules, the procedure for FTC review of trade practices begins with an investigation at the staff level. If the staff issues a complaint, an administrative law judge hears the case and his findings and orders are subject to review by the full Commission. The Commission's orders are then appealable directly to a federal court of appeals. 16 C.F.R § 3.1-.72 (1980).

\textsuperscript{41} The Commission cited \textit{Sylvania}'s justifications for the loss to intrabrand competition that vertical restraints may cause. The restraints may be justifiable if they "promote interbrand competition by inducing capital investment and promotional and service activities by the supplier's customers, by increasing marketing efficiency, and by improving quality control," the Commission stated. Coca-Cola Co., 91 F.T.C. at 626. \textit{See} Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. at 54-55. The Court referred to these factors as "redeeming virtues." \textit{Id.} at 54.

refuted the soft drink industry's use of territories to prevent the "free rider" problem. The Commission pointed out that, unlike the dealers in *Sylvania*, bottlers sell to retailers and not directly to consumers. Thus, the effectiveness of price advertising would be limited to the suggested retail price level.

The Commission then considered whether interbrand competition in the soft drink industry was sufficiently intense to outweigh the absence of intrabrand competition. The Commission focused on the practice of "piggybacking" which enables a single bottler to bottle and sell more than one trademarked brand of soft drink. This practice, according to the Commission, tends to increase the concentration of power in the industry among the few large manufacturers. Because of "piggybacking," a bottler is able to control pricing and market strategies for several different, allegedly competing, brands. The Commission concluded that "piggybacking," coupled with territorial restrictions, shields bottlers from interbrand competition.

Having concluded that the territorial arrangements inhibit both interbrand and intrabrand competition, the Commission ordered Coca-Cola to cease and desist from entering into and maintaining the territorial restrictions.

While judicial review of this adverse ruling was being pursued, the soft drink industry continued to seek legislative action exempting its system of exclusive territorial franchises from unfavorable treatment under the antitrust laws. Because *Sylvania* mandated a rule of reason test for vertical restraints, there was little reason for bottlers to continue to fear the rigidity of the *per se* approach. Thus, the legislative focus turned to defining how

43. Coca-Cola Co., 91 F.T.C. at 630.
44. See note 36 supra.
45. Coca-Cola Co., 91 F.T.C. at 638.
46. The Commission illustrated how piggybacking lessens interbrand competition by quoting a Coca-Cola bottler who decided to piggyback Dr. Pepper: "[W]e would rather compete with ourselves than have somebody else compete with us." 91 F.T.C. at 637.
47. *Id.* at 676. The Commission did allow Coca-Cola to continue using territorial arrangements for the sole purpose of distributing soda in returnable bottles. The Commission concluded that the continued distribution of returnable containers depends on bottlers being able to identify and recapture the bottles within a given area. For these reasons, the Commission declared it "unnecessary to lift restrictions on the sale of Coca-Cola and allied products in refillable bottles." *Id.* at 650.
49. Although the Court rejected the *Schwinn per se* approach, it did "not foreclose the possibility that particular applications of vertical restrictions might justify *per se* prohibition." 433 U.S. at 58. See Louis, *Vertical Distribution Restraints After Sylvania: A Postscript and Comment*, 76 MICH. L. REV. 265 (1977). Louis notes that even under *Sylva-
the rule of reason would apply to the territorial allocations of the soft drink industry. Following extensive discussion of the rule of reason, a final bill emerged which allows territorial restraints as long as there is “substantial and effective” interbrand competition. The Act specifies, however, that its provisions do not legalize traditional per se violations.

A major purpose of the Act is to end the lengthy litigation process which has overshadowed the soft drink industry by clarifying the application of the antitrust laws to territorial franchise agreements. The Act, however, provides little guidance to either the courts or the bottlers because of ambiguities in the Act and inconsistencies in the legislative history.

III. The Act and the Development of the Rule of Reason as Applied to Vertical Restraints

While proponents said the Act attempted to codify the rule of reason, the Act actually sets forth a new test, requiring “substantial and effective” interbrand competition. This test varies the traditional rule of reason by condoning the absence of intrabrand competition caused by exclusive territorial arrangements.

Thus, to understand the test created by this statute, it is necessary to understand the development of the rule of reason and the historical tension between the rule of reason and the per se test in vertical restraint situations.

Because the Sherman Act’s statutory mandate governing anticompetitive business activity is broad, the Supreme Court devised a “rule of reason” test in early antitrust cases. Under this test, only those practices
determined to be unreasonable restraints of trade violate the Sherman Act. Courts found this test difficult to apply. Responding to this problem, the Supreme Court offered a less complex, alternative analysis: the per se rule. Under this test, courts will find certain practices illegal without analyzing their reasonableness. Price fixing and resale price maintenance are examples of restraints of trade that are considered per se illegal because of their severely detrimental effect on competition. Horizontal restraints are agreements made between competitors at the same market level. When competitors at the same level of the market agree to limit or influence trade, all levels of the market are affected. Anticompetitive practices at one level are amplified throughout the market. These horizontal restraints, considered "naked restraints of trade with no purpose except stifling competition," are therefore treated as illegal per se. There was uncertainty, however, as to whether the per se rule was properly applicable to nonprice vertical restraints. These restraints involve agreements

55. See Comanor, supra note 42, at 1419.
56. But courts often found guidance in the now famous quote by Justice Brandeis:
   The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.

Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918).

57. See Comanor, supra note 42, at 1419. See also Bork, The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, 75 YALE L.J. 373 (1966).

[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle . . . avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable. . . .

Id. at 5. See also United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).
59. For a discussion of the types of restraints which require per se treatment, see Maher, On the Path from White to Schwinn to Sylvania to . . . ?, 82 DICK. L. REV. 433, 443-46 (1978).
61. See Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911). For a discussion of the per se illegality of vertical price fixing see, Pitofsky, supra note 29.
made between persons at different levels of the market structure for the purpose of advancing their market position, and they generally have a less destructive impact on competition.63

In *White Motor Co. v. United States*,64 where exclusive territorial and customer restraints in the truck manufacturing business were challenged, the Supreme Court refused to apply the *per se* rule. Justice Douglas, writing for the majority, claimed that the Court did not know enough about the economics of such arrangements to determine whether they had a “pernicious effect on competition” necessitating *per se* treatment, or whether they should be examined within the scope of the more flexible rule of reason.65

A few years later, however, in *United States v. Arnold, Schwinn & Co.*,66 the Court was willing to apply a *per se* rule to certain vertical restraints imposed by the Schwinn bicycle company. In its distribution plan Schwinn had allocated exclusive territories to distributors and confined the distribution of merchandise to franchised dealers.67 The Court held that Schwinn had committed a *per se* violation of the antitrust laws when it sought to restrict and confine areas or persons with whom its products could be traded after Schwinn had parted with dominion and control over those products.68 Citing the ancient rule against restraints on alienation, the Court distinguished and upheld those territorial restrictions and franchising agreements where the manufacturer retained title, dominion, and risk of the product.69 The Court’s use of a seemingly irrelevant factor, the distinction between retaining or parting with dominion as a test for declaring certain vertical restraints illegal *per se*, prompted extensive criticism from legal and economic commentators.70

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63. Vertical restrictions are those restrictions which are imposed among companies or individuals at successive stages of distribution. A common example of vertical restraints is the agreement made between a manufacturer and a distributor or a dealer. *See United States v. Topco Associates, Inc.*, 405 U.S. 596, 608 (1972); Zelik, Stern & Dunfee, *A Rule of Reason Decision Model After Sylvania*, 68 CALIF. L. REV. 13, 15-18 (1980).


65. *Id.* at 263 (quoting Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958)).


67. *Id.* at 371.

68. *Id.* at 379.

69. *Id.* at 380. Under the common law, courts attempt to promote the alienability of property by proscribing restraints on alienation. The *Schwinn* court apparently reasoned that allowing a manufacturer to exercise control over a product after he has parted with ownership of that product would restrict that product’s transferability and thus violate the rule against restraints on alienation.

Subsequently, *Sylvania*\(^7\) provided the Court with an opportunity to respond to the criticism of *Schwinn*\(^7\) and to re-examine the soundness of the *per se* rule in the context of nonprice vertical restrictions. GTE Sylvania, a television manufacturer with a relatively insignificant share of the national market, instituted a franchise plan in which franchisees were limited to selling Sylvania products only from designated locations.\(^7\) The Court rejected the *Schwinn* Court's *per se* analysis and adopted the rule of reason to examine Sylvania's location clauses. The Court balanced the slight reduction of intrabrand competition caused by the restrictions against the increase in interbrand competition.\(^7\) The Court noted that various efficiencies result from the use of location clauses and similar territorial restraints. For example, a manufacturer may use vertical restrictions to encourage distributors "to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products."\(^7\) When a distributor knows that no other distributor in his area will enjoy a "free ride" on his advertising efforts, he is more likely to engage vigorously in advertising activities.\(^7\) Because of potentially positive effects that location agreements may have on stimulating interbrand competition, the Court could not justify application of the *per se* classification required by *Schwinn*.\(^7\) It therefore returned to the rule of reason test for vertical restrictions.\(^7\)

Thus, with the holding in *Sylvania*, the rule of reason became the test for determining the legality of vertical territorial agreements, including those in the soft drink industry. Before passage of the Soft Drink Interbrand Competition Act, therefore, the rule of reason test as expressed in *Sylvania* (1976); *Maher*, *supra* note 59, at 434; Case Comment, *A Rule of Reason for Vertical Restraints*, 12 VAL. L. REV. 179, 188 (1977).

72. *Id.* at 47-49.
73. *Id.* at 38.
74. *Id.* at 54. For a discussion of the balancing test used in *Sylvania*, see Steuer, *Beyond Sylvania: Reason Returns to Vertical Restraints*, 47 ANTITRUST L.J. 1007, 1008 (1978).
75. 433 U.S. 36, 54-55.
76. See Bork, *supra* note 57, at 430-38. See also notes 42-43 and accompanying text *supra*.
77. Justice Powell termed the potentially positive effects of vertical restraints "redeeming virtues" which may justify the otherwise anticompetitive practice. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. at 54.
78. Because Sylvania parted with title to its products, the *Schwinn* rule would have held the location clauses illegal *per se*. *Id.* at 45. The Court specifically overruled *Schwinn*. *Id.* at 58.
79. The Court did not attempt to set forth an interpretation of the rule of reason other than noting the interbrand/intrabrand balancing. The Court referred to Justice Brandeis' oft-quoted formulation of the rule of reason. *Id.* at 49.
governed the franchise agreements in the soft drink bottling industry.\textsuperscript{80}

Whether the territorial restraints would have survived judicial scrutiny under a \textit{Sylvania} rule of reason analysis is not certain.\textsuperscript{81} The issue raised by the Soft Drink Interbrand Competition Act, however, is how the bottlers' distribution will fare under the "substantial and effective competition" test. Unfortunately, the congressional mandate is not altogether clear.\textsuperscript{82}

The Soft Drink Interbrand Competition Act purports simply to codify the \textit{Sylvania} decision.\textsuperscript{83} However, the standard of legality described by reports of both the House and Senate Judiciary Committees modify \textit{Sylvania}'s rule of reason for the soft drink industry by virtually removing from consideration the degree of intrabrand competition in the industry. Instead, the factors to be considered in determining if there is "substantial and effective competition with other products of the same general class in the relevant market or markets" are set forth by the Committees.\textsuperscript{84} The

\textsuperscript{80} In \textit{Tomac, Inc. v. Coca-Cola Co.}, 418 F. Supp. 359 (C.D. Cal. 1976), the court applied the rule of reason test to uphold the territorial allocations of Coca-Cola bottlers in California, even before the Supreme Court ruled in \textit{Sylvania}. \textit{See also} \textit{First Beverages, Inc. v. Royal Crown Cola Co.}, 612 F.2d 1164 (9th Cir. 1980). The court in \textit{First Beverages} upheld the lower court's instruction to the jury that the rule of reason be applied in judging the legality of Royal Crown's exclusive territorial restraints. \textit{Id.} at 1170-71.

\textsuperscript{81} \textit{See First Beverages, Inc. v. Royal Crown Cola Co.}, 612 F.2d 1164, 1170-71 (9th Cir. 1980) (court upheld trial court's finding that Royal Crown's territorial arrangement was valid under rule of reason analysis).

\textsuperscript{82} \textit{See, e.g., Soft Drink Interbrand Competition Act: Hearings on H.R. 3567 Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary, 96th Cong., 1st Sess.} 6 (1979) (testimony of Richard Favretto, Deputy Assistant Attorney General). An initial difficulty encountered in interpreting the legislative intent of the Act is that the House Judiciary Committee report is itself ambiguous — with dissenting views by three members, additional views by thirteen members, and two supplemental views each signed by one member. \textit{H.R. REP. No.} 1118, 96th Cong., 2d Sess. (1980). The additional views signed by 13 members attempt to clarify the purpose of the bill. It provides, however, that to the extent that the additional views differ from the report's other views, the 13 members intend their views to be controlling. Further, the House report discusses the amended bill which became law while the Senate report comments on the original, slightly different, version of the legislation. The amendments to the original H.R. 3567 are discussed in H.R. \textit{REP. No.} 1118, at 18, and are also described by the author of the revisions, Congressman Butler, in 126 \textit{CONG. REC.} H5541-42 (daily ed. June 24, 1980). The Senate concurred with the House amendments and therefore no conference committee convened to discuss and resolve the differences between the two bills.

\textsuperscript{83} \textit{But see S.598 Hearings, supra} note 13, at 211 (testimony of Eleanor Fox): "I believe the Bill is intended to be much more receptive to the restraint than is \textit{Sylvania}.

\textsuperscript{84} \textit{S. REP. No.} 645, 96th Cong., 2d Sess. 10-11 (1979); \textit{H.R. REP. No.} 1118, 96th Cong., 2d Sess. 5-6 (1980). Senators Metzenbaum and Kennedy question whether any genuine inquiry is intended or whether the language of the bill reflects an automatic judgment that the territorial restraints do promote substantial and effective interbrand competition. \textit{See S. REP. No.} 645, 96th Cong., 2d Sess. 22 (1980) (minority views). \textit{See also S. 598 Hearings,
factors for consideration under a substantial and effective competition test focus on the components of interbrand competition, including:

- the number of brands and types of flavors of available soft drinks;
- the persistence of long-run anticompetitive profits;
- the number of retail price options available to consumers;
- the existence of inefficiency and waste;
- the degree of service;
- ease of entry into the market;
- the number and strength of sellers of directly competing products in a relevant market; and
- the availability of various forms of containers or packaging.85

These factors are useful indicia in determining interbrand competition, but they do not require consideration of competition among bottlers of the same brand. Only if interbrand competition is shown to be insubstantial will an inquiry into intrabrand competition become necessary.86 In contrast, the rule of reason discussed in Sylvania and prior cases requires consideration of “all of the circumstances of a case,”87 including both the intrabrand harm and the interbrand benefit.88 In Eiberger v. Sony Corp. of America,89 a post-Sylvania case involving the legality of territorial restraints imposed by Sony, the court applied the rule of reason test by examining the effect that the territorial allocations had on both intrabrand and interbrand competition. The Sony distribution scheme in question was enforced through a system of warranty fees through which the dealer in territory A, for example, would be able to detect whether the dealer in neighboring territory B or C was selling in territory A.90 The court noted that this territorial distribution system operated to eliminate intrabrand competition altogether. Further, the court found significant the fact that Sony's standing in the relevant market was high, Sony being “one of the
principal sellers dominating an oligopolistic market." In light of the damage to intrabrand competition and Sony's high market share, the court held the territorial restraints to be illegal.

In another post- *Sylvania* case, *Donald B. Rice Tire Co. v. Michelin Tire Corp.*, the court upheld the vertical restriction but applied a similarly thorough test of reasonableness. The dealer sales agreement in *Rice* contained a location clause and also prohibited dealers from selling wholesale to other unauthorized dealers. The court began its analysis by noting that *Sylvania* demanded an examination of "[t]he economic rationales underlying these restraints as well as the evidence presented concerning actual competitive consequences. . . ." The court found that the restraints were reasonably necessary for Michelin to eliminate the free rider advertising problem and to ensure that specialized services be provided.

The court did not, however, conclude its analysis at this point. It proceeded to scrutinize the detrimental effect that the restraints had on intrabrand competition, noting that "the rule of reason standard requires an assessment of the potential detriment to intrabrand competition of the challenged restraints." The court found that Michelin had in fact taken steps to increase intrabrand competition by increasing the number of outlets and dismantling the geographic allocation system. Because the restraints were reasonably necessary to meet interbrand competition, and because they did not adversely affect intrabrand competition, the court found them to be valid under the antitrust laws.

Unlike the courts in *Eiberger* and *Rice*, a court applying the Soft Drink Interbrand Competition Act will not consider the loss to intrabrand competition in light of market share standing and other relevant factors. Only after interbrand competition is shown to be insignificant will there be any discussion of intrabrand competition.

The Act's departure from the *Sylvania* rule of reason test is further apparent in congressional criticism of the Commission Opinion by the FTC in the Coca-Cola and Pepsico cases. In those cases, the Commission purported to follow *Sylvania*'s mandate under the rule of reason, but proponents of the legislation claimed that the Commission had unduly relied on

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91. *Id.* at 1284. The Court determined that Sony's market share in the relevant market (dictation equipment) was over 12%. *Id.* at 1283.
92. "The damage to intrabrand competition far outweighs any benefits which may have accrued to interbrand competition as a result of the program." *Id.* at 1284.
94. *Id.* at 753.
95. *Id.* at 760.
the loss to intrabrand competition caused by the territorial restrictions without adequate consideration of the interbrand competition in the industry. The Commission, rightly or wrongly, did specifically conclude that competition among competing brands of soft drinks had been seriously impaired by the vertical restraints. Congress, however, has implied a contrary conclusion and has devised a standard of legality under which it expects the territorial restrictions to be upheld. Further, the legislative standard ignores the caveat in *Sylvania* that some vertical restraints still require *per se* scrutiny.

Although the Court specifically rejected *Schwinn*’s reliance on parting with dominion as determinative of the applicability of a *per se* rule, the Court allowed for application of a *per se* rule when warranted by “demonstrable economic effect.” This reservation echoes the early cases which explained the need for a *per se* rule where the effect of the restraint on competition was highly detrimental. As discussed earlier, courts have categorized as illegal *per se* those practices that greatly restrict competition with little or no redeeming value to the economy.

Some of the characteristics which may, even under *Sylvania*, subject a particular restraint to *per se* scrutiny, such as high concentration and high level of product differentiation, can be found in the soft drink industry.

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97. In view of some of the oligopolistic characteristics of the soft drink industry, the Commission’s conclusion that there is little interbrand competition is not necessarily incorrect. *See Katz, supra note 18; Mongoven, supra note 15; Mueller, Franchising and the Antitrust Laws: The “Territorial” Problem, 9 ANTITRUST L. & ECON. REV. 59, 71 (1977).*

98. Coca-Cola Co., 91 FTC at 640.

99. The additional views contained in the House Judiciary Committee report suggest that the majority of the committee members believe that the industry’s practices already meet the test of competition in the Act. *See H.R. REP. NO. 1118, 96th Cong., 2d Sess. 18* (1980) (additional views).

100. *See 433 U.S. at 58. See note 49 supra.*

101. *See Zelek, Stern & Dunfee, supra note 63, at 68. Even after *Sylvania,* a test of presumptive illegality under which certain restraints, while not considered illegal *per se,* are presumed illegal, may be appropriate. The authors contend that this test of presumptive illegality is applicable “if concentration, product differentiation, and entry barriers in the relevant market are all high . . . [and] more specifically, if the concentration level is such that four firms command fifty percent of the relevant market . . . [and] the defendant supplier is one of the four largest firms.” *Id.* at 34. The soft drink industry may fit into this test for presumptive illegality. *See Steuer, supra note 74, at 1012, for a discussion of the possible development of a presumptive illegality test.*


103. *See notes 57-61 supra.*

104. In his concurring opinion in *Sylvania,* Justice White explains why he would not
First, as has been previously indicated, four major soft drink companies control a sizable share of nationwide sales. Thus, the nature of the companies benefiting from the restraints here differs significantly from the company seeking protection in Sylvania. GTE Sylvania was a small company seeking to establish a position in a highly competitive business, whereas Coca-Cola and Pepsico cannot be characterized as small firms seeking to enter the market. Further, each of the four major firms issues franchises for several different flavors and brands of soft drinks. As a result, even though there may be over 100 different brands of carbonated soft drinks in a particular area, a large percentage of these brands are manufactured by Coca-Cola, Pepsico, Dr. Pepper, or Seven Up.

Second, substantial product differentiation exists in the soft drink market: that is, consumers have a strongly established preference for a particular brand of soda. Extensive advertising in the industry has effectively given certain soft drinks a unique identity so that consumers consistently buy a favorite brand of beverage rather than even consider substituting any competing brands. In markets where the level of product differentiation is substantial, interbrand competition tends to be less intense and any other restraints on competition may be suspect.

Finally, the territorial restraints themselves may be of questionable utility in light of changes in transportation modes and population patterns. For this reason some economic commentators have labeled the industry as inefficient. Thus, the very efficiency and flexibility which the antitrust laws are designed to promote may be undermined by statutorily sanctioning a possibly outdated and inefficient distribution system.

Application of the statute's test may require consideration of these fac-
tors in determining whether interbrand competition is substantial and effective. The legislative history does suggest that the courts should consider a number of the components of interbrand competition, such as the number of brands and flavors and the degree of inefficiency. But because the statute contemplates examination of the importance of intrabrand competition only after a court finds inadequate interbrand competition, there is a danger that the rule of reason's careful balancing and analysis of "all relevant factors" will be replaced by a less thorough test.

IV. Conclusion

The Soft Drink Interbrand Competition Act was purportedly enacted to codify the rule of reason and, thus, to remove the question of the legality of the soft drink industry's territorial arrangements from the courts. But Congress' "substantial and effective competition" test actually alters the rule of reason by essentially removing intrabrand competition from the factors for determining the reasonableness of a restraint. The present statutory test is ambiguous and confuses, rather than clarifies, an already difficult area of the law.

If Congress truly intended to ensure that the rule of reason would be applied to territorial agreements in the soft drink industry, it could have easily left the question to the courts which, following Sylvania, are now required to apply the rule of reason to vertical agreements. Even if the FTC applied the rule of reason incorrectly, as some members of Congress contend it had, the soft drink industry still had recourse to the United States Court of Appeals, where the case is still pending. In light of the legislation, however, the FTC has asked the Court of Appeals to set aside the Coca-Cola case and remand it to the FTC for dismissal. This action would effectively preclude a review of the industry under a rule of reason test. Were it not for the Soft Drink Interbrand Competition Act, the Court of Appeals for the District of Columbia Circuit would be bound by the rule of reason as articulated by Sylvania. Under this test, the soft drink industry's practice would have been scrutinized both as to the interbrand benefit and the intrabrand harm resulting from the restraints.

Now, however, even if it continues consideration of the case, the Court of Appeals will be bound by the more limited "substantial and effective competition" test under which the components of interbrand competition are key. If the court looks for guidance to define "substantial and effective competition," however, it will find that Congress' expressed intent is incon-

sistent with the new test. Under the rule of reason which the Act attempts to embody, all relevant factors, including intrabrand competition, the business' relevant market share, and the degree of product differentiation would be examined. In light of the oligopolistic nature of the soft drink industry and the extent of product differentiation, the territorial restraints, which totally eliminate intrabrand competition, may be questionable under a rule of reason analysis. Congress, however, presumed that interbrand competition in the soft drink industry is vigorous and should be enough alone to remove the industry from further scrutiny. The rule of reason offers a more flexible approach to the difficult antitrust analysis and it should not be abandoned in favor of a more narrow review. By narrowing the focus of the rule of reason, Congress has set forth a test approximating presumptive legality in the soft drink industry. Congress expects the soft drink territorial arrangements to be upheld under the new Act. This special treatment for one industry confuses existing law and may set a bad precedent for future cases. It is unfortunate that Congress has removed the opportunity for a full and thorough rule of reason analysis of the soft drink industry's exclusive territorial allocations.

Agnes Pek Dover