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# DISTRIBUTION PROBLEMS AFFECTING SMALL BUSINESS

GOVERNMENT  
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## HEARINGS BEFORE THE SUBCOMMITTEE ON ANTITRUST AND MONOPOLY OF THE SUBCOMMITTEE ON THE JUDICIARY UNITED STATES SENATE EIGHTY-NINTH CONGRESS

SECOND SESSION

PURSUANT TO

**S. Res. 191**

**PART 3**

ON

**S. 2549**



TO AMEND THE SHERMAN ANTITRUST ACT TO PROVIDE THAT EXCLUSIVE TERRITORIAL FRANCHISES, UNDER LIMITED CIRCUMSTANCES, SHALL NOT BE DEEMED A RESTRAINT OF TRADE OR COMMERCE OR A MONOPOLY OR ATTEMPT TO MONOPOLIZE, AND FOR OTHER PURPOSES

JUNE 21, 22, 23, AND 27, 1966

Printed for the use of the Committee on the Judiciary



# THE HISTORY OF THE

# ROYAL NAVY

# FROM THE EARLIEST TIMES TO THE PRESENT

BY

ADMIRAL LORD ALBERT TOWNSEND

OF THE BARRONS

IN TWO VOLUMES

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HEARINGS

BEFORE THE

SUBCOMMITTEE ON ANTITRUST AND MONOPOLY

OF THE

COMMITTEE ON THE JUDICIARY

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# DISTRIBUTION PROBLEMS AFFECTING SMALL BUSINESS

## (Exclusive Territorial Franchise Bill)

TUESDAY, JUNE 21, 1966

U.S. SENATE,  
SUBCOMMITTEE ON ANTITRUST AND MONOPOLY  
OF THE COMMITTEE ON THE JUDICIARY,  
*Washington, D.C.*

The subcommittee met, pursuant to recess, at 10:05 a.m. in room 1114, New Senate Office Building, Senator Hiram L. Fong presiding.

Present: Senators Fong and Hruska.

Also present: S. Jerry Cohen, staff director and chief counsel; Horace L. Flurry, general counsel; Charles E. Bangert, assistant counsel; Peter N. Chumbris, chief counsel for minority; James Schultz, minority counsel; Gladys E. Montier, clerk, and Patricia Bario, editorial director.

Senator FONG. Will the subcommittee please come to order?

Senator Hart, who is chairman of the subcommittee, has been unavoidably detained this morning and has asked me to act as chairman for today's hearing.

The hearings are on S. 2549, the so-called exclusive territorial franchise bill.

(S. 2549 follows:)

[S. 2549, 89th Cong., 1st sess.]

▲ **BILL** To amend the Sherman Antitrust Act (15 U.S.C. 1 et seq.) to provide that exclusive territorial franchises, under limited circumstances, shall not be deemed a restraint of trade or commerce or a monopoly or attempt to monopolize, and for other purposes

*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 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."

Senator FONG. We have had requests from many people to be heard on this proposal and we will be most interested in following the testimony. Today we will hear from representatives of various tobacco distributors and manufacturers.

The three witnesses who are listed on the witness list are accompanied by 16 other witnesses who desire to make a brief presentation. We have agreed that we will hear as many as possible by the hour of 12:30.

We are happy to have Senator Joseph Montoya here this morning to lead off as first witness.

Senator, you may proceed. Happy to have you here.

**STATEMENT OF HON. JOSEPH M. MONTOYA, A U.S. SENATOR FROM  
THE STATE OF NEW MEXICO**

Senator MONTOYA. Thank you, Mr. Chairman.

I certainly appreciate the courtesy extended to me by the subcommittee. I came here merely to present a constituent of mine from Albuquerque, Mr. Thomas D. Pickett who is the vice president of the Ponca Wholesale Mercantile Co., in Amarillo, Tex., which company serves New Mexico, Texas, Arizona, and Colorado.

Mr. Pickett is also president of the Rocky Mountain Wholesale Co., and he is national president of the Young Executive Division of the National Association of Tobacco Distributors.

He is still a resident of New Mexico, although he was called into the State of Texas and it is very unusual for people from the State of New Mexico to move to the State of Texas, Mr. Chairman. Usually it is the other way around.

Senator FONG. I thought they usually came to Hawaii.

Senator MONTOYA. Because of the climate and because of economic opportunity. And we welcome these Texans into New Mexico and we have a slight resentment when they take our New Mexico boys into Texas.

But Mr. Pickett is very knowledgeable on this subject from the practical end and I want to say that he is a young man who has carved for himself a bright career in New Mexico and has been in this business for a long time and has enjoyed great success. I want to present him to this committee, Mr. Chairman, and at the same time thank you for giving us this opportunity.

Senator FONG. Thank you, Senator.

Mr. Pickett, with that fine introduction, you may proceed.

**STATEMENT OF THOMAS D. PICKETT, VICE PRESIDENT, PONCA  
WHOLESALE MERCANTILE CO., AMARILLO, TEX.**

Mr. PICKETT. First let me thank you very much for those fine words.

My name is Thomas D. Pickett. I am vice president of the Ponca Wholesale Mercantile Co., of Amarillo, Tex. We are the base of operation for a far-flung distributive network encompassing New Mexico, Colorado, a great portion of Texas and Arizona. By virtue of employing a sizable sales force, a large inside staff and maintaining a huge inventory of consumer product lines, we are able to sell and service thousands of retail outlets throughout the Southwestern part of the United States.

Geographically, our area epitomizes typical America. We operate in urban cities, rural areas, hamlets, villages, and what is sometimes referred to as "the backwoods." We employ a dual method of distribution—that of advance salesmen who solicit orders to be delivered by our own trucks—and driver-salesmen, where the order is taken and delivered on the spot.

In some of the not easily accessible areas, we are the primary suppliers to the retail merchant. He is dependent on us to assure him an uninterrupted flow of tobacco, confectionary, and kindred products, generally, but he is also counting on us to keep him abreast of merchandising trends, marketing developments, and, significantly, with new products, new packings, and new promotions.

It would be wholly unsound and unbusinesslike for us to canvass, call, and deliver to a vast number of these small entrepreneurs who courageously exercise their initiative to engage in business, unless we serve as a catalyst for the manufacturer of a new or exclusive product which was entrusted to us for distribution and exposure.

This technique serves a tripartite purpose. It enables the merchant to retain and enjoy the patronage of his customer. It enables the salesman to earn a livelihood. It enables the firm to enjoy a prestige without which its security is placed in jeopardy.

Is this system conducive to our economy generally? I do not believe that it is open to argument for the following reasons:

- (a) We are the wealthiest nation in the world.
- (b) We are the most powerful nation in the world.
- (c) We enjoy the highest standard of living in the world.
- (d) We have more ready access to numerous assortments of life's luxuries and necessities than any other people in the world.
- (e) The consumer is king and concurrently the principal beneficiary of the entire economic spectrum.

Every unit of production, from forest, farm, mine, and industry is in every way related to processing and manufacturing goods for the consumption of the consumer. The franchise method of distribution accords with this fundamental philosophy of the American distributive system.

That is the end of my statement and I thank you very much for the opportunity of appearing before you this morning.

Senator FONG. Mr. Pickett, you are a wholesaler; is that correct?

Mr. PICKETT. Yes, sir; that is correct.

Senator FONG. And then you represent quite a few companies that do business with you?

Mr. PICKETT. Yes sir.

Senator FONG. Then you, in turn, have franchisees?

Mr. PICKETT. Well, we have some arrangements on cigars and this type of thing at the present time.

Senator FONG. And these people represent you exclusively, many of them?

Mr. PICKETT. I am sorry; I don't understand.

Senator FONG. You are the franchisee here.

Mr. PICKETT. That is right.

Senator FONG. And then you distribute to whomever wishes to deal with you?

Mr. PICKETT. Retail; that is right; yes.

Senator FONG. You are speaking from the standpoint of the franchisee?

Mr. PICKETT. That is right.

Senator FONG. What products do you represent?

Mr. PICKETT. Well, in our case we have various cigar manufacturers that we distribute for in the area which we cover.

Senator FONG. Would it be all right for you to give us an idea as to the size of your business?

Mr. PICKETT. Well——

Senator FONG. Would you rather not tell us?

Mr. PICKETT. We do about \$40 million a year.

Senator FONG. How much?

Mr. PICKETT. About \$40 million in sales.

Senator FONG. Forty million a year?

Mr. PICKETT. Yes.

Senator FONG. And you have the franchise for the States of New Mexico, Colorado, and a great portion of Texas, is that right?

Mr. PICKETT. Not in all instances; no, sir.

In other words, we do not have one franchise that covers the entire area in which we operate. It might cover a portion of an area. In no case do we have one item for the entire area in which we operate.

Senator FONG. Is this primarily in tobacco?

Mr. PICKETT. No; we sell tobacco, cigarettes, cigars, candy, sundry merchandise, many different types of merchandise.

Senator FONG. And you are the only franchisee within this area?

Mr. PICKETT. Oh, no, sir. No, no. In other words, we might have a franchise for a part of Texas, part of New Mexico, part of Arizona, and there are other franchise distributors in the same area from which we operate that will represent a different brand of cigars, for instance.

Senator FONG. In your experience, has this system worked well with the distribution of goods?

Mr. PICKETT. Yes. Extremely so. In fact, I think that without this system it would be very difficult for both ourselves and for the manufacturers that we represent and other people represent.

Senator FONG. And has this system kept other tobacco products from entering the market, candy and things like that?

Mr. PICKETT. No. I think it encourages more new products in the market than would be conversely true.

Senator FONG. Thank you very much.

Mr. PICKETT. Than you very much, gentlemen.

Senator FONG. I am very happy to have with us my colleague in the Congress, Mr. Phillip Burton, whom I have known for a very, very long time, who comes from that very populous district, San Francisco. I understand he is here to introduce a very good friend, Mr. Marcus Glaser, whom I met just a few minutes ago.

Congressman Burton?

#### STATEMENT OF HON. PHILLIP BURTON, A U.S. REPRESENTATIVE FROM THE FIFTH DISTRICT OF CALIFORNIA

Mr. BURTON. Thank you very much for your kind words, Senator.

I am very grateful that you reside in Hawaii rather than my city of San Francisco, for I am afraid I wouldn't be able to continue in office if you cast your eyes on the seat I happen to hold in Congress.

Mr. Chairman and members of the committee, I would like to introduce to you Mr. Marcus Glaser who is a personal friend of mine. Mr. Glaser is one of the outstanding business and civic leaders not only in our city of San Francisco but in the entire State of California.

Mr. Glaser is the largest franchise distributor in the Western United States and I believe he is the largest cigar distributor of cigars in the Nation. He is the chairman of the board and chief executive officer of Glaser Bros. which is located in the city of San Francisco.

He has spent a great deal of time preparing what I am sure will be most useful and interesting testimony for the committee, and I appreciate this opportunity to introduce to you and the staff and the committee members Mr. Glaser of San Francisco.

Senator FONG. Thank you for coming before this committee, Congressman Burton.

**STATEMENT OF MARCUS GLASER, CHAIRMAN OF THE BOARD,  
GLASER BROS., SAN FRANCISCO, CALIF.**

Senator FONG. Mr. Glaser, you may proceed any way you wish.

Mr. GLASER. Thank you, sir.

Gentlemen, members, ladies, I have an oral statement to back up my written statement.

Senator FONG. If you wish, we may accept the statement as it is given and you could highlight it if you wish.

Mr. GLASER. This is rather highlighting it.

I am Marcus Glaser, chairman of the board, chief executive officer of Glaser Bros., which has been in business 78 years, the largest wholesale distributor of tobacco products on the west coast.

We cover an eight-State territory ranging from the Canadian border to the Mexican line. Our business is essentially a system of separate jobbing houses, located throughout the territory, none of which necessarily dominates the sales volume in any major market area.

Most of my discussion today about exclusive territorial franchises will be directed toward the cigar business and the cigar industry, although it has application to other tobacco products. It is also applied to the candy business. Cigarettes are not sold nor could they be very well on a franchise basis, due to many factors involved that will be not necessarily relevant to the committee.

I plan to limit my comments to 10 minutes so I will just keep on this track.

I strongly urge the enactment of the legislation, S. 2549, with the suggested changes submitted in my written statement. Clarifying legislation is urgently needed to reduce the turmoil in the marketing of franchise tobacco products. In my written statement I have discussed the marketing structure of the tobacco industry and the role of the wholesaler. Without going into detail, let me state for purposes of my oral presentation that I would like to make a point and give you two definitions. The point is that the effective distribution of tobacco products is dependent upon the maintenance of strong independent wholesalers, both franchised distributors and jobbers. Definition—a "franchised distributor" is a wholesaler who must invest the necessary time, money, and effort to make the franchised product a significant factor in the market and who must render services to

the retail outlets at all distributing levels. The "jobber" is a wholesaler without the obligations and responsibilities of a franchised distributor who provides distribution services to a limited segment of the market as contrasted with the franchised distributor who must saturate the market.

The franchised distributor performs vital functions in the distribution of cigars. The franchised distributor is the most effective channel of distribution for the broad-based distribution permitting the manufacturer's product to get to the many small independent shopkeepers who may operate a drug store, grocery store, gas station, liquor store, anything else that you might call it, a restaurant or a bar.

The franchise distributor renders numerous services to these retail outlets, including furnishing display racks, proper storage of merchandise, advance of credit, frequent delivery of small supplies of fresh merchandise, and the replacement of dry merchandise. Later on, this becomes quite a factor.

It is the distributor who introduces the new and competitive product to the market. The franchise distributor also aids the manufacturer in performing many of the selling functions for him. The distributor's salesmen call upon each of the million-and-a-half retail outlets throughout this country to make the products of the manufacturers available to the retailers. Part of that selling function is the warehousing and storage of the merchandise for the manufacturer, so that the goods will be readily available at all retail levels.

In addition, the activities of the distributor permit the advantages of large shipments, permit the lower effective cost of shipping and reduction of paper work that would otherwise be necessary at the national level from manufacturers themselves. Without the wholesaler's services, the manufacturer only would be able to afford to sell most of the large- and medium-sized buyers or would be required to set up his own distribution at a much greater cost.

For instance, in our territory there are 60,000 outlets handling tobacco products. We cover 40,000 of these outlets sometime within a 40-day period. No manufacturer could hire enough salesmen in 554,000 square miles that we cover to effectively cover the distribution and give the services to the small dealer. The present uncertainty in the antitrust laws have permitted the large manufacturers to control the wholesaler level of distribution because the manufacturers who seemingly want to give an exclusive territorial franchise to a wholesaler says the antitrust laws do not permit protection of territorial franchises. Those manufacturers who grant franchises to a distributor like Glaser Brothers who services the manufacturers say—and I believe they say it in good faith—that it may violate the antitrust laws to enforce territorial franchises. I ask you, what is a franchise worth that the manufacturer can't protect? Even when an exclusive franchise is granted, the manufacturer in many instances also will insist on reserving the right to sell directly to the chains at the same prices as the franchised distributor gets, and the chains perform none of the services to the small stores that the franchised distributor performs. These little retailers compete with these chains at a higher wholesale price than these big buyers pay. This inequality helps some of the manufacturers and the large buyers, but it is destroying the small retailer and the large and small independent franchise distributors and jobbers. For example—the California State Board of Equalization

published figures of 1954 showing that there were 22,000 retail outlets without counting the little restaurants, hamburger stands, in Los Angeles County. In 1965, with over twice the population, there are only 14,000 small stores.

You who live in the East, if I may digress here very pointedly, look at cigarstores all around you. They are here because the streets have a large foot traffic and they can afford to do business. In the West, there are no cigar stores of any amount to speak of. In the whole city of Los Angeles, a city of over 4 million people, there are only about 15 cigar stores, real cigar stores. That is all. The rest of the business is done either through drug stores, liquor stores, chains, or such.

If legislation were enacted allowing legally enforceable exclusive territorial franchise agreements, a more healthy competitive situation in the tobacco industry would be promoted in the following ways:

One: the small retailer would be strengthened in his ability to compete with the large volume stores.

Two: an exclusive territorial franchise would help discourage the dual distribution system used by most manufacturers which has the effect of driving the independent wholesaler and the small retailer out of business.

Example: In many cities of the country, a company, for instance, in our city of Los Angeles, two of the companies have their own distributing houses selling their own product which is comparable to the product they give me under another name. This is true for every factory in the business. If there were enforceable exclusive franchise, territorial franchises, there would be greater interbrand competition because more small businessmen would be willing and able to go into the distribution of franchise items to compete for the business of the small, as well as the large, retailer.

There is no incentive for the small jobber to want to become a franchise distributor because he can be eaten up by many factors that are in this nonenforcement of the franchise territory.

Legislation clarifying the validity of enforceable exclusive territorial franchises not only would promote competition in the tobacco industry, but it would be of great assistance in permitting franchise distributors to create a business with some value in the nature of good will that could be sold at the time of the businessman's death or retirement.

Example: There have been instances within the last year or two where two or three old-line jobbing houses sold out. None of them, not one of them, gentlemen, got dollar for dollar on their book assets. None of them got any payment for goodwill. And I think most of them sold, though I don't know the prices, but from what rumor tells me, most of them sold at a loss.

This is one of the problems because there is one thing that a distributor has not. He has not anything he owns. He has not anything he owns, but he spends his lifetime working for it. He controls nothing. Though he spends his energy, his time and his money and is remunerated, yes, by financial success if he is a good operator, but he owns nothing and controls nothing.

An enforceable exclusive territorial franchise agreement would assist the franchise distributor in preserving his sales from the destructive activities of the parasitic tobacco transshippers, bootleggers—I don't know what word you call them. But they are within the legal

rights, not certainly within the moral right, of going into other territories where they have no responsibility except to see how much they can sell and how much they can take out.

Senator FONG. Mr. Glaser, you have used the words "jobber, distributor, franchise, owner." Will you please define these terms. You have defined them but I have not been able to follow you.

Is a jobber—

Mr. GLASER. As a jobber—I perform two functions. I am both a franchised distributor and a jobber. As a franchised distributor, I am responsible, or Glaser Brothers, pardon me, sir Glaser Brothers is responsible for the franchise.

Senator FONG. First, are you a franchisee also?

Mr. GLASER. I am a franchisee.

Senator FONG. You represent a manufacturer?

Mr. GLASER. I represent the manufacturer.

Senator FONG. Who gives you a franchise?

Mr. GLASER. Yes.

Senator FONG. So you are a franchisee?

Mr. GLASER. Yes.

Senator FONG. And you are a franchise owner?

Mr. GLASER. Yes, sir.

Senator FONG. And you are a distributor?

Mr. GLASER. Yes; and a jobber.

Senator FONG. You consider yourself a jobber?

Mr. GLASER. Also.

Senator FONG. Now, from there will you relate what the other people are who help you in the distribution of this product?

Mr. GLASER. The jobber is the wholesaler who buys both from the manufacturer and from the franchise holder and distributes his merchandise to the accounts that he sells to. In other words. I sell to jobbers. I sell to retailers. Any jobber can buy from me. Any retailer can buy from me. And we are both fighting for the same man's business.

The only thing that happens is that because the jobber's costs of doing business are less than mine, not having the responsibility of working the small store for the franchises, the jobber who buys from me in many cases can undersell me even though I sell it to him, and he does this in many cases.

Senator FONG. How does he do that?

Mr. GLASER. Well, we have a discount setup. If a man buys 300 cigars he gets 2 percent. If he buys 1,000, he gets 5 percent. If he buys 1,500, he gets 5 and 2. Now we sell to the jobbers at 7 and 2. They, in turn, can go into a retail store and sell a man off at any price they want. There is no standard price. They can take an account away and give the man 5 percent on one box if that is their policy and I can't stop it, and I won't refuse to sell them and I do sell them.

Is that clear, sir?

Senator FONG. Yes.

Mr. GLASER. It becomes a little confusing, to say the least.

This transshipper and this parasitic bootlegger that I talk about has become the evil of the industry. This is why we need so badly the territorial protection.

For example, a concern in New York will buy a brand of ours—I will name the brand to clarify the problem. I have no illusions about it. The brand is called Roi-Tans which is a 10-cent cigar, and even though I sell at 7 and 2, he will come out and for 1 percent he will ship across country to large buyers, large chainstores, and sell them at 10 off to take their business away from me, taking away the profit that I would get at a fair price from the distributor or the large chain for 1 percent.

Now, this doesn't mean anything to the consumer. Nothing. Even if it was 2-percent discount, it wouldn't mean anything because you boil it down to numbers and it looks like this. If a man bought a thousand dollars worth of Roi-Tans, a thousand dollars worth at \$80 a thousand would be 12,500 cigars. If he got 2 percent more than I gave him, it would be \$20. He couldn't give away a penny a box. It would be \$125, a penny a cigar to the retailer. A penny a cigar, would be \$125. So all that happens is that the large chainstore or the large buyer or somebody else who buys from this man makes an extra \$20. That is all that happens. And I have lost a profit from this transaction that helps me stay in business and helps me render service.

Senator FONG. You are a franchise owner and a franchise distributor?

Mr. GLASER. Yes.

Senator FONG. You distribute franchises?

Mr. GLASER. Yes.

Senator FONG. Who gets the franchise? Jobbers, too? Distributors?

Mr. GLASER. I don't know whether I understand what—who gets this franchise?

Senator FONG. You have a franchise.

Mr. GLASER. Yes.

Senator FONG. From the manufacturer.

Mr. GLASER. Yes, sir.

Senator FONG. You in turn give franchises out?

Mr. GLASER. No. We just sell it openly. There is no such thing as giving out a franchise as everybody is entitled to buy. There can be no selling restrictions in the cigar business; this is why the cigar and candy business is different than every other business that I have known. In the cigar business and in the candy business, especially where the depth of distribution goes into the small outlet, every piece of coverage is necessary. For example, we have jobbers in Los Angeles that do as much volume in the city of Los Angeles as I do but I sell them. We also sell a big supply house that has 10 or 15 peddling trucks and they go out and sell to the trade.

The idea is coverage. The idea is to see that the legitimate channels of distribution are covered with exact pinpoint because a 5-cent and 10-cent cigar require—on the basis of cigarette distributions—require 75 percent coverage in the retail outlets. Seventy-five percent. Without this, you cannot extract the volume.

Senator FONG. And none of your jobbers, none of your retailers, are franchisees?

Mr. GLASER. No; they are not my franchisees.

Senator FONG. You are the franchisee?

Mr. GLASER. Yes, sir. This is—I said I would try to make it short. I have the rest of this page here. The foregoing has been a thumb-

nail sketch of the problems of the independent franchise distributor and the small manufacturer and the retail outlets. And I want to stress on this for just a moment.

Without the franchise distributor, without him, without the protection of territorial franchises, without the protection of real territory, the small manufacturer can't exist and the proof of this is that there are now 388 manufacturers where there were 1,700 just a few short years ago, 8 short years ago.

More and more, unless a small manufacturer can offer protection to his territory, he is at a disadvantage. You have an ideal situation, Senator, you are in Hawaii. Nobody can tranship over there. The costs will not allow it. But with the ICL rate from New York to the west coast being almost equal to the carload price, there is not very much difference. We are directly in competition with everybody in the United States.

Senator FONG. In other words, any of these people could invade your territory?

Mr. GLASER. Everybody does.

Senator FONG. And they are doing it now?

Mr. GLASER. They are doing it now.

Senator FONG. And you think with the passage of this bill, you can more effectively serve your customers?

Mr. GLASER. I think with the passage of this bill and a few little changes we made in there, but even without them the passage of this bill would enable us to help fight and keep a territorial franchise clear and clean.

Senator FONG. I see.

Mr. GLASER. We are always under the gun when it comes to competition. We are always under the gun of the manufacturer. I have said this before but now let me give you an illustration.

The Consolidated Cigar Corp. who makes up Dutch Masters, Muriels, and El Producto, sell me exclusive as a franchise dealer Dutch Masters and Muriels. I buy these as a franchised distributor. The Consolidated Cigar Corp. has a branch in the city of Los Angeles and they sell in that branch exclusively their El Producto cigar. They compete with me. I can't have my price any higher than they have it. That is a reality. Because it is the same type of merchandise going to the same type of trade.

So this competition is here. However, if this competition was in the hands of small franchise distributors, for example, in San Bernardino, they have a franchised distributor for El Producto—and yet I buy from that man there and I have rougher competition in a little area like San Bernardino from him than I have from the factory in Los Angeles because the big factories are run by rules. They run by rote. They are not pliable. And this is a pliable industry, believe me. There are more ways than one to do business in it and we go the limit as far as we can because we realize that the price of the merchandise is such that if you don't go the full distance the retailer cannot exist. The profit isn't there.

Senator FONG. You are talking about this San Bernardino—this Los Angeles distributor. He is not a distributor from you?

Mr. GLASER. No. He buys Productos from the El Producto factory. He doesn't buy Dutch Masters. He buys Productos.

Senator FONG. So therefore he is in competition with you?

Mr. GLASER. Yes.

Senator FONG. And he is able to undersell you in your own market?

Mr. GLASER. He has got less cost than I have and I have got to fight him all the time.

Senator FONG. I see.

If this bill went through, how would it help you in that situation?

Mr. GLASER. It would help me this way: I don't mind fighting a wholesaler at the level who has the same aims that I have and has to give the same coverage I have to give. I don't mind that. The place where I get hurt is from the transshipper, the bootlegger, this parasite who ships the goods in from the East to the large buyer and takes what I call my legitimate profit, the real profit of a few big buyers that might be there and leaves me without them and cuts my volume.

Senator FONG. Will this bill prevent the bootlegger from sending in tobacco?

Mr. GLASER. With the addition that we added to the bill, I think that it would but even without it, I would rather have the bill than not have it, believe me.

Senator FONG. And you think that will discourage—

Mr. GLASER. It will discourage it greatly and it would at least start the point where a manufacturer, if he gave a franchise and it was legal to give a franchise, would then be forced to go into court and protect his franchise and at least we might get a ruling somewhere along the line on protecting a franchise.

You can't protect now when you haven't got it.

Senator FONG. Let me see if I get it.

Mr. GLASER. Yes, sir.

Senator FONG. Because of the uncertainty in the law, the manufacturer is reluctant to give you the exclusive franchise and not to sell it to any other person because he may be guilty of antitrust violations?

Mr. GLASER. He is unwilling to give me a written franchise guaranteeing me territorial protection or even giving me a franchise due to the uncertainty of the law. Even saying it—

Senator FONG. Yes. He is afraid that he will be prosecuted.

Mr. GLASER. In violation.

Senator FONG. Yes. If this bill goes through—you feel that he will be willing to give you that?

Mr. GLASER. At least it would be legal. At least it would be legal to give me a franchise. Whether he could enforce it or not, that would be up to the courts.

Senator FONG. And if he gave you such a franchise, in pursuance of this bill, he would tell the other people who deal with him that he has a franchise owner out there and that he will be unwilling to sell it to this other person?

Mr. GLASER. Well, he would—

Senator FONG. He would more probably—

Mr. GLASER (continuing). In our territory where we have the exclusive zone, our brand at the present time, I don't call them franchise, I call them exclusive, in our territory he doesn't sell anybody else but us. We sell everybody. Everybody.

Now, this cigar business also is very peculiar, Senator. The cigar business is not what you would call a dynamic business. It is not a growth business of great proportion.

Senator FONG. Now, you say that in your territory he sells to you and doesn't sell to anybody else?

Mr. GLASER. My brands.

Senator FONG. Your brand. But that doesn't prevent him from selling to a person, say, in Texas.

Mr. GLASER. He sells every place he wants to sell.

Senator FONG. And that man in Texas will ship it into your territory?

Mr. GLASER. Yes, sir.

Senator FONG. How will a situation like that be cured by the passage of this bill?

Mr. GLASER. Well, two things. First, we have added something that might help stop the transshipper. But, second, if a franchise were given, if it were legal to give a franchise—and right now the aura seems to be that it is illegal to give a contractor a franchise—if there were a franchise and somebody violated it, there would be the chance that legally some manufacturer would be strong enough and brave enough to take the violator into court and find out from the courts whether this would hold up in the wording and the feeling of the law would hold up.

Senator FONG. This would be a violation of the franchise; is that correct?

Mr. GLASER. Yes.

Senator FONG. The company then probably would go to court and say he is going over the bounds of his franchise, he is going into territory which he is not supposed to go into.

Mr. GLASER. That is right.

Senator, let me tell you how far I carry this, if I may. We are the distributors for El Producto in the State of Utah. We are distributors for the General Cigar Co.'s White Owls and Tiparillos and the rest of their line in the State of Nevada.

And yet in the State of California, or wherever we operate, we buy from the local jobber or the local manufacturer at 5 and 2 or whatever his price is, we will not ship the goods in from the outside territory. This is something I practice. I think if you understood something about the cigar business itself and what it looks like, the approach to it might be a little broader.

In 1920 there were 8 billion cigars sold in the United States. Today, after the Surgeon General's report in 1964, when the cigar business spurted up, it went to 9 billion from 7 billion. Today it is down to 8,700 million. This is the rate it is running at.

Now, there are only 15,400,000 cigar smokers in America. These are the figures taken from the Cigar Institute of America. Of these, 4,500,000 smokers account for better than one cigar a day and they account for about 5 billion of the 8,700,000. The rest are occasional smokers, fellows that smoke on a holiday, a man that smokes while he is doing a lawn on a Saturday, a man who smokes at a wedding, or when he gets a free cigar. Who knows, see?

Now, this is the problem with this industry and it needs protection to live. It needs protection at all levels to live.

But the reason that it needs the protection is that I have submitted in this brief of mine a picture of the dry cigar room that we have in Los Angeles. I personally think it might be an indictment to everybody, including myself. But I will take the time to tell you that we have 210 salesmen in the four Western States who pick up 400,000 dry cigars a month. We return them to the factory. That is 5 million cigars a year. And these are from the little retailers. You put a cigar out, it dries, you bring it back, and this is the only way that the little retailer is going to be able to have fresh merchandise because he can't afford a humidor.

Everywhere is not like Hawaii, Senator, where you have beautiful humidity and the cigars keep beautifully.

Southern California, the Arizona desert, the Nevada desert, you can't even put cigars on the counter in Nevada.

Senator FONG. How long does it keep in Nevada?

Mr. GLASER. In the case, they will keep about 8 days. On the top of the counter, about 24 hours. So what we do is give these fellows bricks, you know, to try and keep them, and sometimes they take care of it and moisten their bricks and sometimes they don't.

Senator FONG. Just as bad as keeping bread fresh?

Mr. GLASER. We are in the brick business.

May I submit to you—I have some cigars here, Corona, that I want to submit, both boxes.

Senator FONG. Are they for exhibits or—

Mr. GLASER. They are for both.

Senator HRUSKA. Dry ones?

Mr. GLASER. No, sir. Senator, they are not the dry ones. I never handle dry cigars.

Now, here is a picture of the cigars of one company, no label, and there are the boxes. We not only do business with the small manufacturers. We do business with the large ones. So here is M & N Cigar Co., Cuesta Rey and Rigaletto, and here are their cigars and here are their brands. They do about \$4 million. This is what we carry and have to keep fresh.

Here is the Optimo brand. This is also the small factory. They do \$7 or \$8 million a year.

You want to remember something else, gentlemen, that 65 percent of the total cigar business is done with six cigar companies. Six cigar companies do 65 percent of the total business.

Senator FONG. How many varieties of cigars do you carry?

Mr. GLASER. Gentlemen, I would have to count them. Maybe—well, we carry Anthony and Cleopatra and Corona and Roi-Tans from the American Co. We carry Corina from the General Cigar Co. We handle also Gold Labels from the General Cigar Co. We handle Cuesta Rey and Rigoletto from M & N Cigar Co. which is a small one. Optimos from the Universal Cigar Co.

Senator FONG. And each one of these names, there are some 18 different types of cigars, 20 different types.

Mr. GLASER. There are up to 45 sizes.

Senator FONG. Forty-five sizes.

Mr. GLASER. Yes. Forty-five sizes.

Here is Anthony and Cleopatra. We have 16 sizes in this.

In Coronas it is 41. But in the packings there are 31 packings in Anthony and Cleopatra.

Take a look at it. This is why it requires—I say, Senator, if you pardon the colloquialism, I say that cigars are sold with TLC and if you don't give them TLC, they won't sell and that TLC stands for tender, loving care. You must love this business. You must fight for it. You have got to take care of it just like you would a baby. It has got to be fresh; it has got to be clean.

The shop has to be clean and the store must be something other than just a place where you drop a box of cigars for the sake of a sale. And this indoctrination we try to give our retailers as much as we possibly can and I think we have been fairly effective with it.

I understand—I would say that the Antitrust Division's approach to territorial franchises is not realistic when applied to our business. Just not realistic when applied to our business.

The Antitrust Department believes that if we cannot sell in competition, then we ought to get out of business and I agree with the Antitrust Department. If we can't sell in competition, we should get out of business.

But let those who compete with me do the same thing I do for the retail trade and then it will be competition. Let them take care of this business as I take care of it or as any franchise distributor will take care of it. Let them watch the little man, let them give overnight service.

Today in Los Angeles, if you phone an order in at 4 o'clock in the afternoon, if it is for \$2, a carton of cigarettes or a box of cigars, \$2, we will deliver it the next day. We will deliver it the next day. We run a night shift from 3 to 11 to deliver this merchandise.

The transshipper, this man who violates the territory, this parasite who lives off of the large buyer and takes away the profit that we get, prevents us from giving the service to the small independent dealer. Believe me, he does. When I talk of being—when I talk of there being less retailers in the county of Los Angeles, let me again say to you something else.

In 1953, we had an organization in California and southern California which had 52 jobbers. Today when we have a meeting, if you have 14, you are lucky.

The small jobber has been gradually driven out and we need him. He is part of our economy. He is part of a way of life. We have to take care of his stock the same way we take care of a retailer's stock. It is imperative that we do.

Now, if we have to be jobbers, we have shown our strength, that we can be jobbers, and sell everything. But the peculiar part about cigars, and cigars are a peculiar thing—maybe I talk about them with love, but if it is, it is because I love them. They are a very peculiar thing. Every cigar has a customer shape. All shapes have customers. And if you were to diminish the number of sizes, if you were to diminish the number of sizes and shapes, you would diminish the cigar business. There is no question about that. There is no question about that.

One of the improvements of smoking that we had was the cigarillo, the small cigarillo type. This brought a lot of new cigar smokers, a lot of them, and every manufacturer competed with little cigarillos later and everybody has them. We have got two or three of them. We weren't the first. Somebody else had it.

Senator FONG. You are through, Mr. Glaser?

Mr. GLASER. Well, I will close off.

Senator FONG. We will incorporate your whole statement as presented to us in this printed sheet as your testimony as if it was given entirely.

Mr. GLASER. Thank you very much.

I will say I want to thank you very much. You have given me a great deal of attention and a lot of time.

Senator FONG. I will ask Mr. Cohen if he has any questions.

Mr. GLASER. I will leave it right where it is.

Senator FONG. Mr. Cohen tells me he has one question to ask you and I think—Senator Hruska, do you wish to ask the gentleman any questions?

Senator HRUSKA. No. I had gone over his statement briefly, Mr. Chairman. It is a powerful statement and he makes a very clear case. Just what we can do from there on is something that is problematical at this time but I think he states his case well.

Mr. GLASER. Thank you, sir.

Mr. COHEN. Do you understand that this bill does not say that an exclusive franchise is always illegal or always legal? All it says is that an exclusive franchise shall not be per se illegal.

Mr. GLASER. That is all we ask. I just don't want it called illegal. I don't ask that you force any manufacturer to give a franchise; because if no manufacturer wants to give it, it is perfectly all right with me, but let him have the legal right to give the franchise.

Mr. COHEN. But you realize, even if he has the legal right to give it—which I think most people would agree he has under present law—that it can still be illegal if it unreasonably restrains trade under this bill. Do you understand that?

Mr. GLASER. Yes, sir, I understand this also. We carry three different 10-cent cigars from three manufacturers. Every other distributor does about the same thing. Every other distributor carries two or three—no distributor in this business can live with one house and make a profit. Nobody. And give the service that has to be given. This is the contention. So there would have to be free and open competition and the more free and open competition there is, the better would be the business.

Mr. COHEN. But as I understand your position, you don't want free and open competition inside the area where you have your exclusive territorial franchise?

Mr. GLASER. You misunderstand the position. I said I am perfectly willing to have free and open competition, providing the competition comes from inside the territory and not from the transshipper without.

Mr. COHEN. If you have an exclusive territorial franchise in your area of 550,000 square miles that you can enforce, where are you going to have any free and open competition?

Mr. GLASER. Mr. Cohen, I have it right now. I have it right now. We have jobbers and franchised distributors in the 25 cities of California. We have little jobbers in almost every city. Plenty of competition. In San Francisco, there are two large distributors—one large distributing house that has a lot of brands. In San Jose there are three of them. In Oakland there are five of them. They all have

different franchises. No manufacturer wants to go all to one guy, and besides, you couldn't take them.

Mr. COHEN. You think this bill will assist you to keep all competition from outside your territory from coming inside your territory?

Mr. GLASER. That is right. That is all we ask.

Senator HRUSKA. Will counsel yield?

Mr. COHEN. No further questions.

Mr. GLASER. Is that clear, sir?

Senator HRUSKA. It seems to me, Mr. Cohen, that starting in line 9 of the bill, there are those conditions which must prevail even under a franchise granted under this bill. It is that which I understood the witness to explain earlier in his testimony, and in his statement, which would guarantee competition and would be the standards by which a franchise would be considered legal or illegal.

It is also those conditions which prevent a franchise from being called illegal per se.

Mr. GLASER. That is right.

Senator HRUSKA. Those conditions must exist. And the court's job would then be to examine the franchise and to examine the other marketing conditions within that franchise territory to see whether these conditions are met.

Mr. GLASER. That is correct.

Senator HRUSKA. Isn't that the theory of the bill?

Mr. GLASER. That is correct. That is the feeling that I get from the bill and that is the way it should be.

Mr. COHEN. So that the uncertainty that you are worried about now would still remain if this bill were put into law because the court would have to determine whether or not from a factual point of view, these conditions were in fact met.

Mr. GLASER. Yes. And some manufacturer would have to take it to court and find out. Right now—let alone to take it to court—they won't even give you a franchise.

Senator FONG. Part of the per se approach.

Mr. GLASER. Gentlemen, I want to thank you very much. You have been more than attentive. I have taken more time than I should.

Senator FONG. I understand you are one of two main witnesses and the others are here just for very short statements. So you didn't take too much time.

Mr. GLASER. Thank you very much.

Senator FONG. Thank you very much.

(Mr. Glaser's prepared statement follows:)

#### STATEMENT OF MARCUS GLASER

My name is Marcus Glaser. I am chairman of the board and chief executive officer of Glaser Bros., a California corporation. Thank you for the opportunity to submit a statement with respect to proposed Senate Bill 2549, which is legislation of direct interest to Glaser Bros. and its customers.

Glaser Bros. is the largest wholesale distributor of tobacco products and sundries on the West Coast and the largest distributor of cigars in the country. Glaser Bros. is essentially a large group of small jobbing houses under one central management. Glaser Bros. has been distributing tobacco products for over 78 years, starting in San Francisco and today covering a territory of over 544,000 square miles ranging from the Canadian border to the Mexican border in eight states with a population of about 25,000,000 people. While

we are big, sales are highly competitive in all of the major marketing areas where we do business. Most of what I have to say will be about the cigar industry, but the principles also apply to other industries, such as candy, with mass distribution at the small store level and products with a limited shelf life.

I strongly urge the enactment of Senate Bill 2549 with certain changes I am suggesting. The evils in the trade practices in our industry will be alleviated by enactment of legislation which clarifies the right of a distributor to have an exclusive territorial franchise. Without clarifying legislation the turmoil in the marketing of tobacco products and other perishable commodities requiring constant service and attention at the consumer level will get worse. Distributors, both large and small, will be forced out of business.

#### I. STRUCTURE OF TOBACCO MARKETING

Before commenting upon the particular practices which need correction, let me briefly outline for you the marketing structure of the tobacco industry and the role of the wholesalers. The tobacco industry is an extremely high volume, low mark-up industry, with the pricing structure substantially controlled by the prices and methods of distribution of the major manufacturers. The effective distribution of tobacco products is dependent upon the maintenance of strong independent wholesalers, both distributors and jobbers. For purposes of this discussion, a "franchised distributor" is a wholesaler who has been granted an exclusive franchise by a manufacturer, and who is required to purchase products in sufficient quantities to introduce, display, service and take care of many franchised products in a substantial percentage of retail outlets throughout a specific territory. For example, there are 60,000 retail outlets in our territory. We service about 40,000 of such retailers. In cigar distribution alone, a distributor may have 20 to 50 different sizes, shapes and packages to stock, maintain and service for one brand of one manufacturer. See Exhibit B attached for photographs of the multitude of varieties available in most of the different competing cigar brands we carry.

A "jobber" is a wholesaler who purchases in quantities from both the franchised distributor and the manufacturer and sells to a limited number of retail outlets without necessarily providing distribution services to the small retailer. In our area the jobber will generally limit the size of the order he is willing to deliver because he cannot economically service the smaller outlets. Since the jobber has no responsibility to service smaller outlets, he does not do so. In the Los Angeles area, practically all of the jobbers have a \$100 order minimum before they are willing to deliver with any degree of regularity or even on special notice, unless the customer is a large chain or a large buyer. This means that the franchised distributor must take care of the small dealer, usually at a loss. (See discussion under part IV(2) for Glaser Bros. loss figures.) Moreover, franchises are subject to predatory practices by the transshippers (or bootleggers) who are the parasites of the present distribution system. Manufacturers claim that they cannot fully protect the franchise against the transshipper because of the uncertainty of the antitrust laws.

Tobacco products, and particularly cigars, are perishable. Without proper care they quickly become stale and dry. However, tobacco products must be readily available on the retailer's shelf since they are primarily impulse purchase items. In addition, cigars are low price, low profit products. Approximately 75% of all cigars are sold at retail for 10¢ or less. Because cigars are sold on a guaranteed return basis, for a franchised distributor to maintain fresh products in the thousands of retail outlets within his territory, he must make frequent personal calls and deliveries to each outlet and replace stale and dry products so the small retailer can compete with the large chain stores.

In other industries many companies, such as Eastman Kodak and Ronson Corporation, establish a price for the high volume direct retail buyer but also provide a functional discount for the distributor who performs certain services. But in the tobacco industry the manufacturers will usually sell at the same price to any direct purchaser whether it be a large retail outlet, chain or a franchised distributor. The manufacturer has one price for all unless he has a branch sales outlet which will make volume discount differentiations to retail stores and jobbers. Problems caused by this dual distribution system will be discussed later.

## II. THE FRANCHISED DISTRIBUTOR PERFORMS A VALUABLE FUNCTION IN OUR ECONOMY.

Tobacco sales involve intense inter-brand competition. With a quality product, a large manufacturer's sales can only increase if (1) the product is readily available in the largest number of outlets possible, (2) the quality for the price to the consumer is competitive and (3) his advertising program creates a demand for his product. A small manufacturer who cannot afford extensive national advertising must rely solely upon the promotional efforts of the franchised distributor to create the demand. All manufacturers demand that the franchised distributor obtain the maximum possible distribution in his particular territory. Most of the retail outlets which are serviced by the distributors are small independent shopkeepers who operate drug stores, grocery stores, candy stores, gas stations, restaurants, bars, liquor stores and cigar counters. These small retail outlets receive numerous services from the distributor in the form of display racks, proper stocking of merchandise, credit, frequent deliveries of fresh merchandise and replacement of stale merchandise. (See Exhibit C attached for statistics on dry cigars replaced at retail stores and a photograph of the cigars returned for credit in one branch for a two week period.) I cannot overemphasize the need to have fresh cigars in stock. Dry and stale cigars are bitter and all the expensive brand advertising of the manufacturer and the promotion work of the distributor are lost when a man smokes one bitter cigar. The problem of dry cigars varies with the climate but the problem is most severe for the small outlets who must rely on the distributor to replenish their stocks since the large accounts and chains can afford humidifying equipment or store-rooms to preserve their inventory.

It is the distributor who introduces the new and competitive products to the market. As was pointed out on page 77 in the Report of Subcommittee 4 of the Select Committee on Small Business, House of Representatives, 88th Congress, Second Session, on *The Impact Upon Small Business of Dual Distribution and Related Vertical Integration*, December 30, 1964, "New products . . . are always introduced through the wholesaler, who performs the service of distributing them and helps to create a demand for them. Once a product becomes accepted, however, the manufacturer begins selling it direct to the chains." In other words, the franchised distributor incurs considerable expense and effort to launch a new product for the manufacturer, but once the demand is created, the distributor and retailer often do not reap the benefits of their efforts. This frequently occurs because the manufacturer sells direct to the chain stores, or allows a bootlegger (who performs no services in the territory) to transship the new product from a different territory at a cut price. The bootlegging transshipper is not stopped by the manufacturer because the manufacturer claims that the antitrust laws will not permit him to cut off anyone he knows is supplying the transhipper even to protect his own business. These activities eliminate the opportunity of the distributor to recoup his costs of creating the demand or earn an adequate profit and also cause the small retailer to be at a competitive disadvantage. It is true that no product, and especially no tobacco product, has ever become a national brand when introduced solely by any chain or group of chain stores. Moreover, the product must have mass distribution at all levels to be a profitable national brand. The manufacturers' profits are attributable not just to sales to the large chains but must essentially rest upon the broad distribution base of many small retailers serviced by the franchised distributor.

The franchised distributor also aids the manufacturer in performing the selling function for him. The distributor's salesmen call upon each of the million and a half retail outlets in this country and make the products of the manufacturer available to the retailer. The distributor performs much of the storage functions for the manufacturer. He is required to maintain an inventory of a large number of products in an assortment of prices, sizes, shapes and qualities. These must be stored near retail market areas in temperature and humidity controlled storage facilities to make them available to the retailer. The distributor also provides the manufacturer with information about acceptance of products and the state of the market. This information enables the manufacturer to determine his marketing and promotional policies. Selling to distributors, rather than direct to many retailers, permits the manufacturer to minimize transportation costs by taking advantage of economy on large shipments, minimize credit risks and reduce the paper work that would otherwise be necessary. Without

the wholesaler's services, the manufacturer could only afford to sell to the large volume buyers or by mail.

### III. PRESENT UNCERTAINTY IN THE LAW CAUSES SERIOUS PROBLEMS

The present uncertainty in the antitrust laws has permitted the large cigar manufacturers to control the wholesale level of distribution because the manufacturer who seemingly wants to give an exclusive territorial franchise to a wholesaler says the antitrust laws do not permit protection of the territorial franchise. Those manufacturers who grant franchises to a distributor like Glaser Bros. whose services the manufacturer needs, say (and I believe in good faith) that it may violate the antitrust laws to enforce the territorial franchise. I ask you, what is a franchise worth that the manufacturer can't protect? Even when an exclusive franchise is granted, the manufacturer in many instances also will insist on reserving the right to sell directly to chains at the same prices as the franchised distributor who must in turn sell to retailers competing with those chains at a higher wholesale price than the chains pay. This uncertainty helps the manufacturers and the large chain stores but it is destroying the small retailers and the large and small independent franchised distributors and jobbers.

### IV. EXCLUSIVE TERRITORIAL FRANCHISES WOULD ALLEVIATE PROBLEMS

If legislation were enacted allowing legally enforceable exclusive territorial franchise agreements, a more healthy competitive situation in the tobacco industry would be promoted in the following ways:

#### 1. *Strengthen Small Retailer*

The small retailer would be able to obtain fresh merchandise and service at a price which would permit him to make a reasonable profit and at the same time compete with a good variety of fresh merchandise against the large volume stores. This is possible only if the retailer has the services of a franchised distributor.

#### 2. *Discourage Dual Distribution*

An exclusive territorial franchise would help discourage the dual distribution system used by most manufacturers. With the present uncertainty on the legality of exclusive franchises, after a "franchised" distributor has built up the demand for products, the manufacturer is often free to open a factory branch selling the same products to the chain stores, jobbers and other large volume customers at the same prices the manufacturer charges the franchised distributor or for prices at which the distributor cannot resell and make any profit. If the distributor had an enforceable franchise agreement, the distributor would have an incentive to create more jobs and be able to support and service more small retail accounts. There are not many distributors who would spend the time and money building up a territory on the strength of an unenforceable agreement. The manufacturer would have to protect franchised distributors or it would have to spend its own time and money building up a territory. There are many franchises available today from large manufacturers for leading brands which have not yet been developed in certain territories. The wholesalers will not and cannot afford the expense of developing those brands without protection.

The manufacturers may try to justify their factory sales branches on the ground that no distributor will put in the necessary work, time or money to become a franchised distributor, but if the manufacturer could give the distributor an enforceable franchise and reasonable support, the distributor would have sufficient incentive to work hard to build up good will in the franchised products. Once the territory is developed, the distributor's continued efforts can be assured by the terms of the default provisions of the franchise. The factory branch is not needed.

The second evil of the dual distribution system is that the factory branches establish the price levels at which the distributor must sell and the discounts granted do not permit an independent wholesaler to compete on the sale of products to large volume customers and to provide the services necessary to the small retailer and still make a profit. The factory and the factory-owned branches do not and would not provide regular and adequate services to the numerous small retail outlets which the franchised distributor must service at

considerably more cost per dollar of sales volume. With the present high cost of doing business the factory-owned branch cannot break even at the discount prices it establishes for the comparable products it sells even when it limits itself to high volume customers. These branches are subsidized by the factory. This same subsidization to the factory branch, if given to the franchised distributor, would allow the distributor a fair profit. Almost seven years ago to date, I was privileged to appear before the Antitrust Subcommittee of the Judiciary Committee of the House of Representatives concerning legislation calling for mandatory functional discounts. This legislation was not enacted and the situation has only become worse. Factory branches should not be authorized unless realistic functional discounts are granted to the franchised distributor.

Right now Glaser Bros. is subsidizing the small retail outlet even when selling cigars at the full list price. This occurs in those cases where we cannot spread the cost of the sale over a larger variety of goods and this is the problem that the factory branch would face if it tried to sell to the small outlets. For example, in the month of March 1966, 16 Glaser Bros. cigar salesmen catering solely to the small retail outlets who generally purchase only our franchised cigars, and not cigarettes and candy as well, made 6,500 calls upon customers or an average of 19 calls per working day. The average total order booked was \$29.50 at a gross profit of 10%. Our total volume for these accounts for the month was about \$110,000 with a gross profit margin of about \$11,000. Each salesman costs the company about \$1,000 per month, which includes his car, out-of-pocket expenses, salary and fringe benefits. So before including my general overhead, the company lost about \$5,000 on the handling of its franchised cigars to these small accounts. Why do we continue? As conscientious distributors we perform our required duties and don't complain so long as we are able to make a fair profit on the large volume accounts. At the present we lose some of this profit because of dual distribution and transshippers; and if we continue to lose profits, we too will have to discontinue selling to the consumer convenience outlets.

The Federal Trade Commission on June 30, 1964, issued revised trade practice rules for the tobacco industry which expressly recognized the propriety of granting functional discounts to wholesalers for functions actually performed. To the best of my knowledge, no manufacturer in our industry servicing the wholesale tobacco trade has offered functional discounts for services rendered. After the revised rules were issued, I requested such a discount for services rendered. I was told personally by the chief executives of the largest companies in America with whom I do business, whether it be tobacco, cigars, candy or cigarettes, that functional discounts were illegal and that their attorneys would not allow them to grant them. This is why I feel so strongly that the authorization of enforceable exclusive territorial franchises is so important. I would even favor legislation that would require the manufacturer to enforce the agreements once they are granted. In good part due to this dual distribution system, and bootlegging, approximately 70% of the independent wholesalers in the Los Angeles area in 1956 are no longer in business today. This problem of the devastating effects of dual distribution upon the franchised distributor of tobacco products was thoroughly considered in the hearings leading to the Report of the Select Committee on Small Business referred to earlier. I recommend that you review the material contained on pages 217-253 of Volume I of these hearings before the House of Representatives Subcommittee No. 4 of the Select Committee on Small Business, May 16, 1963, and the 1959 hearings at which I testified. See Case Study No. 1 in Exhibit A attached for another current example of how dual distribution affects Glaser Bros.

### 3. *Limit Vertical Integration*

Exclusive territorial franchises will enhance competition by limiting the trend to vertical integration by manufacturers. Unless the distributor is able to engage in an orderly and reasonably profitable sales program, the distributor and the small manufacturers must go out of business (as many have done) and the vacuum will be filled by the manufacturer. If the manufacturer fills the vacuum, the small retailer and the consumer will lose out. The factory branches and jobbers cannot and will not service these customers in the way that the independent franchised distributor does. Few manufacturers can afford to provide the credit service, inventory service, delivery and collection service and all the other services that an independent distributor provides to the independent retailer at anywhere near the small mark-up charged. This is because the manufacturer cannot spread his selling costs over the wide variety of merchandise handled by the distributor. Most distributors carry similar products, such as cigarettes, cigars, pipe tobaccos, candy and sundry other products of many

competing manufacturers so that the costs of distribution are spread over a larger dollar volume when dealing with the small retailer. Unless the marketing system is improved so that the franchised distributor can make a living, the small retailers will be forced out of this business along with the distributor and the consuming public will be forced to purchase the products solely from large retailers and chains. Thus, a substantial marketing business will be further concentrated into the pockets of the large manufacturers and chains. The small manufacturer also could not survive in such event as he is dependent upon an independent distributor system. He cannot afford factory branches. This trend toward concentration in the cigar industry has already begun since there are now only 336 cigar factories (many of which are owned by the same manufacturers), while 15 years ago there were 1,821.

*Number of cigar manufacturers*

	United States	California
1950.....	1,821	59
1956.....	786	31
1965.....	336	18

Source: U.S. Internal Revenue Service. And only 11 manufacturers account for approximately 80% of the production.

*4. Inter-brand Competition Would Be Increased*

If there were enforceable exclusive franchises there would be more small businessmen willing to go into the franchised distribution business to sell to the small as well as the large retailers. With franchises there would be more distributors in the market place selling similar goods under separate franchises to the same customers. What is better, distributors competing on price and service at the retail outlet level or prices controlled on a national level by large manufacturers? When there is only one distributor who can or will service the smaller outlets, the price to the retailer will tend to be fixed by the manufacturer.

Because of the intense inter-brand competition and competition between wholesalers on similar quality and priced cigars, even if all cigars were sold under exclusive franchises the competition would remain very high because the manufacturer of the No. 2 best seller in the territory will keep after his distributors to out-promote the competing No. 1 best seller. If the distributor doesn't remain competitive and sales slip, the franchise agreements are usually drawn in a manner to protect the manufacturer so that he can threaten the loss of the distributorship unless the distributor does a better job.

It must be recognized also that the small manufacturer just to break into the market and compete with the larger manufacturer must rely entirely on the franchised distributor. It is the small manufacturer who is hurting by the uncertainty of the antitrust law as he cannot find qualified distributors unless he can protect them. A small manufacturer can in some cases produce a better quality cigar for the same money as the national brand, but the consumer won't know or have the benefit of this unless there is a distributor to make it available. Therefore, in the cigar industry, if you want to encourage inter-brand competition and enable the small manufacturer to remain viable, exclusive territorial franchises should be permitted.

*5. No Good Will Value in Distributorships*

Legislation clarifying the validity of enforceable exclusive territorial franchises would not only promote competition in the tobacco industry, but also would be of great assistance to the franchised distributor. At the present time, as a result of the uncertainty of the law, many tobacco manufacturers will neither grant, recognize nor enforce exclusive franchise contracts. Because the distributor's rights to distribute a product are not protected and because his profit margins, even with a fast-selling product, are so low, the return on investment is not adequate to create any good will in his business. This conclusion is not mere speculation. It is amply evidenced by the number of wholesalers who have gone out of business and the fact that several of the old-line tobacco distributing houses have recently been sold at book value or less. The absence of good will means that businesses terminate causing many lost jobs and further concentration of distribution in chain stores and manufacturer-controlled outlets. Most of the distributors who have been in the business for many years now find that

after diligent effort in building up substantial sales volumes, their businesses are not even worth book value. The ability to obtain enforceable exclusive territorial franchises would help create a climate for continuation of businesses and jobs.

#### 6. Bootlegging destroys patterns of distribution and competition

An enforceable exclusive territorial franchise agreement would assist the franchised distributor in preserving his sales from the destructive activities of parasitic tobacco bootleggers. These parasites transship products across territorial lines in order to capture the large volume business from the franchised distributor. This is how they operate. A manufacturer occasionally gives a special promotional discount or deal to only one part of the country. The bootlegging wholesaler (usually a jobber) who receives this special allowance will purchase extra merchandise for transshipment to a different part of the country where the discount is not available. He then undersells the local franchised distributor. Naturally, just as in the case of dual distribution, this parasite only sells to major accounts, jobbers or the large volume chains, which not only injures the local distributor so that he cannot service the small retail accounts, but also may make it impossible for the small retailer to compete on many items. However, the bootlegger does not just transship when promotional deals are available. See Case Study No. 2 on Exhibit A attached for a more comprehensive example of how bootleggers operate and injure competition.

I wish to emphasize that the savings of the high volume purchaser who buys from the transshipper are never passed on to the consumer. This is because the savings are too small to filter down to a reduction in the retail price. Let me give you a concrete example. The wholesale cost of a 10¢ cigar is \$80 per 1,000 so \$1,000 will pay for 12,500 cigars. The bootleggers sells to the high volume buyer at 1% to 2% lower than Glaser Bros. On \$1,000 this means \$10 to \$20. This saving is not passed on to the consumer because if the high volume buyer reduced the cost of the 12,500 cigars 1¢ each, it would cost the outlet \$125. Therefore, all that happens is that the larger volume buyer pockets this cost reduction. This \$10 to \$20 per \$1,000 purchase of cigars has a substantial effect upon Glaser Bros. revenues because of the large volume we handle. When revenues from the high volume purchasers are denied us, we cannot adequately provide our services to many of the small outlets where the cost of distribution is substantially greater per sales dollar. See discussion in part IV(2) above for illustration on the cost of servicing the smaller outlets.

Bootlegging only became a serious problem to our firm within the last five years with the new increased efficiency of freight traffic handling. The piggyback and less-than-carload shipments have enabled the transshipper to ship goods across the country almost as cheaply as at full-car rates. This was not possible before.

The transshipper not only affects the franchised distributor but also the small jobbers in Glaser Bros. territory. The transshipper will often raid the jobber's biggest outlet in a town taking about 20-25% of his business. Since the transshipper can buy for less than the jobber, the jobber can't compete and soon may go under because there is not enough profitable business left to keep going. More business is directed to the large volume sales outlet away from the smaller stores in the town. The manufacturer suffers also because when the jobber goes under, there is no one else in the town to deliver and service the other stores and so the sales of the brand fall off.

If the transshipper provided some services to the industry, I would not be so vitriolic about him. But this type of middleman is truly only a parasite who provides no service to his fellow businessmen but only pockets a fast buck to the detriment of countless independent small businessmen who strive daily to earn a reasonable income to support their families.

The law is uncertain today: an enforceable exclusive territorial franchise might enable the manufacturer to stop the bootlegger from transshipping into the exclusive territory and might permit the local distributor to sue the transshipping bootlegger for damages. Senate Bill 2549 would not ban bootlegging, however. All Senate Bill 2549 would do is clarify the position of the manufacturer on whether or not the manufacturer will use a franchise system of distribution.

#### V. RECOMMENDATIONS ON LEGISLATION

I recommend the changes in Senate Bill 2549 as set forth in Exhibit D attached. These changes will permit manufacturers to choose the benefits of a distribution system utilizing exclusive territorial franchises. At line 3, page 2 of the Bill

there should be language permitting the franchise agreement to limit distribution to a particular clearly delineated territorial area in all the channels below the supplier. At line 5, page 2 of the Bill, a provision should be added which would allow the purchaser to seek an exclusive franchise in a delineated territory making it clear that the law will permit a single exclusive franchise rather than require duplication of franchises. This exclusive franchise would permit the distributor who has built up his business to protect it by preventing the manufacturer and transshippers from breaching the franchise agreement.

I wish to make this clear. Nothing in the proposed changes on Exhibit D would prevent the manufacturer from selling at the wholesale or retail level where there are no franchises, or from negotiating a franchise agreement restricting his distributors to certain channels of distribution or from reserving the right to change the franchise some time in the future if provided in the contract. The whole thrust of the suggested changes is to permit the manufacturer to choose any legitimate methods of distribution. But once the selection is made and the distributor has entered into an agreement with the manufacturer, then the manufacturer must abide by and enforce the methods of distribution that it has selected.

One of the principal reasons we need the suggested changes is to solve the following bootlegging problem, which the present Bill does not solve. Under the present language of Senate Bill 2549, an exclusive franchised distributor in New York could buy merchandise and resell it to a jobber in New York. This jobber, who has not executed an exclusive territorial agreement, in turn transships this merchandise into my territory in California. The present language of Senate Bill 2549 does not expressly permit agreements that can prevent this transshipment since the transshipper has not signed any agreement with the manufacturer. The revised language would permit the manufacturer to require the distributor to obtain similar territorial restrictive covenants from the jobbers.

It is necessary to have legislation which would permit territorial control of the redistribution of the merchandise on the wholesale level. An alternative approach to my suggested changes on Exhibit D to solve this transshipping problem would be to delete the words on line 3, page 2, "the right of the purchaser to". I would be satisfied if either of these suggestions would be incorporated into the Bill, because unless we are able to control the transshipping jobber, the proposed legislation is worthless. Bootlegging is one of the principal problems we have today in the industry and one which all the manufacturers say they cannot control or stop because of the antitrust laws.

#### VI. CONCLUSION

I hope the foregoing has given you some idea of the problems faced by the independent franchised distributor and the small manufacturers and retail outlets because of the uncertainty of the antitrust laws. I am no economist or lawyer, but I have been selling cigars for 54 years, so I feel I know something about our industry and its problems. I have great respect for the ideas of the economists and the professors on economic theory, but the theoretical approach taken by the Department of Justice in opposing the legality of exclusive territorial franchises is just not realistic when applied to our industry. I understand the Antitrust Division believes that if a seller cannot afford to meet the lower prices of a transshipper and cannot survive on the remaining business, there is no reason to keep that seller in business. In certain high profit industries this theory might hold true, but it certainly does not apply to the cigar industry. Glaser Bros. can survive the onslaughts of any transshipper—we still make a small profit; it just isn't a reasonable rate of return for the capital invested—the men who are going to be put out of business are the small retailers whom we will no longer be able to service adequately, and the small manufacturers who will not be able to get distributors. The corner grocery store, cigar counter, candy store or lunch counter will *not* be losing business in this instance because they are not run efficiently or don't provide a necessary and valuable marketing function. The small retailer just doesn't have a chance to survive against the economic power of the large chains and volume outlets unless the small retailer can obtain the credit, inventory control and other services of the franchised distributor.

The Department of Justice's policy against exclusive territorial franchises as it applies to certain industries may be justified because of the foreclosure of competition that developed. However, in Logic I at college we learned about syllogisms, such as: all fish swim, John swims, John is a fish. Following this

system of logic, let us assume this syllogism: exclusive territorial franchises in certain industries are bad as they foreclose availability of retail outlets and lead to price fixing; the cigar industry has exclusive territorial franchises; therefore, the cigar industry franchises foreclose availability of retail outlets and will lead to price fixing. This is patently incorrect in the tobacco industry where we have keen competition on the manufacturing, wholesale and retail levels. John is not a fish. It must be remembered that we are dealing with very low price items yielding on an industry basis only 4/10th of 1% net profit on sales, and my company's profit is less than that! Cigars are a \$750 million industry, while cigarettes are over \$8 billion, but the wholesalers gross mark-up on all these items only range from 2% to 12%. In some industries this amount of gross margin wouldn't even pay for the rent.

The bad trade practices which might arise from exclusive territorial franchises are not prevalent in our industry and are prohibited by Senate Bill 2549. Tobacco distributors carry the franchised and unfranchised brands of many manufacturers. Neither retailers nor wholesalers are restricted on the brands they carry. We will sell to any retail outlet and we will buy anyone's product as a jobber to service our customers. The application of the Department of Justice's theory to our industry works in the reverse. It favors the further consolidation of power in a few manufacturers and the large chain and retail outlets.

The proposed legislation expressly requires that there be open competition for goods of like grade and quality, free and open competition with other vendors in the territory and no contracts restricting the purchasers' source of supply. This closes the door to the trade practices which have been associated with exclusive franchises in some other industries. With these conditions in the Bill, I firmly believe that the interest of the public will be protected. The legislation is so drafted that it cannot be used as a sword to create unfair trade practices.

If you are concerned about the scope of legislation permitting exclusive territorial franchises in all industries then limit the legislation to the tobacco industry. You will learn that great strength can come to our country by strengthening the American free enterprise system of distribution, and you will learn that an exclusive territorial franchise will strengthen that system. If necessary, you can even go as far as Congress did in the liquor industry and license the entire industry. Tobacco sales is the third largest revenue producing activity to the government and to many states tobacco sales are either first or second in revenue. An exclusive franchise distribution system in the tobacco industry will be good for business and good for government.

I wish to close with this thought. Our nation and our economy have been built by the combined efforts of many little people. This proposed legislation will help the little guy—my customer—give him a break. It's tough enough for a small businessman to make a living today in competition with the giants. Don't let the present confusion in the abstract theories of the antitrust laws continue to consolidate power in the giants. Enact Senate Bill 2549 and give the small man the slingshot he needs to stay alive.

[Exhibit A]

#### CASE STUDIES

##### STUDY NO. 1: DUAL DISTRIBUTION—COMPETING IDENTICAL BRANDS

Cigar manufacturers often produce physically identical cigars which are sold under several different brand names. Within the same area they may sell one brand through a franchised distributor like Glaser Bros. and a second brand directly through a factory branch. Both brands are sold to the same jobbers with the same suggested retail prices. The only differences are that there may be a few different sizes and shapes that are not sold in both brands.

The factory branch purportedly purchases its brand at the same price as Glaser Bros. However, the factory branch sets its resale prices and promotional deals at a level at which Glaser Bros. cannot make a reasonable profit. We must meet the price of the factory branch since the cigars are the same except for the name. The factory branch in order to provide credit, delivery and inventory servicing must be obtaining a subsidy (direct or indirect) from the manufacturer in order to meet its out-of-pocket expenses of distribution and still sell at the price levels it establishes.

The factory branch usually is established only at the major marketing areas with high volume sales, leaving large, sparsely populated geographical areas

to be serviced only by the distributor. However, Glaser Bros. must establish the same prices in these areas, where there are higher sales costs per dollar of sales volume. This is the reason franchised distributors have requested functional discounts comparable to the subsidy being paid to the factory branches.

STUDY NO. 2: TRANSSHIPPING (BOOTLEGGERS)—PARASITES WHO TRANSSHIP

At the present time Glaser Bros. estimates it is losing \$100,000 of net income per year because of transshipping bootleggers. The typical pattern of operation is that a franchised distributor will place an order for a quantity of cigars far larger than he could reasonably sell in his own territory. He then resells them to a jobber in his area for a very small profit, in most cases on 1 or 2%. The entire sale is merely a bookkeeping transaction, since the goods are usually shipped directly to the transshipper in original cases for transshipment. The price charged this transshipper is usually less than the price charged to other jobbers in the distributor's territory since the goods will not be sold in the distributor's territory in competition with local jobbers and this I understand may not constitute illegal price discrimination.

The parasitic bootlegger usually has already made arrangements to sell the cigars to one or more large volume retailers, jobbers or chain stores in California for a lower price than is offered to comparable California purchasers. The differential is only 1 to 2% at the most. The original distributor and the transshipper can afford to sell the cigars for less since they provide no distribution services in connection with the sale. Though the cigar manufacturers have refused to code their merchandise on the grounds that it may violate the antitrust laws, it can be demonstrated that transshipping occurs because certain distributors in the East and Middle West have placed substantial orders for 300,000 to 400,000 branded cigars of certain sizes and shapes which are sold almost entirely in Glaser Bros. territory. There is practically no demand in the East for these particular cigars. The only demand is that built up by Glaser Bros. in its territory. When the manufacturer is questioned about this, it pleads that it can do nothing because of the uncertainty of the antitrust laws and if he does cut off the distributor, the bootlegger can easily get all he wants from other sources.

[Exhibits B and C held in Committee files]

[Exhibit D]

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 *and subsequent purchasers*<sup>1</sup> to the distribution of the suppliers product within a clearly delineated territorial area *and giving the purchaser an exclusive franchise in that area*<sup>2</sup> 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."

Senator FONG. The next witness is Mr. Louis H. Ehrlich, Jr., president of Rothenberg & Schloss Cigar Co., Kansas City, Mo.

STATEMENT OF LOUIS H. EHRlich, JR., PRESIDENT, ROTHENBERG & SCHLOSS CIGAR CO., KANSAS CITY, MO.

Mr. EHRlich. Senator and other members of the committee, counsel, gentlemen, I will read my statement because what I have tried to do

<sup>1</sup> Change need to stop transshipment (bootlegging).

<sup>2</sup> Change need to stop (a) duplicate franchises and (b) competing branches controlled by the supplier.

in my statement is to highlight, as I see it, what are the present conditions that would be in support of this bill.

With your indulgence I will read this statement and then I will be glad to answer any questions.

Senator FONG. You may proceed.

Mr. EHRLICH. My name is Louis H. Ehrlich, Jr., and I am president of Rothenberg & Schloss Cigar Co. of Kansas City, Mo., which is now in its 92d year of operations. I am also president of the National Association of Tobacco Distributors whose membership consists mainly of small wholesale distributors of tobacco, confectionery, smokers' accessories, shaving instruments, electrical appliances, and a number of additional consumer products purveyed by approximately one and a half million retail outlets, ranging in scope from the perennial "mom and pop" store to large retail stores.

This assortment of products is supplied by several thousand manufacturing firms, varying in size and product mix. The experience and method of operation of my own firm to an appreciable measure parallels those of a preponderant majority of the distributors.

From its very inception, the founders of this firm—and, by the way, I represent the third generation—have without any reservation operated it on the premise that a reputable distributor can only justify his existence in the economic framework by assuming full responsibility for the introduction, promotion, and promulgation of the public acceptance and sale of a product; that such product or products must be in competition with other products; and that it was incumbent upon the firm to undertake the cost—and, frequently, even the gamble—of propelling the product into the marketplace.

Emulating the first, neither the second nor third generation of our firm have digressed from that policy, to this very day, in spite of the burgeoning cost of operation, despite the crucial problems inherent in labor-management relations, in spite of the regrettable erosion of a vast number of smaller merchants constituting our customers, we cling to that policy because it fulfills a need. It provides a vehicle and an opportunity for even the smallest inventor or creator of a new product or a new commodity to "have a place in the sun."

Our operations embrace an eight State area including Kansas, Nebraska, Oklahoma, and parts of Arkansas, Missouri, South Dakota, Wyoming, and Iowa. About 72 percent of our business is in cigars, which are distributed on a franchise basis. Our competitors, too, distribute cigars on a franchise basis. The franchise distribution system is a necessity for our industry. Cigars are perishable, and, without proper humidification, become dry. Many retailers will not buy new cigar brands or sizes without an understanding that, if they do not sell, they can be returned. Consequently, the cigar wholesaler is continuously picking up or exchanging cigars—entailing both time, effort and nonreimbursable expense.

In my opinion, neither my firm nor any of its vigorous and militant competitors could afford to perform this nonremunerative function were it not for the assurance of a franchise. We incur these losses, and perform these services, in the hopes that once the brand gains acceptance we will be compensated for our losses, by the repeat business that will be engendered through our efforts. Without the hope of such repeat business, none of us could afford the painstaking efforts and costs of introducing a new brand or maintaining an established

brand for a small-scale manufacturer who cannot afford large-scale advertising of his product. And, it is our franchises that keep alive this hope of repeat business. Without cigar franchises, tobacco distributors could not perform the necessary function of developing and marketing cigar brands.

These comments apply with equal force to a great number of products, other than cigars, whether distributed by my firm or by other firms with which we are in competition. That the problem is of nationwide and all pervasive significance is indicated by an editorial appearing on page 5 of the Monday, June 13, 1966, edition of the Wall Street Journal.

That editorial, commenting on the recent decision of the U.S. Supreme Court in the case of *Federal Trade Commission versus Brown Shoe Co.* expresses better than I ever could hope to do my feelings and the feelings of countless thousands for whom I speak on the importance of franchises for the small businessman. With your permission, I would like to submit, to your committee a reprint of the Wall Street Journal editorial for inclusion in the transcript of this hearing.

Senator FONG. That will be included.

Mr. EHRlich. This is a part of my testimony and I will not read it. (The document referred to follows:)

[From the Wall Street Journal, June 13, 1966]

#### REVIEW AND OUTLOOK

##### FRANCHISES UNDER FIRE

An unhappy axiom governing regulatory agencies is that they rarely regulate their own voracious appetites. So the Supreme Court decision last week broadening Federal Trade Commission authority to challenge franchises is probably only an hors d'oeuvre.

A rather plump one, to be sure. The Court held, in a unanimous decision reversing a lower-court ruling, that Brown Shoe Co.'s franchise system—in which the company provided such benefits as sales training and group-rate insurance to retailers who pledged not to sell competitors' shoes—was illegal even though the FTC proved no harm to competition. In so doing it brushed aside the company's observation that the franchise applied to only 650 of the 6,000 U.S. dealers that sell Brown shoes and that the franchised dealers, on average, bought 25% of their stock from other, not directly competitive manufacturers.

The part of the decision that seems to give the FTC new muscle is the emphatic assertion of that agency's authority to challenge potential restraints on trade "in their incipiency." In the specific instance of Brown Shoe, the Court said, the challenge was justified because the company is large and its franchise system "anticompetitive."

That's a tenuous principle, at best. Who is to say for certain that an "incipient" problem will ever become a real one? And since when is it a sin to be big and to try to outperform your competitors?

But the most regrettable effect of the decision is the new confusion it injects into antitrust law, an area that was already baffling enough. So far no officials of the FTC have commented publicly on the implications of the Brown case, but it is clear the agency regarded Brown as a test. It's a good guess that the FTC will soon proceed with dozens of formal complaints against similar programs; no franchise system can be considered entirely safe from attack.

Of course this isn't to say that all franchise systems operate in ways that are either desirable or defensible. In some cases they may give the manufacturer so much control that they facilitate price-fixing or otherwise truly restrict trade.

Nevertheless, a full-blown assault on the entire franchise structure could lead to the general discrediting of what can be a quite legitimate and valuable business tool—to franchise owners and consumers as well.

From the point of view of the store operator, the franchise offers an opportunity to identify with a big national company and to benefit from national advertising

and promotion campaigns. Franchise plans differ, but they often carry other benefits as well.

Properly handled, franchises can also be an advantage to the consumer. Franchised dealers frequently show more concern for their product or service than do the nonfranchised, simply because they have a direct stake in maintaining the national company's reputation. Complaints to the national company frequently get faster and more satisfactory results because of the company's close relationship with its franchise holders.

If franchises were to disappear or to become greatly damaged by a Government vendetta, the results are easy to predict. As a matter of self-preservation, many manufacturers would probably set up more factory-owned outlets as a substitute for franchise dealers, a step that could be pretty rough on the small businessmen Washington contends it favors.

There would still be a great deal of rugged competition, all right, but elimination of franchises would be likely to force concentration of retail-store ownership into fewer hands, the sort of thing the Government at least professes to abhor. No manufacturer who wants to stay in business can afford to cast his product onto the market with no thought at all as to what happens to it there.

Unquestionably, franchises on occasion have been and will be abused, and in such cases plenty of legal remedies exist. But no one will benefit if, in the current confusion, the system itself should be destroyed in a misguided attempt to cure its alleged ills.

Mr. EHRlich. I therefore respectfully urge this committee to give favorable consideration to S. 2549 so that the almost century old firm which I represent and the many, many other franchised wholesale distributors to exit and play our small role in the growth of the country of which we are proud to be a part.

Senator FONG. Mr. Ehrlich, you have gone through this Senate bill 2549 and you are satisfied with it?

Mr. EHRlich. Yes, sir, I am. I feel that that would clarify the present situation with respect to the uncertainty of franchises under the limitations set out in that bill.

Senator FONG. And you understand that, even with the passage of this bill, there may be antitrust prosecution if there is restraint of trade?

Mr. EHRlich. Yes, sir, I do. I also would like to point out to you, Senator, and your committee, that we are a small business; that our business, even though we cover this broad area, our volume is around \$5 to \$6 million a year. We are not a large wholesale distributor in excess of many, many thousands of dollars.

We do not carry cigarettes.

Senator FONG. And your business is different from the cigarette business. In the cigarette business do they go out and pick up dry cigarettes?

Mr. EHRlich. I am not certain, but to the best of my knowledge, if they do, it would be in a limited way.

Senator FONG. I see.

Mr. EHRlich. With reference to dry cigars, since that has been brought up earlier, I happened to see a debit memorandum just before I left Kansas City, and I believe for that one shipment, that covered about a month and a half, the credit which we will receive back on those dry cigars is close to \$9,000—which will give you some idea as to that.

Senator FONG. Senator Hruska?

Senator HRUSKA. You are familiar with the amendments proposed by Mr. Glaser, are you not?

Mr. EHRlich. No, sir, I am not.

Senator HRUSKA. In essence, what he would do is to extend this bill not only in its restrictive features to the franchise within a given territory, but he would extend it also to prohibit an outsider from coming into that territory, not only the supplier himself but an outsider, to bring in that same kind of merchandise that is the subject of the franchise, the bootlegger.

Would you be able to identify that as a situation in your franchise dealings?

Mr. EHRLICH. I would say this, that there are some shipments that do come in if you want to describe it as a bootlegging situation. We do have some.

Senator HRUSKA. If you were able to give a franchise to, say, somebody to cover the State of Nebraska and the State of Iowa, that franchise wouldn't be worth very much if you would be selling to somebody in Missouri who would then go into Nebraska with the stuff he purchased from you, and it is the purpose of the amendment to stop anybody in Missouri from coming into Nebraska with your merchandise.

Does that spell any difficulty in your pattern of doing business? That type of bootlegging from Missouri to Nebraska and Iowa in that situation?

Mr. EHRLICH. If I understand—you are talking about at the present time, is that correct?

Senator HRUSKA. Yes.

Mr. EHRLICH. Rather than Mr. Glaser's—

Senator HRUSKA. Well, really, under the bill, if it was legal to give territory to Nebraska and Iowa and it was also legal to give a franchise to somebody in Missouri, you would not be able to supply anybody else in Nebraska and Iowa, nor would you be able to supply anybody in Missouri.

Mr. EHRLICH. We have a situation like that at the present time, sir.

Senator HRUSKA. Yes, you have that so far. But when the man in Missouri buys from you and then he goes into Nebraska and Iowa, this bill would not cover his bootlegging. That is Mr. Glaser's position. And he wants it to include that kind of a situation.

Mr. EHRLICH. Well, I believe that would be a matter for the court's interpretation and it would be a matter for lawyers to advise me on.

I would say this, that as I understand this bill at the present time, even though this bill under the very limited conditions, would permit the giving of a territorial franchise, it would still be up to the manufacturer and the courts, the manufacturers to try and enforce it and the courts to interpret that. And I don't see how I could testify as to what the effect of that bill would be under Mr. Glaser's amendments, because, to me, that would be a matter for lawyers to interpret.

But I would say this, from the standpoint of our company. We do not knowingly ship outside of the areas for which we have the franchise. Now—and what I started to say was that as far as—in our State of Nebraska, we do have certain brands for which we have part of Nebraska. There are other distributors in Nebraska. There is one at Grand Island, Nebr., who has the franchise for that same brand.

Since he has it for that section of his territory, we do not send into that portion of Nebraska.

Senator HRUSKA. Thank you. That is all the questions I have.

Senator FONG. Thank you, Mr. Ehrlich.

The next witness is Mr. Owen Beach, vice president of General Tobacco & Candy Co., Lincoln, Nebr. Will you please come forward.

Senator HRUSKA. While the witness is coming up, may I say Mr. Beach is from the capital city in my native State. He is, I believe, sort of the second generation in his business. Mr. Baldwin was a pioneer in this business and his father before him a merchandiser in Nebraska. I recall well Mr. Baldwin's efforts to get into the field of legislation for functional discounts under the Robinson-Patman Act and way from those early years I learned a little bit about the company of which Mr. Beach is vice president.

It is a well run company, well administered, and the problems it is battling are not the regular competitive problems but, rather, some of these exterior forces about which he is going to testify.

I am glad to join you in your welcome to Mr. Beach at this time.

Senator FONG. You are welcome.

Mr. Beach, go ahead.

#### STATEMENT OF MR. OWEN BEACH, VICE PRESIDENT, GENERAL TOBACCO & CANDY CO., LINCOLN, NEBR.

MR. BEACH. Thank you, Senator Hruska for your kind comments.

Gentlemen, my name is Owen Beach, vice president of General Tobacco & Candy Co. of Lincoln, Nebr. The firm, which handles a wide range of consumer products, was established by my father-in-law 27 years ago and I seem to belong to the generation sometimes referred to as "marrying the boss' daughter." Specifically, however, my marital status, happy as it is, had but minimal influence in my decision to respond affirmatively to the invitation to join the firm.

I was persuaded to invest my destiny in the enterprise for several reasons:

(a) The firm was enjoying an enviable reputation as an effectual and dynamic vehicle in expediting the movement of branded products from the maker to the retailer.

(b) Owing to its fine character, it has served as a magnet for producers of new and established products using its services to assure maximum exposure in the market.

(c) As a student in marketing, I was fully aware that consumers are excited and interested in newness and novelty. This is sharply underscored by our annual explosions of new automobiles, television sets, and major appliances. Even though a product may continue to be mechanically and physically superior for many years, the manufacturer who with reasonable frequency creates something about his product which permits the facade of newness or novelty is truly giving the customer what he wants.

(d) I was further persuaded by the knowledge that an efficient distribution system requires people to run it who have been nurtured under a regimen that teaches personal responsibility in an atmosphere of challenge. Since this is exactly the opposite of that of a dictatorship—which initiates discipline from above—the opportunity to become allied with a distribution establishment had a particular appeal to me and my family.

I feel very firmly, however, that were anything to occur to deprive the firm—which, thanks to the aid and counsel of my father-in-law, I have been given responsibilities of total management of—to vitiate

or nullify its opportunities of getting products on franchise basis, my attitude toward and confidence in the long-range prospects of the firm would require a lot of soul-searching and studious reexamination.

As a young man, I am candidly puzzled about the hullabaloo appertaining the monopolistic overtones of franchised products. In my experience, I find that the contrary is the prevailing condition. Every competitor militantly promotes his franchise in competition with all the others. It seems to me that the true version of it is that franchises are the veritable deterrent to monopolies.

Senator FONG. Have you any questions, Senator Hruska?

Senator HRUSKA. Yes.

Thank you, Mr. Chairman.

Mr. Beach, you seem to think that if it were not for franchises being a continuing way of doing business, you would engage in a lot of soul-searching and studious reexamination. That is a diplomatic way of saying you would consider quitting this line of business in this way, is that it?

Mr. BEACH. You hit it right on the head, Senator. I would.

Senator HRUSKA. What would develop? If that were done, what would develop in the sales of cigars and tobacco? Small businessmen would be out of the picture. Somebody would sell tobacco. Who would it be?

Mr. BEACH. Who would it be? Well, the only thing I can say, Senator, is I appear here for this bill, S. 2549, in order to protect people like me and our company. If we drop out of the picture—and there have been some figures presented earlier today on the disappearance of the small jobber—the job probably would fall back on the manufacturers. And I think it has been shown that they cannot distribute economically or get their products out to these small retailers which are the type that we do service, in our area, as you know.

Senator HRUSKA. Well, from that, I would gather that two results would flow from the removal of the small businessman such as your company so well represents.

One is that the sale of tobacco products, cigars, and the like, would concentrate into the hands of the manufacturer who would have to do it the best he could.

Mr. BEACH. Correct.

Senator HRUSKA. If that were done, we run into a relatively small number of salesmen in the field and that would go toward monopoly; wouldn't it? That would go toward lessening competition?

Mr. BEACH. This is true; but it also would eliminate the small manufacturer who cannot compete with the big one.

Senator HRUSKA. And who is not in a position to do marketing directly on that basis.

Now, the second effect that would be indicated by your answer is this, that without somebody in the field to render the service that you and that retailers have always considered necessary, service would be out of the picture; wouldn't it?

Mr. BEACH. Yes.

Senator HRUSKA. So we would find first of all a concentration of large dealers, meaning a tendency toward monopoly? We also would find a lessening of service to the consumer and we ought to have some consideration for the consumer. He is pretty important.

Mr. BEACH. Very important.

Senator HRUSKA. Very important.

Mr. Chairman, I think that the points made by this witness are quite pertinent to the core of the thing and from a very valuable standpoint.

Thank you for the opportunity given me to ask him questions.

Senator FONG. Thank you.

The next witness is Bernard A. Martin, Capital Cigar & Tobacco Co.

Mr. Martin.

**STATEMENT OF BERNARD A. MARTIN, PRESIDENT, CAPITAL CIGAR & TOBACCO CO., WASHINGTON, D.C.**

Mr. MARTIN. Mr. Chairman, my name is Bernard A. Martin, and I am president of the Capital Cigar & Tobacco Co., Washington, D.C., a wholesale firm engaged in handling cigars, cigarettes, and sundries, rendering service to over 4,000 retail outlets in the District of Columbia and adjacent counties of Maryland and Virginia.

To implement this service, we employ salesmen to canvass customers, an office staff, shipping and receiving personnel, warehouse people, order pickers, order checkers, and allied employees. We receive our merchandise in large bulk, warehouse and store it, and break it up in the smallest of units to accommodate even the most modest "papa and mama" store. Our cost of doing business ranges between 6 and 7 percent of sales, our gross markup is only marginally above that to enable us, by dint of effort and business prudence, to net around one-half of 1 percent on sales. While we handle and market a large assortment of merchandise, traditionally and inevitably the benchmark of our operation and, for that matter, our very survival is grounded in the retention of cigar franchises. Without such cigar franchises, it is doubtful whether our firm or any firm similarly situated could be perpetuated.

It stands to reason that few, if any, such manufacturers of cigars could, by their own unaided efforts, obtain distribution of their products on a nationwide basis. In order to introduce their respective products to retailers within any specific region, they must obtain the services of a firm such as our own, willing to undertake the costly and time-consuming promotional activities necessary to generate consumer acceptance.

Before undertaking to assume the heavy obligations of cigar brand representation, my firm employed scores of college students to make a serious, intensive, and in-depth research of cigar-smoking patterns in our market, including the number and types of retail outlets through which cigars could be sold or were actually being sold.

Having established the potential of our market, it was necessary to take effective steps to exploit it for the benefit of our franchise brands. We had to call on considerably more than 5,000 retail accounts in order to induce a substantial portion of our present customers to stock and display our franchise lines. Then, having introduced the brands, these customers had to be persuaded to permit our salesmen to put up posters and point-of-sale material so as to attract consumer attention. In addition, calls have to be made at regular intervals upon each of our retail customers. These calls are not only for the purpose of soliciting

reorders, but for the equally important purpose of checking on retailers' stock to assure the freshness and salability of their cigars.

Cigars are a delicate commodity. They lose flavor, taste and consumer acceptance when not sold in peak condition. To preserve good will in our franchise products, we must constantly check our customers' stock and take back—for credit—cigars in stale, deteriorated, or unsalable condition. In our own warehouse, we maintain extensive humidification facilities to protect the manufacturers' brands in accordance with established industry practice. In addition, we give instructions to retailers in basic humidification precepts and we aid such retailers to obtain humidification units.

Nor is this all. In addition to our routine calls on trade, we run, in behalf of the manufacturer, special promotional drives at particular seasons of the year. Contests are often held and valuable prizes given to our customers and to our salesmen who maximize distribution and sales. Advertising is engaged in—in the form of handbills, newspapers, radio, and television. Our devotion to our franchise brands is a continuing and ongoing endeavor. Naturally, we expect to be recompensated for the efforts we are expending.

Our efforts, endeavors, and financial investment have benefited the manufacturers we represent. When the Capital Cigar & Tobacco Co. was given the franchise for Muriel and Dutch Master cigars in 1952, the volume of these brands in the Washington market was practically nil and it was only through time, effort, and energy on the part of our firm that they were built to the point where they now enjoy a large percentage of sales in the Washington market. This also applies to practically every franchise we have.

A franchise distributor who invests years of life, a major portion of his savings and labor, as well as the efforts of his sales staff, in the development and growth of a cigar brand has contributed much to the manufacturers' good will in that brand. He is certainly entitled to regard himself as having a property right in his franchise as a joint creator with the manufacturer of the reputation and esteem in which the manufacturer's product is held in the distributor's market area. Not only is he entitled to this property right, but he also should have the necessary protection, provided the manufacturer agrees. The law should not prevent this.

That he must put forth effort and must show results is manifest in the requirement that he account to the manufacturer for the amount of products sold and establish that he is meeting his reasonable quota in the market in which he operates.

A cigar distributor who so performs provides an invaluable service not only to the manufacturer but also to the community by keeping before the public a product which otherwise would not be available; he insures against price rigidity and monopoly which otherwise would prevail if only a few of the leading cigar products were exposed to the consumer.

It is not only fair and proper, but imperative, that the cigar manufacturer be permitted to grant to him the exclusive right to sell in the geographic market which he has created, so long as he continues to do the painstaking and careful job of maintaining and promoting the manufacturer's product.

There is tremendous competition at all levels in our industry. In Washington, we compete with six wholesale distributors and seven

subjobbers. In addition to this competition, many of the manufacturers sell their products direct to the large chains. This competition also exists at the retail level giving the consumer a free choice of merchandise at whatever price he wishes to pay.

In conclusion, I would like to point out that the granting of an exclusive franchise to the distributor does not run contrary to the American ideals and traditions of free enterprise and open competition. The average distributor handles many cigar lines, most of which compete with each other at both the wholesale and retail levels. Capital Cigar & Tobacco Co. handles White Owls, Muriels, and Optimos from three different manufacturers, all retailing at 10 cents. We also distribute Robert Burns, Dutch Masters, Berings, and Optimos which compete with each other in the two-for-a-quarter-and-up price categories, in addition to many other competing brands.

This does not in any way deny the consumer the greatest possible freedom of choice and value. Should the franchise system be destroyed, the small manufacturer, who depends on the wholesaler for his distribution, would no longer be able to compete with the large manufacturer. This would result in less competition and do a disservice to our free enterprise system.

Senator FONG. Mr. Martin, does your Capital Cigar & Tobacco Co. now have a franchise for White Owl?

Mr. MARTIN. Yes, sir, we do.

Senator FONG. And for Muriel and Optimo?

Mr. MARTIN. And many other brands.

Senator FONG. Three different companies?

Mr. MARTIN. Three different companies all selling the same price merchandise.

Senator FONG. How many franchises do you have?

Mr. MARTIN. I would say we have approximately eight. Of course, these manufacturers manufacture many price categories and brands. We do business with approximately eight manufacturers.

Senator FONG. And when you say you are in competition with six wholesale distributors, you mean you are in competition in the cigar business?

Mr. MARTIN. In the cigar business, and they have comparable brands, from other manufacturers in the same price categories. We are out trying to get placements and business on the particular brands we are responsible for against the brands our competitors sell.

Senator FONG. And if you did not have the franchise, you would not put the effort into it?

Mr. MARTIN. We could not afford to put the effort into it. We have built these brands. We have rendered a service and have gotten the necessary distribution.

A distributor who is willing to do this work can always get a franchise. He will have no trouble obtaining one. There are plenty of franchises available, but you must put forth the effort, spend money and invest years of work, we invested many years of work before we began to show a profit.

Senator FONG. How many franchises do you say you have?

Mr. MARTIN. We have approximately eight.

Senator FONG. And how many manufacturers of cigars are there in that?

Mr. MARTIN. I would say we do business with about eight manufacturers. We do business with a small firm that makes House of Windsor cigars. If we did not get the distribution for them, they could not get into this market. They need a cigar distributor to get the distribution for them. Their cigar was unknown in this market. Today it is known due to the efforts of our sales force, investment of capital, and time.

Senator FONG. If you did not have the franchise, the small cigar company could not get distribution.

Mr. MARTIN. They could not come into this market without assistance. Some distributor would have to do it for them. Otherwise, they could not compete with the large manufacturer. If you eliminate franchises, you will wind up with the cigar business in the hands of one or two manufacturers and you will have fewer distributors. Instead of encouraging competition, it will do just the opposite.

Senator HRUSKA. As a matter of fact, Mr. Glaser indicated that about 65 percent, or two-thirds of the market, is being supplied by six large tobacco companies. Is that a statistic that is familiar to you?

Mr. MARTIN. No. If it is a statistic, it does not exist in Washington.

Senator HRUSKA. No; perhaps not, because his testimony was further to the effect that there are still 336 cigar manufacturers in America.

Mr. MARTIN. He happens to have one brand which is exceptionally strong, built over the years, and I believe he is using a figure based on his experience, I can only speak for myself.

Senator HRUSKA. The point I want to make is that there are many manufacturers, 336 in 1965, according to Mr. Glaser's testimony.

Now, if his testimony is correct, there is a concentration to this extent: that about 65 percent of the market is being supplied by six large tobacco companies.

Now, what would happen if you had a destruction of the franchise system? What would happen in regard to the size of those six companies and the remaining 330 companies?

Mr. MARTIN. Senator, I believe if we did not have the franchise system, you would not wind up with six. I think you would wind up with two or three manufacturers dominating 95 percent of the cigar business.

We represent many small manufacturers, such as the Blue Ribbon Cigar Co., a very small manufacturer in Pennsylvania. Rum River Crook, another small manufacturer, House of Windsor, which I mentioned before. Only through our efforts are they able to exist in this market or exist in the cigar business. The same applies in any market they may go into. If they do not have a good distributor who is willing to take on the responsibility of distributing their products, they are out of business; and if we did not have a franchise system, these manufacturers must go by the board.

Senator HRUSKA. The franchise system, of course, is under heavy and intense attack in all lines of business. Only lately the Supreme Court spoke in the *Brown Shoe Co.* case and they gave them the boot and I imagine that same thing is being attempted in the *Schwinn* case and in the *Sealy* case.

Now, it would seem that there is a policy being followed which would result in the buildup of the big corporation and that means a

tendency toward monopoly. It means a tendency toward a position where competition would lessen. Would you agree with that?

Mr. MARTIN. Yes, I agree; I believe this would happen if you eliminate the franchise system in the cigar and candy field. We have plenty of competitors in our business. There is no lack of competition. As far as this bill is concerned, competition is so keen without per se rule, if this were ever taken to court, I don't believe there would be any question as to the outcome. I would not hesitate to go to court as far as our industry is concerned.

Senator HRUSKA. We have had some hearings, Mr. Chairman, on this general subject of franchises in our series distribution. I suggest to the chairman that these hearings be included in that series, because here we are dealing with field application, instead of abstractions, generalities, theory, and philosophy. Here we see exactly how finely ground the process of competition is really being—how it is really suffering. I would say that it would be well to have this type of testimony in that series franchises in the larger field.

Mr. MARTIN. I agree with you, Senator.

Senator HRUSKA. Thank, you, Mr. Martin.

Mr. MARTIN. Thank you very much.

Senator FONG. Senator Eastland, chairman of the Judiciary Committee, of which this is a subcommittee, has asked that we call Mr. J. C. Williams, who is president of the Corr-Williams Tobacco Co., Jackson, Miss., to testify.

Mr. Williams, Senator Eastland is unavoidably detained. He is sorry that he is not here to introduce you.

Mr. WILLIAMS. I am sorry to have missed him. I am glad to have this opportunity, gentlemen.

#### STATEMENT OF J. C. WILLIAMS, PRESIDENT, CORR-WILLIAMS TOBACCO CO., JACKSON, MISS.

Senator FONG. You may proceed. Do you supply Senator Eastland with all the cigars he smokes?

Mr. WILLIAMS. Down in Mississippi.

Senator FONG. That must be a pretty good cigar, because he is always with a cigar.

Mr. WILLIAMS. He is running for reelection—

Senator HRUSKA. We hope you are not giving him any functional discounts.

Mr. WILLIAMS. Senator Eastland has been very honest. Our families sort of grew up together, we and some of the others down there.

I will read my statement here. My name is J. C. Williams, president of Corr-Williams Tobacco Co., headquartered in Jackson, Miss., with branches throughout the State.

May I point out at the outset that owing to the changed complexion, in recent years, in the pattern of retail distribution, the term "tobacco" in the title of the firm is rather an anachronism because our assortment of products encompass items of several dozen fiercely competing manufacturers.

As an example, we handle several numbers of 10-cent cigars, 5-cent cigars, two-for-25-cent cigars, and so on. We handle a number of blades and shaving instruments all encountering merciless competi-

tion. This picture equally applies to a number of other consumer goods. Notwithstanding the aggressive distribution accorded all these branded products, we do not enjoy more than 20 percent of the market potential in any of our establishments.

As efficient distributors, we spend our time and money to develop a market for the product of the manufacturer. Certainly, it would be foolhardy on our part or for that matter—on the part of any prudent businessman—to dissipate hard-earned cash to cultivate a market for a branded product without any expectation of reaping a reasonable harvest for the investment. After all, our form of society fortunately differs from other societies. This is the reason why an efficient mass distribution system was never developed by others. Their political climates simply do not inspire the sort of energetic effort that produces tangible results.

Let us ask ourselves—why are we in business? Under our free American democratic system, we engage in business for a threefold purpose: One, to exercise initiative; two, to earn a livelihood; and, three, to make a profit.

Since no one is “an island unto himself,” we can only prevail by engaging, orienting, and training people to carry out assignments and follow through on programs. In effect, we can only succeed by providing an opportunity for our people to succeed.

Industrial history emphasizes the truism that no one worthy of respect or reputable business status can be “all things to all men.” We endeavor to utilize our abilities and talents to the maximum advantage of all concerned. Maximum advantage to the consuming public by assuring it ready availability and easy accessibility to meritorious products; maximum advantage to our personnel by infusing them with pride in the products we handle; maximum advantage to manufacturers of qualified products by assuring them a close coverage and attractive exposure; maximum advantage to our competitors because when we dynamically promote a franchised product, we activate and spark them to the need and urgency of aggressively promoting their competitively franchised products.

Because we are in daily contact with actual market conditions, we become acutely sensitive to the desires of the consumers. As a result, we are often called upon to advise manufacturers on market trends and to recommend new product or product improvements. Were it not for franchised products, our interest in such preoccupation would be reduced to naught.

Senator FONG. How old is your company, Mr. Williams?

Mr. WILLIAMS. The Corr-Williams Tobacco Co. was established in 1904.

Senator FONG. And how many franchises do you enjoy?

Mr. WILLIAMS. We have eight houses and at the Corr-Williams Tobacco Co., I would say we have about 10 franchises. We have houses that have practically no franchises. For instance, in Mississippi, we cover about two-thirds of the State with eight houses. Most of our houses are old established houses which we have bought from time to time. Some of these houses have few or no franchises.

Senator FONG. When you say “old houses,” what do you mean, branches? Do you call a house a branch?

Mr. WILLIAMS. Houses built and operated by other people and then we bought them and operate them as branches of our business.

But we are not under our franchise set up with the manufacturer privileged, and we try to follow the wishes of the manufacturer to sell his products to our other houses even though he may not be in a position to tell us "don't ship these cigars to this house or that one." We do respect his wishes in that we buy from the franchised distributor, in the territory where our branch house is located, or we do without the product. But we are looking at all times like all jobbers are for franchises of different products, not only cigars but other products that will lend to help build the business, because without franchises in a jobbing setup such as ours, you have very little.

And if I might take a minute, I would like to give you an example of how you take advantage of every opportunity you have to try to establish a franchised product.

We have a small cigar manufacturer over here in Red Lion, Pa., the Neff Cigar Co. I doubt if any one of you gentlemen ever heard of him. Mr. Neff. He is a very small manufacturer and sells his cigars in a very limited territory. We are members of the Mutual Merchandising Cooperative, which is a buying organization for gift items, houseware items, and a sort which we sell through a catalog and a catalog department. In connection with that, and through Mutual, several years ago, in 1963, I believe, we were given the franchise on the 5-cent cigar, "Mac," manufactured by the Neff Cigar Co. Well, the problem is always what do you do to establish a brand that had been entrusted to you by a manufacturer? At that particular time, in Mississippi, we were trying to find a way to raise the the gunboat *Cairo*. You gentlemen may be acquainted with the battleship *Cairo* which was sunk in the Yazoo River close to the mouth where it runs into the Mississippi. Governor Barnett had appointed me chairman of a finance committee, and I was trying to raise funds. I could not even get my own committee to contribute any money. So we tried to figure how could we kill two birds with one stone, to be perfectly frank. So, our company took the gamble, even though many people said they did not believe the *Cairo* was down there. They knew something was down there. We were convinced that the *Cairo* was there, as our boys who had been doing the diving to determine just what was there assured us that it was the *Cairo* and that it could be brought up. At that point, our company determined that would take the gamble to raise the boat provided we could devise some means of trying to recoup the money we might appropriate for this purpose.

So this brand of "Mac" cigar being new with us, we made a proposition to all our dealers throughout the territory. We have this particular brand "Mac" on a franchise basis in all of our houses. We set up displays on the dealers' counters—here is a picture of it here, as you can see—and said that we would contribute 25 cents a box for a 4-month period for every box of cigars that they sold provided they would set a "Mac" empty box on top and distribute a card which gave the story of the *Cairo* which was sunk, I believe in 1862 by our southern boys down there. It was not a southern boat, but instead a Federal gunboat.

Anyway, we said we would contribute that and we felt sure that within that period of time we would be able to collect at least a good part of what was considered necessary to raise the boat; at least get it up where people can say, yes, this is it, and then we would get the State or someone to come in and help out.

So we as a company contributed \$20,000. Then we printed a half million of these cards and the only reference to advertising, which, of course, is playing our brands, is at the bottom of the card—this is the story of the *Cairo* and a picture of it. This reads, "This historic information made available and distributed by Mac 5-cent cigars and the dealer you received it from." And that was set on the counter of many thousands of dealers with a large card reading, "It is history, take one," and as a result, we collected about twice the amount of money that we thought we would collect.

We raised the *Cairo* up. However, it broke and settled back to the bottom of the river. Then the State, because they were sure it was there, willingly contributed, I think, about \$16,000, broke it all to pieces and got it up. Now it is in the hands I think of the Federal Government who will restore it at a cost of several million dollars and make it a part of a national cemetery setup at Vicksburg.

So we not only, as I say, killed two birds with one stone. When the job was finished, we had spent beyond what we had collected, because advertising of all types was used, we had spent possibly \$15,000, but we had established a brand, too.

So when it comes to any brands, what do you do? The one thing you have to do you have to have distribution. You have to have—you have to show it to the consumer. You have to do that something which will attract consumers' attention to it. So as I say, in this instance, we used this means.

Senator FONG. How much did you spend to put this brand on the market?

Mr. WILLIAMS. We spent in total about \$30,000. The brand today, I am glad to say, is our leading 5-cent cigar. But the happy thing of it is we sell just as many other brands of 5-cent cigars and we must handle—we are in Mississippi, remember and the buying power in Mississippi is not what it is in New York or California. We sell just as many 5-cent cigars as the other brands, in fact, we have shown an increase not only on our 5-cent cigars, as we did the others. We don't neglect one for the other. We must handle five or six 5-cent cigars, but we try also to promote new products, especially where we think we have a quality product, where the manufacturer will stand behind it to the extent that if it is necessary for us to pick up dry unsalable cigars, they will make them good. But we try not to promote one at the expense of others.

Of course, our operation is pretty wide in its assortment of merchandise. When it comes to franchises, it is not confined just to cigars. We have items of small manufacturers, like—Mr. Neff who could never go out on his own and get a distribution that our 50-odd salesmen get in the territory, and that is true all over the country with the other jobbers, because it is too expensive. But these other small manufacturers—take, for instance, I took on right recently, you may laugh at this, a potato chip franchise, a little fellow who makes potato chips. But he is interested in selling them. He can't afford a sales organization. In many instances, we broke his carton and would sell a dealer a half dozen packages of 10-cent potato chips.

We have taken on another franchise of certain medicines like one is a cough drop and one is Johnson's antiseptic, for instance, packed in a dozen. If need be, we sell a quarter of a dozen or half a dozen. We

stand behind it a hundred percent with the dealer. We try to get him to put it on the counter to get as good a showing as possible, because the little manufacturer does the best he can to stand behind us. And in my opinion, those are the things that we are talking about. How do we help the little fellow do more business? How do we all do more business? And the franchise system from my point of view is the only proper system to keep competition free and open. I have only been in the jobbing business really since 1953. This is not a family business. I bought this business from Mr. Walter Gibson, who was there 49 years prior. But I have learned that you sell more goods by adding new products which you can go out and do something to promote, something that the small manufacturer cannot.

As we look back, isn't it a fact that most of our big manufacturers today were small once upon a time? And that is what franchise in my opinion does. It enables the little fellow to get a start and what I am afraid of today under the questionable conditions; that is, is that we cannot effectively handle my product, a new product or a new business I may venture into, in a safe and sound way. Can I depend upon franchise distributors? Can I get franchise distributors to do the job that is to be done? It is the little fellow and not only the little manufacturer but the dealer, the little dealer must protect.

As I say, in our thinking it goes far beyond just cigars, but cigars, of course, is the most important thing that we have on which we have franchises. And we value those franchises and we spend a lot of money as I have illustrated in this one instance of taking on a new brand, to try and promote the brand, but if you didn't have an opportunity to, with some protection, that you could continue to have that brand on a basis of a franchise basis, you cannot afford to do it, that is all. You just couldn't do it.

In the first place, you wouldn't carry it.

Senator FONG. Senator Hruska, any questions?

Senator HRUSKA. How many distributors like yourself are working in Mississippi?

Mr. WILLIAMS. Well, I would say—

Senator HRUSKA. Companies of your nature.

Mr. WILLIAMS. There are about 35. Our State is small, you know, in a lot of respects. It is about 35. In no instance is there a section where I have a house that I don't have competition.

Senator HRUSKA. Mr. Williams, there have been some dire predictions here as to what happens to small business if the franchise system is held illegal per se in and of itself. What do you think would happen in Mississippi, it being a small State and one having a relatively small per capita income; what do you think would happen by way of sales there if the sales in America would gravitate into the hands of a relatively few large companies?

Mr. WILLIAMS. Well, you would have—you are bound to have in our territory reduced sales. Because in our instance, if we did not have franchises or if we had no opportunity to get franchises, I would get out of the business. I have been in the business since 1953, and I have enjoyed the business and I have had good relationships, but I don't have all the franchises by any means. But I am working toward each house getting franchises that will help not only me but will help the little dealer to sell more goods and we are selling more good all the time.

Senator HRUSKA. When you talk about the little dealer selling more goods and making a little profit and earning a livelihood, there is something beyond that, isn't there? There is a service being rendered that is wanted by many thousands of people in your State?

Mr. WILLIAMS. That is right. We service—

Senator HRUSKA. And if you don't have the sales, you don't have those services available.

Mr. WILLIAMS. You cannot—in our State, as you can well imagine, if you have not been in the State, we have a lot of really small dealers, but to us they are valuable and we service them. We call on with our eight houses about 7,000 accounts and there is not a—I daresay there is not a single one of those approximately 7,000 accounts that is not called on by other distributors. We don't enjoy, as my statement says, probably over 20 percent of the business.

Senator HRUSKA. Well, you know, that is quite a bit, Mr. Williams. The Supreme Court tossed out a merger a couple of weeks ago where the merger covered only 7½ percent in one of our big cities. You had better look out.

Mr. WILLIAMS. Not any instance we don't. Some of them we don't go that high. But there is no instance where we go better than 20 percent.

Senator HRUSKA. Of course, this isn't a merger case. However, it is a franchise case; and, if the effect will be to impair the position of the small dealers, then you would be in trouble.

Mr. WILLIAMS. In my opinion, if we didn't have franchises or opportunity to acquire franchises in the houses that we don't have, I wouldn't be interested in the business, because there are so many other businesses that you can get in.

Senator HRUSKA. Thank you very much.

Mr. WILLIAMS. Yes, sir. Thank you.

Senator FONG. Mr. Chester Inwald, Hartman & Craven. Mr. Inwald.

**STATEMENT OF CHESTER INWALD, OF HARTMAN & CRAVEN,  
ESQS., NEW YORK, N.Y.**

Mr. INWALD. Thank you, Mr. Chairman.

Senator FONG. I was informed that probably by 12:20 we will have a vote on the treaty, and we will not be able to go to 12:30. Meanwhile, you have a very long statement here. The statement will be incorporated as if all of it were read and you may proceed as you wish.

Mr. INWALD. Thank you, Mr. Chairman.

Senator FONG. If you will just give us the highlights.

Mr. INWALD. I believe incorporating the statement in the record as though it were read would be adequate.

Senator FONG. That would be fine.

Mr. INWALD. I would prefer to address myself to certain points which have come up in the course of the hearing. In that regard, I have before me a copy of Management Aids No. 182, issued by the Small Business Administration, containing a statement by the president of International Industries which the Small Business Administration issued in March of 1966. The first paragraph of this Management Aids states: "Franchising offers small companies a way to accelerate their growth, to increase sales. In this method of distribu-

tion, the small manufacturer can obtain new outlets for his products by granting franchises to men who are also small businessmen."

This was in March of 1966. In February of that same year, Professor Turner, Assistant Attorney General in charge of the Antitrust Division, U.S. Department of Justice, made a speech before the New York State Bar Association, antitrust law symposium. Segments of that speech I already have quoted in my statement submitted. But at the outset of his speech, Professor Turner says, "I approach territorial and customer restrictions not hospitably in the common law tradition but inhospitably in the tradition of antitrust law."

Well, I assume the businessman will read the Management Aid given him by the Small Business Administration and he might consider going into franchises. His lawyer, however, will read the 1966 New York State Bar Association symposium which carries Professor Turner's speech and will tell his client not to go into the franchise.

I submit that right now within our administration we have a split personality in enforcement problems. Nobody really knows to what extent franchises are valid if at all. At this time we are all familiar with the fact that starting in 1949, and reaching its apex in 1958 or 1959, the Antitrust Division of the Department of Justice took the position flatly that a territorially restricted franchise was a per se violation of the law. They have not completely abandoned this position. They have gotten consent decrees even as recently as 1963, 1965. There are about 26 or 27 of such decrees.

In the statement by Professor Turner, which I have quoted in my prepared statement, he says he sees one justification only for a restrictive territorial franchise and that only for a limited period of time. That is in the case of the introduction of new products or the introduction of a new manufacturer.

This was, as I say, in February of 1966. In August of 1965, some 6 months before that, Professor Turner, in a speech before the American Bar Association, stated, "In one unusually thoughtful study, the author concluded that territorial restrictions on dealers were justified only in two limited situations. One, where a manufacturer was seeking to enter a market for the first time. And the other where the manufacturer was so weak and the market for his products so thin that he could get distribution on no other basis."

Now, this was 6 months before. Suddenly, the situation of the weak manufacturer and the thin market has disappeared between August of 1965 and February of 1966. At present there is only one justification.

I submit, gentlemen, that the law is not clear on this subject, that the guidance we are getting from administrative personnel, from people charged with enforcement of the antitrust laws, changes, blows with the winds of change from time to time, that they, as much as the businessmen, need guidance under what circumstances and what situations a franchise is clearly not a subject which carries the anticompetitive effects which we all fear.

Now, it is useless to discuss with this honorable committee the factual background or legal background concerning franchise distribution. You have held many hearings on this subject. You have amassed a plethora of information on it. There is little that can be added by discussion the *Arnold Schwinn* case, the *Sealy* case, the *Sandura* case, and all these others.

Incidentally, in terms of guidance, the *Sandura* case is interesting in that the Solicitor General refused to take this up to the Supreme Court for guidance, refused to get an ultimate decision from the Supreme Court on that situation, which is duplicated in many other instances. Consequently, for the small businessman to have to wait for a case-to-case determination of this thing means that his hope will be deferred, his chances are gone and his lawyer who doesn't read the management aids but reads the antitrust symposiums of the bar associations will discourage him from doing what the SBA urges him to do and we will continue to watch an attrition of small business while government hesitates—on both sides of the doorstep.

Nor is the Federal Trade Commission's position that clear cut on the situation either. The Federal Trade Commission has said, let us wait until we amass the economic information necessary for us to know whether there are some circumstances where a franchise does not have an anticompetitive effect. They take as their bellwether on this the decision of the Supreme Court in the *White Motor Car* case. That case was decided in 1963. Since that time, there has been more than enough opportunity for the Federal Trade Commission to conduct massive investigatory studies, and they have that power, more than enough time, which has been most fruitfully employed by this committee, to look into the entire subject of franchise distribution, and certainly enough time to come to at least tentative conclusions as to some circumstances where a franchise system would not have anti-competitive effect.

To date, except for this honorable body, nobody has come out with guidance. The Federal Trade Commission on a case-to-case basis has held that Sandura's franchise arrangement violated the law. That was reversed in the circuit court; the Commission held on a case-to-case basis that the Snap-on Tools franchise system violated the law. That was reversed on a case-to-case basis.

Gentlemen, we cannot afford to go on, on a case-to-case basis. Most firms do not have the resources to battle this thing up to the circuit court of appeals, let alone to the Supreme Court. They require some guidance from the legislative bodies which have enacted the Sherman antitrust laws, the Clayton Act, the Federal Trade Commission Act, to let them know under what circumstances a manufacturer may validly enter into an agreement with his distributor restricting the territory in which the distributor may resell the product.

I submit that S. 2549 very carefully delineates those circumstances under which it can be done. It does not carry with it any overtones which would result in undue restraint on trade. It carries with it enough built-in precautions to make sure this can only be done in a thin market such as many of the gentlemen who testified before me have given evidence of the existence of, or it can only be done in a situation where there is vigorous and active competition, to use the phrase of the circuit court of appeals in the *Snap-on Tools* case, "where competition is bitter and bloody."

Now, given that set of circumstances, there is no reason at all why a franchise system should not be allowed; and there is much good reason in terms of encouraging competition, of keeping viable small competitors, why franchise systems should be used.

In the trade which I am privileged to represent, there are distributions on different levels, cigarette distribution, cigar distribution,

candy distribution. It is significant that the cigarette distribution picture shows no franchise arrangements at all and there you have, in effect, an oligopoly in terms of few manufacturers, in terms of administered prices, if you will, but there are no franchises.

The cigar business, which is vigorously competitive, is characterized by franchises. So we cannot make hard and fast rules. All we can do is establish guidelines. I submit that S. 2549 gives you those guidelines. I submit that anything else I have to say is already in my statement and I thank you very much.

Senator FONG. You are satisfied with S. 2549, is that right?

Mr. INWALD. I think it adequately serves the purposes of advising manufacturers and distributors under what circumstances they may with impunity enter into a franchise arrangement.

Senator FONG. Mr. Cohen, do you have any questions?

Mr. COHEN. As I understand, most of the testimony so far here today is concerned with the preservation of the smaller businessman and smaller manufacturer, is that it?

Mr. INWALD. I had understood it the same way, Mr. Cohen.

Mr. COHEN. Suppose we had a bill that said where smaller manufacturers are involved and give you certain lines—say where no manufacturer has more than, say, 8 or 9 or 10 percent of the market—that exclusive territorial franchise could not be a per se violation. But that if a manufacturer had over—say, 20 percent of the market—it would be a per se violation. Now, wouldn't that protect the smaller manufacturer that we are talking about and at the same time leave the court free to set forth some reasonable rules in this area?

Mr. INWALD. I would think that you would run into more problems in trying to draw lines that way. The Small Business Administration has had an awful time determining under what circumstances a business qualifies as small business.

Mr. COHEN. Precisely. It would be difficult, but it would give you that same certainty that you are asking for.

Mr. INWALD. On the other hand, it would not give you the flexibility that you need to temper the thing with the economic situation now. A small manufacturer in steel is a different thing than a small manufacturer in bobby pins.

Mr. COHEN. Take your own market, New York. Suppose Chrysler had one dealership in all of New York, Ford had one dealership in all of New York, and Chevrolet had one dealership in all of New York. Now, I would assume at least as a consumer you would think that such a situation would have anticompetitive effects and possibly should be ruled illegal per se.

Mr. INWALD. You are talking now about distribution at the retail level, aren't you?

Mr. COHEN. Yes.

Mr. INWALD. It would be rather difficult for me to get from where I live to the particular dealer in Fords, that is true.

Mr. COHEN. The one dealer could establish branches throughout the city. He would have exclusive territory.

Mr. INWALD. Is that like the Bruno situation?

Mr. COHEN. That is a different kind of situation than when you are talking about an industry that might have 1,200 manufacturers.

Mr. INWALD. Yes.

Mr. COHEN. When we are dealing in a commodity like cigars.

Mr. INWALD. That is right, in an oligopolistic industry—characterized by a few producers—in those cases you have more chance of an integration forward than you do in this type of situation because your manufacturers cannot do it. But, on the other hand, what would you do with White Motor Car which presumably was competing with General Motors? You would have that situation again.

Mr. COHEN. What I am saying is you might want to have different kinds of rules when you are dealing with giant manufacturers holding 80 or 90 percent of the market than when you are dealing with a manufacturer who holds 3 or 4 percent.

Mr. INWALD. What you are suggesting, in other words, is we have one rule for the automotive trade to apply to Mack Trucks, International Harvester, and another rule in the same trade to apply to General Motors, Ford, Chrysler, and possibly American Motors. I think you are going to run into an awful lot of administrative difficulties.

I am a great believer in flexibility. I think if you have generalized rules and examples in each situation where it is, we are taking a wild hypothetical when we are talking about one dealership for Ford and so on. You have to think of the thing in terms of what the actual situation is.

Mr. COHEN. This is, I think, precisely the point. Yet with this bill you are suggesting that a per se rule cannot be applied in any situation. There may be situations where a per se rule makes sense.

Mr. INWALD. I don't think that—

Mr. COHEN. All I am suggesting is if you want certainty, you are not going to have flexibility, and if you want flexibility, you can never have certainty. You just cannot have it both ways.

Mr. INWALD. I cannot agree with you, because we are not saying the per se rule will not apply in this situation. It will not apply in this situation where these conditions exist and those are readily verifiable things. Are there other people in competition with the manufacturer? Are there other people in competition with the distributor? Is the distributor inhibited or not inhibited from dealing in competing products of other manufacturers? Those are three good litmus papers you can use to test whether the competition is going on.

Mr. COHEN. Three good tests and introduce back into the case the element of uncertainty that exists in the present cases.

Mr. INWALD. I cannot agree because it is an easy enough thing to verify and these are simple facts to determine.

Mr. COHEN. Like grade and quality standards.

Mr. INWALD. We have grades and standards in the Robinson-Patman Act.

Mr. COHEN. We had Fred Rowe come down and tell us the like grades and quality provision poses all sorts of problems.

Mr. INWALD. I have crossed swords with Fred Rowe before. He and I do not agree on many subjects, including Robinson-Patman. But you can talk to Paul Warneke and he will tell you it is conceivable and practical to deal with like grades and quality in the Robinson-Patman Act. We are not operating here ab initio. The language, I think, was well chosen by the legislative drafters and I think there are guidelines in here and people have learned over a generation to live with Robinson-Patman. And those guidelines can be imported here.

I think we have too much of a dichotomy in our thinking between hard competition and soft competition. You have a situation where you should consider not the shibboleths with which we have grown up but does this maximize competition or does it minimize competition? I submit the tests here would maximize competition rather than minimize it.

Mr. COHEN. This subcommittee held dual distribution hearings. We heard from franchisees who possibly were in the same situation Mr. Martin was in. They are franchisees who have gone into a territory, built it up all by themselves—the product was nothing until they went in. They developed the territory, sold the product and then the manufacturer said, “OK, you have got the thing all built up, thank you very much, you’re out. I am cancelling your franchise.”

Isn’t this also a problem that you are faced with in this field?

Mr. INWALD. If I were advising a particular distributor, I would say before you get started with the manufacturer, get down in writing your obligations to him and his obligations to you and what circumstances you can keep this going.

Mr. COHEN. Precisely, in most fields.

Mr. INWALD. But this is something that we cannot legislate or we would find rather difficult to legislate nor are we attempting to legislate that situation here. What we are doing is merely establishing a matrix, the background out of which individual distributors and individual manufacturers can come to their agreements. We cannot say you must agree to do so and so, you must do such and such, but we can—

Mr. COHEN. Mr. Glaser is upset about the situation where you build up a territory and then in comes the manufacturer and steals your own territory that you built up.

Mr. INWALD. It is something to concern yourself about but I think the solution to that must be on the individual level.

Mr. COHEN. Level of uncertainty.

Mr. INWALD. Not the level of uncertainty. The level of—the framework in which both parties know what is permissible to do and then the extent to which the parties will agree to do that which is permissible depends upon the mutual willingness of both parties to enter into an agreement. That is the level of uncertainty of the marketplace which is all we are trying to establish.

Mr. COHEN. Well, for instance, we have heard *Brown Shoe*, criticized today and yet it seems to me for a small manufacturer and distributor, *Brown Shoe* would make good sense.

The court says that a dominant manufacturer cannot force you to handle only his products if you want to handle his products at all.

Mr. INWALD. This bill agrees with *Brown Shoe*, doesn’t it? Because this bill says that you cannot have a valid franchise unless the distributor is free to go along and handle competing products.

Mr. COHEN. You would agree, then, that *Brown Shoe* is probably a good decision as far as the small manufacturer is concerned.

Mr. INWALD. I have dealt with *Brown Shoe* at pages approximately 26 through 29 of my prepared statement. I have a copy of the Law Week Report on *Brown Shoe*.

I see nothing in *Brown Shoe* that would be at odds with this bill. I don’t want to take a position on whether the Supreme Court’s determination that the Federal Trade Commission was right in saying that

*Brown Shoe* foreclosed a substantial part of the market to competing manufacturers is justified by the facts. I haven't been that deeply involved in the *Brown Shoe* case. I think it is completely extraneous to the issue we are discussing here. *Brown Shoe* does not begin to affect us.

Mr. COHEN. One of the things we have been involved in all through our franchise hearings, of course, is the survival of the franchise as a method of allowing small manufacturers a system of distribution. We also have seen the situation where the large manufacturers have been able to coerce the smaller franchisee and put restraints into the marketplace that way.

All I am suggesting to you is aren't we in a situation here where you have got a different problem when you are dealing with a dominant manufacturer and his franchisee than when you are dealing with a smaller manufacturer and his franchisee?

Mr. INWALD. We certainly will submit that this bill takes that into account. It provides that the kind of franchise concerning which hearings were held back in 1948 and 1949 on the automobile dealer situation, is not the kind of franchise that would be validated by this kind of a bill because the conditions put in here preclude the possibility of coercion and domination. He cannot dominate by telling the franchisee you may not handle competing lines. He cannot even give a franchise at all if he is the only one or enjoys a great percentage of the entire market in the area. It is only where there is fluid competition both at the franchisee and franchisor level that this bill would come into operation and when it comes into operation only on that level, I submit, it is unexceptional and in line with all our thinking on antitrust laws.

Mr. COHEN. I think there is room here for reasonable attorneys to differ as to the language and meaning of some of the things this bill holds. Possibly it is an area that ought to be discussed in some other forum besides this one in terms of what may or may not be necessary to make this bill conform to what you seem to feel at the present time it does.

Mr. INWALD. Well, certainly the legislative drafting and redrafting of a bill is within the province of this committee and if it requires refinement, I am sure everybody would try to cooperate with that and refine it in such a way so that it will accomplish the objective which we are all trying to get.

Probably no language is definitive and perfect and everything has a certain amount of imprecision in it. To the extent we get greater clarity, it will be a service not only to the law but to all those who have to comply with the law. But I think something along these lines should come out to distinguish the sheep from the goats, as it were.

Senator FONG. Mr. Chumbris.

Mr. CHUMBRIS. Thank you, Mr. Chairman.

First, Mr. Chairman, we received a call from Senator Aiken's office this morning that Mr. Richard Ryan, of Rutland, Vt., would be one of the witnesses. I think time is running out. But he wanted us to know that Mr. Ryan will be here this morning and wants to extend him every courtesy.

Senator FONG. Yes.

Mr. CHUMBRIS. I have just one question which, Senator Hruska asked of several previous witnesses. Do you believe that this bill as it

is now drafted without any of the suggested amendments would protect the franchisees of the various States or various territories from a situation where another franchisee, let us say from one part of the country, would go to the manufacturer and buy in big lots and then take those big lots and go into other franchisees' territories and find distributors have them distribute and when the franchisee of a given State who has been invaded goes to the franchisor and asks him, "Can you stop this," and the franchisor says, "I cannot, because I might violate the antitrust laws"?

Mr. INWALD. I have not really studied Mr. Glaser's suggested amendments to it. I don't want to outright—

Mr. CHUMBRIS. Would you have any objection to his suggested amendments?

Mr. INWALD. My thought on the thing is that possibly it would not be necessary. I would like to call your attention to the case of *Exercise of Michigan v. Wayson and Hale and Hearty* a 1965 decision reported at 341 Federal 2d 335, indicating that if franchises were validated, under the general rules of unfair competition and third beneficiaries to contracts, a franchisee whose territories were invaded by a bootlegging neighboring franchisee would not be without remedy. The important thing is to encourage manufacturers to believe that they can enter into the franchise. After that I don't think we can legislate everything. Self-help has to be one of the things relied on. There are laws. We just want them to know that this would be a valid arrangement and after that, protect yourself as best you can. We are not trying to wet nurse anybody.

Mr. CHUMBRIS. The bell just rang, which indicates a vote coming up. I want to point out that there are some who have not had an opportunity to testify this morning, but will submit their papers. Some of those have raised that particular question.

Mr. COHEN. I think you would agree we have to be careful in drafting any bill to differentiate between what some people would call "bootlegging" or "transshipment" and what other people might call legitimate competition.

Mr. INWALD. Yes. That is always a problem and I think there are cases like that. That is a place for case-by-case determination by the courts.

Senator FONG. Thank you, Mr. Inwald, for coming and helping us in this problem. I regret the urgency of the hour requires us now to close the hearing until tomorrow.

(Mr. Inwald's prepared statement follows:)

STATEMENT ON S. 2549 BY CHESTER INWALD, ESQ., HARTMAN & CRAVEN, ESQ.; NEW YORK, N.Y.

My name is Chester Inwald. I am a member of the firm of Hartman & Craven attorneys-at-law, and I have been, for the past 10 years, general counsel to the National Association of Tobacco Distributors, Inc. The firm of which I am a member has represented this association as well as others in the field of distribution of consumer commodities, since about 1933 and I, myself, have, for the past 15 years devoted much of my time in practice to problems arising out of interpretation and enforcement of the provisions of our federal trade regulatory laws in the field of retail and wholesale distribution.

I make this statement in support of S-2549, which your honorable committee is now considering, as representing a vitally needed clarificatory measure which, if adopted, will serve to shed light on the presently obscure and vexing situation now prevailing in the field of franchise distribution.

That such legislative light is needed already has been brought to the attention of this committee by Small Business Administrator, Eugene P. Foley who, in March of 1965 testified before this body on the need for legislation with respect to "territorial restrictions preventing each of a franchiser's outlets from selling in an area assigned to another." Administrator Foley stated "Such fencing is a very effective method of encouraging each franchisee to advertise in his territory, secure in the knowledge that the soil thus fertilized will not be invaded by others. Further it serves to direct the competitive energies of all the franchisees away from each other against rival brands. Because of their importance to his operations, the franchisor should have some reasonably reliable means of determining how far the antitrust laws will permit the imposition of restraints on franchisees. . . . In view of the growing differences between the antitrust agencies and the courts, regarding the validity of franchise restraints, clarification is badly needed. Since time is an important consideration in this connection, there is a question in my mind whether we should wait for the clarification to be developed by case law. *Consideration should be given to clarifying legislation.*" (Hearings pursuant to Senate Resolution 40, 89th Cong., 1st Sess., March 2, 3 and 4, 1965, pages 11-13).

The problem to which Administrator Foley directed this committee's attention about a year ago arises out of the phenomenal growth of the franchising method of distribution. It has been stated (Volume XVII NATD Briefs, No. 23, September 3, 1965) that "approximately \$60,000,000,000 worth of products are now sold through 400,000 franchised operations. The wide assortment of products ranges from doughnuts to automobiles. Generally, a franchisee allows an aspirant with meager capital to embark on a business career armed with the assurance that management knowledge, selection of sites, electronic data processing and other services will be provided the franchisee by his franchisor in the same fashion as is available to the larger corporations. It is estimated that about 100 new franchise operations are opened every day and that this number will double in the next decade."

In a study commissioned by the Small Business Administration of the federal government and prepared by the University of Minnesota in 1963, it was pointed out that, in addition to the automobile, truck, gasoline and oil industries, which are well known to operate under a franchise system of distribution, "a very substantial share of this nation's food, drugs, hardware and auto parts and accessories is sold through franchised outlets." (Lewis & Hancock, *The Franchise System of Distribution*, University of Minnesota Press, 1963, page 11).

Franchising as a method of distribution long has been embedded in the economic fabric of our country. One of the early uses of franchising occurred in 1898 when the first independent dealer was established to sell and service electric and steam operated automobiles. Other early developments in franchising took place after the turn of the century and involved Rexall Drug Stores, Liggett Drug Stores and wholesale distributors such as Butler Brothers of Chicago and Western Auto Supply of Kansas City (Lewis & Hancock, *supra*, page 10).

Franchise operations obtained judicial sanction and approval as early as 1903 in the case of *Phillips v. Iola Portland Cement Co.* (CCA 8, 1903) 125 Fed. 593. In that case the Iola Portland Cement Co. sued one Phillips who had bought from it 50,000 barrels of cement on condition that it not be sold or shipped outside the State of Texas. Phillips subsequently refused to pay for the cement claiming the contract was unlawful as a restraint of trade. The court, which included two judges who later sat on the Supreme Court of the United States, rejected this restraint of trade defense, pointing out that the test of the validity of a contract is not whether it restrains trade, since all contracts, in effect, restrain trade, but whether the restraint is an arbitrary or unreasonable one. The cement manufacturer, the court there pointed out, "had no monopoly on the manufacture or sale of cement in the United States. It was surrounded by competing manufacturers, and the contract which it made . . . had no direct or substantial effect upon competition in trade among states. It left the manufacturers who were competing with the plaintiff for the trade of the country free to select their customers, to fix their prices and to dictate their terms for the sale of the commodities they offered so that in this regard no restraint whatever was imposed. If it had the effect to restrain (the defendant) from using the product which they purchased to compete with other jobbers or manufacturers in the country beyond the limits of the state of Texas, this restriction was not the chief purpose or the main effect of the contract of sale, but a mere indirect and immaterial incident of it." (*id.* at 595).

The franchise system of distribution was, therefore, launched with judicial approval and for almost two generations it was considered to be an acceptable and lawful avenue of distribution that might be employed by a manufacturer in response to the cardinal and ever recurring problem of achieving efficient distribution of the maximum units of their production at minimum cost. A protean number of devices have been assayed by manufacturers, and either adopted or rejected in an effort to achieve this desired goal.

Over the years, manufacturers—faced with intense competition from kindred producers—have discovered that no more comprehensive solution of the problem is offered than that furnished by the establishment of a relationship with one or more wholesalers in each area of the country in which the manufacturer desires to do business, under which arrangement the wholesalers will undertake to use his best efforts to promote the manufacturer's product.

Individual attention at the local level may be neglected by certain few large scale manufacturers who can compensate for that lack by nationwide saturation advertising campaigns which, in effect, presell the commodity to the consumer. The majority of manufacturers, however, cannot afford the preselling practice and thus, the practice has grown up in many of the great basic industries to confine the custody of the product within a particular territory to a single distributor and to require a certain level of performance from that distributor commensurate with the absorptive capacities of the market involved.

In the industry which I am most familiar, both these patterns of production and distribution co-exist. The cigarette branch of the industry is characterized by a limited number of manufacturers and producers, most of whom operate on a nationwide scale with massive resources available for advertising and preselling the products they manufacture.

The cigar branch of the industry, is typified by a great range and number of manufacturers almost all of whom have limited or no resources available for consumer advertising purposes. Thus, the United States Tobacco Journal Supplier Directory for 1964-1965 lists more than 200 manufacturers of cigars, of which number the top 60 firms offer to the consumers more than 500 separate and distinct brands and types of cigars which are further subdivided into sub-units representing difference sizes and packages.

Both the cigarette and the cigar trades require distribution of their products. The cigarette area of the industry, however, which in 1964 accounted for consumer expenditures in the United States of more than \$7,100,000,000 (1966 NATD Co-ordinator, page 205) requires less in the form of individual attention from wholesaler and retailer than does the cigar industry which in that same year (*id.*) accounted for only \$760,000,000 of consumer expenditures in this country.

Lacking the resources necessary otherwise to place their products before the consuming public, cigar manufacturers, by the very nature of their limited operations, must obtain the services of a distributive firm in each area where it intends to compete if its products are to be given the exposure and care which are required for such competition. However, to secure the cooperation of such distributors, cigar manufacturers must make the deal sufficiently attractive to warrant such cooperation. Relatively speaking, the market for cigars is a thin one in the United States. Sales of a given brand in a particular area, distributed among a number of wholesalers, would not yield sufficient profit to repay the care and handling of this perishable product, much less the promotion and vigorous maintenance of a market for the brand. Distributors, consequently, are reluctant to take the brand unless given reasonable assurances, through a franchise arrangement, that they will obtain a return for their efforts and their monetary investments in the establishment and maintenance of the product as an accepted consumer commodity in their area.

Such a franchise arrangement usually prohibits the manufacturer from selling to other distributors within the trading area. It does not prohibit the distributor from purchasing the products of other manufacturers desirous of making similar arrangements with the distributor and therefore does not foreclose avenues of distribution to competing manufacturers. As such, therefore, it falls outside of the strictures of the recent decision by the United States Supreme Court in *Federal Trade Commission v. Brown Shoe Company, Inc.* (June 6, 1966) 34 Law Week 4468.

Nor does this arrangement foreclose competition at the whole level. Mention has already been made of the fact that, in the cigar industry, more than 500 brands of cigars in all price ranges actively compete with each other for

consumer attention. Most cigar distributors are of modest means with limited sales personnel. Not one distribution house that I know of is capable of obtaining and actively maintaining the franchise for even 10% of these major cigar brands. Consequently, there is nothing in the structure of this market which would prohibit any distributor from obtaining access to at least one or more major cigar brands which he could promote, exploit and develop in his trading area in competition with franchises already granted to another distributor.

Given such an atomistic market, it is quiet clear that the franchise system of distribution could have no adverse competitive effects and would not serve to unreasonably restrain trade. For almost two generations this was standard legal doctrine in the United States. In addition to the *Portland Cement* case cited and quoted previously, the federal courts have sustained exclusive franchise agreements for the sale of automobiles (*Cole Motor Car v. Hurst*, 228 Fed. 280, cert. den. 247 U.S. 511; *Boro-Hall Corp. v. General Motors Corp.*, 124 Fed. 2d 822; *Packard Motor Car Co. v. Webster Motor Car Co.*, 243 Fed. 2d 418; *Schwing Motor Co. v. Hudson Motor Co.*, 138 Fed. Supp. 899) commercial washing machines (*Bascom v. Telecoin*, 204 Fed. 2d 331) optical glass (*United States v. Bausch & Lomb*, 43 Fed. Supp. 487 affd. 321 U.S. 706 at 719) ice cream mixes (*Susser v. Carvel*, 332 Fed. 2d 505 at 517 affd. 379 U.S. 885) chemicals (*United States v. Imperial Chemical Industries Ltd.*, 105 Fed. Supp. 215) metal fluxing materials (*Foundry Services Inc. v. Beneflux Corp.*, 206 Fed. 2d 214 at 215) furniture (*Dennison Mattress Factory v. Spring-Air Co.*, 308 Fed. 2d 403 at 409; *United States v. Sealy, Inc.*, 1964 CCH Trade Cases par. 71, 258, appeal filed United States Supreme Court June 9, 1965) kitchen equipment (*Fargo Glass & Paint Co. v. Globe American Corp.*, 201 Fed. 2d 534 cert. den. 345 U.S. 942) automatic vending equipment (*New York Automatic Canteen Corp. v. Automatic Canteen Co. of America*, 1963 CCH Trade Cases par. 70, 625) and therapeutic equipment (*Ewercycle of Michigan Inc. v. Wayson and Hale & Hearty, Inc.*, 341 Fed. 2d 335).

In the state courts, franchise agreements have likewise been uniformly upheld (see e.g. *Dawn to Dusk Ltd. v. Brunckhorst Co.* (App. Div. N.Y.) 23 App. Div. 2d 780; *Stemmerman v. Kelly* (App. Div. N.Y.) 150 App. Div. 735; *Revlon Products Corp. v. Bernstein* (Sup. Ct. N.Y.) 204 Misc. 80; *Liedermann v. Voco* (Sup. Ct. N.Y.) 73 N.Y. Supp 2d 462; *Tri-State Pipelines Corp. v. Sinclair Refining Corp* (App. Div. N.Y.) 24 App. Div. 2d 756; *Avon Products v. Berson* (Supp. Ct. N. Y. Cty.) 206 Misc. 900; *General Electric Co. v. Ovalle Inc.* (Pa. Sup. Ct.) 21 D. & C. 413; *Wood v. Greenwood* (Sup. Ct. S.C.) 75 S.C. 55; *Milton v. Hudson Sales Corp.* (Calif. Ct. App.) 152 Cal. App. 2d 418; *Rolley Inc. v. Merle Norman Cosmetics Inc.* (Calif. Ct. App.) 129 Cal. App. 2d 844; *Superior Coal Co. v. Darlington Lumber Co.* (Sup. Ct. Ill.) 236 Ill. 83; *Pittsburgh Plate Glass Co. v. Paine & Nickson Co.* (Sup. Ct. Minn.) 182 Minn. 159; *Kansas City Pants & Skirt Co. v. Cohlmia* (Okla. Sup. Ct.) 138 Okla. 151; and see too Restatement on Contracts Section 516 (a) and (e)).

Specifically, within the field of tobacco distribution, the validity of franchise arrangements have long been accepted. As long ago as 1914, the Circuit Court for the Second Circuit held valid an exclusive territorial franchise in tobacco between a manufacturer and a jobber, the court remarking that, since the manufacturer could choose to sell the product on its own, there was no reason why it could not designate a representative or agent to sell for it on a territorial basis (*Locker v. American Tobacco Co.*, 218 Fed. 447 at 449). And in 1932 the Federal Trade Commission reaffirmed a position it had originally taken in 1916 (Conference Ruling No. 13, 1 FTC 543) and held that a cigar manufacturer which had allocated restricted territories to 46 independent wholesalers and assigned all its remaining markets to 17 wholly owned branch houses did not violate the anti-trust laws or the Federal Trade Commission Act (*General Cigar Co. Inc.*, FTC Docket No. 1879, 16 FTC 537). And again, in 1962, District Judge Palmieri upheld against attack a franchise distribution arrangement for cigarette vending machine equipment in the case of *New York Automatic Canteen Corp v. Automatic Canteen Co. of America*, remarking that franchise arrangements are not illegal under the Sherman Act unless they are exacted by a party or parties with monopoly power (D.C. N.Y., December 27, 1962, Docket No. Civ. 128-324, 1963 CCH Trade Cases par. 70, 625).

Were the status of the law now in the position recounted above, there would be no purpose to the present hearings before this committee. However, commencing approximately in the year 1956 the Anti-Trust Division of the United States Department of Justice began to take the position that an exclusive ter-

ritorial franchise is a per se violation of the anti-trust laws of the United States. Acting on that assumption, the Department of Justice investigated a number of industries and obtained, between 1956 and 1959, a series of consent decrees under which manufacturers in different industries agreed to cease employing the franchise system of distribution (see e.g. *United States v. Philco Corp.* (E.D. Pa. 1956) 1956 CCH Trade Cases 68, 049; *United States v. Seeburg Corp.* (N.D. Ill. 1957) 1957 CCH Trade Cases 68, 613; *United States v. Wurlitzer Co.* (W.D. N.Y. 1958) 1958 CCH Trade Cases 69, 011; *United States v. Necchi Sewing Machine Corp.* (S.D. N.Y. 1958) 1958 CCH Trade Cases 68, 957; *United States v. Bostich* (D.C. R.I. 1958) 1958 CCH Trade Cases 69, 207; *United States v. Gemex Corp.* (D.C. N.J. 1959) 1959 CCH Trade Cases 69, 421). None of the cited cases were litigated to a conclusion. All of them were resolved by the entry of consent decrees which neither admitted the facts nor found the law. In some cases, the defendants were found in *flagrante delicto* with respect to other practices which involved arrant violation of the antitrust laws and were in no position to bargain as to the terms as to the consent decree to be entered. An example of such a case is manifested in the consent decree entered in *United States v. Cigarette Merchandise Association* (D.C. N.Y. 1957) 1957 CCH Trade Cases par. 68, 599) where the defendants were accused of price fixing, eliminating competitors, dividing markets on a horizontal basis and other practices including physical intimidation and coercion. It goes without saying that all these practices are illegal under our law and a person so charged is scarcely in a position to quibble when requested to agree to a decree enjoining the defendant from employing exclusive territorial franchises.

With this string of hollow victories achieved, the Anti-Trust Division of the Department of Justice adopted the stance that there was sufficient authority to hold an exclusive territorial franchise arrangement to be a per se violation of the Anti-Trust laws on the theory that such agreements restrain trade in that the manufacturer may sell to no other distributor in the franchised territory and the distributor may not sell the franchised product outside of the trading area franchised to him. This position was not adhered to by the Federal Trade Commission which, as late as 1959, was proclaiming that the legality of an exclusive franchise is unquestionable in the absence of any evidence of a threat to monopolize or to injure competition (*Columbus Coated Fabrics Corp.*, order to cease and desist issued March 23, 1959, F.T.C. Docket No. 6677).

The dichotomy between the position on the trade regulatory laws taken by the Department of Justice and the Federal Trade Commission came into sharp focus in 1961 when a decision of a district court in Ohio held that an agreement between a manufacturer and his franchised distributor for the division of sales territory was a per se violation of the Sherman Act. That case (*United States v. White Motor Co.* (N.D. Ohio 1961) 194 Fed. Supp. 562) granted that White Motor Co., a pygmy among the giants in the automotive field, required franchise agreements in order to obtain dealers who would be willing to promote the company's line of trucks, but nevertheless held that such a franchise was inherently a violation of Federal law inasmuch as it restricted and restrained trade. According to that decision, therefore, an exclusive territorial franchise was put on the same unlawful level as an agreement between competitors to fix prices.

Commentators were quick to point out that the decision of the Ohio Court proved too much. It is quite true that an exclusive franchise agreement restrains trade but it is equally true that all agreements between merchants restrain trade. The test is not whether a particular agreement is a restraint on trade but rather whether such restraint is an unreasonable one (see *Chicago Board of Trade v. United States* (1918) 246 U.S. 231 at 238 and *Handler, Sixteenth Annual Review of Antitrust Developments*, Record of the Association of the Bar of the City of New York, 1963, pages 460-469). What was presumed by the District Court in the *White Motor* case was that because exclusive territorial franchises restrain trade they must therefore, unreasonably restrain trade. This synapse was pointed out as impermissible by the Supreme Court of the United States on appeal from the District Court decision (*sub. nom. White Motor Co. v. United States* (1963) 372 U.S. 253). The Supreme Court noted the arguments raised by White Motor Co. to the effect that "the territorial (franchise) clauses are necessary in order for appellant to compete with those who make other competitive kinds of trucks; appellant could theoretically have its own retail outlets throughout the country and sell to users directly; that method however is not feasible as it entails a costly and extensive sales organization; the only feasible method is the distributor or dealer system; for that system to be effective against the existing competition of the larger companies, a distributor or dealer

must make vigorous and intensive efforts in a restricted territory and if he is to be held responsible for an energetic performance it is fair, reasonable and necessary that appellant protect him against invasions of his territory by other distributors or dealers of appellant; that appellant, in order to obtain maximum sales in a given area, must insist that its distributors and dealers concentrate on trying to take sales away from other competing manufacturers rather than from each other."

Accordingly, the court concluded "we do not know enough of the economic and business stuff out of which these arrangements emerge to be certain. They may be too dangerous to sanction or they may be allowable precautions against aggressive competitors, or the only practicable means a small company has for breaking into or staying in business." (*White Motor Co. v. United States*, *supra*, at 263.) Accordingly, the Supreme Court of the United States sent the case back to the trial court with instructions that the facts be inquired into and a decision made on the basis of the facts as found.

Unfortunately, this case was never retried before the District Court. Instead, the defendant company agreed to the entry of a consent judgment. Government authorities and private individuals are at odds as to the inferences that may properly be drawn from this consent judgment. Shortly after the *White Motor* case was decided in the District Court, the position of the Federal Trade Commission was beginning to alter and to conform with that espoused by the Department of Justice. This shift in posture was signalled by an address given by Mr. Rufus E. Wilson, Chief, Division of General Trade Restraints of the Federal Trade Commission before a briefing conference on Anti-Trust laws sponsored by the Federal Bar Association on January 4, 1962. In that address Mr. Wilson sought to distinguish away prior Federal cases validating franchise agreements and to make applicable to vertical distributive restrictions, sanctions applied by the courts in connection with horizontal distributive restrictions.

Both these agencies hailed the consent decree in the *White Motor* case after its remand as tantamount to a confession that no economic justification could be established for a franchise system of distribution. Other commentators, however, noted that White Motor Co. had, between the time of the initial decision by the District Court in Ohio and the date of the remand, merged with another company and no longer sold its trucks through franchise distributors. Thus, White's refusal to go through with a trial *de novo* was most probably based on its unwillingness to flog a dead horse and to vindicate a principle at the expense of assets better used in manufacturing, distributing and selling trucks. Such a consent judgment can hardly be deemed a concession that it could not have established an economically viable case for the franchise system.

Nevertheless, because the *White Motor* case was never prosecuted to a conclusion we have been left with a legacy of conflicting and often inconsistent opinions in the lower courts as to the validity of an exclusive territorial franchise.

Typical of this inconsistency are the results obtained by two different manufacturers in two unrelated fields. A case arising in the floor covering industry yielded one result and another in the bicycle trade gave rise to an almost diametrically opposite conclusion. I refer, of course, to the case of *Federal Trade Commission v. Sandura* (CCA 6, 1964) 339 F 2d 847 and *United States v. Arnold Schwinn & Co.* (D.C. Ill. 1964) 237 Fed. Supp. 323.

The *Sandura* case involved the manufacture of hard floor coverings, such as linoleum. This company, in 1949, developed a unique fabricating process to which it gave the name Sandran. Because of the difficulties in the manufacturing process, the product, when initially introduced, enjoyed an unfavorable reputation and many distributors were reluctant to carry the line. By 1954 the company was almost bankrupt, although, by that time, the manufacturing difficulties that had given Sandran a bad name had been corrected. Nevertheless, it was difficult for the Sandura company to obtain distributors willing to accept the line and to pay for the mass advertising and promotion necessary to overcome its poor reputation in the eyes of the public. In order to attract distributors, Sandura granted them closed territories in which no other Sandura wholesaler would be allowed to sell Sandran to the retail customers of the distributor franchised for that territory. This system of exclusive territorial franchises worked wonders for Sandura. From 1954 to 1959 sales of Sandran increased by 800%. It became such a success that three of its major competitors introduced similar products into the market.

Despite the obvious success of Sandura in reviving competition in the hard floor covering industry through the introduction of a new product on a franchise basis (which served as the forerunner for the introduction of an entirely new line of

new goods) the Federal Trade Commission took the position that the system of exclusive territorial franchise used by Sandura was an unfair method of competition and a restraint of trade. It ordered the company to cease and desist from the employment of exclusive franchise territories. On appeal to the Circuit Court, the decision was reversed by a unanimous bench which held (*Sandura v. Federal Trade Commission, supra*) "we are satisfied that the record in this case is barren of credible evidence that the public would be benefited by requiring that Sandura distributors be allowed to intrude on each others territories. The distributors, the dealers and the public will be served by the continued economic health and competitive existence of Sandura as well as its distributors. We are of the opinion that, on this record, the only justified conclusion is that elimination of the closed territory arrangement would impair competition rather than foster it."

Accordingly, the court concluded "We believe that the cumulative effect of the facts offered is legally sufficient to justify Sandura's use of closed territories. Unless vertical imposition of closed distributor territories were now to be declared illegal *per se*, it is difficult to imagine a basis for finding an unreasonable restraint of trade at the time Sandura instituted the scheme in 1955. While its spectacular successes in the 1955-59 period may be due to the novelty of its perfected product, it is clear that the product could not have been successfully marketed if Sandura had not been able to attract distributors by the promise of closed territories."

Although the above quoted decision of the Circuit Court in the *Sandura* case should have put the quietus on the perennially vexing question of the legality of an exclusive territorial franchise, the Federal Trade Commission was strangely reluctant to bring the decision of the Sixth Circuit to the Supreme Court for review. In a statement issued in August of 1965 the Federal Trade Commission rather lamely announced that it deemed this case "not appropriate for Supreme Court review" and not "a suitable vehicle for obtaining Supreme Court clarification of questions concerning the application of Section 5 of the Federal Trade Commission Act to a manufacturer's exclusive allocation of territories to the distributors of its products." (5 CCH Trade Reg. Rep. par. 50, 116). Considering that the entire issue of "a manufacturer's exclusive allocation of territories to distributors" is now most obscure, it is indeed a pity that the Federal Trade Commission did not deem it suitable to obtain Supreme Court review of this subject. This is all the more so deplorable in the light of the contrary resolution obtained in the case of *United States v. Arnold Schwinn & Co.* (D.C. Ill. 1964) 237 Fed. Supp. 323.

In that latter case the Department of Justice brought suit against Arnold Schwinn & Co., a century-old manufacturer of bicycles in the United States. This company found itself subjected to the ever increasing competition of mail order houses which put out bicycles under their own brand names and which did not service or maintain the vehicles they distributed to the public. In the face of this new and engulfing competition, the Schwinn Co. introduced what was called the "Schwinn Plan" under which the jobber or distributor serving the territory extended to his retail customers the option of buying Schwinn bicycles either directly from the Schwinn Co. under a plan of refinancing or buying the product from the distributor's warehouse.

Where the retailer bought from the manufacturer, the distributor did not receive the purchase price but got only a commission as though it were merely the selling agent for the manufacturer. On the other hand, when the distributor sold to the retailer from its own stock, the distributor could establish whatever price was desired for the merchandise and kept all of the profit. Both Schwinn wholesalers and Schwinn retailers were franchised for their particular territories and a Schwinn wholesaler was permitted to sell only to properly franchised retailers in his area. The retailers were chosen by the manufacturer on the basis of their ability to perform the supplementary services necessary to maintain the image of the Schwinn bicycles as a high quality product.

In the last cited case, the Department of Justice maintained that this system of exclusive territorial franchises was a violation of the Sherman Anti-Trust Law as a restraint of trade. In sum and substance, the trial court held that, since Schwinn could have sold directly to the retailers on a franchised agreement basis with territorial restrictions, it could continue to employ the same territorial restrictions when dealing with the retailers through the wholesale distributors when those wholesalers sold as agents of the manufacturer. However, where the wholesale distributor sold to retailers for their own account, the court professed to find different considerations applicable, stating: ". . . When distributor

fills orders from warehouse stock that he has purchased, where he can set the price, and where there may be a differential in shipping costs or promptness or quality of service, he is acting as an owner and not as an agent or salesman for Schwinn. Where the ultimate risk and loss is borne by the distributor, as where he has purchased and taken title to the Schwinn products, he is truly an entrepreneur, or just a plain businessman. It matters not that no actual damage has been shown to any distributor or dealer. Such division of territory by agreement between the distributor is horizontal in nature, and whether agreed upon after being imposed or even merely suggested from above in a vertical manner by the manufacturer, does not alter its illegality and violation of Section 1 of the Sherman Act."

Thus, the court for the Northern District of Illinois has again reverted to the theory espoused by the District Court in Ohio in the *White Motor Co.* case and continues to assert that where a wholesaler takes title to property under a franchise agreement for division of territory even when "imposed from above . . . by the manufacturer" a per se violation of the Sherman Act occurs even in the absence of proof of adverse effects upon competition.

We are, therefore, faced still with the ghost of *White Motor Co.* Nor do we now know how many courts will follow the rationale of the *Sandura* case which holds that a territorial division established by a manufacturer is in all respects legal in the absence of a showing of adverse competitive effects as opposed to those courts which will follow the opinion in the *Schwinn* case which holds such division to be illegal no matter what effect such franchises have upon the competitive system. In the *Schwinn* case, it must be noted, the evidence was clear that but for the franchise system adopted by Schwinn, that company would have gone under in the face of vigorous competition from the mail order giants.

Subsequent decisions by the Supreme Court of the United States, since the conflicting *Schwinn* and *Sandura* decisions, have not been enlightening, as will be demonstrated below. The decision of the District Court in the *Schwinn* case has been incisively criticized in a note appearing in the June 1965 edition of the *Columbia Law Review* ("Legality of Vertically Created Divisions of Territory" 65 C.L.R. 1115). It is there pointed out that "in a highly concentrated industry, particularly where a new entrant does not have sufficient capital to establish his own distribution system, or to finance the advertising necessary to develop a market for his product, the use of closed territory systems may be essential to attracting and holding independent distributors. The alternative to territorial restriction—integration forward, in which the manufacturer and distributor are merged, is objectionable, even in the case where it is economically feasible, for several reasons. Not only does a pattern of vertical integration in an industry itself preclude intrabrand competition, but it increases the barrier costs for new entrants who could provide a spur to innovation, thus encouraging industry concentration. Growth of the concentrated industry creates fertile possibilities for price leadership and covert conspiracy, which could necessitate control of the economy by administrative agencies rather than market forces." (*id.* at 1122-3).

Despite these strictures there are many who sincerely believe that the courts have, by now, condemned vertical market divisions by manufacturers. This, despite federal decisions such as that in *Snap-On Tools Co. v. Federal Trade Commission* (CCA 7, 1964) 321 F. 2d 825 where, in a case not dissimilar to the *Sandura* one, the Seventh Circuit stated with respect to exclusive territories; ". . . there is merit in respondent's contention that the maintenance of exclusive territories is indispensable to the successful operation of its business; that "confusion and chaos" would result if it were ordered to abandon the policy. In the absence of the maintenance of a very large corps of salesmen employees, the practice of exclusive territories for its dealers appears to be the only way in which respondent can be assured that sales territories will be adequately worked, that periodic calls will be made on customers and that satisfactory service will be rendered customers."

It has, nevertheless been claimed, that decisions rendered this year by the Supreme Court of the United States foreclose, under the present construction of our antitrust laws, forbid use of a territorial franchise system. If this were indeed the case, it would be a most deplorable blow to small business in the United States both at the manufacturing and distributing level. Happily it is not.

It is commonly claimed, for example, that the decision of the United States Supreme Court on April 28, 1966 in the case of *United States v. General Motors Corporation* (Docket No. 46 October Term, 1965) 66 CCH Trade Cases para. 71,

750, stands for the proposition that General Motors Corp. territorial restriction of its dealers through the "location clause" has been held by the Court to be a restraint of trade. Indeed, in that case, the Department of Justice did so contend in an attempt to reverse the decision below (234 Fed. Supp. 85) holding that the actions of the defendants, in eliminating discounters from the sale of automobiles in California was not a violation of the antitrust laws. The Supreme Court, however, refused to agree with the Department of Justice's contentions and held that the case should be decided on the recognized principle that a group boycott of a competitor is a violation of the Sherman Act and a restraint of trade, citing the well established case of *Klor's Inc. v. Broadway-Hale Stores, Inc.* (1959) 359 U.S. 207. But the Supreme Court of the United States specifically refused to accede to the invitation of the Department of Justice to hold a territorial franchise arrangement in and of itself a restraint of trade. To put it in the very words of the court in the *General Motors Corp.* case above cited "the Government invites us to join in the assumption, only for purposes of this case that the 'location clause' encompasses sales by dealers through the medium of discounters. But it urges us to hold that, so construed, the provision is unlawful as an unreasonable restraint of trade in violation of the Sherman Act.

"We need not reach these questions concerning the meaning, effect, or validity of the location clause or of any other provision in the Dealer Selling Agreement, and we do not. We do not decide whether the "location clause" may be construed to prohibit a dealer, party to it, from selling through discounters, or whether General Motors could by unilateral action enforce the clause, so construed. We have here a classic conspiracy in restraint of trade: joint, collaborative action by dealers, the defendant associations, and General Motors to eliminate a class of competitors by terminating business dealings between them and a minority of Chevrolet dealers and to deprive franchise dealers of their freedom to deal through discounters if they so choose."

Thus, the *General Motors* case holds only that a conspiracy to boycott is an unreasonable restraint of trade; with which all antitrust scholars will agree. It does not hold that a manufacturer may not unilaterally enforce the territorial restrictions contained in his franchise agreement with his dealers.

Another case that will be cited undoubtedly by opponents of franchise distribution as showing judicial repugnance to such economic activity will undoubtedly be *Federal Trade Commission v. Brown Shoe Company, Inc.* (Docket No. 118 October Term, 1965) 34 Law Week 4468 decided by the Supreme Court of the United States on June 6, 1966. In point of fact, even so reputable and careful a publication as the Wall Street Journal in its June 7, 1966 issue (page 5) has stated that the significance of this decision lies in the fact that, unlike several other cases the Federal Trade Commission has brought, no charge was made that the Brown Shoe franchise system involved price fixing or allocation of territories. If such a conscientious reporter of the national scene as the Wall Street Journal can make such a statement about the recent decision of the Supreme Court in this latest Brown Shoe Company decision, it may safely be conjectured that others, less careful, will build even more fantastic superstructures which will effectively disguise what is it that the Supreme Court actually decided in the *Brown Shoe* Case.

In the first place, it is inaccurate to say, as did the Wall Street Journal on June 7, 1966 that the F.T.C. charges in connection with the *Brown Shoe* case decided this year did not involve a claim of price fixing. The order to cease and desist issued by the Federal Trade Commission in March of 1963 which was here under review specifically found that the Brown Shoe Company had a scheme of resale price maintenance and "went to considerable lengths to secure adherence to its suggested resale prices" (F.T.C. Docket No. 7606, CCH F.T.C. Complaints and Orders 1961-63 para. 16, 316 page 21, 147). The Circuit Court of Appeals disagreed with this finding (339 F. 2d 45) and the Supreme Court, in reversing, revalidated the F.T.C. findings of a resale price maintenance scheme.

Nor is it accurate to hold that the *Brown Shoe* case decided by the Supreme Court this month took any position at all on the issue of territorial franchises. What was involved in the Brown Shoe case was the issue of an exclusive dealing arrangement under which the purchaser from Brown Shoe Company was obligated to restrict his purchases of competing products of other manufacturers. As such, it falls under the structures of Sec. 3 of the Clayton Act making it unlawful for any person to sell any commodity on condition that the purchaser shall not use or deal in the commodity of a competitor (see e.g. *Standard Fashion Co. v. Magrane-Houston Co.* (1922) 258 U.S. 346). The *Brown Shoe* case merely

held that an exclusive purchase arrangement was not only bad under the Clayton Act but also an unfair method of competition under Sec. 5 of the Federal Trade Commission Act, under which latter act the proof of adverse effect on competition is less stringent, and the court merely held "that the Commission has power under Sec. 5 to arrest trade restraints in their incipency without proof they amount to an outright violation of Sec. 3 of the Clayton Act or other provisions of the antitrust laws." (34 Law Week 4468 at 4470).

But the restraint of trade to which the court directed its attention in the cited *Brown Shoe* case was not exclusive territorial franchises but rather exclusive purchasing contracts. Such agreements are concededly violative of our antitrust laws. The issue in that case, as formulated by the Supreme Court (Law Week, supra 4469) is whether the Federal Trade Commission can declare it to be an unfair practice for Brown, the second largest manufacturer of shoes in the Nation, to pay a valuable consideration to hundreds of retail shoe purchasers in order to secure a contractual promise from them that they will deal primarily with Brown and will not purchase conflicting lines of shoes from Brown's competitors." This issue, it will be noted, has nothing whatever to do with exclusive territorial franchises, nor is it or will it be in any way effected by the bill which this honorable committee is now considering.

Nevertheless, it is not without point to remark on the aura of confusion which presently beclouds the entire subject of franchise distribution. The purpose and the sole purpose of S-2549 which you are considering is to remove this confusion from at least one area of the law as to which there can be no effective dispute concerning the propriety of the economic transactions involved in this kind of a franchise system.

S-2549 is a carefully drawn piece of legislation, intended to spell out with great clarity those forms of franchise distribution which clearly do not constitute an unreasonable restraint of trade. It provides that a territorial franchise is valid under our antitrust laws if, and only if, the product franchised is in free and open competition with products of like, grade and quality produced by others; if, and only if, the purchaser under such a franchise is in free and open competition with other vendors of like and similar merchandise; and if, and only if, the terms of the franchise agreement do not prohibit the purchaser from dealing in competitive products. As such, this Bill cannot possibly restrain trade or inhibit competition. It is free of the defects found by the Supreme Court in other cases where franchises were prohibited or modified. It complies in all respects with standard law on territorial franchises evolved during the course of the past sixty years and only recently brought into question by a spate of ill thought through actions of lesser antitrust enforcement officials whose zeal overcame their prudence. It remains but to consider whether any substantial economic arguments can be addressed in opposition to this carefully drawn blue print which will assure manufacturers and distributors a safe course to chart in determining the validity of their exclusive territorial franchise arrangements.

Clearly, the present bill would not satisfy our present Assistant Attorney General in charge of the Anti-Trust Division, Professor Donald F. Turner who, sees only one justification for territorial restraints. In an address given before the New York State Bar Association Anti-Trust Law Symposium on February 2, 1966, he stated:

"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. . . .

"As I have said, I have not yet seen a convincing case made for any other exceptions to a rule of illegality." (CCH Trade 1966 New York State Bar Association Anti-Trust Law Symposium, pages 4 and 5).

Professor Turner's inability to see any other justification for a territorial franchise is a strange form of economic myopia fortunately not shared by other anti-trust lawyers who have considered this problem.

The introduction of a new product and the introduction of a new firm is indeed justification for territorial franchises. But what of the need to support an already introduced product and an already established manufacturer verging

on the edge of bankruptcy while its product is being retooled, as in the *Sandura* case? And what of the need to support an existing small company engaged in an unequal struggle with commercial giants whose advertising capacities cannot possibly be matched by those of their smaller competitor, as in the *White Motor* and the *Arnold Schwinn* cases? And what of the situation involving a large manufacturer and distributor which was engaged in what the court declared to be "bitter and bloody" competition with over eighty other concerns in the same line of business, as was the situation in the *Snap-On Tools* case? These few examples show the inapplicability of the line attempted to be drawn by Professor Turner as to what justifies a territorial franchise arrangement.

Nevertheless, Professor Turner's comments, as Chief of the Anti-Trust Division of the Department of Justice, are illuminating to show not only the crabbed attitude taken by our law enforcing officials as to the restrictive scope they will permit territorial franchises but also as demonstrating the need for Congressional action which will establish guidelines that will prevent the Department of Justice from inhibiting rather than fostering competition. The passage of S. 2549 will assure small firms that they can compete with their more favorably circumstanced rivals through the employment of a franchise distribution system provided that it is so structured as to eliminate undue restraints of trade.

In enacting this law, the Congress of the United States will be performing a needed service in clarifying a presently obscure section of our anti-trust laws and giving a new lease on life to those firms which rely for their continued existence upon the exclusive territorial franchise system.

Senator FONG. And we have here with us Leroy F. Ball, of King Cigar Co.; Morton Meyer, of Metropolitan Tobacco Co.; William Eakin, of Modesto Tobacco & Candy Co.; Edward T. Lagonegro, of Elmira Tobacco Co.; Richard M. Ryan, of the Quebec Cigar Co.; J. Donald Blankenship, of Bianchi Cigar Co.; James R. New, Jr., of New Cigar Co.; T. Monroe Kildow, of W. H. Kildow Co.; Donald Gregg, of Faber, Coe & Gregg, Inc.; Joseph Kolodny, managing director of the National Association of Tobacco Distributors; Harold K. Smith, of John H. Swisher & Son, Inc.; and Congressman E. S. Johnny Walker, who wishes to present his statement for the record; and Congressman Thomas G. Morris, of New Mexico, who also wants to present his statement for the record.

Without objection, all of you who are prepared to submit your statements will have the statements presented to the reporter here and have it incorporated in the record.

Is there any objection? If not, these statements will be incorporated in the record and if any of you wish to come and testify tomorrow, you may do so, but I don't think it is necessary.

(The statements begin on p. 1097.)

Senator FONG. The committee now stands adjourned until tomorrow morning at 10 a.m. in this room.

(Whereupon, at 12:20 p.m., the committee adjourned until tomorrow, Wednesday, June 22, 1966, at 10 a.m.)

## DISTRIBUTION PROBLEMS AFFECTING SMALL BUSINESS

(Exclusive Territorial Franchise Bill)

WEDNESDAY, JUNE 22, 1966

U.S. SENATE,  
SUBCOMMITTEE ON ANTITRUST AND MONOPOLY  
OF THE COMMITTEE ON THE JUDICIARY,  
*Washington, D.C.*

The subcommittee met, pursuant to recess, at 10:05 a.m. in room 1114, New Senate Office Building, Senator Philip A. Hart (chairman) presiding.

Present: Senator Hart.

Also present: S. Jerry Cohen, staff director and chief counsel; Charles E. Bangert, assistant counsel; Peter N. Chumbris, chief Counsel for minority; James Schultz, minority counsel; Gladys E. Montier, clerk, and Patricia Bario, editorial director.

Senator HART. The committee will be in order.

Before opening, let me thank the able Senator from Hawaii, Senator Fong, who yesterday presided at these hearings in my absence. The presence, of course, of Senator Hruska always contributes to a record that is full. On the record I will state my regret that a matter of some moment to Michigan, the auto safety bill, was in a markup session in another committee that I am on, which explains my absence yesterday.

Today we will ask all of the witnesses to come forward to the witness table, Douglas Marshall and Herbert McCalley, Leroy Litman, and Abraham Tunick.

Just be seated, gentlemen. You have all given the committee in advance, as our rules require, written statements. We are grateful for that. If there is no objection, the record will contain in full as though given in full each of these statements. As each of you proceeds, if you care to summarize or extend or footnote, feel free to do it.

Our first witness is R. Douglas Marshall, president of Marshall Co., Albany, N.Y., who will speak to us in his capacity as president of the National Association of Wholesalers.

Mr. Marshall.

### STATEMENT OF R. DOUGLAS MARSHALL, PRESIDENT, NATIONAL ASSOCIATION OF WHOLESALERS

Mr. MARSHALL. Mr. Chairman, members of the committee, my name is R. Douglas Marshall. I am president of the National Association of Wholesalers, a federation of 51 national commodity line

wholesaler-distributor associations whose members operate over 18,500 wholesale distribution establishments throughout the 50 States.

I am accompanied by three other spokesmen for the wholesaler distribution industry, each of whom will present a statement following my presentation.

The subject before us today, franchising, is of utmost concern to the wholesale distribution industry. We live in a very large nation, with hundreds of thousands of manufacturers, who produce millions of products desired by people in every city and every hamlet. Basically, these middle channels of distribution are organized by commodity lines, my own being air-conditioning and refrigeration parts, supplies and products. The gentlemen accompanying me today represent the hobby industry and electrical products and the wine and spirits wholesalers. Some products must be distributed through many channels. For example, some electrical components must be carried by air-conditioning and refrigeration wholesalers, by electrical distributors, by electronic distributors, and even heating supplies wholesalers. Similarly, some manufacturers distribute some products through one type of wholesale channel and another product, same manufacturer, through another type. For example, Armstrong Cork distributes containers to drug wholesalers, floor and ceiling products through building supplies distributors, and Armstrong's insulating products through air-conditioning and refrigeration wholesalers.

The marketing economics vary from product to product, and there is a need for great flexibility as to the marketing arrangements and agreements between suppliers and distributors. Our appearance here today on exclusive territorial franchise is not designed to present that arrangement as an ideal pattern for all types of distribution.

With your permission, I would like to emphasize that point and read it again, that "our appearance here today on exclusive territorial franchises is not designed to present that arrangement as an ideal pattern for all types of distribution." Certainly it is not.

Rather, it is to present the need of suppliers and distributors for considerable latitude and flexibility in developing marketing programs not only for the introduction and sale of new products but for continued market development and penetration.

The bill before us, S. 2549, recognizes the increased pressures from the Federal Trade Commission and the Department of Justice against exclusive territorial franchises. In most cases, when suits have been defended, the Federal courts have rendered decisions in favor of the exclusive territorial arrangement, usually citing that the Government had failed to prove the exclusive territory unduly restricted competition. The more frequent result is complete capitulation in the face of a Government suit. The reason is quite obvious—neither the franchisor nor the franchisee has the financial resources to fight the long and prolonged legal battle to a conclusion. As a result, many manufacturers are reluctant to grant exclusive territorial franchises.

Mr. Chairman, what follows here for the next four or four and a half pages obviously is not mine. I am not a lawyer. This is a summary of many cases that have been brought before the courts and was prepared by our legal counsel. You have copies, and while I will not take the time of this committee to read it, may I respectfully request that it be included as part of my testimony.

Senator HART. It shall.

Mr. MARSHALL. Briefly, the four and a half pages summarize and compare several cases involving such national companies as the White Motor Co., Snap-On Tools, Sandura Co., the Brown Shoe Co., Sealy Mattress Co., and others.

As a businessman, not a lawyer, these court cases leave me somewhat confused. Apparently what is sauce for the goose is not always sauce for the gander, though it does seem if the gander is willing to fight long enough and hard enough he eventually will wind up with some of the same sauce but he has to put up a fight for it. I find evidence that the Federal Trade Commission and the Department of Justice are permitting marketing activities on the part of large companies while denying the same actions and activities to smaller companies. I admit my prejudices as a small businessman but I feel my response to this apparent discrimination is strictly in accord with the American tradition of freedom and equity, equality.

I would say that the complexity of these decisions and the contradictions they contain illustrate the difficulty with the case-by-case approach which leaves business in an unhealthy state of uncertainty. To paraphrase the famous remark of the Supreme Court in its 1959 Northwestern States Portland Cement decision inserting the help of Congress, the judicial application of legal principles to antitrust statutes has left "much room for controversy and confusion and little in the way of precise guides."

This is what we are pleading for here, the establishment of clear rules of the road.

In discussing exclusive territorial franchises, we are discussing marketing. I should make clear at this point that my observations about exclusive territorial franchises also refer to "selective distribution", where the supplier limits his customers to one or two instead of more than that in the territory. In the metropolitan areas a manufacturer may choose several wholesaler-distributors to sell his product, yet in less populated areas, he may select only one.

This is a very common practice in the air-conditioning and refrigeration industry and in many, many others.

I hesitate to make this statement, because you have heard it before that this is the "day of big government, big business, and big labor." It is not completely so because smaller enterprises still offer employment opportunities to millions of people, manufacture an endless array of products and even our own wholesale industry is today primarily composed of smaller business enterprises. We move about \$190 billion of products through wholesale distribution channels. Yet we do battle with the giants in the marketplace.

How does a manufacturer develop a nationwide market? The truly large national companies are able to develop market demand through extensive advertising and promotion programs. National television and radio coverage, advertising in national magazines and in hundreds of newspapers across the country will develop heavy demand for a product which any distributor is happy to carry. In the trade this is referred to as "pull", the product is "pulled" through the channels of distribution and is made available by merchant wholesalers to hundreds of thousands of outlets.

The smaller manufacturer is in a much different position. He is often the manufacturer of highly technical and specialized equipment. His volume of output is not large enough to support advertising in

national marketing media, he has no network of salesmen to cover the country, perhaps he cannot afford regional warehouses. Yet he still can become a national marketer through the use of independent merchant wholesalers provided he can enter into a distribution arrangement which will be attractive to them. For some suppliers—for some products—this may require the granting of exclusive territories, not only in the initial or introductory stage, but later as well so he can continue to compete as other manufacturers enter the field with similar products.

Is it in the public interest to permit an arrangement whereby in return for taking on a product, or a line of products, aggressively promoting and selling of the product, extending a wide variety of services including extending credit and maintaining a full inventory of repair and replacement parts on the part of the distributor, the supplier in return designates the distributor as the exclusive distributor for the market area he can best serve? We believe that it is. The large national well-financed company may, without any legal restrictions whatsoever, establish its own or captive regional or marketing area distribution outlet and assign to each such outlet an exclusive marketing area. Yet the smaller manufacturer in direct competition with the national company cannot by contractual arrangements with independent merchant wholesalers take a parallel action without legal hazards. Thus the law is placing restraints on the practices which are required for smaller enterprises to compete with larger enterprises.

We have reviewed with great interest, the statement submitted to this subcommittee on March 2, 1965, by the then Administrator of the Small Business Administration, Eugene P. Foley. At that time, Mr. Foley stated that franchise arrangements frequently include agreements by the franchisee: (1) to limit his sales to a specified area and (2) to deal only in the merchandise furnished him by the franchisor. With respect to territorial restrictions Mr. Foley observed, "Such fencing is a very effective method of encouraging each franchisee to advertise in his territory secure in the knowledge that the soil thus fertilized will not be invaded by others." We heartily concur in that appraisal and note that such franchise arrangements stimulate and enhance competition between brands. As long as there is vigorous competition between brands we see no restraint of trade and no trend toward monopolistic practices. In fact we see the opposite. Again, we note that the true giants of industry, in addition to manufacturing their product, can maintain regional or market area distributors and their own retail outlets. Where ownership of manufacturing, wholesale distribution outlets and retail stores is in one pair of hands, lines may be limited, sales territories specified and even prices set for all levels of distribution. Yet the Federal Trade Commission and the Department of Justice in prosecuting distributors and suppliers who have entered into exclusive territorial franchises are directly aiding, abetting and encouraging further economic concentration and discouraging the independents who are trying to meet competition.

It should be remembered that not all products are sold through regular retail outlets. Many distributors sell primarily to other businesses including contractors and service and repair organizations. I

believe that conditions in my own commodity line might be used as an illustration. As an established business, we know well the air-conditioning and refrigeration contractors in our marketing area, and they know us. Because we are well known, a new manufacturer or manufacturer who has not worked our market area may ask us to distribute their products.

We mentioned Armstrong Cork Co. a few moments ago. About 10 years ago Armstrong developed a new flexible insulation for cold water or hot water lines and cold refrigeration lines. No one had ever had anything like it and there was no ready-made sales channel or organization through which to market it. So Armstrong came to the air-conditioning and refrigeration wholesaler since we dealt with contractors who could use this insulation and were familiar with its application.

The many sizes and thicknesses of this material require a large inventory—and to sell it, which we must do to turn over our inventory—requires intensive promotion on our part. Naturally an exclusive distribution arrangement was necessary at that time for us to undertake this risk. Now Armaflex, as the product is named, is a success and this has inspired imitators and competitors. To provide the product at the lowest cost to the user in competition with other producers such as Goodyear, Johns Manville, Owens Corning, Pressite Engineering, etc., Armstrong continues its exclusive distribution policy.

To take on a new line involves many decisions including the necessity to maintain almost for the unforeseeable future, a full line of repair and replacement parts.

As an illustration, consider ITT-General Controls. Most of their sales originally are made to manufacturers of air-conditioning and heating equipment. They also make products which are used by industry to control manufacturing processes or conditions. It is very important that replacement parts be instantly available in the field. This is our job, and in return for our stocking the large variety of repair and replacement parts, ITT-General Controls has appointed us factory authorized distributors and repair and replacements are made through us.

It may be asked why not appoint many factory authorized distributors. The answer is that too big an inventory is required with too small a turnover to be economically profitable. By having one full inventory in one territory the sales volume is large enough to permit the factory authorized distributor to keep the prices to a minimum.

We value the reliance and trust our contractor-customers place in us. If we start to sell a line of products, encourage their use and installation by our regular customers, they in turn will expect us to maintain a full line of repair parts. Often this is a requirement in a franchise, but even if the supplier had no such requirements, the need to maintain the good will of our customer requires it.

Once we make the investment in the inventory of a new line, it is imperative that we launch an aggressive campaign to sell the product. This initial venture is costly, and we cannot justify the initial expenditures with the initial returns. We need to know that the market we build will be our market, that we are sowing seed for a later harvest.

Two companies come to my mind in this connection. Both are well known nationally but the products we handle are so specialized

and require such highly trained salesmen that both companies are now working through exclusive wholesale distributors to cheaply and efficiently move their product. We pull them through. The companies are Honeywell, Inc. (formerly Minneapolis-Honeywell), and the Taylor Instrument Co. in Rochester, N.Y. We have sent our men to their factory schools largely at our expense to learn about their products. We most certainly would want exclusive distribution rights before making an investment of this kind of time, money, and manpower.

Of course, if the manufacturer and his products are well known and in great demand, if he advertises extensively in my area, then he is making that investment and an exclusive territory is not so essential. But the smaller manufacturer expects us to develop all the marketing tools and exploit the media in our market area. He wants us to do this because our name is better known to the potential customers in our community than is his, and our name helps build the demand for his product.

If I may interpose here, Mr. Chairman, in a great many cases the wholesaler is a much larger company than these smaller manufacturers whose products he is introducing into this territory.

The potential customers know that if we handle the product of an unknown company, it is a reliable product, deliveries will be made when promised, a full line of repair parts will be carried, fair credit terms will be extended, emergency orders will be rushed, and adequate product information and advice will always be available.

These are valuable assets, not to be placed at the disposal of a manufacturer lightly. But these assets mean productive selling of the franchisor's full line, never hesitating for fear we will not be able to recover our initial investment, and with a feeling of responsibility to render every service to the user of our supplier's products.

Are exclusive territorial franchises in the public interest? We believe they are. The board of trustees of the National Association of Wholesalers has endorsed the principle contained in S. 2549, and as president, I convey that endorsement today.

Our board also suggests the deletion of the phrase "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." The basic reason for the deletion is that the phrase is unnecessary. The Clayton Act forbids agreements between suppliers and purchasers which ban the purchaser from dealing in products produced by other suppliers. With that suggested amendment we urge enactment of S. 2549.

Mr. Chairman, this is the end of my testimony.

Senator HART. Thank you, Mr. Marshall.

Without intending to delay unduly hearing from the others, I have just one question. It wouldn't be fair to engage you in a discussion over those series of Supreme Court cases. However it is my impression that the Court shares the point of view that exclusive territorial franchises, may be in the public interest sometimes—but not always. When you come to Congress and suggest that we can clarify the Sherman and Clayton Acts by an amendment such as the one we are considering here, I am not at all clear in my own mind whether we would be adding clarity to this field or contributing further to the confusion. This really is basic to my concern about the bill.

I take it you would agree that if there were just one Chevrolet dealer in the District of Columbia, this might raise a question as to whether it was or wasn't a desirable limitation in the public interest.

Mr. MARSHALL. I don't know that I am quite ready to discuss the Chevrolet case. This is an example of the large giants of industry who can control their vertical distribution straight through and the courts have held that this type of control over distribution by the large companies is legal. There are no restrictions against it.

I feel that in general—reviewing the cases that are outlined, the White Motors, Snap-On Tools, and these cases, though again here I am not a lawyer—the courts have tended to uphold the right of the manufacturer to grant exclusive franchises, whereas the right of doing this has been challenged in the first place by the Federal Trade Commission and the Department of Justice.

Senator HART. The only reason I used Chevrolet as an example is I am trying to find a case where there would be general agreement that in such a situation an exclusive territorial arrangement would not be desirable. The courts, as I understand it, have indicated pretty clearly to that particular giant, General Motors, that he cannot handcuff a dealer—

Mr. MARSHALL. I would agree; yes.

Senator HART (continuing). And that seems to make good sense from the public's viewpoint.

Mr. MARSHALL. Yes, it does.

Senator HART. And my problem is how you find language around Congress to make adequate provision for the exception and do it by statute—not leaving it to the court to determine on all of the facts whether this is one where reason would suggest the public would be served by permitting an exclusive arrangement or denying it.

Mr. Cohen?

Mr. COHEN. Just to put this thing in perspective, what we are talking about with exclusive territorial arrangements is giving a distributor a monopoly in a particular area. I am using the word now not in a bad sense. But he has a monopoly to sell that product in that area and nobody else can do it. As you point out, there may be a difference between General Motors giving somebody a monopoly or Sandura giving somebody a monopoly in that same area.

Yet you represent three companies, two of which—ITT and Honeywell—are among the top 100 companies in the Nation. Armstrong, is among the top 200. And Taylor, which is a pretty good account, I would imagine, from your point of view. How would you fit them into this problem?

Mr. MARSHALL. We represent probably about 200 companies, as a matter of fact, some on an exclusive basis and some not. They include people like Nebco who make sweat fittings, and every plumber or air-conditioning man has to have them and all wholesalers handle products of this kind. But certain other products which are specialized in nature, which require intensive sales effort, promotion, sales knowledge, and so forth, these are the types of arrangements that manufacturers generally will go to in order to find someone who is willing to invest his time and money in handling a product of this kind.

Mr. COHEN. I understand that, of course. But as you point out in your statement, you are concerned with helping the "smaller manufacturer," as I understand the wording used.

Mr. MARSHALL. Yes. This is one thing that would be accomplished.

Mr. COHEN. You say in your statement—

The smaller manufacturer expects us to develop the marketing tools and exploit the medium in our marketing area.

Mr. MARSHALL. Yes.

Mr. COHEN. But we are talking about Armstrong and I.T. & T. and Honeywell. We are not talking about helping the smaller manufacturer.

Mr. MARSHALL. This is true. We should probably not emphasize the smaller manufacturer but any manufacturer introducing new products.

Mr. COHEN. Whether he be big or small.

Mr. MARSHALL. Oh, yes.

Mr. COHEN. How long would you let him have the exclusive territory, then, after the new product is no longer new?

Mr. MARSHALL. No. I don't think we should say he should not be able to have it on an exclusive basis. Because if the new product is successful, as in the case of Armstrong, they have big competitors. To successfully compete in the marketplace, they have, rather than expanding their sales forces broadside, consistently continued to specialize through one channel of distribution in one area. So that I don't think we should put a time limit on this. I think that if it is right once, it is probably right at all times.

Mr. COHEN. You see, there are some people who have suggested that the exclusive territory concept—while it may help the manufacturer occasionally—is desired most by the distributors themselves because it does lock you into an area where you are not going to have any competition. If somebody wants to buy their parts from Honeywell he has no choice but to go to you to buy that part if he lives in the area where you have the exclusive. It effectively does away with competition in that area.

How do we justify this in the public interest?

Mr. MARSHALL. Because Honeywell, of course, has many competitors and makes consumer products for similar applications, and Honeywell feels that they can best serve their customers by one aggressive exclusive distributor in a territory.

Mr. COHEN. Now, Armstrong Cork comes out with Armaflex.

Mr. MARSHALL. That is right.

Mr. COHEN. This is a unique sort of thing.

Mr. MARSHALL. It was.

Mr. COHEN. If anybody wanted to buy these unique goods—this Armaflex—they have only one place in an entire area that they can go. Naturally they have to pay the price the distributor is charging in that area.

Mr. MARSHALL. Except that now there are many competing products identical in formulation, identical in appearance, and in performance with Armaflex.

Mr. COHEN. Let's see what this bill would do. You mentioned the *Sandura* case and, of course, in the *Sandura* case and *Snap-On* tools, the courts did seem to lay down the rule that an exclusive territory is probably all right if you are dealing with a smaller manufacturer who is competing with a larger manufacturer.

Mr. CHUMBRIS. They were about to go bankrupt.

Mr. COHEN. In *Snap-On Tools* they were not about to go bankrupt and there were several other cases where they were not about to go bankrupt where the courts seemed to indicate that to help a smaller manufacturer compete with the larger ones, as long as there is inter-brand competition, there is nothing wrong with an exclusive franchise. They have taken somewhat of a different attitude probably when they are dealing with the giant manufacturers. *Sandura* won their case. They are allowed to have their exclusive territories. And to that extent there is certainty in the law.

But now, under this bill, "the territorial area shall not in and of itself be deemed to be an unfair method of competition," and so forth, "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."

Now, the court might well reason that if there is not free and open competition with products of like grade and quality, in view of this bill, you would have a per se violation which is much farther than any of the Supreme Court's decisions have gone to date. There is no Supreme Court decision that I know of that says an exclusive territory is a per se violation. Yet this bill could lead itself to that interpretation if this condition is not met.

Now, the condition is "free and open competition with products of like grade and quality." *Sandura*, as I understand it, claimed that their floor covering was unique, like your *Armaflex* is unique, so that there may not be competition with products of like grade or quality. This raises the interesting question that if this bill had passed, *Sandura* might well have lost the same case they won without the bill. This is frankly some of the concern we feel.

Is this bill really going to help you or isn't it? Or, as the Senator said, "Does this add a new degree of uncertainty to the law which in a situation like *Armaflex* may well mean that you face a per se rule now where you have never faced a per se rule before?" That is a question and a concern at the same time.

Mr. MARSHALL. Indeed. Well, this is a question of law and interpretation that I am not qualified to answer. I just think that the average distributor to take on a product in an exclusive territory rarely has a monopoly because there are always competing products. *Armaflex* has half a dozen competitors now. *Taylor Instrument Co.* is competing with a dozen thermometer manufacturers—including *Honeywell*. But to insure the best, most efficient distribution of their products, they feel it necessary to go through exclusive territorial franchises.

Sometimes, now, these are not spelled out in detail that involve counties, and so forth, but are rather selective distribution agreements, that you carry so much of this in stock—they spell out what the wholesaler has to do. I think a monopoly is a bad thing. I am not going to try to defend this and I presume there would be instances where a monopoly could be established under certain conditions, but this is not what we are asking for.

We feel that a need does exist for clarification and spelling out the rules of the road so that we know, and our manufacturers know, where we stand on this thing.

Mr. COHEN. I guess the big question is whether this particular bill really spells out the rules of the road. Or whether it puts a few more clouds in front of the sun of reason.

Mr. MARSHALL. Our position is that it clarifies satisfactorily for our purposes.

Mr. COHEN. Can you just explain how, how does this clarify the present law?

Mr. MARSHALL. We have manufacturers coming to us, sir, saying, "No, I can't give you an exclusive on this thing because the law forbids it." At the same time you will have a manufacturer calling on you the next day and saying, "We must sell it to you on an exclusive franchise arrangement."

Manufacturers don't know where they stand. Federal Trade Commission and the Department of Justice say that you must not do this, and yet the courts have upheld, generally speaking, the legality of exclusive distribution. So that we are being pressured on both sides by opposing forces. One arm of our Government says no. We go to court. If we have the money, we go to court and the court says yes.

Mr. COHEN. So this bill passes and the same manufacturer comes to you and says, "No, we can't give you an exclusive because the law won't let us, because under the facts and circumstances it seems to us they might interpret this to be an unreasonable restraint." They can still give you the same reason. This bill does not say that all territorial franchises are OK. It just says they shall not be a per se violation.

Mr. MARSHALL. This is true.

Mr. COHEN. Which the courts have never said they are in the first place.

Mr. MARSHALL. The courts have never said this, very true, but the Federal Trade Commission—

Mr. COHEN. So the manufacturer can still come in and say, "Under present law as we look at this situation, our lawyers tell us that territorial restraints here might be interpreted as being an unreasonable restraint, and therefore we can't give it to you."

I am raising these questions because this committee has been concerned for about a year or a year and a half with problems of the small franchisee and the small franchisor. We have been concerned about the problems in these dual distribution situations, the problems that you have when you work yourself to death to build up an area and the manufacturer says, now that you have got it all built up, thank you, we are canceling your franchise and we will take over.

You have all kinds of problems as a franchise. The only question is whether or not your efforts might not be better spent on legislation that you know is going to have some beneficial effect in terms of your ultimate survival.

Mr. MARSHALL. Congratulations.

All I can do is to repeat that we do feel that this bill spells out and delineates our possibilities better than the law as it now reads which in our thinking is unclear. People who want to twist things around are going to find a way to do it no matter what we come up with. But we feel that once and for all, to say that an agreement of this kind is not per se illegal, a statement of this kind by our Government would be a good thing.

Mr. COHEN. Well, we had Rand Dixon down here and he made the statement that exclusive territories are not per se illegal. So, at least, even without the bill, you made some progress in this area.

Mr. MARSHALL. Good.

Senator HART. Mr. Chumbris.

Mr. CHUMBRIS. Mr. Marshall, tomorrow we are going to hear the witness from the International Franchise Association. The reason I bring this out now is because he points out three defects in the proposed bill and they go to the colloquy that you just had with Mr. Cohen. I would like for each of you four gentlemen at the table to get a copy of that statement so that you may have the opportunity to respond to the three defects that he mentions. Because at the conclusion of his statement he says, because of these three defects and other factors, he is reluctantly opposing this particular bill.

First, he says, from the standpoint of the probable effect on a substantial number of franchise systems, Senate bill 2549 in its proposed form contains several basic defects. The most significant defect is the provision that limits the scope of the exemption to franchise agreements under the terms of which the franchisor is not inhibited from dealing in like or similar products of persons other than the supplier. He says:

We interpret this provision to deny the benefits of the bill to a franchisor that retains the power to require its franchisees to sell only the trademarked product or service in an exclusive dealer relationship.

Then he goes on and explains it.

The second significant defect of the proposed amendment is the uncertain scope of the bill. The language of the proposed amendment refers to an agreement restricting the right of the purchaser to the distribution of the supplier's product within a clearly delineated territorial area.

Would this language include an agreement that limits the franchise to one place of business within a defined exclusive territory?

And finally he says:

S. Bill 2549 is by its terms applicable to "a contract or agreement between a purchaser and a supplier".

Though the bill is probably intended to cover franchising generally, we question whether its language is broad enough to encompass those franchised relationships under which there are no sales of products or services by the franchisor to its franchisees or where such sales of equipment, raw materials or ancillary products constitute an insignificant percentage of the franchisee's growth business. A related defect is the failure of the bill to specifically cover services as well as products. In the light of the interpretation which has been placed on Section 3 of the Clayton Act which refers exclusively to products and has been interpreted as so applying, this omission is significant.

And his last point, about section 3 applying to only products, is a subject matter of another hearing that this subcommittee is conducting on TV discount rates where the Federal Trade Commission considers televising of ads not a product but service, et cetera.

Now, I hope that you gentlemen who are going to speak, or you, too, Mr. Marshall, might want to comment because this gentleman is very much interested in the franchising industry and he appears to be against the bill.

Mr. MARSHALL. I think that we would all like to get a copy of this testimony and prepare a rebuttal for you and submit it to the committee.

Mr. CHUMBRIS. Yes. It is unfair really to read his paper before he comes here, because he may make a change or during a colloquy he may explain away something here that is not shown in the paper itself. But I thought you should have the advantage of it because you gentlemen are for the bill and he indicates that he would have to be against the bill because of these defects.

Mr. MARSHALL. We would like to get a copy of it.

Mr. CHUMBRIS. If you wish to comment upon any of these points he raised, you are free to do so since it is the only immediate opportunity you have to do so.

Senator HART. I would suggest, we could receive that comment for the record after you have an opportunity to analyze the statement.

Mr. MARSHALL. I would rather hold off for the moment, Mr. Chairman.

Mr. COHEN. It also should be pointed out, just to put this thing in perspective, that that witness also felt that judicial review was the more orderly process, rather than legislation.

Mr. CHUMBRIS. Yes. I said, "and among other reasons."

Senator HART. Thank you, Mr. Marshall.

(The full prepared text of Mr. Marshall follows:)

TESTIMONY OF R. DOUGLAS MARSHALL, PRESIDENT, THE NATIONAL ASSOCIATION OF WHOLESALERS

My name is R. Douglas Marshall. I am President of the National Association of Wholesalers, a federation of 51 national commodity line wholesaler-distributor associations whose members operate over 18,500 wholesale distribution establishments throughout the fifty states.

With your permission, Mr. Chairman and members of the Committee, we would like to handle our presentation here today as a panel. I am accompanied by two other spokesmen from the wholesale distribution industry, each of whom will present a statement following my presentation.

The subject before us today, franchising, is of utmost concern to the wholesale distribution industry. We live in a very large nation, with hundreds of thousands of manufacturers, who produce millions of products desired by people in every city and hamlet. It is our economic function as wholesaler-distributors to determine the products the people in our market area need and desire, obtain and store that product in advance, and make it possible by selling, delivering and extending credit their taking possession of the product. Basically, these middle channels of distribution are organized by commodity lines, my own being air-conditioning and refrigeration parts, supplies and products. The gentlemen accompanying me here today represent the hobby industry and electrical products. Some products must be distributed through many channels. For example, some electrical components must be carried by air-conditioning and refrigeration wholesalers, by electrical distributors, by electronic distributors and even heating supplies wholesalers. Similarly, some manufacturers distribute some products through one type of wholesale channel and other products through another type. For example, Armstrong Cork distributes containers to drug wholesalers, floor and ceiling products through building supplies distributors and insulating products through air-conditioning and refrigeration wholesalers.

The marketing economies vary from product to product, and there is a need for great flexibility as to the marketing arrangements and agreements between suppliers and distributors. Our appearance here today on exclusive territorial franchises is not designed to present that arrangement as an ideal pattern for all types of distribution. Rather, it is to present the need of suppliers and distributors for considerable latitude and flexibility in developing marketing programs not only for the introduction and sale of new products but for continued market development and penetration.

The bill before us, S 2549, recognizes the increased pressures from the Federal Trade Commission and the Department of Justice against exclusive territorial franchises. In most cases, when suits have been defended, the Federal courts have rendered decisions in favor of the exclusive territorial arrangement usually

citing that the Government had failed to prove the exclusive territory unduly restricted competition. The more frequent result is complete capitulation in the face of a Government suit. The reason is quite obvious—neither the franchisor nor the franchisee has the financial resources to fight the long and prolonged legal battle to a conclusion. As a result, many manufacturers are reluctant to grant exclusive territorial franchises.

In the *White Motor* case in 1963, the U.S. Supreme Court had before it a holding by the trial court that a truck manufacturer's distribution system which allocated exclusive territories to distributors was a *per se* violation of the Sherman Act. The Supreme Court reversed, stating that it was not ready to hold such a distribution system illegal in itself, without a fuller understanding of the economic effect of the restrictions imposed by it. Pointing out that this was the first case involving a vertical restriction, the Court said that while horizontal territorial limitations are "naked restraints of trade with no purpose except stifling of competition", a vertical limitation "may or may not have that purpose or effect. They may be too dangerous to sanction, or they may be allowable protection against aggressive competitors or the only practicable means a small company has for breaking into or staying in business."

Although *White Motor* case was terminated by the consent decree, the Supreme Court's language was given effect in several later decisions upholding the validity of franchising agreements. In *Snap-On Tools v. Federal Trade Commission*, the Court of Appeals for the Seventh Circuit followed the hint from the Supreme Court, and examined Snap-On's contract against the background of the situation in the hand tool industry. It found that Snap-On distributed its products through approximately 900 dealers, who energetically solicited and serviced customers. The dealer contracts provided that the dealer would sell only in his geographic area, assigned to him by contract. He was, however, free to sell in that area to any customers who wished to come to him.

The Court held that these contract requirements did not unduly restrict competition, and did not violate Section 5 of the Federal Trade Commission Act, when the nature of the hand tool business and the number of persons engaged in it were considered. First, it appeared that interbrand competition among some 80 suppliers was "bitter and bloody", and that Snap-On was in no position to acquire a monopoly. Second, the nature of the industry made geographical divisions of territory particularly appropriate to efficient distribution. The sale of mechanics' hand tools requires regular calls on customers, at the customer's place of business, by routine salesmen or dealers. Purchases are generally in limited quantities and often on impulse, or because a special tool is required for a current job. Re-designing of the product often requires physical demonstration of them at the customer's place of business. Further, sales are frequently on credit, and the dealer must make collections. In view of these reasons for frequent customer contact, many dealers use completely equipped trucks as sales vehicles.

Considering all the evidence, the Court concluded that Snap-On's vertical territory franchises were prompted by reasonable business expectations, and were not in restraint of competition. On the contrary, it said, these business methods were necessary to prevent Snap-On from being "submerged by the other companies in the field," and interbrand competition was thus fostered.

In December of 1964, the Court of Appeals for the Sixth Circuit reached a similar conclusion in the case of *Sandura Company*, which had been charged by the Federal Trade Commission with unfair competition within the meaning of Section 5. The manufacturer assigned defined geographical areas to its various distributors and prohibited them from selling in the territory of a neighboring distributor. The Court remarked that although this was a restraint of competition between the dealers, it did not follow that it was an "unfair method of competition". The Court noted that the system was introduced at a time when the Company was having financial difficulties, had had trouble with its product, and dealers were reluctant to act for it unless they could have closed territories. The reasoning of the courts in this line of cases is expressed in the *Sandura* opinion:

"We believe that the cumulative effect of the facts offered is legally sufficient to justify Sandura's use of closed territories. Unless vertical imposition of closed distributor territories were now to be declared illegal *per se*, it is difficult to imagine a basis for finding an unreasonable restraint of trade at the time Sandura instituted this scheme in 1955. While its spectacular success in the 1955-1959 period may be due to the novelty of its perfected product, it is clear that the product could not have been successfully marketed if Sandura had not

been able to attract distributors by the promise of closed territories. Not only would the hard floor-covering market have likely lost a competitive factor which proved the spur to innovation by other manufacturers, but there would also have been no intrabrand competition to stifle . . ."

The recent decision of the Supreme Court in *Federal Trade Commission v. Brown Shoe Company* also was concerned with a charge by the Federal Trade Commission of "unfair competition" under Section 5. The complaint alleged that the Brown distribution plan required its customers to restrict their purchases of shoes for resale to the Brown lines and prohibited them from purchasing, stocking or reselling shoes manufactured by competitors of Brown. Brown Shoe is one of the world's largest manufacturers of shoes, and distributes to some 650 retail stores. Brown admitted that approximately 259 of its retail customers had executed written franchise agreements and that over 400 others followed the franchise agreement without a formal contract. These dealers agreed to concentrate their business "within the grades and price lines of shoes representing Brown Shoe Company Franchise" and to "have no lines conflicting with Brown Brands".

The complaint charged that Brown's customers who entered into this franchise agreement were given in return special treatment and valuable benefits which were not granted to other customers who did not so agree. The Commission found that the services provided by Brown were the "prime motivation" for dealers to join the program, and that the effect of the plan was to foreclose retail outlets to Brown's competitors, particularly small manufacturers. The enforcement of the plan was effected by teams of field men who called upon the shoe stores, urged the elimination of other manufacturers' conflicting lines and reported deviations to Brown who then cancelled under a provision of the agreement.

Without referring to *White Motor*, *Snap-On Tools*, or *Sandura*, the court said that the question before it was "whether the Federal Trade Commission can declare it to be an unfair practice for Brown, the second largest manufacturer of shoes in the Nation, to pay a valuable consideration to hundreds of retail shoe purchasers in order to secure a contractual promise from them that they will deal primarily with Brown and will not purchase conflicting lines of shoes from Brown's competitors." The Court thus treated the case as involving something more than a mere plan of distribution, and analyzed it in terms of the power of the Commission to act under Section 5.

Holding that its power was correctly exercised, the Court said that: "This broad power of the Commission is particularly well established with regard to trade practices which conflict with the basic policies of the Sherman and Clayton Acts even though such practices may not actually violate these laws. The record in this case shows beyond doubt that Brown, the country's second largest manufacturer of shoes has a program, which requires shoe retailers, unless faithful to their contractual obligations with Brown, substantially to limit their trade with Brown's competitors. This program obviously conflicts with the central policy of both Sec. 1 of the Sherman Act and Sec. 3 of the Clayton Act . . . The Commission has power under Section 5 to arrest trade restraints in their incipiency without proof that they amount to an outright violation of Sec. 3 of the Clayton Act or other provisions of the antitrust laws."

The Court specifically rejected the contention that there must be proof that the effect of the conduct may be to substantially lessen competition. It thus disregarded an element considered important in both *Sandura* and *Snap-On Tools*.

Two cases involving the legality of franchise systems of distribution are on appeal to the Supreme Court and will not be decided until next fall. *United States v. Sealy* is a direct appeal arising out of a civil action brought by the United States charging that Sealy, Inc., violated Sec. 1 of the Sherman Act by conspiring to fix retail prices and allocating mutually exclusive sales territories. After trial, the district court held that though Sealy had violated the Act by agreeing to set prices, its exclusive territorial arrangements did not violate the law.

The fact situation in *Sealy* distinguishes it from the cases discussed above, because the territorial allocation there was horizontal rather than vertical. Sealy does not manufacture mattresses, but licenses approximately 30 companies to manufacture and sell products under its trade-mark, which has been used on bedding since 1889 and is well-known and respected. These manufacturers agreed to confine their sales of Sealy products within mutually exclusive terri-

tories. They also agreed to pay \$10 to Sealy for each item sold in the territory of another licensee.

The District Court found that the plan was lawful, apparently on the grounds that its primary purpose was to finance national advertising of Sealy products in competition with larger manufacturers of other brands, and to protect the good will attached to the Sealy trademarks. On appeal to the Supreme Court, the Government argues that since this is a horizontal agreement between potential competitors to divide territories, the defenses noted by the District Court are irrelevant.

The other case pending is the Schwinn case. The District Court found that Schwinn has a right to assign primary responsibility to a distributor in a territory. Following the line of *Sandura* and *Snap-On Tools*, it further found that the Schwinn franchising system is "reasonable, fair and good business procedure under all the circumstances existing in the bicycle industry."

The complexity of these decisions, and the contradictions they contain, illustrate the difficulty with the case-by-case approach which leaves business in an unhealthy state of uncertainty. To paraphrase the famous remark of the Supreme Court in its 1959 *Northwestern States Portland Cement* decision inviting the help of Congress, the judicial application of legal principles to anti-trust statutes has left "much room for controversy and confusion and little in the way of precise guides".

In discussing exclusive territorial franchises, we are discussing marketing. I should make clear at this point that my observations about exclusive territorial franchises also refer to "selective distribution", where the supplier limits his customers to two or more instead of one in the territory. In the metropolitan areas a manufacturer may choose several wholesaler-distributors to sell his product, yet in less populated areas, he may select only one.

I hesitate to make this statement, because you have heard it before that this is the "day of big government, big business and big labor". It is not completely so because smaller enterprises still offer employment opportunities to millions of people, manufacture an endless array of products and still our own wholesale industry is even today primarily composed of smaller business enterprises. We move about \$190 billion of products through wholesale distribution channels. Yet we do battle with the giants in the market place.

How does a manufacturer develop a nationwide market? The truly large national companies are able to develop market demand through extensive advertising and promotion programs. National television and radio coverage, advertising in national magazines and in hundreds of newspapers across the country will develop heavy demand for a product which any distributor is happy to carry. In the trade this is referred to as "pull", the product is "pulled" through the channels of distribution, made available by merchant wholesalers to hundreds of thousands of outlets.

The smaller manufacturer is in a much different position. He is often the manufacturer of highly technical and specialized equipment. His volume of output is not large enough to support advertising in national marketing media, he has no network of salesmen to cover the country, perhaps he cannot afford regional warehouses. Yet he still can become a national marketer through the use of independent merchant wholesalers provided he can enter into a distribution arrangement which will be attractive to them. For some suppliers—for some products this may require the granting of exclusive territories, not only in the initial or introductory stage, but later as well so he can continue to compete as other manufacturers enter the field with similar products.

Is it in the public interest to permit an arrangement whereby in return for taking on a product, or a line of products, aggressive promoting and selling of the product, extending a wide variety of services including extending credit and maintaining a full inventory of repair and replacement parts on the part of the distributor, the supplier in turn designates the distributor as the exclusive distributor for the market area he can best serve? We believe that it is. The large national well financed company may, without any legal restrictions whatsoever, establish its own or captive regional or marketing area distribution outlet and assign to each such outlet an exclusive marketing area. Yet the smaller manufacturer in direct competition with the national company cannot by contractual arrangements with independent merchant wholesalers take a parallel action without legal hazards. Thus the law is placing restraints on the practices which are required for smaller enterprises to compete with larger enterprises.

We have reviewed with great interest, the statement submitted to this Subcommittee on March 2, 1965 by the then-Administrator of the Small Business

Administration, Eugene P. Foley. At that time, Mr. Foley stated that franchise arrangements frequently include agreements by the franchisee 1) to limit his sales to a specified area and 2) to deal only in the merchandise furnished him by the franchisor. With respect to territorial restrictions Mr. Foley observed, "Such fencing is a very effective method of encouraging each franchise to advertise in his territory secure in the knowledge that the soil thus fertilized will not be invaded by others." We heartily concur in that appraisal and note that such franchise arrangements stimulate and enhance competition between brands. As long as there is vigorous competition between brands we see no restraint of trade and no trend toward monopolistic practices. In fact we see the opposite. Again, we note that the true giants of industry, in addition to manufacturing their product, can maintain regional or market area distributors and their own retail outlets. Where ownership of manufacturing, wholesale distribution outlets and retail stores is in one pair of hands, lines may be limited, sales territories specified and even prices set for all levels of distribution. Yet the Federal Trade Commission and the Department of Justice in prosecuting distributors and suppliers who have entered into exclusive territorial franchises are directly aiding, abetting and encouraging further economic concentration and discouraging the independents who are trying to meet competition.

It should be remembered that not all products are sold through regular retail outlets. Many distributors sell primarily to other businesses including contractors and service and repair organizations. I believe that conditions in my own commodity line might be used as an illustration. As an established business, we know well the air-conditioning and refrigeration contractors in our marketing area, and they know us. Because we are well known, a new manufacturer, or a manufacturer who has not worked out market area may ask us to distribute their products.

We mentioned Armstrong Cork Company a few moments ago. About ten years ago Armstrong developed a new flexible insulation for cold water or hot water and cold refrigeration lines. No one had ever had anything like it and there was no ready-made sales channel of organization through which to market it. So Armstrong came to the air-conditioning and refrigeration wholesaler since we dealt with contractors who could use this insulation and were familiar with its application.

Many sizes and thicknesses of this material require a large inventory . . . and to sell it, which we must do to turn over our inventory . . . requires intensive promotion on our part. Naturally an exclusive distribution arrangement was necessary at that time for us to undertake this risk. Now Armaflex, as the product is named, is a success and this has inspired imitators and competitors. To provide the product at the lowest cost to the user in competition with other producers such as Goodyear, Johns Manville, Owens Corning, Preststone Engineering etc., Armstrong continues its exclusive distribution policy.

To take on a new line involves many decisions including the necessity to maintain almost for the unforeseeable future, a full line of repair and replacement parts.

As an illustration, consider ITT-General Controls. Most of their sales originally are to manufacturers of air-conditioning and heating equipment. They also make products used by industry to control manufacturing processes or conditions. It is very important that replacement parts be instantly available in the field. This is our job . . . and in return for our stocking the large variety of repair and replacement parts, ITT-General Controls has appointed us Factory Authorized Distributors and repair and replacements are made through us.

It may be asked why not appoint many Factory Authorized Distributors. The answer is that too big an inventory is required with too small a turnover to be economically profitable. By having one full inventory in one territory the sales volume is large enough to permit the Factory Authorized Distributor to keep the prices to a minimum.

We value the reliance and trust our contractor-customers place in us. If we start to sell a line of products, encourage their use and installation by our regular customers, they in turn will expect us to maintain a full line of repair parts. Often this is a requirement in a franchise, but even if the supplier had no such requirements, the need to maintain the good will of our customer requires it.

Once we make the investment in the inventory of a new line, it is imperative we launch an aggressive campaign to sell the product. This initial venture is costly, and we cannot justify the initial expenditures with the initial returns.

We need to know that the market we build will be our market. We are sowing seed for a later harvest.

Two companies come to my mind in this connection. Both are well known nationally but the products we handle are so specialized and require such highly trained salesmen that both companies are now working through exclusive wholesale distributors to cheaply and efficiently move their products. We "pull" them through. The companies are Honeywell Inc. (formerly Minneapolis-Honeywell) and the Taylor Instrument Companies in Rochester, N.Y. We have sent our men to their factory school largely at our expense to learn about their products. We would most certainly want exclusive distribution rights before making an investment of this kind of time, money and manpower.

Of course if the manufacturer and his products are well known and in great demand, if he advertises extensively in my area, then he is making that investment and an exclusive territory is not so essential. But the smaller manufacturer expects us to develop all the marketing tools and exploit the media in our market area. He wants us to do so because our name is better known to the potential customers in our community than is his, and our name helps build the demand for his product. The potential customers know that if we handle the product of an unknown company, it is a reliable product, deliveries will be made when promised, a full line of repair parts will be carried, fair credit terms will be extended, emergency orders will be rushed, and adequate product information and advice will always be available.

These are valuable assets, not to be placed at the disposal of a manufacturer lightly. But these assets mean productive selling of the franchisor's full line, never hesitating for fear we will not be able to recover our initial investment, and with a feeling of responsibility to render every service to the user of our supplier's products.

Are exclusive territorial franchises in the public interest? We believe they are. The Board of Trustees of the National Association of Wholesalers has endorsed the principle contained in S. 2549, and as President, I convey that endorsement today.

Our Board also suggests the deletion of phrase "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". The basic reason for the deletion is that the phrase is unnecessary. The Clayton Act forbids agreements between suppliers and purchasers which ban the purchaser from dealing in products produced by other suppliers. With that suggested amendment we urge enactment of S. 2549.

Senator HART. The next witness, speaking for the National Association of Electrical Distributors, is Herbert O. McCalley, vice president of the Tristate Electrical Supply Co., Hagerstown, Md.

I have indicated that in the case of each of these statements they will be printed in the record in full as though given. As we go along, if there are additional comments or summarization you may wish to submit, that will be accepted.

**STATEMENT OF HERBERT O. McCALLEY, VICE PRESIDENT,  
TRISTATE ELECTRICAL SUPPLY CO., INC.**

Mr. McCALLEY. Mr. Chairman, gentlemen, my name is H. O. McCalley. I am vice president of the Tristate Electrical Supply Co., Inc., Hagerstown, Md. I am also a member of the board of governors of the National Association of Electrical Distributors. Our association is a member of the National Association of Wholesalers, on whose behalf I am presenting this statement.

The National Association of Electrical Distributors includes a membership of over 1,100 establishments engaged in the wholesale distribution of electrical construction materials.

I appear today in my individual capacity as an independent businessman and also as a representative of the National Association of Electrical Distributors and the National Association of Wholesalers.

My purpose is to endorse Senate bill 2549 and urge its approval by this subcommittee and eventual passage by the Senate.

S. 2549, if enacted into law, would, in substance, authorize exclusive territorial distribution. On the other hand, it would permit the seller to limit his distributor-customer to a clearly delineated territorial area provided (a) that the products involved are in free and open competition with others of like grade and quality, and (b) the customer is himself in free and open competition with other vendors of like or similar merchandise. On the other hand, it would permit the seller to make such a customer his sole and exclusive distributor within that designated territorial area. Basically our support of this legislation rests on two general grounds, legal and business economics. Legally, the whole structure of franchise distribution is at present cloudy, confused, and subject to continuous challenge by Government enforcement agencies. To help businessmen, in general, and small businessmen, in particular, this untenable situation should be clarified and once and for all.

From a business viewpoint, exclusive territorial limitations, in many instances, provide economies in business operation; encourage loyalty and cooperation between vendor and customer; strengthen competition among manufacturers and between distributor-customers; and frequently provide the only means by which a small manufacturer can enter a new market area or compete against already established, more affluent competition.

Some background information about the electrical supply distribution industry may be helpful toward a better understanding of our support for this legislation.

As an electrical supply distributor, my company owns and operates warehouses which regularly stock more than 10,000 individual items. Our products are used primarily in electrical construction work, commercial and industrial lighting, air-conditioning installations, and the maintenance and repair of electrical systems.

One of the economic problems we distributors face is the necessity of carrying duplicate lines and duplicate items. While the distributor, ideally devotes his primary time and attention to certain selected supply lines, this aspect of business is necessarily diluted by the necessity of carrying and selling many duplicate items. The net result is that the loyalty, support, cooperation and help we, as nonexclusive distributors, can give to our suppliers and which they can give to us is greatly reduced.

A supplier who is compelled to service 20 nonexclusive distributors in a given trading area, of necessity must limit his services proportionally and the customer who is only one in 20 in a given trading area must sacrifice the time and attention he devotes to any particular line. The net result is a rather dog-eat-dog existence where adequate promotion, salesmanship, and service are sacrificed on both sides to volume alone.

I am not an attorney and will not attempt to discuss in detail the legal implications of selective distribution. I do know, however, from many conversations with attorneys that this whole area is one of legal

confusion and uncertainty. This was reflected in an editorial in the *Wall Street Journal* of June 13, 1966 commenting on the Supreme Court decision in the *Brown Shoe Company* franchise case. The editorial said, "But the most regrettable effect of the decision is the new confusion it injects into antitrust law, an area that was already baffling enough."

Neither the Department of Justice nor the Federal Trade Commission has made a secret of their respective disapproval of the restrictive clauses—both territorial and exclusive—contained in distribution or franchise agreements. In the *White Motor Company* case the U.S. Supreme Court refused to accept the theory of the Department of Justice that a vertical territorial limitation was a per se violation of the Sherman Antitrust Act. The Court recognized that it was a question of fact whether such restrictions have an adverse effect on competition which can be answered only after a thorough study of all the economic factors involved.

I also am informed that in a case brought against Sandura Co. by the Federal Trade Commission the U.S. Court of Appeals for the Sixth Circuit held that closed territories imposed on its distributors by Sandura were economically justified and not an unfair method of competition. Similarly, the U.S. Court of Appeals, Seventh Circuit, held that exclusive territories provided for in Snap-On-Tools Corp. dealer franchise agreements did not violate the Federal Trade Commission Act where such restrictions were based upon sound business reasons and did not have the inhibitory effect of a horizontal division of markets.

There are undoubtedly many other decisions upholding the validity of territorial restrictions but these should suffice to show that the courts have upheld the proposition that economics of the marketplace can be a proper justification for such territorial restrictions. These decisions, however, have done little to change the attitude of the Department of Justice as witnessed by the statement made by the recently appointed Assistant Attorney General in charge of the Antitrust Section of the Department of Justice. Mr. Turner said:

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 such cases to induce dealers to make the investment necessary to get the manufacturer's new product effectively introduced . . . To conclude, my tentative view is that territorial restrictions of dealers are more restrictive than is necessary to obtain legitimate objectives in all but very limited circumstances. There are ample alternative devices, all less restrictive than territorial restraints, whereby a manufacturer can attempt to achieve an efficient, aggressive marketing system.

The legal issues involved are even further beclouded by the very recent decision of the U.S. Supreme Court in *FTC v. Brown Shoe Company* where the Court reversed the Court of Appeals for the eighth Circuit and said that a restriction contained in the Brown franchise stores program which restricted the right of the franchise store owners to purchase from other sources shoes competitive to the Brown line, was an unfair method of competition in violation of section 5 of the Federal Trade Commission Act, even without any evidence

that the effect of the restriction may be substantially to lessen competition or tend to create a monopoly. This reasoning was based upon the Commission's power under section 5 to arrest trade restraints in their incipency without proof that they amount to an outright violation of section 3 of the Clayton Act or other provisions of the antitrust laws.

As an editorial in the Wall Street Journal previously referred to asked editorially, "That's a tenuous principle, at best. Who is to say for certain that an 'incipient' problem will ever become a real one?" The editorial might well have asked another question which continuously bothers businessmen, that is, who is to advise businessmen of the legality of their plans and programs if the decision as to legality is to rest solely upon the opinion of the FTC even when there is no evidence that the business practice adversely affects competition or contravenes previously accepted legal principles?

Returning to the business considerations which favor enactment of S. 2549, probably the most compelling reason in favor of exclusive territorial restrictions for the distributor would be to give him the assurance that the special effort he expends on a product and the expense he incurs in stocking and marketing it will be safeguarded. Usually, it is safer, easier, and less expensive to sell only with the well-known, well-entrenched lines. Unless a distributor can be assured that his special effort on a new product has a good chance of success and will yield him a reasonably good profit, he will normally refuse to handle products of small or new manufacturers.

This, of course, stifles competition since it tends to preclude new entrants from the market and tends to solidify the position of those already present.

Manufacturers who have only a limited and selective number of distributors can more economically provide greater service to the customer. With established outlets to market his products properly the manufacturer can better afford to improve his products or develop new ones. His advertising, promotion, and marketing programs will be better suited to the customers' wants and actual conditions in the market and he will have a much greater assurance of the distributor's using these marketing tools to greater advantage. All of which will stimulate competition in the marketplace.

No electrical distributor worthy of the name fears wholesome, aggressive competition but every distributor wants and needs the incentive and encouragement of his supplier in order to build a solid, economically sound business enterprise. Passage of S. 2549 would permit the supplier to give his distributor such a climate in which to operate his business.

For the reasons expressed herein, I, speaking individually and for the National Association of Electrical Distributors, and the National Association of Wholesalers, respectfully urge the members of this subcommittee to report favorably on S. 2549 and support its passage by the Senate.

Senator HART. Thank you very much. There is no need, I think, to repeat both our expression of sympathy and our concern as to whether this is the right device to be helpful.

Mr. McCALLEY. Yes, sir.

Senator HART. We went through this with Mr. Marshall.

I am sure we recognize, though, that the point that you make as the most compelling business reason or justification for these exclusive franchises is very much like the set of conditions that the Assistant Attorney General, Mr. Turner, himself acknowledged to be a possible justification. Namely these are the new entry, need for promotion, the requirement that to get an effective distributor you have to provide this kind of protection.

Mr. Cohen?

Mr. Chumbris?

Mr. CHUMBRIS. Mr. McCalley, it is good to see you again. You are an old University of Maryland student?

Mr. McCALLEY. Yes, sir.

Mr. CHUMBRIS. Give my regards to Carl Shank and Jack Stonebraker when you get back to Hagerstown. They were there a few years ago. We don't like to say how long ago. We may be dying our hair black and we don't want to give that away.

Mr. McCALLEY. I would be tickled to death to have some.

Mr. CHUMBRIS. Would you say, if Mr. Turner states that the exception that he would make would be for a person who may be bringing a new product into the market, whether the franchisor and franchisee who would have to be competing against that product should also have the same privilege?

Mr. McCALLEY. If I understand correctly, you mean if other distributors were willing to put the investment in inventory and promotion and extension of credit into the same products, should they be allowed to have it, too? If they could do the same job for him?

Mr. CHUMBRIS. Mr. Turner says the only time he would say per se should not apply is if franchisor A should put a new product on the market and that would give him an opportunity to get his product recognized. Well, then, if that is the case, let us say, if franchisor B has a similar product although not as newly developed a product as franchisor A, and if franchisor A has special privileges, he may be able to knock B, C, D, E, and F completely out of the market. Sometimes we have seen in our hearings where a man comes out with a new product and within 5 or 6 months he has captured 65 percent of the market on that new product.

The philosophy of the Federal Trade Commission is that the rule of reason should apply rather than per se doctrine and the Commission will have to look at all of the factors to determine whether there is a violation of the existing antitrust laws.

You don't have to answer. I am really making an observation at this point.

Mr. McCALLEY. It has been my experience under those conditions, though, that the man whose product has been knocked out recovers very quickly and redesigns his, doesn't he?

Mr. CHUMBRIS. That is right, if he has the same privileges of franchisor A's new product.

Senator HART. Thank you, Mr. McCalley.

Mr. McCALLEY. Thank you.

Senator HART. Next we will hear from Mr. LeRoy Lipman, also of Maryland.

**STATEMENT OF LEROY LIPMAN, JR., PRESIDENT, KRAMER-BALTIMORE, INC., BALTIMORE, MD.**

Mr. LIPMAN. Mr. Chairman, members of the committee, my name is LeRoy Lipman, Jr. I am president of Kramer-Baltimore, Inc., located at 319 Fallsway, Baltimore, Md. My firm is a wholesale distributor of models, hobbies, and crafts covering an eight-State area from New York to North Carolina. We are members of the Hobby Industry Association of America, an organization composed of manufacturers, wholesalers, retailers, publishers, and manufacturers' representatives. I am now chairman of the wholesaler's section of HIAA. Our association is a member of the National Association of Wholesalers, with whom we appear here today.

Our company, Kramer-Baltimore, Inc., serves 1,100 active accounts, including department stores, chain and variety stores, toy and hobby shops, as well as a wide range of independent retail dealers. My firm is among the top 10 hobby distributors in the Nation by reason of an annual sales volume in excess of \$2 million. The hobby industry, as we know it today, was born of the depression. By 1955 hobby retail sales had reached \$651 million and it has been estimated that sales will exceed the \$1-billion mark by 1980. Today we offer a range of models beginning with the Neanderthal man and ending with outer space. Each kit offers a varying degree of difficulty of assembly, challenging age groups from 7 to 70.

The hobby wholesaler offers a varied inventory of all the components required for the student scientist. Included are chemicals, laboratory apparatus, glassware, microscopes, prepared specimen slides, and a selection of preserved biological specimens. Available are an extensive array of philatelic items including albums for every country, stamp packets and mixtures, first-day covers, and a wide range of accessories.

For the coin collector, we offer albums and coinholders for the United States and other countries, currency plus coin tubes, coinholders, magnifiers, reference books, and a considerable listing of the actual coins themselves. Supplies are available for the hobby geologist, the entomologist, and the boy or man who just loves to collect, whether it be military miniatures, automobiles from the antique to the modern day, or the creative dabbler in the arts who can find within our inventories all manner of artist's materials in the way of water colors, oils mediums, palettes, brushes in infinite variety, sizes, shapes, and styles; to say nothing of canvasses, papers and pads, pastels and drawing pencils, instruction manuals and, for the not too advanced, hundreds of paint-by-the-number sets and a truly amazing array of wall plaques, mosaic tile, stone, sequin, braid and bead in all manner of design for do-it-yourself interior decorators.

The model railroader can choose from an inventory, both in kit form and ready to run, locomotives in steam, from the DeWitt Clinton and Tom Thumb through the articulated monsters of steam's heyday. For rolling stock there are freights and passenger cars spanning the entire history of American and European railroading. There is no shortage of accessories for the railroader and to mention a few there are power packs, track of every size and variety, buildings, scenic accessories, tools and hardware of all description.

A completely different category covers model aviation; and here we begin with the simple glider of balsawood retailing from 5 cents, followed by a galaxy of increasingly complex design and engine power stepping from rubberband power to gasoline powered, and finally into radio control equipment where we contend with such terms as "selective super-super-heterodyne" and "analog proportional systems."

My own favorite spare time activity is model ship building and here the hobbyist may choose from raw materials, complete kits and accessories for both scale display model and operating model just about any ship that ever plowed the seven seas. These ships may be powered by wind, battery, or gasoline and controlled by radio only slightly less complex than the flying model airplane.

The newest explosion within the hobby industry has been in model car racing and within the past 2 years over 2,000 retail establishments devoted exclusively to model car racing have been opened in the United States. Almost every component used in the manufacture of the real automobile is now available. Wheels, tires, axles, bodies, chassis, gears, bearings, maintenance products, hardware, tools, motors, decorative accessories, complete kits, and assembled ready-to-run cars that would turn Detroit's production lines green with envy. To equip these new specialized stores we now offer a welter of specialized equipment including magnetizers, timers, lap counters, basic power supplies, signs, interior decor and the tracks themselves, ranging in size up to 300-foot lane lengths. The hobby industry has never experienced an impact so great as that brought on by model car racing.

The vastness and technical complexity of the hobby business has created an inventory problem of the first magnitude for the over 1,000 wholesalers in the United States and Canada who stock and sell hobby craft merchandise. The day is gone forever when even the largest of hobby distributors can say, "If its made, we stock it." We are becoming more and more selective in our buying and we now scrutinize every item of every line on its own merit. A course of constant amazement to me is the total of exclusives or franchises.

And, Mr. Chairman, here I would like to depart from the text.

My background is from the tobacco industry where franchises are the rule rather than the exception. Moving immediately to the hobby industry, at first I was puzzled, and secondly dismayed, because I found that my company salesman represented over 200 manufacturers and in his brief weekly visit with his retail accounts, it was impossible for him to so much as mention each line with stock to say nothing of the items within the lines.

Each salesman tends toward his own sales items, and the result is the same as firing a shotgun compared with other industries where franchises receive the support of the entire sales organization.

This shotgun method of selling results in a relatively slow turnover of inventory as opposed to clear-cut rifle shot of a concentrated effort in a single line or group of lines. This slowdown of inventory turnover is costly to us and, in turn, to our customers and the hobbyist. Higher inventory turnover would permit many economic savings.

My firm has supported any number of new and untried products and done the creative sales work of initial distribution many times, only to have the fruit of our pioneering fragmented by our competition jumping on the bandwagon as the result of our successful labor.

The natural result of this series of disappointments is that today we hesitate to undertake the building process involved in a new product or new concept knowing full well the pitfalls of having spent our energies unwisely. The manufacturer is reluctant, in the extreme, to grant exclusive territorial franchises due to the mounting interest of the Federal Government and the continued attacks by the Federal Trade Commission and the Department of Justice on such arrangements.

The small business manufacturer is finding it increasingly difficult to gain the support of the hobby wholesaler in marketing initially his products. My company is finding it more and more and more difficult to justify the addition of new lines. We have reached the point where in order to make room for any new merchandise we must drop at least the equal number of established lines of old and duplicating items. With this atmosphere existing we would certainly be agreeable to accepting a franchise which involved agreement not to deal in similar products; in fact, if there were adequate legislation in existence, we would pursue this course most aggressively. There are many reasons for our adopting such a policy. One of our largest problems is in the matter of obsolescence caused by the ever-improving methods of manufacturer as well as changing market conditions. We now stock such a vast variety that we are hard pressed to give adequate attention to each line and the result is that we often overlook the early indicators that should alert us to a new inventory problem. In accepting a franchise or group of franchises we could simplify our inventory, giving closer attention to each line and avoid a large percentage of future obsolescence. The simplification of inventory would result in better initial buying and the avoidance of protracted out of stock conditions. In our industry a completion percentage of dealer-order of 80 percent is considered average—

Senator HART. Mr. Lipman, I read that. What does that mean? Completion percentage of dealer order—

Mr. LIPMAN. Mr. Chairman, we are bombarded each day by dealer orders. These orders come as a result of the aggressive work of our sales organization and they come by mail, by phone, and by personal visit of dealer to our warehouse. He presents us with a list from an array of product lines and manufacturers that causes us extreme concern. Usually it is a list compiled as a result of his failure to receive goods from our competitors as well as his current daily needs. We find that often the dealer will order merchandise that is no longer made, no longer available. He will order lines which we do not stock.

Senator HART. I understand now. I missed it on reading this.

Mr. LIPMAN. Right, sir.

Senator HART. I cut you off in the answer but my understanding is correct, is it not, that in reviewing your records, it would appear that every fifth request is one where your inventory does not provide the answer.

Mr. LIPMAN. Exactly. If we fill an order 100 percent, it is an accident.

As I was saying, in our industry a completion percentage of dealer-order of 80 percent is considered average and our dealers would welcome any change that could improve this critical factor.

No retail establishment, regardless of size, can possibly stock all of the items offered in our industry and the result must be ever more

selective buying. The competition for shelf space in the hobby shop or hobby department has become acute and the small manufacturer with a limited promotional budget stands little chance of gaining his fair share of space to get his product effectively introduced nor is there any reason for the wholesaler to make the effort or run the risk without reasonable expectation of future sales.

Adequate, clear-cut legislation regarding franchising would improve the lot of the retail hobby dealer in vastly simplifying his ability to locate needed supplies as each distributor would be able to supply his exclusive in depth and variety. The retailer could depend on his wholesaler salesman for adequate and accurate information and could look forward to prompt and complete advice regarding any new development within his company's franchise. The retailer would be protected under this arrangement from the unfair practices of dual distribution, wherein the manufacturer has been guilty of selling to the national retail organizations at the same price as the wholesale distributor and creating a situation in which the independent retail dealer cannot survive.

In conclusion, we believe the continued attacks by the FTC and the Department of Justice on exclusive territories have already created a jungle of fear and apprehension that should be remedied and clarified by the Congress. We believe that true competition—by that I mean aggressive, positive selling—would be enhanced by exclusive territory arrangements.

We believe they would aid small manufacturers, wholesalers and retailers, and in turn the hobbyist. We would urge the subcommittee's approval of the bill with the amendment that would permit the franchisee to agree not to deal in similar products of other producers if he chooses to do so.

Senator HART. Now, in all of the description of the problem that you confront, you haven't mentioned, or did I miss it, the need for exclusive territory. You are not describing to us anybody in there punching for business that you now have at the same level, are you?

Mr. LIPMAN. I am not sure I understand your question, Senator.

Senator HART. Well, you described the inventory problem of proliferation of lines, and so on, but as far as an exclusive territorial right is concerned, you add that you want an amendment to restrict any other man from dealing with a product of like kind.

Forgetting that for a minute and getting back to the basic bill which, as the introducers would argue, is making clear permissibility of exclusive territorial arrangements, where in your experience have you discovered the need for exclusive territorial arrangements? Isn't yours the proliferation problem only?

Mr. LIPMAN. We cannot afford to support and give our total energies to a line where we cannot enjoy the fruits of benefit. We cannot afford to drop or discontinue the distribution of one or more lines without the compensating business achieved as the result of a stronger sales effort, a broader and deeper inventory, in a specific single line.

Proliferation in our industry I can illustrate by the example of an axle. Every manufacturer who makes model car racing products or accessories offers a series of axles. There must be available to us 17 different axles. I am convinced that a large percentage of them are made by the same basic manufacturer and simply packaged differently. Being granted an exclusive in a specific line, we would stock in depth

that specific line, axles and accessories, as well as their major items in completed cars and kits.

The retailer is in the impossible position of asking, "Do you stock?" which is followed by, "if you stock, do you have?"

We are dealing with a wide range of manufacturers but a great majority are very small potatoes in our industry. Their ability to fill an order is questionable. Their ability to fill the demand of an item once it begins to really sell at the retail level is "hideous," is about the only word I can think of.

The average manufacturer in the hobby business is incapable of contending with the demand in the market for an item that does sell. This forces the distributor, if he wishes to truly support his dealer aids, to stock inventories at a level that would allow him to exist from one delivery to the next, and these deliveries can often be 30 to 60 days apart. If we attempted to carry an inventory that would support our sales volume for a period of 60 days in every item of every line, we would need a warehouse half the size of the city of Baltimore, I believe.

Right now space and dollars and time limit our investment in merchandise and the minute an item shows any sign or indication of taking off, we are immediately in an out-of-stock condition.

Senator HART. Have you attempted to obtain an exclusive territorial arrangement with any of these manufacturers?

Mr. LIPMAN. I have discussed it with a number of our manufacturers.

Senator HART. And what is the outcome?

Mr. LIPMAN. Our industry, as I mentioned in my testimony, is a new industry. Seniority, I think, can only extend about 30 years at this point. It is a dynamic growth industry. It is a method of distribution that at this point is foreign to our average manufacturer. The concept is being fought about.

The first manufacturer who successfully establishes the pattern of distribution by use of exclusive franchise will be followed I believe by many and I can foresee a network of franchises, exclusives, offered within our industry and I can see it coming in very short order as the result of clarification of the current legislation on the books.

The excuse, as you discussed before, of cloudy legislation often has been used. Just as often the economic problems where we have in the industry an intermeshing of major distributor coverage that is not unique but certainly considerably different than the other gentlemen who have testified this morning.

We serve a megalopolis which includes the metropolitan areas of New York and Philadelphia, Baltimore and Washington. Certainly we could not look forward to a franchise that would cover all of this area.

Senator HART. Why not?

Mr. LIPMAN. This is a situation where although we are the prime distributor in regions of the area we cover, we are not the prime distributor in other areas. We cannot serve a retail account in New York City as well as a wholesaler based in New York City. Although we cover it with regular salesman calls, we could not ask our manufacturer or indicate to him that we are the prime distributor in the area.

In discussing this situation with our manufacturers, we have asked only for that part of our area which we truly saturate to be assigned to us as an exclusive.

Senator HART. If you could get an exclusive territorial agreement and if the bill were amended as you suggest so as to permit that product line to be limited to you only, what type manufacturer would you seek to establish this relationship with?

Mr. LIPMAN. That is an excellent question. We have five basic categories within our industry. Plastic hobby kits are the most commonly sold. We would certainly seek a franchise in this area.

The lines of hobby manufacturers today are so extensive that a hobby department could exist within a very few manufactured lines.

To give an example, a line that was 30 items long when I joined the industry some 10 years ago is today 300 items long. We could supply a department or a hobby shop within the confines of one, two, or more major lines but still give such a variety that the consumer would be delighted with what he would find.

To move into model railroading, here the problem is heightened. A consumer will be looking for a specific car with a specific road name. This particular item possibly is within more than one line but if we were able to stock a single line in depth, we could offer to the retail dealer every item within the line.

Today we find that we are forced to high spot. For example, in our line of model railroading we certainly would carry Pennsylvania and B. & O. road names because of the area we are in. The odds against our carrying a Santa Fe or Canadian Pacific item would be high. Yet when the consumer is interested in a foreign road name, he finds it next to impossible to procure it.

We find that our retail dealers are dealing with distributors as far as California simply to procure some of the more unusual of the items.

Then when my dealer who was asking in turn for the consumer as to the availability of a product, if I had it, fine. But if I didn't, if I could intelligently tell him where could possibly find it, which of my competitors were possibly carrying that item within the line, that would be an enormous assist to the consumer, the hobbyist, as well as the retail dealer, as well as the manufacturer and the industry as a whole.

Senator HART. That is where I have my problem. If the three or four largest hobby dealers—wholesalers—in the country had exclusive arrangements with four manufacturers, what would soon happen to all the other manufacturers?

Mr. LIPMAN. The conclusion you have reached that a hobby distributor would make an arrangement, an exclusive, with a single manufacturer is basically impossible. The type of arrangement—

Senator HART. I thought you were asking for an amendment which would permit you to agree not to handle so many.

Mr. LIPMAN. That is correct. I feel strongly that what is sauce for the goose is sauce for the gander.

Senator HART. Let's not lose sight of my question. What happens to the manufacturers who don't hitch up with the four big wholesalers?

Mr. LIPMAN. Sir, it would be impossible for a hobby wholesaler to accept the exclusive franchise of a single manufacturer in a line such as plastic kits. It couldn't be. There is too much not covered in every line.

For example, only one manufacturer today offers kits on space and space vehicles while there are manufacturers who offer nothing but current automobiles. I could accept an exclusive in a line of current automobiles but I could not accept as part of that agreement not to stock another line in which aviation was covered, for example. The complexity of our industry is sometimes very mystifying and I don't mean to mislead you in that we would reduce in general our availability. We would simply reduce the duplication within our industry, the triplication, quadruplication. We would not reduce in any way, shape, or form the variety. We would simply simplify it.

A brand name is an important thing in our industry as in almost any other, and yet no single brand name is so important that a wholesaler cannot exist without it.

Senator HART. Well, our exchange is simply to develop a clearer understanding on our side. I am reluctant in the presence of counsel who does understand this field to express an opinion, but as you describe your objective, your method of doing business, I wonder what there is about the law today that prevents you from doing what you are seeking.

Mr. LIPMAN. I believe that the amendment that is being discussed the legislation that is being discussed, is the most clear cut available today that we can support. Possibly as you yourself have pointed out it is not the one answer to all the problems of franchising, but on the horizon it seems to be the best vehicle available and we would support it.

Senator HART. Mr. Cohen?

Mr. COHEN. Just two questions. The *Sandura* case and *Snap-On Tools* would appear to be much clearer guidelines than this legislation. You can do exactly what you say you want to do. Or is your problem that the manufacturer does not want to give you the exclusive you are seeking for economic reasons?

Mr. LIPMAN. I am afraid in our industry the problem is one of education.

Mr. COHEN. Not legislation?

Mr. LIPMAN. Perhaps.

Mr. COHEN. One last question. You define true competition as meaning aggressive positive selling. I had never heard that definition of competition used before. Where does price figure into this?

Mr. LIPMAN. Price is only 1 of 4 four major factors that a buyer must consider before making a purchase.

Mr. COHEN. I just wonder what you meant by defining competition as aggressive positive selling. What does that mean?

Mr. LIPMAN. It is difficult to explain without going into the four basic reasons that a purchaser must consider before he buys, consciously or subconsciously, and it is involved in selling. The concept of selling in my book is to answer these four questions. The basic ethics of the house is by far the most important, and yet the least discussed. The availability of product is second in importance to this. Service is third, and the least important of all is price.

For me to have the best price in my industry and yet not be able to deliver a product is of little consequence.

A combination of all four elements is necessary and desirable, and this is what I refer to in my statement.

Mr. Chumbris?

Mr. CHUMBRIS. I think one of the problems that you gentlemen are having is the fact that there is a difference of philosophy in the Federal Trade Commission and the Department of Justice as to what rules should apply. Mr. Cohen referred to the *Sandura* and *Snap-On Tools* cases, where they were successful, but had the Department of Justice filed the suit against Sandura and Snap-On Tools, they may have brought about a different result, we don't know.

Mr. Timberg, who appeared before the subcommittee, so stated. In other words, a gamble. I understand there is an agreement between the Federal Trade Commission and the Department of Justice, you take this case and I will take this one. Just like playing a game of roulette.

If it happens to be the Department of Justice's turn to take the case, you may be running into a stricter policy than the Federal Trade Commission's. That is what Mr. Timberg brought out in his testimony. That is one of the things you gentlemen are trying to clarify, so that whether you go before the Department of Justice or the Federal Trade Commission, you would get equal treatment, that both agencies would pretty much follow the same rule rather than this diverse rule that seems to be in effect at this time.

Senator HART. If Mr. Chumbris would let me interrupt, whether it is the Department of Justice or Trade Commission, they take it to the same referee. The circuit court of appeals. The answer would come from that same fellow.

Mr. CHUMBRIS. Well, we could expand on that because if the Federal Trade Commission decides not to proceed because of its philosophy and the company wins without much action at the FTC or going to court and the company does not spend a half million dollars to win his case as Snap-On Tool stated it spent. But if the Department of Justice had taken the case and the company had gone to court and then had gone through the court of appeals and possibly the Supreme Court before it finally won its case, the company probably would have spent a half million dollars or a million dollars in the process.

It does make a difference which one of those two agencies is going to take over a particular case.

Getting back to one other question, you stated that you were once in the tobacco field, and I ask this question in relation to some of the testimony we received yesterday. I believe Mr. Marcus Glaser stated that in dealing with cigarettes, because there are not a large number of cigarette manufacturers, five or six, there is no exclusive contract, is that right?

Mr. LIPMAN. That is correct.

Mr. CHUMBRIS. The distributor handles the products of all such companies. But because there are about 360-some manufacturers of cigars, the only possible way for the little man to get his cigar across to the market is to get an exclusive dealer who will push that cigar. Is that correct?

Mr. LIPMAN. That is correct.

Mr. CHUMBRIS. So we have the situation here where it depends upon what type of product is being handled as to what type of relief a person is looking for; and whether this particular bill will cover his problem or will not cover it. The witness tomorrow is going to show that for various reasons he is not in favor of the bill. Mr. Glaser has added a suggested amendment on page 2 of the bill and I am not so sure whether you gentlemen are familiar with his two suggested amendments to the bill to make it more applicable to the problem that the tobacco people have.

I can understand the subcommittee's problem, that unless it can crystallize the problems of each one of the people that come before us, it would be difficult for the subcommittee to write a bill that would meet the problems of the many without trying to reach just one segment of the franchise distribution industry.

Do you have any comment on that?

Mr. LIPMAN. Yes. I am afraid I didn't clarify at all my position. In our industry, as in the other industries being heard from today, there are any number of very basic items. In our industry it happens to be glue, paint, and brushes, no matter what model or hobby is attempted. Glue, paint, and brushes are a prerequisite, just as certain fittings in the electrical field and in the air-conditioning field. These items don't lend themselves to exclusive arrangements. There are highly technical items. There are enormously involved and long lines of products which lend themselves quite readily to exclusive distribution. And it would be impossible in our industry as in most to have each and every item handled by the distributor as an exclusive or proprietary item.

Mr. CHUMBRIS. Thank you, Mr. Chairman.

Senator HART. Thank you very much.

Now we conclude this morning hearing from Mr. Abraham Tunick, who, I believe, is speaking on behalf of the Wine & Spirits Wholesalers.

#### STATEMENT OF ABRAHAM TUNICK, WASHINGTON COUNSEL, WINE & SPIRITS WHOLESALERS OF AMERICA

Mr. TUNICK. Mr. Chairman, gentlemen, my name is Abraham Tunick and my office address is Shoreham Building, Washington, D.C. I am Washington counsel for Wine & Spirits Wholesalers of America (WSWA), a national trade association comprising of approximately 687 independent wholesalers doing business in the 32 open license States and the District of Columbia. I am submitting for the information of the committee our 1966 directory which contains a list of the names and addresses of our members, officers, and directors.

Senator HART. It will be received for the file.

(The document referred to will be found in the files of the subcommittee.)

Mr. TUNICK. WSWA supports S. 2549 and urges its enactment. WSWA is a member of National Association of Wholesalers (NAW) and in the interest of conserving the time of the committee, associates itself with all of the testimony presented on its behalf in support of the bill except that part of its testimony which suggests that the last proviso of the bill be stricken.

The bill provides that an agreement to grant exclusive territorial franchises shall not in and of itself be deemed a violation of the Sherman Antitrust Act and the Federal Trade Commission Act provided, (a) the products are in free and open competition with products of like grade and quality produced by other suppliers, (b) the franchisee is in free and open competition with vendors of like or similar merchandise within the territory and (c) the terms of the franchise do not inhibit the franchisee from dealing in like or similar products produced by other suppliers.

It is the latter provision which NAW seeks to eliminate. It justified its position on the ground that some franchisees may be willing to agree not to handle competitive lines in return for an exclusive territorial franchise and that the law should not inhibit them from doing so. We do not subscribe to this view and are in total disagreement with it.

Each of the three provisos under which an exclusive territorial franchise may be granted under the bill is vital to the preservation of free and open competition.

Section 3 of the Clayton Act in general terms makes it unlawful for a seller engaged in commerce to require a buyer not to deal in competitive goods under the circumstances stated therein if the effect may be to lessen competition or create a monopoly. For over half a century that provision has been a bulwark against anticompetitive and monopolistic practices. It is firmly woven into the fabric of our antitrust laws.

Although NAW asserts that it does not seek the repeal of that provision its suggested amendment would weaken it substantially.

For the Congress to sanction this type of agreement, directly or indirectly, would in our judgment constitute a giant step backward. Any suggestion by the Congress, however subtle, that sellers may exact an agreement from the buyer not to handle competitive products in return for an exclusive territorial franchise will place in the hands of the supplier a powerful economic weapon which would enable him to do the very things the antitrust laws were designed to prevent.

Major suppliers of nationally advertised brands have no difficulty obtaining distributors. It is reasonable to assume that if permitted to do so they would as a matter of course impose the requirement of no competitive lines as a condition to handling their lines on an exclusive territorial basis. Any idea that such an arrangement would be bilateral is more illusory than real. Private brands, which in some industries serve as a hedge to the distributor, would be eliminated because they compete with the major brands, and wholesalers would be inhibited from handling secondary lines on peril of forfeiting the major line.

In such a setting, smaller suppliers would find it difficult, if not impossible, to find distributors to handle their lines.

In our view the recommendation of NAW to delete the third proviso of the bill is unsound, not in the public interest, and should not be adopted.

We respectfully urge that the bill as drafted be reported favorably.

Senator HART. Mr. Tunick, your statement, though brief, is very much to the point.

Mr. TUNICK. Thank you, sir.

Senator HART. Not in the least obscure.

Mr. TUNICK. Thank you very much.

Senator HART. Do you so strongly oppose elimination of the condition that the dealer be free to handle other product lines, because of certain unusual aspects of the distribution of wines and spirits not present with hobbies or electrical supplies or building supplies?

Mr. TUNICK. I address myself and the objection which I had made, the regional proviso, only insofar as it affects wine and spirits distributors. I make no claim of having any familiarity with the other trades.

Senator HART. So the evils or the undesirable results that you describe as likely to occur if a major supplier of a nationally recognized product could condition an exclusive territorial grant on agreement that a similar line would not be handled you identify only in the wines and spirits field.

Mr. TUNICK. I do. Conceivably they may extend to other industries but I speak only as a—

Senator HART. I don't want to involve you in a difficult morning with your colleagues in the association, but why wouldn't the same results follow inevitably in any field?

Mr. TUNICK. It may very well. I say that I am not sufficiently familiar to make this judgment with respect to some of the industries as, for example, the hobby industry, with which I have no familiarity at all. It may very well follow in the other industries as it does ours.

Senator HART. Well, let's limit it then to yours, you tell us in substance, I take it, that the big would get bigger among the distillers and the small would be smaller and fewer.

Mr. TUNICK. Precisely, sir.

Senator HART. And if you like further concentration of industry, then—

Mr. TUNICK. This is a good way to do it.

Senator HART (continuing). So be it. But if that disturbs you, then you should be disturbed at the proposal to eliminate that condition. Is that a fair statement?

Mr. TUNICK. Yes, indeed.

Senator HART. Mr. Cohen?

Mr. COHEN. What that amendment would do, in fact, is repeal section 3 of the Clayton Act, wouldn't it?

Mr. TUNICK. That is exactly what I am concerned about. As a matter of fact, when I inquired whether this was their intention, and I have no desire in the presence of this committee to suggest that there is any inharmonious relationship between NAW and our association, the answer given to me was that they had no intention of repealing section 3, that their purpose, for urging the elimination of this proviso was because it was unnecessary and because section 3 remains in full force and effect.

My concern is that if a bill should be enacted ultimately, that the legislative history of the bill would show that as introduced, it did contain this third proviso and it was stricken in committee. There might be read into that something similar that was read into the legislative history of the Robinson-Patman bill in the *Borden* case.

Mr. COHEN. If section 3 is going to be repealed, you suggest that Congress ought to realize what they are doing and give that problem

a full hearing and not do it indirectly as an amendment to the franchise bill which supposedly is supposed to be dealing with exclusive territories.

Mr. TUNICK. That is exactly right.

Mr. COHEN. As a lawyer, let me ask you one more question. On the bill, line 16, it uses the words—

is not inhibited by the terms of such agreement or contract from dealing with like or similar products or persons other than the supplier.

It has been suggested this might be a defect in the bill and that the franchises may be inhibited by other agreements or other contracts or other means.

Therefore, this particular language may be defective and ought to be enlarged to cover any kind of inhibition from exclusive dealings.

Mr. TUNICK. I would agree with that entirely.

Mr. COHEN. Thank you, Mr. Chairman.

Senator HART. Mr. Chumbris.

Mr. CHUMBRIS. Just one question.

There have been many references in previous statements to the *Brown Shoe* case, recently decided by the Supreme Court. In that particular case the court of appeals held that the custom of giving free service to those who will buy shoes is widespread and it could not agree with the Commission that it is an unfair method of competition in commerce. So the court reversed the Federal Trade Commission.

Mr. TUNICK. Right.

Mr. CHUMBRIS. But the Supreme Court in its decision stated, and I will read from the opinion:

Thus, the question we have for decision is whether the Federal Trade Commission can declare it to be an unfair practice for Brown, the second largest manufacturer of shoes in the nation, to pay a valuable consideration to hundreds of retail shoe purchasers in order to secure a contractual promise from them that they will deal primarily with Brown and will not purchase conflicting line of shoes from Brown's competitors. We hold that the Commission has the power to find on the record here such an anticompetitive practice unfair, subject, of course, to judicial review.

Now, in the industries that you gentlemen are representing, do you find a parallel in your procedures with the procedures of doing business by Brown Shoe Co. with its franchise?

Mr. TUNICK. Are you directing it to me, Mr. Chumbris?

Mr. CHUMBRIS. Any one of you four gentlemen.

Mr. TUNICK. We do not have that type of practice in our industry.

Mr. CHUMBRIS. Thus, as far as you are concerned, the *Brown Shoe* case wouldn't necessarily be applicable to the particular industry that you are dealing with.

Mr. TUNICK. We are in a rather unique position because we have a built-in set of unfair trade practice laws in the Federal Alcohol Administration Act. We also, of course, are subject to the provisions of the Federal Trade Commission Act and all the antitrust laws. So we have a separate set of unfair trade practice laws in the Federal Alcohol Administration Act which very definitely affects us.

Mr. CHUMBRIS. The Supreme Court said here that the Federal Trade Commission considered all the facts. The fact that the Brown Shoe Co. is the second largest in the country, and it was able to get these promises from independent shoe dealers to use its product only because of the considerations that they were giving in return. But

had this shoe company been a shoe manufacturer from New England that was probably 99th on the list, and it followed the practices of the Brown Shoe Co., we don't know whether the court or Commission would have come to the same conclusion. At least the *Brown Shoe* case is a little bit different from the problems as I understand it that you gentlemen have been relating this subcommittee and the problems that were related to us yesterday and by many of the witnesses who appeared during the 1965 hearings, and the hearing we held in January of this year.

Any of you gentlemen wish to comment?

Mr. McCALLEY, I know that you mentioned the *Brown Shoe* case in your paper.

Mr. McCALLEY. We don't have any similar circumstances that I know of that I can recall in the distribution of electrical products.

Mr. CHUMBRIS. No further questions, Mr. Chairman.

Senator HART. Gentlemen, thank you very much.

Mr. TUNICK. Thank you, Senator.

Mr. MARSHALL. Mr. Chairman, Mr. Chumbris wanted some comment on the testimony to be given tomorrow by the International Franchise Association.

This is a different kind of franchising and there is an honest opposition of interest here because Mr. Tunick insists that they must not be allowed to insist on exclusive territorial lines, and yet the International Franchise Association is built entirely upon that principle.

We do have a conflict here, an honest difference.

Mr. TUNICK. I think, sir, that you misunderstand my position. We are entirely in accord with the position taken by NAW, that we support this bill which would under the circumstances permit this type of agreement under provisos which we have discussed earlier, and that such an agreement would not per se constitute a violation of the Sherman Act or the Federal Trade Commission Act.

The point of our difference, however, is NAW's proposal to eliminate the final requirement, that is, the requirement which in any way would inhibit the franchise from buying the same or similar merchandise from any other supplier.

Mr. MARSHALL. Yes. I am aware of that.

Mr. CHUMBRIS. Mr. Marshall, you pointed out that the procedures of doing business by the International Franchise Association are different from yours. Now, in order for us to understand fully the impact of your statement, I think that you ought to amplify that. You don't have to do it today. In other words, you should show us how your franchise system in your particular industry is different from what the IFA is pointing out so that we could understand what your problem is and we can better understand what the IFA problem is.

Mr. MARSHALL. I merely wanted to point out that there was an honest conflict here between the International Franchise Association and what we have been saying here, and that I sympathize with your job in trying to put all these things together and coming up with something that covers it all. But we will respond to this.

Senator HART. We will hold the record for that account.

Mr. CHUMBRIS. You see, a Senator often faces that problem every day because he has to synchronize the problems with the Northeast, the Southwest, the Northwest, and the South. It is everyday business with him. [Laughter.]

Senator HART. All you have to do is look at the batting order of this committee to understand the problem.

Mr. CHUMBRIS. I am referring to things other than what comes before this committee.

Senator HART. Gentlemen, thank you very much. It has been very helpful.

Mr. MARSHALL. Thank you.

Mr. TUNICK. Thank you.

Senator HART. Tomorrow we will hear three witnesses as indicated, Chairman Dixon of the Federal Trade Commission, then Mr. Grove of Snap-On Tool from whom we have heard at earlier hearings, and Mr. Harry R. Rudnick, counsel for the IFA.

We will adjourn to resume in this room tomorrow at 10 o'clock.

I should indicate I think that we are on notice that a meeting of the Judiciary Committee will convene at 10:30. So that shortly after 10:30 we will have to suspend to resume following the closing of the meeting of the Judiciary Committee.

(Whereupon, at 12:20 p.m., the committee stood in recess, to reconvene at 10 a.m., on Thursday, June 23, 1966.)

Senator HARR: All you have to do is look at the banking order of this committee to understand the problem.

Mr. CHAMBERLAIN: I am referring to things other than what comes before the committee.

Senator HARR: Chairman, thank you very much. It has been very helpful.

Mr. HARR: Thank you.

Mr. CHAMBERLAIN: Thank you.

Senator HARR: Tomorrow we will have three witnesses as indicated. Chairman, I want to see the report of the Federal Trade Commission from Mr. Groves of New York and from whom we have heard at earlier hearings and Mr. Lewis, Mr. Lusk, counsel for the I.W.O.

We will adjourn to resume in this room tomorrow at 10 o'clock. It should indicate I think that we are on notice that a meeting of the Judiciary Committee will convene at 10:30 A.M. that probably after 10:30 A.M. will have to suspend to resume following the closing of the meeting of the Judiciary Committee.

(Adjournment at 12:30 p.m. The committee stood in recess to reconvene at 10 a.m. on Thursday, June 22, 1933.)

**DISTRIBUTION PROBLEMS AFFECTING SMALL  
BUSINESS**

**(Exclusive Territorial Franchise Bill)**

THURSDAY, JUNE 23, 1966

U.S. SENATE,  
SUBCOMMITTEE ON ANTITRUST AND MONOPOLY,  
OF THE COMMITTEE ON THE JUDICIARY,  
*Washington, D.C.*

The subcommittee met, pursuant to recess, at 10:10 a.m. in room 1114, New Senate Office Building, Senator Philip A. Hart (chairman) presiding.

Present Senator Hart.

Also present: S. Jerry Cohen, staff director and chief counsel; Charles E. Bangert, assistant counsel; Horace Flurry, assistant general counsel, Peter N. Chumbris, chief counsel for minority; James Schultz, minority counsel; Gladys E. Montier, clerk; and Patricia Bario, editorial director.

Senator HART. The committee will come to order. Our first witness as we announced yesterday, and all of us look forward to, is our former associate, the Honorable Paul Rand Dixon, now the Chairman of the Federal Trade Commission.

**STATEMENT OF PAUL RAND DIXON, CHAIRMAN OF THE FEDERAL  
TRADE COMMISSION; ACCOMPANIED BY JOHN WHEELOCK, EX-  
ECUTIVE DIRECTOR; JOHN V. BUFFINGTON, ASSISTANT TO THE  
CHAIRMAN; AND FLETCHER COHEN, ASSISTANT GENERAL  
COUNSEL**

Mr. DIXON. Mr. Chairman, may I introduce—

Senator HART. Let me welcome, before you do, Messrs. Wheelock and Buffington—

Mr. DIXON. And Fletcher Cohen.

Mr. Chairman, I am always pleased to appear before this subcommittee which I had the honor and pleasure of working with for several years.

The bill which you are now considering, S. 2549, 89th Congress, first session, would amend the Sherman Antitrust Act (15 U.S.C. 1 et seq.) by adding a new section which would provide that a contract of agreement between a purchaser and a supplier, restricting resales of the supplier's product by the purchaser to the territory designated by the supplier would not be deemed "in and of itself" a violation of either the Sherman Act or section 5 of the Federal Trade Com-

mission Act (15 U.S.C. 41 et seq.), if three conditions set forth in the act were met. The first condition is that the product must be "in free and open competition with products of like grade and quality produced by persons other than the supplier"; second, the purchaser must be "in free and open competition" with "vendors of like or similar merchandise within the territorial area" defined by the agreement; and third, the contract or agreement must not prohibit the purchaser "from dealing in like or similar products with persons other than the suppliers."

As we interpret the bill, it has as its ultimate purpose to prevent any judicial or administrative developments resulting in a rule of law that agreements and contracts between suppliers and purchasers which restrict the distribution of a supplier's product to a defined territorial area are illegal per se.

In our experience at the Commission we have found that territorial exclusivity often is found in the granting of franchises. The subject bill would, in my opinion, affect prevailing franchise arrangements between suppliers and their purchasers.

I do not favor enactment of the proposed bill because I believe such enactment is neither necessary nor desirable.

Horizontal agreements or contracts between or among competitors relating to territorial restrictions for many years have been declared illegal. *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1950). In *White Motor Co. v. United States*, 372 U.S. 253 (1963), the Supreme Court was asked to extend the holding in the *Timken* case to a vertical arrangement by one manufacturer restricting the territory of his distributors or dealers.

In response to this request, the Court stated (p. 261) :

... We intimate no view one way or the other on the legality of such an arrangement, for we believe that the applicable rule of law should be designed after a trial.

This is the first case involving a territorial restriction in a vertical arrangement; and we know too little of the actual impact of both that restriction and the one respecting customers to reach a conclusion on the bare bones of the documentary evidence before us.

You will recall they sent that case back.

The Federal Trade Commission has never imposed a "per se rule" in cases before it which challenged the legality of vertical territorial restrictions. *Sandura Co. v. Federal Trade Commission*, 61 FTC 756 (1962), 339 F. 2d 847 (6th Cir. 1964); *Snap-On Tools Corp. v. Federal Trade Commission*, 59 FTC 1935 (1961), 321 F. 2d 825 (7th Cir. 1963).

In the case of the *Snap-On Tools Corp.*, the Commission found that the overall effect of the distribution system employed by the respondent was to restrain competition unreasonably and, therefore, it violated section 5 of the Federal Trade Act. The respondent was a large manufacturer and distributor of tools for mechanics and related equipment. Its complete line of tools was composed of some 4,000 items, which are used principally in the automotive and aircraft fields. Its distribution was partly by direct sales and partly through independent franchised dealers who were confined by contractual restrictions to specific territories. Other restrictions related to the prices at which the products were to be sold and the parties to whom the purchaser-

franchisees were to sell the products. The Commission considered the entire program of distribution system of Snap-On and held that viewed as a unitary whole it was violative of the provisions of the Federal Trade Commission Act.

The Court of Appeals for the Seventh Circuit reversed the Commission's ruling, holding that there was not sufficient evidence to support a finding of price fixing and that the other restrictions in the agreements when viewed separately, upon the facts of record, could not be considered unreasonable restraints of trade upon the record.

This case is illustrative of the importance of the factual background of a franchise program and the industry in which it operates, in determining whether or not a territorial restriction arrangement is or is not reasonable.

In the *Sandura* case, the Court of Appeals for the Sixth Circuit reversed that part of a Commission's decision which declared illegal Sandura's system of territorial restrictions for purchasers. The court emphasized the importance of the particular factual and economic context in which a franchise program including territorial restrictions, occurs in determining whether its operation was unreasonable so as to constitute an invalid restraint of trade. It is interesting to note that in this case the court considered that while the closed territorial arrangement limited intrabrand competition between purchasers of the suppliers, it also promoted interbrand competition by giving economic strength to a small company which was competing in an industry dominated by a few giant corporations. The court took the position that the evidence showed Sandura would have been unable to continue competing in the industry had it not adopted its system of closed territories.

Hence, it is clear that there is no valid reason for believing that antitrust laws relating to franchise agreements and territorial exclusivity will be developed without adequate factual and legal bases. There is, therefore, no need for the proposed bill.

Nor do I think it appropriate or desirable, as the subject bill would do, to completely foreclose judicial or administrative developments of per se rules in this area of vertical territorial exclusivity. Again, may I quote from the *White Motor* case where Mr. Justice Douglas speaking for the majority of the Court stated:

Horizontal territorial limitations, like "group boycotts, or concerted refusals by traders to deal with other traders" (*Klor's v. Broadway-Hale Stores, supra*, 212), are naked restraints of trade with no purpose except stifling of competition. A vertical territorial limitation may or may not have that purpose or effect. We do not know enough of the economic and business stuff out of which these arrangements emerge to be certain. They may be too dangerous to sanction or they may be allowable protections against aggressive competitors or the only practicable means a small company has for breaking into or staying in business (cf. *Brown Shoe, supra*, at 330; *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545, 560-561, aff'd 365 U.S. 567) and within the "rule of reason." We need to know more than we do about the actual impact of these arrangements on competition to decide whether they have such a "pernicious effect on competition and lack \* \* \* any redeeming virtue" (*Northern Pac. R. Co. v. United States, supra*, 0. 5) and therefore should be classified as per se violations of the Sherman Act.

The whole per se concept has been determined judicially. We believe this policy should be pursued with reference to whether or not it should be applied to vertically exclusive territorial restrictions and not be prevented by a legislative edict as proposed in S. 2549.

The case of *Northern Pac. R. Co. v. United States*, 356 U.S. 1 (1958) is illustrative of how and why the per se rule for price fixing developed judicially. The Court in discussing the rationale for such a rule stated (p. 5):

\* \* \* there 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 of per se unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also 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—an inquiry so often wholly fruitless when undertaken. Among the practices which the courts have heretofore deemed to be unlawful in and of themselves are price fixing, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 210; division of markets, *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, aff'd, 175 U.S. 211; group boycotts, *Fashion Originators' Guild v. Federal Trade Commission*, 312 U.S. 457; and tying arrangements, *International Salt Co. v. United States*, 332 U.S. 302.

At this point, Mr. Chairman, it just occurred to me, that this rule on—we might say the per se rule against price fixing—we had the Sherman Act a long time before the court would allow that per se. There were many many cases where the economic aspects and the business justification had been gone into as to whether it passed the rule of reason before *Socony-Vacuum*.

I believe *Socony-Vacuum* was in the late thirties, 1938 or 1939. We are just coming to this vertical territorial question and I think the expressions of the court in the *White* case—they said there the court wasn't ready yet, they didn't know enough of the stuff that controlled these business decisions and they didn't say that they would not some day do this. But I point out that in the four-so-called areas of per se that were not legislatively determined, they were judicially determined, that there was a long history of judicial development by the doctrine of inclusion and exclusion.

It is my belief that the Commission and the courts in dealing with cases involving vertical territorial restrictions will develop a thorough knowledge of the possible competitive effects of such restrictions; at the same time they undoubtedly will acquire an understanding of any possible compensating benefits which may arise from such restrictions.

It is possible, although not probable, that such knowledge and experience might ultimately indicate reasons which would justify the adoption of the per se rule for vertical territorial restrictions. It might develop that such restrictions are inconsistent with the aims and objectives of the free enterprise competitive system which has made America economically strong. Also, it might be found that any benefits which such restrictions are supposed to achieve might be obtained by methods or activities not having an impact on competition which result from such restrictions.

In my opinion, the quotation from the *White Motor* case is justification for the position that not enough is known now to justify a conclusion, as would result from enactment of the subject bill, that there never shall be a per se rule of law holding such restrictions illegal.

May I give you a few examples of possible situations which might possibly be considered in connection with the restrictions arising from agreements and contracts for vertical territorial exclusivity.

What we know already about franchising systems indicates that while many are procompetitive, through enabling more businesses to be established, faster, more efficiently, and with lower costs of entry, others could become dangerous to vigorous free competition, resulting in a possible injurious effect on the consumer.

Broadly speaking there are three ways for a supplier to reach the consumer: (1) an open system, selling to independent wholesalers and retailers; (2) a closed system, selling only through the supplier's own vertical integrated retail outlets or agents; and (3) something intermediate in the way of contract integration, where the supplier sells through partially independent retail or service outlets. Franchising is one of a number of possible contractual methods of coordinating the supplier with retail sale or service outlets. Other methods of contract integration are, for example, agency agreements, exclusive distributorships, consignment selling, and requirements contracts.

There is certainly no per se prohibition under the law on the choice of any one of these routes to the consumer. By and large, subject to antitrust laws, suppliers of any product or service are free to make an independent selection of their most efficient method of distribution.

Competitive complications can or may arise when franchising companies employ more than one route to the consumer, that is, dual distribution. If, for example, a franchising company also sells directly to the biggest customers in a market, leaving the less desirable for its franchisees, a set of territorial restrictions on franchises could combine with the restrictions on the types of customers to whom they can or may sell so as to result in an illegal restraint of trade. In such a situation, not only the franchisees might suffer competitive injury, but if the franchising company had market power in significant markets, consumers might suffer as well through insufficient market competition.

Most importantly, in interpreting the possible competitive significance which may arise through the enactment of S. 2549, where firms hold a substantial share in some significant market, danger to the public interest in healthy competition may follow. Market power also may be present where firms with smaller market shares substantially insulate themselves by product differentiation from interbrand competition within the same line of commerce. In both situations, the franchising supplier might have a higher percentage of the national market, and considerably higher market shares in some individual markets or regions. Hence, if such a dominant supplier were permitted to establish exclusive franchise territories, consumers in such markets would be deprived of competition in the distribution of the product.

Mr. Foley, formerly the Small Business Administrator, now Assistant Secretary of Commerce, testified before this subcommittee a year ago last March, that franchising establishments are multiplying at a rapidly increasing rate. If franchising should continue its rapid growth rate, it is entirely conceivable that problems of market dominance may arise with some of the most successful franchise systems.

And where conditions of entry limit the number of participants in markets, problems of market dominance may arise with franchising companies that are not large and successful. Finally, in light of the substantial merger movement which our economy is now experiencing, it is quite possible that large corporations will acquire many of the more successful franchising networks. This could add materially to the success of many well-established corporations. In addition, such mergers could also add greatly to the market power of established franchising systems and thereby present serious dangers to competition.

Many of the firms using franchise operations are already big business—with hundreds of outlets spread through the country. Among the large corporations involved in the franchise boom are B. F. Goodrich, Sears, Roebuck & Co., Swift & Co., Olin-Mathieson Chemical Corp.'s Winchester-Western Division—with a program for franchising public trap- and skeet-shooting ranges. B. F. Goodrich acquired the Rayco seatcover and auto accessories chain several years ago, and has since added a 44-store network of tire and accessory outlets. Pet Milk bought Stuckey's—everyone riding along the highways knows Stuckey's—the chain of candy shops which is found in the East and particularly in the South.

Other successful franchise systems are Ben Franklin stores, Howard Johnson restaurants, the Holiday Inn motels and hotels, National Car Rentals, A. & W. Root Beer, Chicken Delight, to name a few.

Not to be forgotten as franchise systems users are some of the major oil companies in the United States. Similarly, our great automakers all use franchise distribution. The major soft drink companies are extensive users of franchising. Still other important franchise systems have been developed in the manufacture and distribution of clothing and bedding.

This is not to say that any particular franchising company I have cited should be challenged for its territorial restrictions in franchises. The point is, rather, that we must face the fact that the franchise systems appear to be going through a period of great growth and change. To limit the evolution of antitrust rules of law now would be premature, and in conflict with the wise tradition of case-by-case development of our antitrust law.

In my opinion, the quotation which I gave from the *White Motor* case is justification for the position that not enough is known now to justify a conclusion as to the eventual appropriateness or inappropriateness of a per se rule of law with respect to territorial restrictions in franchise arrangements.

I feel that it is only by the extensive presentation of fact and arguments in a number of cases involving such franchise restrictions that sufficient experience can be acquired to form a sound basis for making a determination in this area of the law.

That, Mr. Chairman, completes my prepared statement.

Senator HART. Thank you very much. We have listened in this subcommittee to a great many men and women over the years comment upon pending legislation and I think we would be hard put to find an example of a clearer, more responsive and useful statement than yours.

Mr. DIXON. Thank you, sir.

Senator HART. Now, having softened you up, let me ask a favor. It occurred to some of us here that perhaps with the very competent staff the Commission has, without too much of a burden you could furnish the committee for the record, just the briefest sort of chronological evolution from the year 1914 until 1938 or 1939, whenever you suggested the per se position finally was taken.

Mr. DIXON. Of all four of those areas?

Senator HART. Yes. Would this be feasible?

Mr. DIXON. I think so. It could be done because it was late in the 1930s before the court first addressed itself and laid down the per se rules. I believe it was in the 1930s. I think you want a digest of the early cases dealing with the point?

Senator HART. Let's define "digest." We don't want something that is so long that nobody will read it. But a brief brief of the decisions as they came along—a commentary.

Mr. DIXON. You take section 2 of the Sherman Act that addresses itself to monopolization or at attempts to monopolize. Here the Congress says flatly that this is illegal. This was challenged, if I remember, in the late teens and early 1920s. Then there was the famous steel case that the Court was confronted with and eventually the Court laid down its doctrine there that they would refuse to hold bigness in and of itself, just size, as a violation of law.

Now, that was driving toward the per se doctrine. That has been reconfirmed by court decision, many many times. So what does section 2 mean? Section 2 means what it says as interpreted currently by the Supreme Court. What does section 1 mean? It means what it says as currently interpreted by the Supreme Court. And as I said to you, there are only four areas of the law that have been whittled out as per se.

Now, I might say that from the Federal Trade Commission's standpoint, we have never approached it as per se that is to just go far enough and show the agreement and say there would be a violation of the Federal Trade Commission Act, even though I remind you it is in the statute. We have gone forward in each one of our cases where this question has come up and developed the full impact of the arrangement and offered the opportunity for a full explanation of it.

Now in the two cases that I cited we decided them against the respondents and were reversed in both cases. They did not go up but we accepted the opinion and the review of the two respective circuit courts in those decisions.

I think we can accommodate you. You are not just looking for an index of cases. You are looking for a review of them to try to determine the high points in a case. Did the court give early indication they were approaching it or did it just come out of the blue?

Senator HART. You are recommending, as I take it, that we permit this kind of traditional evolution in the franchising question rather than a congressional yes or no answer at the moment.

Mr. DIXON. That is my recommendation because it has been the historical approach in this field. It seems to me, Congress, when they early addressed themselves to the problems of competitive restraints, very wisely legislated in broad terms and left it for these terms to be filled out by a body of law.

Now, this committee certainly knows and you certainly know that if the court were to develop a per se rule and it displeased the Congress, the Congress could reverse that. All they would have to do is pass the law then. Why pass it in advance? It hasn't happened yet. So people said we don't want it to happen, but remember that it may develop that it might be necessary for it to happen, and pretty sound reasoning for it, too.

Now, if you just chop it right now, that is not going to happen. It will just say this is whittled out of the law now, right now.

Senator HARR. What situation would you suggest would develop that would make it pretty sound for the court to reach the per se point?

Mr. DIXON. You know, this is like asking me how much injury do you have to have. What is the quantum or proof or the burden of proof to carry the burden on a merger case that would equate "may substantially lessen competition." There is not a scintilla. I think that we have to have substantial evidence, but I don't think it has to be what one would call preponderance. It would have to be such evidence that any reasonable reviewing authority would be soundly convinced that the decision was sound, sir.

I read in the *Northern Pacific* case on page 6 as to the court's explanation for the per se rule against price fixing, there was the court's interpretation. They had already laid it down and here they come still in 1958, probably 20 years after the rule had been laid down, they felt it incumbent still to explain the soundness of the per se price-fixing rule.

Now, there have been many cases decided between 1938 and 1958 before this case, relying upon *Socony-Vacuum* and you can "shepardize" the thing and just like this, they have lined up where they have all leaned upon that authority.

But here they felt they gave a pretty good definition of it.

I would be hard put to say to you right at the moment what kind of facts. Well, I tried to anticipate several of them in here and there may be others. I say they would have to be so restrictive that there was injury to the consuming public or to realistic competition. You couldn't just say, "Aha, you see, you have an agreement, I rest my case." That is per se. Just show that there is an agreement between company A and the franchisee with the understanding and agreement that he shall exclusively have a territory and be restricted to only that territory and stop right there.

Now, that is proof in price-fixing cases. Under price fixing all the per se doctrine says is I prove that you and I in commerce have agreed to fix price, and once I do that I don't have to prove that it affects the consumer or the system. It is stopped right there.

I think I gave an example of the monopolistic position in the market where there was no interbrand competition. It would be a very serious situation, but even there, sir, I would not feel it incumbent that we could not handle the law without the per se doctrine. Per se doctrines by the Supreme Court are kinds of plusses in antitrust enforcement but I can tell you and I have said it to other committees of the Congress, you could carry even the per se doctrine of price fixing to such a stupid result that that daisy chain would snap.

The prosecutor could be faced with that. It could be carried to a stupid conclusion.

We do have, you know, the *Appalachian Coal* case doctrine. The *Phelan Co.*, the agreements that fall from this, even the per se doctrine. This is a hard one, and if you began to make exceptions to the per se doctrine, what are you left with?

Senator HART. No per se doctrine.

Mr. DIXON. That is one of the problems.

Senator HART. Yesterday there was some comment, critical I think, of the Commission in not asking or seeking a certiorari in the *Sandura* case.

Mr. DIXON. Mr. Chairman, maybe Mr. Buffington, my assistant, might be a little bit more current on that.

Senator HART. Let me explain it as we reconstruct it. The Commission attacked price fixing together with territorial allocation and the circuit court reversed you on the territorial aspect?

Mr. DIXON. Both aspects.

Senator HART. But it upheld an order against the price fixing.

Mr. DIXON. I think you are correct.

Senator HART. Now, is it possible that the Commission wouldn't have even brought the case if it involved only the territorial aspect?

Mr. DIXON. That is correct. We charged both together and the Court disagreed with us, you see. I know you are fully aware of this but we don't go to the Supreme Court just because we want to go. We make application to the Solicitor General of the United States to file our petition. And quite often he disagrees with us and then we have conferences and then as a result of the conferences, quite often we agree with him.

We had such a conference here and we agreed with his suggestion that we not go. But I don't mean—I really don't mean that out of line, sir, because—

Senator HART. I think it is a useful—

Mr. DIXON. At times I have thought that we have labored under some adverse difficulty in this field because I think we are more expert in our law, our particular law, than many others are, and the Solicitor has a tremendous responsibility. But my relationship with the two Solicitors General that I have thus far had have been excellent. I feel that we have had a mutual benefit from our association.

Senator HART. Mr. Cohen?

Mr. COHEN. One comment. During the course of our franchise hearings, those people supporting the bill have talked entirely in terms of helping the small businessman. But as you very forcibly and in detail point out, also involved in the franchise system are some of the largest corporations in this country.

Mr. DIXON. Yes, sir.

Mr. COHEN. It may well be that the courts may wish to develop a different kind of rule in dealing with the small manufacturer than when dealing with a large dominant firm. As you well know, in making use of monopoly power, being able to deny access to others to the area of distribution is also an important factor. If a dominant firm can, by a franchise system of exclusive territories, tie up the distribution of a product, it may be encouraging that same kind of monopoly power both from the manufacturing end, and from the distribution end.

Mr. DIXON. I tried to make that clear. You see, I think when you lay down per se rules, they are per se rules. That is all there is to it.

And it revolves upon the law enforcer, of course, with the funds and staff he has available, to try to use the law at the stage it is to do what in his opinion I suppose inures more to the public interest.

Now, as the court told us I believe in Sandura, you know, there are two sides to this thing. This to us is the only way this small company could compete against these large giants. That is what the court said to us. And that is to be considered. That has to be considered under certainly any rule of reason.

Senator HART. Mr. Chumbris?

Mr. CHUMBRIS. Yes, Mr. Chairman, thank you.

Chairman Dixon, the *Brown Shoe* case was recently decided by the Supreme Court of the United States which in its opinion stated:

Thus, the question we have for decision is whether the Federal Trade Commission can declare it to be an unfair practice for Brown, the second largest manufacturer of shoes in the Nation, to pay a valuable consideration to hundreds of retail shoe purchasers in order to secure a contractual promise from them that they will deal primarily with Brown and will not purchase conflicting lines of shoes from Brown's competitors.

In that instance they made a stress that Brown was the second largest manufacturer. Would you say that this decision of the Supreme Court which has been cited over and over again by the witnesses who have appeared before us in the last few days, would change your policy toward another case, for example, such as the *Sandura* case, if it came before you? If you feel that it is inappropriate for you to answer what your policy might be, you can say so.

Mr. DIXON. I don't know that it would cause any change in our policy, Mr. Chumbris. Because as the Court was very careful to say, laying down that case, had Brown Shoe gone to all these outlets and said, "We will only sell to you on the agreement and understanding that you won't handle anybody else's shoe," that would be a section 3 *Clayton Act* case. But section 3 *Clayton Act* cases are not illegal per se. Only those agreements and conditions are illegal which may substantially lessen competition and tend to create a monopoly—a burden.

If you will note, the Court in that opinion pointed to the contractual agreement itself and I think indicated that it is enough. Mr. Chumbris, we are very careful at the Commission to not only note the hearing examiner's findings of injury that flowed from this arrangement but we make due findings. And flowing from that arrangement we found was the actual harm, not speculative harm, but actual harm proven by facts of the record of where the small independent shoe manufacturers—and this country is full of a lot of these people—were effectively precluded from getting their shoes in these desired outlets which had been preempted by this so-called arrangement.

Now, what the Court said here is something that has long been the law. But they really have stated it very clearly and I am very thankful for this opinion because this opinion says that the Federal Trade Commission Act is an act passed by the Congress aimed at things that were specifically in effect aimed at in the Sherman Act. But in the Federal Trade Commission Act it can be determined as a matter of record that these things are occurring even though they are in their incipiency, and it can be illustrated by the record, that they do constitute unfair practices or unfair methods of competition, it is within the purview of the Federal Trade Commission to declare them to be illegal.

Now, this is the incipience doctrine in its fullest. But mind you, this *Brown Shoe* case did not fit section 3 just as the Court describes it. It had the same effects, but didn't preempt all people because you could find in the record here that where there was no conflict with the lines that Brown sold, someone could sell specialty, sport shoes, canvas, and what-have-you, kind of shoes into those. But so far as to their lines, they didn't want anybody else selling in those places and they went there and they said, "Now look, we dangle a carrot in front of you, we will give you so many services and things if you will make this agreement." What was the effect? And we found the effect and that is what the decision is about.

Mr. CHUMBRIS. The main purpose of my bringing this out, as I noted earlier, is that many of the witnesses referred to the recent *Brown Shoe* case. They were concerned that the *Brown Shoe* case would be a precedent that franchising is in serious trouble, and I wanted your explanation because if we refer to the Supreme Court decision, it also quotes the court of appeals decision which noted, "The custom of giving free service to those who will buy their shoes is widespread and we cannot agree with the Commission that it is an unfair method of competition in commerce."

But the Supreme Court went further and said Brown Shoe Co. is the second largest company that is doing this.

Now, my point—

Mr. DIXON. That is a very significant point, Mr. Chumbris, very significant. Now, where would we have been had we chosen the smallest shoe company and—

Mr. CHUMBRIS. That was my next question, if it were No. 20 instead of No. 2.

Mr. DIXON. The harm that would flow from that. We would have to have relied on some kind of mechanical doctrine if we went down that road because I just rationalize out loud that it would be very difficult to prognosticate the type of injury or the type of restraint that really does violation to the competitive system.

Mr. CHUMBRIS. I didn't mean to interrupt a while ago but my point was if this Brown Shoe had been, say, the 20th or 50th largest shoe manufacturer, the whole situation might have been looked at differently by you at the Commission and also the Supreme Court in its decision.

Mr. DIXON. You are very likely right.

Mr. COHEN. Just to tie this up so we are sure about this, the point that the Wall Street Journal editorial made erroneously that everyone was quoting was that the effect of the *Brown Shoe* case is that you would not have to show harm to competition. But the point you make and as one reads the Supreme Court case what is still clear is that in a section 5 case of this type, the harm to competition still must be shown.

Mr. DIXON. I wish the Wall Street Journal editorial writer was a better lawyer than he is. I find that quite often. He suffers from that fault.

Mr. COHEN. The Supreme Court specifically found in that case the harm that was done and, as you pointed out, you did show the harm and felt it was a part of your case to show that harm.

Mr. DIXON. We carried that burden. We did it and we have always considered that as a part of the burden. And it could be said maybe we overprove many cases in some people's minds but bad facts make

bad law. Good facts make good law. Those were good facts. They would stand up anywhere in my opinion and they should have in the Supreme Court. I think they should have stood up in the appellate court, but the appellate didn't see it that way.

Senator HART. Thank you very much, Mr. Chairman, and gentlemen.

Senator HART. As I indicated yesterday, the subcommittee is compelled to recess at this point, the full Committee of the Judiciary having convened. I would hope that we could resume at about noon and having indicated that as a desired time, we will recess at the call of the Chair.

(At this point a recess was taken.)

Senator HART. The committee will be in order.

Our next witness is the president of Snap-On Tool Corp., Mr. Robert L. Grover.

Mr. Grover has been a participant in earlier hearings on franchising and I remember his testimony very clearly. I am sure we will benefit from his specific response to the proposed legislation.

**STATEMENT OF ROBERT L. GROVER, PRESIDENT, SNAP-ON TOOL CORP., KENOSHA, WIS.**

Mr. GROVER. Following Mr. Dixon, Mr. Chairman, I feel lonesome here, unflanked by experts and unaccompanied by specialists.

My interest in bill, S. 2549, stems from the simple fact that the company of which I am president utilizes the franchisee independent dealer distribution pattern in its principal market—the professional automobile and aircraft mechanic. We have over 1,300 independent dealer franchisees distributing our products in the United States, Canada, Mexico, England, and elsewhere.

Our company has developed its franchise pattern and approach over a period of many years of experience and by its use has been able effectively to maintain its competitive health during 46 years of operation in a highly competitive field. Snap-On's sales in 1965 were \$41 million.

During my 29 years of relationship with Snap-On Tools Corp., I have participated in the development, modification, analysis, and defense of the franchise pattern and system of distribution in collaboration with business colleagues—some of whom bring to bear in this area many more years of highly successful and thoughtful experience.

In view of our experience in both the development and administration of franchise relationships, I feel reasonably qualified to express a view on the Senate bill 2549.

The desirability of the continued existence of the franchise relationship as one available channel of developing distribution seems so obvious that it should need no debate. It is a legitimate and valuable business tool to manufacturers and distributors, a resource to franchise seekers and a boon to consumers. It offers an opportunity for a small businessman to identify with a nationally advertised product or service, to reap the benefits of broad-scale, well-conceived promotion plans, to tap the know-how and experience of others, and a host of similar benefits all without sacrifice of the individuality of the franchisee.

Less frequently described, but equally obvious, are advantages to the consumer through the franchise pattern of distribution. Experience indicates that franchised dealers frequently show more concern for their product or service than an unfranchised casual distributor because they have a stake in the maintenance of a continuing reputation.

The existence and availability of franchising as a distribution technique permits manufacturers to establish more outlets for their goods than would be possible if they were building a company-owned sales organization. Thus, the variety of goods and services available in the marketplace to the consumer is broadened, new products and services reach the marketplace more rapidly, and both the expense and timelag between producer and consumer are narrowed.

Speaking from our own experience, communications and particularly complaints are more vigorously advanced and prosecuted from the field and more attentively and promptly viewed by factory or general office because of the independent nature of the relationship between the franchisee and the company. As a consumer who has shared the common experience of attempting to adjust a complaint through a field sales employee, I am very conscious of the consumer advantage of this feature of the franchise method of distribution.

The issue involved in S. 2549 is a great deal narrower than the general desirability of sustaining the franchise relationship as a potent distribution technique. It goes to one single feature which has been the object of attack, direct and collateral, by Government agencies; that is, the so-called exclusive territory.

It is our experience and insistence that territorial assignment unilaterately by the franchisor is essential, indeed vital, to the continuing health of a solid, reliable, continuing franchise distribution network such as ours. Lacking valid evidence of a monopolistic pattern and present interbrand competition so that the consumer has a choice of goods or services, we can see only benefits blowing to all participants in the total transaction from territorial assignment.

Much debate has surrounded the matter of territorial assignment and a good deal of that debate has developed from the inability of Government agencies to disentangle themselves from the life and times of the Addyston Pipe situation and "reroot" their thinking in today's economic soil. Three short comments may illuminate the point.

First, the basic and primary purpose for the assignment of territory by a manufacturer to a dealer is to permit that dealer economically and psychologically to give uninterrupted and enthusiastic attention to the promotion of his line of goods in direct competition with the other lines of goods against which he is competing for the customer's favor. This is the interbrand form of competition and it is the form of competition which produces the ultimate in consumer benefit, in product value, in customer service and in quality.

Second, closely related to the recognition of the interbrand competition as the healthy and constructive form of competition in the marketplace is recognition of the relationship between intrabrand competition and dual distribution. True dual distribution—that is, for the same customer's dollar in the same market area, eventually undermines a manufacturer's total distribution system, reduces his competitive ability, and eventually limits the consumer's choice.

o In the broad sense, by establishing competing dealers with the same product in the same market area and encouraging intrabrand mutual destruction, the same eventual consumer disadvantage results through weakened distribution, loss of dealer enthusiasm, cheapening of customer service, and consequent failure of vigorous head-on interbrand competition.

Third, it seems indisputably obvious that the availability of an exclusive territorial assignment as one of the elements in a negotiated franchisor-franchisee relationship improves the bargaining power of the franchisee, as well as producing in his thinking a greater feeling of security in the retention of a share of the market in whose development he has pioneered.

A developing and adaptable economy calls for an environment in which imagination and creativity in both manufacturing and distribution may find their outlet in new processes, new forms, and new techniques. In the field of distribution in the United States, currently, we experience rapid and growing limitations upon freedom of choice.

Increasingly, the marketing man is being jammed into narrow channels and highly restricted patterns in his development of the means to bring his goods and services to the competitive marketplace and vie for consumer attention with those competitive goods and services which already were established in the marketplace.

In the course of our discussions of territorial assignment as a proper adjunct to a franchise method of distribution system, carried on between Snap-On and a Government agency in some depth several years ago, it was suggested to us in complete seriousness that assignment of territories could be accomplished with complete propriety through the use of employee salesmen whose every move could be directed and controlled. This would, of course, result in removing 1,100 men from the independent small businessman category, destroying the atmosphere of independent and voluntary collaboration in which our business had prospered and abandoning the free-moving and versatile independent franchisee form of distribution.

We, therefore, demurred to the suggestion, but the point was quite clear. Territorial assignment was proper, beneficial, legally and economically unassailable, but it must be accomplished through the accepted, historic economic pattern and not through the fluid, mobile and highly adaptable franchise distribution technique.

We suggest that this approach to the regulation of distribution techniques is unnecessarily technical, stifles imagination and inhibits the development of creative, economic thinking.

The bill under consideration puts the emphasis where it belongs. It erases from territorial assignment the stigma of impropriety affixed by Government agencies, establishes bench marks for the use of this feature of a normal relationship and introduces interbrand competition and consumer access to a choice of goods as an accepted criterion for evaluating a distributive technique.

These are sound and well-thought-out concepts and they embody a healthy change in attitude from the per se doctrinaire approach which increasingly afflicts economic thinking in some quarters.

Admittedly, this bill has some frailties. As a legislative enactment it falls slightly short in its vagueness in defining what is a "clearly delineated territorial area." An unsympathetic administrative

agency could certainly lean heavily upon this general phrase and attempt to substitute its own emasculating standard.

The bill does take sides in the controversial area of exclusive dealing. It appears to me that the draftsman has purposely limited the scope of the bill to a single objective and has thus reduced the number of areas in which it may be attacked by people who do not agree with the assumed basic desirability of survival of the franchise distribution technique in our economic society.

Philosophically, the bill may be criticized because it assumes a broad pattern of control and limitation upon the content of franchise contracts and singles out a small area for protection from the broad scale attack. As little as I like this assumption, I must accept it as a pragmatic businessman viewing the current scene.

These very narrowly limited and highly compressed suggestions developed during 46 years of experience in the United States, Canada, Mexico, and overseas in the development and effective utilization of the franchise method of reaching a significant market for our product. We could write a book on this single segment of franchising technique and footnote it with hundreds of specific cases. I hope that this background of experience has shone through the abbreviated and simple conclusions embodied in my strong support for the concept embodied in this bill.

Senator HART. We are grateful for the abbreviation and the strength of the statement, and your point of view lost nothing in the abbreviation.

I did last night read our visit of last year, and as I read that, I got the feeling that at that time, and perhaps still, you do see some merit in treating a company which has a predominant or dominant position and a company which is not in that category differently in terms of the appropriateness of franchise conditions. We do agree on that, I suppose?

Mr. GROVER. We do indeed, Senator.

Senator HART. And our problem—you mention the draftsman's chore—is assuming there is general agreement insuring if anything is enacted that it doesn't diminish that kind of ability to respond.

Mr. GROVER. Senator, I view with considerable concern the continuing inclination of the administrative agencies to simplify their tasks by tacking a per se label on practices, thus automatically limiting and constricting the area in which a company may freely and properly operate. I think that the per se label is a very poor substitute for a factual consideration of the merits of an individual case, and perhaps my enthusiasm for this bill stems from the fact that it embodies that same antipathy to per se. Frankly, I have a great deal more confidence in the Congress and its ability to sense the ebb and flow of economic activity than of the administrative agencies which seem to be inclined to rest more and more heavily upon a broad background of established law. Law has an inclination to become frozen into permanent form, particularly where per se comes into play. The economic system is far from frozen. We don't want to get frozen. I feel that a reconsideration case by case, if it is thrust upon the administrative agencies by the Congress, would be a good, sound, healthy way of reevaluating the impact of any given situation upon today's economy in the light of today's results.

Senator HART. Well, you are really commenting upon another aspect of the studies this committee periodically makes—trying to respond to the big man who says that the antitrust is too vague and uncertain—make it specific. I take it you counsel us against making it specific.

Mr. GROVER. I prefer, much prefer, the rule of reason which contemplates I think a lack of specificity.

Senator HART. But you do know that there are a good many businessmen that tear their hair because the only opinion they can get from their lawyer on antitrust questions is hinged with some escape hatches and—the businessman would like to know yes or no. Per se is yes or no.

Mr. GROVER. I am well aware of that, Senator, and I don't share that point of view. The search for absolutes in a world fraught with nonabsolutes I don't think is very rewarding. It is interesting but it is also very frustrating. The businessman likes to have some absolutes because he has such difficult decisions to make. But I would suggest that in this field the fewer absolutes we have the better.

Senator HART. That is not unique to the business community. You and I having agreed on that, you will agree I hope that the problem confronting the committee in this particular area is rather difficult to resolve. There isn't any assured road map.

Mr. GROVER. In all seriousness, Senator, your committee has in its charge one of the most perplexing problems in one of the most vital areas in the life of this Nation, and what you do by way of legislation has almost untold impact upon the way our economy goes. You have my sympathy and my best wishes. I am here because I would hope that what I have to say out of my own experience, and I am speaking only from my own background of experience, might have some illuminating effect. We have practiced franchising for a long time we think properly and successfully, and it is out of this background that we speak and it is limited to this background.

Senator HART. Well, you have given us not only sympathy but help.

Mr. GROVER. Thank you.

Senator HART. Not only now but last year Mr. Cohen.

Mr. COHEN. Or course, as you well know, per se rules are not developed by administrative agencies. They have been developed by courts in response to facts, and situations, and economic development as presented to the court, and as the court sees it. And the per se rules themselves have developed because the courts have decided under certain circumstances it is reasonable to have a per se rule in a particular limited area as in other areas it is not reasonable. What this bill would really do in the franchising area is handcuff the court from developing the concepts in this area in relationship to the facts and circumstances of economic change. For instance, it may well be that a court some day may wish to say if a company has 80 percent of a given market, that it would be a per se violation for such a company to have an exclusive territory, and a franchise agreement based on all the facts, and circumstances that were presented to them. So that while we want flexibility, as you said, these things ought to be determined in view of the facts and circumstances. We are really saying to the court if this bill is passed—there are areas where you cannot develop the law as the facts and circumstances indicate to you it ought to be developed.

Mr. GROVER. With some hesitation, Mr. Cohen, I would challenge your assumption that per se doctrines are developed spontaneously by courts. They are accepted by courts as proposed by litigants. And as I have read the transcripts, and painstakingly some of the briefs in cases which lie at the taproot of some of the per se development, I think it becomes pretty clear the search for the absolute is proposed to the court by one of the litigants; and the proposal for the adoption of the per se appellation in some of these actions under the antitrust laws of this country has not been spontaneously generated by the court, but suggested by enforcement agencies to ease the pangs of enforcement or to simplify or clarify the position of the parties in subsequent litigation. I would suggest to you that the content of this bill would not handcuff the court but would rather guide and limit the efforts of an administrative agency in enforcing a law that has been pretty thoroughly interpreted, and has been on the statute books for many a year.

Mr. COHEN. Of course, it is the court that has to make that ultimate decision.

Mr. GROVER. That is right.

Mr. COHEN. And there are people who come before the subcommittee, and tell the Senators what they think makes good sense. But in the last run it is the Congress that makes that decision based on all of the evidence they have seen, all the different witnesses they have heard, and so with per se. Certainly enforcement agencies have urged it, litigants said don't do it, but the court has over a period of years evolved a per se doctrine in certain types of cases, and certainly it has been their decision based on the facts as they see them. This bill would handcuff the court because it could not ever adopt a per se position under any circumstances in a franchise arrangement. And it may well be there are circumstances where there ought to be a per se rule.

Mr. GROVER. I would suggest to you that under those circumstances the administrative agency, if it feels handicapped in reaching situations which it is convinced, barring per se, are improper, then it could properly come before the Congress and point out that it has been inhibited in the freedom of its action. This I think puts the burden in the right place for seeking more authority, wider area in which to range in the enforcement of the status in the discharge of the statutory responsibilities.

Mr. COHEN. Nobody is talking about a wider range here. The courts so far have not adopted a per se rule. Maybe we ought to wait until the court has under some circumstances adopted a per se rule and then at that time come in and see whether it makes sense or not.

Mr. GROVER. I am reminded of a motor vehicle I saw in a circus which had two front ends and no rear end. You couldn't tell which direction it was going. We are in something of the same situation here. Once the per se appellation has been applied, I suggest to you that the effort to get it removed is a far greater chore than if we place the burden for demonstrating its necessity upon the administrative agency. The FTC has been thrusting, seeking the stigma to be placed upon the territorial assignment philosophy for quite a while in several cases. It wants territorial assignment labeled per se and has said so in some of its proceedings. There are those of us who are concerned that lacking some sort of protective feature, this may happen and then to have it removed is a herculean assignment.

Senator HART. Mr. Chumbris?

Mr. CHUMBRIS. I have no questions, Mr. Chairman.

Senator HART. Thank you very much, sir.

Mr. GROVER. Thank you, gentlemen.

Senator HART. The concluding witness today is Mr. Lewis Rudnick. We had anticipated a visit from his father whom we have heard from before, but we understand that Mr. Harry Rudnick is tied up. We welcome you, sir.

#### STATEMENT OF LEWIS RUDNICK, INTERNATIONAL FRANCHISE ASSOCIATION

Mr. RUDNICK. Thank you, Senator.

The International Franchise Association has followed with interest the introduction of Senate bill 2549 and the similar legislation introduced into the House of Representatives (H.R. 4862 and H.R. 5154). We believe that this proposed legislation arises out of an attempt to solve significant problems that the antitrust enforcement agencies and the courts have not fully resolved. It might better be said had left largely unresolved.

The Antitrust Division of the Justice Department remains largely hostile toward vertical territorial restrictions on franchises, conceding limited justification only for the entry of new companies into a market or the introduction of new products. The Federal Trade Commission concedes a somewhat greater range of justification for vertical territorial restrictions and the courts have gone still further in sustaining the legality of territorial restraints, when they have been found to be reasonably ancillary and necessary to trademark licensing relationships. The Supreme Court's decisions in the *Schwinn* and *Sealy* cases may clarify the law, but to the extent that those decisions leave the law unfavorable or uncertain, substantial pressure will continue to exist for Congress to carve out some form of antitrust exemption for territorial restrictions on franchises.

The antitrust environment which has created this pressure for legislated antitrust exemptions for small business for franchising has been simply and accurately described by Prof. Milton Handler. In a recent issue of the *Northwestern University Law Review* Professor Handler wrote:

Liberating the business world from monopolization and the horizontal (per se) restraints is undoubtedly a man-sized job. I have never been able to understand why time and effort should be spent by enforcement officials on practices whose elimination is without perceptible economic significance, when so much more could be accomplished by a concentrated attack on the hard core antitrust offenses in economically important industries. I do not believe I exaggerate when I assert that there is a national consensus in favor of such concentration of enforcement effort. There is time to search for new dragons to slay after the main job is done.

What I find hard to understand is why there should be such a plethora of litigation on vertical territorial restraints, exclusive dealing agreements and similar arrangements conducive to orderly marketing which are vital for the very survival of small business. Why should the government be so intent on promoting intrabrand at the expense of interbrand competition when the result may well be the disappearance of the independent distributor and dealer and the increase of forward vertical integration by large companies?

It is a cardinal tenet of American public life that everyone should favor and defend the small businessman. Apart from our pious recitation of the universal creed, what exactly is it that antitrust does for the small enterpriser? Does it

permit defensive combinations by which he can equalize his bargaining power with that of his large suppliers or customers? Does it allow joint marketing to augment his selling power vis-a-vis his large competitors? Does it encourage vertical integration, both backward and forward, through cooperative ownership and operation? Does small business enjoy any significant exemption from antitrust's strictures against price-fixing, division of territories, or control of production? The answers are all negative.

I am not suggesting for a moment that antitrust is antithetical to the interests of the small businessman. Like all members of our society, he has a high stake in the preservation of our competitive way of life. But if we as a nation have his interests at heart, there is much that could be done that is left undone. An antitrust Machiavelli could make enormous progress in the extinction of small business. By denying distributors and dealers the historic shelter of the rule of reason for those vertical restraints that are vital to their survival. If we are really serious in our professions of concern for small business, we should do a bit of rethinking about those of our antitrust policies that do little more than hasten its downfall.

Why should businessmen be in the intolerable position where they must violate unworkable rules in order to stay in business? Why should their business life depend upon executive discretion in not invoking the law to its fullest reach? ("The Polarities of Antitrust," Milton Handler, *N.U. Law Review*, Vol. 60, No. 6, January-February 1966).

To digress for just a moment, I think Professor Handler's comment might be amplified by recent statements of an official of the Antitrust Division of the Justice Department, that the recent Supreme Court cases in the area of mergers have now armed the enforcement agencies with sufficient legal tools to upset a substantially greater number of mergers than they can possibly even review, that their resources for review and enforcement are now stretched in the merger area to a point where a great many mergers that are illegal under the law as interpreted by the Supreme Court will just be ignored.

Senator HART. I was distracted. Did Professor Handler say that?

Mr. RUDNICK. No. This—I regret I do not recall the author of the statement. I believe it was either Mr. Turner or one of Mr. Turner's assistants.

In addition to the vertical and horizontal area, the area of conglomerate mergers has been largely untouched by the Federal enforcement agencies and to my way of thinking, conglomerate merger, this area of the antitrust laws, this trend in American business is one in which the potential destructiveness to competition is far greater than any of the vertical restraints that are characteristic of the franchise relationship.

From the standpoint of its probable effects on a substantial number of franchise systems, Senate bill 2549, in its proposed form, contains several basic defects. The most significant defect is the provision that limits the scope of the exemption to franchise agreements under the terms of which the franchisee is not inhibited "from dealing in like or similar products of persons other than the supplier." We interpret this provision to deny the benefits of the bill to a franchisor that retains the power to require its franchisees to sell only the trade-marked product or service—an exclusive dealing relationship.

It has been suggested that this exclusive dealing limitation is essential to preserve this interbrand competition, the only justification for the diminution of intrabrand competition which the proposed legislation would in part sanction. This argument appears to be premised on the theory that interbrand competition is fostered where

the consumer is given a point-of-purchase choice among several competing brands. Though this premise may well be valid with respect to many products and certain types of distribution, it is manifestly inapplicable to the distribution of many of the products and services marketed by franchise systems.

Many franchise systems are, and must by their very nature be, based on a relationship of exclusive dealing. Uniformity of quality and appearance cannot be achieved unless the franchisor can prevent its franchisees from selling both competing and noncompeting products or services which the franchisor has not approved.

The very nature of the trademark licensing relationship typically precludes the franchisee's association of either competing or noncompeting products or services with the trademarked product or service. For three significant reasons, a soft ice cream franchisor, for example, can no more permit its franchisees to sell a competing soft ice cream than it can permit them to sell hamburgers, Christmas trees or one or more of the myriad other products with which one or more of its franchisees might experiment: (1) It would be unreasonable to place on the franchisor the obligation to become familiar with quality standards relevant to competing soft ice creams or the virtually unlimited range of noncompeting products which its franchisees might desire to sell, to educate its franchisees with respect to those quality standards and to police adherence to them. Sales of noncompeting products or services by the franchisees would in many cases yield no income to the franchisor and in other cases insufficient income to offset the costs incurred by the franchisor in formulating, disseminating, and policing adherence to quality standards. Sales by franchisees of competing products or services would decrease the franchisor's income, but not its responsibility for the use made by its franchisees of the licensed trademark. (2) If the franchisor does not have the power to control and limit the products and services sold at the business premises displaying its trademark, and in conjunction with products or services sold under that mark, it loses its ability to maintain the uniformity of its image as presented to consumers by scores or hundreds of widely dispersed franchisees. The uniform image, suggestive and indicative of uniform quality and service, is widely believed to be a key element in the success achieved by franchising. (3) The suppliers of both competing and noncompeting products or services sold by franchisees would unfairly benefit from the franchisor's efforts to advertise and promote its trademark and the products or services sold under it.

Exclusive dealing arrangements basic to many franchise systems are actually conducive to vigorous interbrand competition. The franchisee is forced to concentrate on the franchised products or services and by virtue of the advantages derived from membership in a distribution system with many of the strengths of the vertically integrated chain, the franchisee is an effective interbrand competitor.

The exclusive dealing provision contained in the proposed amendment becomes more significant in light of its potential effect on the doctrine of reasonably ancillary restraints, which the lower courts have, since the *White Motor* case, applied to territorial confinement provisions in franchise agreements. As presently worded, the amending legislation could well raise the inference that, except to the extent

that a particular franchise relationship comes within the terms of the Sherman and the Federal Trade Commission Acts, as amended, territorial confinement constitutes a violation of those statutes. Such an interpretation would create significant problems for the large number of franchise systems that would be forced to choose between non-exclusive dealing and open territories, either of which choices could seriously impair the system's ability to attract franchisees and compete effectively.

A second significant defect of the proposed amendments is the uncertain scope of the bill. The language of the proposed amendment refers to an agreement "restricting the right of the purchaser to the distribution of the supplier's product within a clearly delineated territorial area." Would this language include an agreement that limits the franchisee to one place of business within a defined exclusive territory? The one-place-of-business restriction, which is commonly found in franchise agreements, may be characterized as a form of territorial confinement and is essential to the success and growth of many franchise systems. A franchisee permitted to establish additional business outlets on the periphery of his exclusive territory will thereby encroach on and diminish the exclusivity and value of the territories of adjacent franchisees.

Finally, Senate bill 2549 is by its terms applicable to "a contract or agreement between a purchaser and a supplier." Though the bill is probably intended to cover franchising generally, we question whether its language is broad enough to encompass those franchise relationships under which there are no sales of products or services by the franchisor to its franchisees or where such sales are of equipment, raw materials, or ancillary products or constitute an insignificant percentage of the franchisee's gross business. A related defect is the failure of the bill to specifically cover services as well as products. In light of the interpretation which has been placed on section 3 of the Clayton Act, which refers exclusively to products and has been interpreted as so applying, this omission is significant.

In light of these defects, it is doubtful that this proposed legislation would be beneficial to franchising or the development of the antitrust laws. The antitrust and trade regulation laws are broadly phrased and it has been left largely to the enforcement agencies and the courts to apply those laws to specific business practices. The very rapid growth of franchising, involving the special considerations of trademark licensing and small business, has created problems for the enforcement agencies and the courts with respect to the degree to which prevailing antitrust concepts are, or should be, applicable. The courts and to some extent the Federal Trade Commission have tended to accord special consideration to franchising. The Justice Department has not. Indeed, it has not even indicated that it regards franchising as preferable to vertical integration, apparently believing that vertical contractual integration is as potentially destructive of competition as vertical ownership integration.

Though we are tempted to encourage passage of legislation like Senate bill 2549, with what we view to be that bill's defects cured, and legislative exemptions for other restraints common to the franchise relationship, we believe that it may be preferable to permit the antitrust and trade regulation laws to retain their flexibility, leav-

ing to the judicial and administrative process the fashioning of the exemptions from those laws to which franchisors prove themselves entitled. Such a process of fashioning the antitrust law status of restrictions common to the franchise relationship will be very costly to those companies like Snap-On, and Sandura and Schwinn which must litigate, but the end result might well be a sounder legal basis for the franchise relationship than the one which would result from limited exemptions engrafted on the antitrust statutes.

However, if the Supreme Court casts the law unfavorably, or fails to clarify it, and the Justice Department resumes its crusade against vertical territorial and customer restrictions, franchising will perforce turn to Congress as the only forum sympathetic to its plea to be permitted to survive.

The International Franchise Association is not opposed to what we believe to be the basic objective of Senate bill 2549—the exemption from the antitrust and trade regulation laws of the territorial restraints commonly found in the franchise relationship. For the reasons I have stated, we are strongly opposed to the enactment of this legislation in its proposed form. If this subcommittee makes positive findings with respect to the need for legislative exemptions for vertical territorial restrictions, we urge that the exclusive-dealing limitation contained in Senate bill 2549 be removed; that the amending legislation define the territorial restrictions to which it is applicable in terms sufficiently broad to encompass the one-place-of-business restriction and that such legislation define the types of franchising relationships to which it is applicable in terms sufficiently broad to include franchising relationships not involving sales by the franchisor to its franchisees and those involving the sale of services by the franchisee. Only such broadly phrased legislation can benefit franchising generally.

That concludes my prepared statement.

Senator HART. Mr. Rudnick, the statement is helpful and, I think, particularly timely, because it serves to balance the record at this point. You speak from a broad association with hundreds of franchisor-franchisee relationships. I take it that it is because of your familiarity with the ramifications, rather than your impression of the success or failure of a particular franchise arrangement, that you are persuaded to caution us about the conceivable bad side effects that adoption unamended of this bill would produce.

Mr. RUDNICK. That is correct.

Senator HART. Mr. Cohen?

Mr. COHEN. No questions.

Senator HART. Mr. Chumbris?

Mr. CHUMBRIS. Thank you, Mr. Chairman.

Mr. Rudnick, I wanted to let you know before you read it in the record that yesterday I took excerpts from your statement that you were kind enough to submit ahead of time so that the four witnesses who appeared in favor of the bill would have the advantage of your comments. We wanted to give them the chance to comment at the time or take it with them and comment for the record. We did not want to take unfair advantage of you but we thought that would be a judicious way of handling it so that we could get their impressions of your opinion.

Mr. RUDNICK. That is perfectly all right.

Senator HART. In fact, we are going to receive written replies from—or we invited written replies from—the witnesses of yesterday commenting specifically on some of your points.

Mr. COHEN has a question.

Mr. COHEN. I asked this question yesterday and I would like to ask it again to you as a lawyer. It has been suggested that this bill might have the opposite effect of what it is intended to have. Under the law now we have no court decisions even indicating that an exclusive territorial restriction is a per se violation. Then we come to this bill and it says it shall not be deemed a per se violation under certain conditions, which might leave the inference that if those conditions are not present, that Congress did intend that it be a per se violation. And one of those conditions is free and open competition of products of like grade and quality.

We had one witness yesterday that sold Armaflex put out by Armstrong Cork which he says was a unique product. Sandura had testified that their product was a unique product. If that in fact is true, it might be that they were not in free and open competition with products of like grade and quality and the court might say, therefore, that it was the intention of Congress under those circumstances to make a territorial franchise a per se violation. This would go much further than any court has gone at the present time. We welcome from you, as a lawyer, any comments you might have on that suggestion.

Mr. RUDNICK. I tend to agree somewhat with that suggestion. I can think offhand of several members of our association that have somewhat unique products and the language might better be competitive products. In other words, like grade and quality should not be the test. I think the rationale here is that interbrand competition would be fostered. This is the justification advanced and there would—interbrand competition does not necessarily depend on products of like grade or quality. It depends on the existence of competitive products.

To amplify a little bit, I foresee the inference of the bill having the opposite of the intended effects. I foresee more serious problems as I pointed out, that the other exemptions, the other limitations in the bill, not the like grade and quality limitation but the exclusive dealing limitation as being even more significant. I think that exclusive dealing is equally critical to many franchisors, equally significant, equally important as exclusive territories, and forcing these—if the inference were to arise that territorial confinement is permissible but only if the supplier, the franchisor consents to nonexclusive dealing, I think this would have a most undesirable effect. It would force a very difficult choice on many franchise systems.

Mr. COHEN. It would have the effect of overruling the *Carvel* case.

Mr. RUDNICK. Yes, it would. I feel it would, and also the *Sandura* and the *Snap-On* cases.

Mr. COHEN. It might be helpful to the committee, should Mr. Grover agree that some amendments might be helpful in order not to undo that which at great expense already has been built into the law. This would be the supreme irony.

Mr. RUDNICK. Yes. I agree.

Mr. CHUMBRIS. Mr. Rudnick, although you are against the bill, you still see problems that confront the franchising business in this country.

Mr. RUDNICK. I see some very, very definite problems. I think that franchising—and let me amplify this—when I speak of franchising I perhaps have in mind a narrower class of American businesses than the term is sometimes applied to. I am not so much concerned with the automobile companies and the petroleum companies and the bottling companies as I am with the McDonald hamburger chain, Carvel Ice Cream chain, the Snap-On tools corporation, and companies that are a good deal smaller. They are small business. Franchising also may be a marketing technique, a merchandising technique that has attracted a number of large companies, but I think those are exceptions, at least at the present time.

The International Franchise Association's membership is composed overwhelmingly of what would have to be considered small business. I think these companies do face very serious problems to the extent that the law is unfair with respect not only to territorial and certain customer restrictions but exclusive dealings, exclusive territories, price control.

Here I refer to the suggestion that was made by Commissioner Elman some time ago, late last year, that distinction he drew between price tampering and price fixing. I think many of his suggestions are what would constitute price tampering in his opinion and should be subject to the rule of reason rather than to a per se illegal characterization found in franchising.

I would personally advocate a rule of reason test to price fixing in a franchising relationship. I think these are significant problems. I think the possibility of illegality, the threat of Federal Trade Commission or Justice Department proceedings against companies that would be no bigger than Carvel, and a number of other franchisors, is a serious impediment to these companies.

Mr. CHUMBRIS. I think you summed it up well on the last page where you said:

However, if the Supreme Court casts the law unfavorably, or fails to clarify it, and the Justice Department resumes its crusade against vertical territorial and customer restrictions, franchising will perforce turn to Congress as the only forum sympathetic to its plea to be permitted to survive.

You just want to wait and see how the Court develops these cases.

Mr. RUDNICK. Yes. I was there referring somewhat specifically to the decade before the *White Motor* case in which the Justice Department forced consent decrees on quite a number of companies that just were not prepared to go to the expense of litigating their agreements, and this I think is the one problem I have, the one reservation I have, to advocating the case-by-case approach. It places a tremendous burden on the company that has to make the law. The cost of litigating one of these cases even to the appellate level, let alone to the Supreme Court, can be prohibitive. And this I think, if there is a single justification for legislative exemptions for certain franchise agreement restrictions, I think this is the justification, that putting the burden on the smaller companies to defend their agreements is not fair.

Mr. CHUMBRIS. Thank you very much.

Senator HART. On the point of the cost that must be incurred effectively to litigate, we heard about it from Snap-On, we have heard it from others—it seems those who resist or have very strong reservations about having Congress move now in an effort to clarify and restrain the Court as it seeks to develop prudent rules of law, the burden on that segment of the Congress, then, is fairly heavy to respond to this practical problem of the cost. And I know it is a notion seemingly foreign to our tradition but what would be wrong seriously to consider some Federal recognition, whether in the form of a grant, offsetting tax advantage, some other method to permit effective litigation of key cases in this area? It long has been recognized that the criminal has to have some help and it is no answer to a businessman to say, “well, you have won that case and that is great and you have proved your point,” if in the process he has disabled himself.

This is another question to which I have no answer but it is a very real problem.

Mr. RUDNICK. I think your your suggestion recognizes a very practical problem. There is a lot of merit to it.

Senator HART. Off the record.

(Discussion off the record.)

Senator HART. The committee will adjourn, to resume Monday next room 1318 at 10 a.m. The witness will be the Assistant Attorney General in charge of the Antitrust Division, the Honorable Donald Turner.

(Whereupon, at 1 p.m., the committee recessed to reconvene at 10 a.m., Monday, June 27, 1966.)

The distribution problem of the small business is a complex one, involving many factors. The small business owner must consider the needs of his customers, the availability of transportation, and the cost of distribution. He must also consider the location of his business and the size of his market. The distribution problem is often the most difficult problem facing the small business owner, and it is one that must be solved if the business is to be successful.

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# DISTRIBUTION PROBLEMS AFFECTING SMALL BUSINESS

## (Exclusive Territorial Franchise Bill)

MONDAY, JUNE 27, 1966

U.S. SENATE,  
SUBCOMMITTEE ON ANTITRUST AND MONOPOLY  
OF THE COMMITTEE ON THE JUDICIARY,  
*Washington, D.C.*

The subcommittee met, pursuant to recess, at 10 a.m., in room 1114, New Senate Office Building, Senator Philip A. Hart (chairman) presiding.

Present: Senator Hart.

Also present: S. Jerry Cohen, staff director and chief counsel; Charles E. Bangert, assistant counsel; Peter N. Chumbris, chief counsel for minority; Patricia Barrio, editorial director, and Gladys E. Montier, clerk.

Senator HART. The committee will be in order.

I would like first to have the record reflect that on Saturday last the members of the National Food Marketing Commission were notified that the Commission was to make its report to the President at 11 o'clock this morning. Because the able Senator from Nebraska, Senator Hruska, with others, has filed a substantial dissent—which I think is a fair way to describe it—to much of that report, he felt obligated—and I understand perfectly why—to be at the White House this morning. For this reason he has told me that he shall not be here. I would like to have the record remain open in the event that, after Senator Hruska has had an opportunity to analyze Attorney General Turner's statement, he desires to have an opportunity to question the Attorney General at a subsequent date.

We will now hear from Assistant Attorney General Donald Turner.

### STATEMENT OF HON. DONALD F. TURNER, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF JUSTICE; ACCOMPANIED BY WIL- LIAM COMANOR, SPECIAL ECONOMIC ASSISTANT TO MR. TURNER

Mr. TURNER. Thank you, Senator.

I will just read my prepared statement and then be happy to accept any questions.

I appreciate the opportunity to discuss with you a bill now being considered by this committee, S. 2549. This bill provides that any agreement between purchasers and suppliers "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 held

illegal, provided that the product involved competes with other brands, that the purchasing distributor competes with distributors of other brands, and that the distributor is legally free to handle other brands. While it is difficult to predict exactly how this bill would be interpreted by the courts if it were enacted, I believe that it probably would have the effect of making legal most agreements between suppliers and distributors restricting the territory in which each individual distributor may sell.

At the least, it would be read to impose upon the Government the burden of proving in each case attacking such restriction that the particular agreement involved in fact unreasonably restrained trade or tended to create a monopoly. That is to say, the Government would be prevented from arguing that certain types of supplier-imposed territorial restrictions are inherently so destructive of competition and normally have so little justification that the burden of showing any justification for them should be upon the defendant.

We believe that, while territorial restrictions may be justified in some circumstances, most agreements of this type injure competition in a significant way and do so unnecessarily.

Because the present bill, under either interpretation that I have just mentioned, goes much too far in allowing such restrictions to be imposed, the Department of Justice strongly opposes it.

Territorial restrictions among dealers allocate to each dealer a particular area within which he is free from competition by any dealer selling the same brand of product. Although each dealer must still compete with other brands, freedom from competition by others selling the same brand can provide a dealer with considerable market power in that it enables him to charge higher prices than he otherwise would. For example, although Chevrolet dealers must compete with Ford dealers, a Chevrolet dealer would be able to raise his prices significantly to buyers who have a preference for Chevrolets if he does not have to compete with other nearby Chevrolet dealers as well. Territorial restrictions, in short, have effects similar to those produced by price-fixing agreements. And because dealers frequently, if not commonly, wish to impose territorial restrictions upon each other simply because they restrict competition, the courts have long held all such restrictions illegal when they are horizontally imposed—that is to say, when they take the form of agreements by dealers with each other.<sup>1</sup>

The Supreme Court recently added that such restrictions are similarly illegal when imposed by a supplier acting as a result of pressure brought upon him by a conspiracy among his dealers.<sup>2</sup>

The present bill, of course, does not deal with horizontally imposed territorial restrictions; it deals rather with territorial restrictions when they are vertically imposed—that is to say, when they are freely imposed upon dealers by a supplier.<sup>3</sup> Vertically imposed restrictions, it may be, and is, claimed, should be treated differently from horizontally imposed restrictions for two important reasons: First, and this is the argument, a supplier's motive in imposing territorial

<sup>1</sup> See *Pimken Roller Bearing Co. v. United States*, 341 U.S. 593; *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211.

<sup>2</sup> See *United States v. General Motors Corp.*, 382 U.S. 936.

<sup>3</sup> In *White Motor Co. v. United States*, 372 U.S. 253, the Supreme Court declined to hold vertically imposed territorial restrictions illegal per se. A majority of the Court believed it possible that justification for such restrictions might be shown in certain limited circumstances. See also *Stone, Closed Territorial Distribution; An Opening Question in the Sherman Act*; 30 U. Chi. L. Rev. 286 (1963).

restrictions differs from the motives of his dealers when they impose such restrictions upon themselves. Unlike his dealers, a supplier has no direct interest in reducing dealer competition, and, therefore, it may be thought that he cannot have an anticompetitive purpose in doing so. Second, it may be argued that while territorial restrictions lessen intrabrand competition, they may, at least under some circumstances, improve interbrand competition, and this latter pre-competitive effect may sometimes outweigh the former anticompetitive one. For reasons that I shall mention, I cannot accept the first of these arguments, but in certain particular limited circumstances, I accept the second.

I reject the first argument because even if a supplier has no direct interest in limiting competition among his dealers, his motive for imposing territorial restrictions may still be basically anticompetitive. Suppliers often impose territorial restrictions upon dealers because they hope that these restrictions by increasing dealer profits, will encourage the dealer to spend more on services, on advertising, or on other product promotions. Money spent in this way will help to differentiate a product from competing brands. And product differentiation, by building up consumer preferences for particular brands, will both give the manufacturer the power to charge a higher price and make it more difficult for new firms to enter the industry.<sup>4</sup> In fact, in industries that are relatively concentrated, product differentiation, by raising entry barriers, can significantly lessen the pressure upon firms already in the industry to act competitively. Insofar as territorial restrictions lead to increased product differentiation, they tend to produce this anticompetitive result.

Moreover, regardless of the supplier's motive, the territorial restrictions he imposes still restrict competition to substantially the same extent that they would if they were imposed by a group of dealers. For this reason vertically imposed territorial restraints are analogous to schemes of resale price maintenance. A supplier's motive in requiring resale price maintenance may well differ from the motives of his dealers were they to enter into a horizontal price fixing scheme. Nonetheless, because horizontal and vertical price fixing tends to produce similar results, we give minimal consideration to this difference in motive, and the courts hold both types of price fixing illegal, at least in the instances of the protection afforded by the McGuire Act.

Similarly, while possible differences in motive may conceivably be relevant in deciding whether vertically imposed territorial restrictions should be treated like horizontally imposed restrictions, in view of the fact that both types of restriction produce similar effects, difference in motive does not automatically justify different treatment.

On the other hand, unlike resale price maintenance, I believe that territorial restrictions may sometimes be justified when they materially contribute to interbrand competition. They may be reasonably necessary, for example, to the introduction of a new product or the entry of a new firm into a market. Such situations are commonly associated with relatively high degrees of risk and uncertainty, and it is reasonable to suppose that territorial restrictions may be necessary in many such cases to induce dealers to make the investment necessary to get a manufacturer's new product effectively introduced. The dealer may

<sup>4</sup> See Bain, "Barriers to New Competition," p. 142.

have to make heavy initial promotional expenditures to persuade consumers to give the product a fair trial, and he will not make this expenditure unless he has some prospect of recovering it through later sales at high enough prices. He would not be able to recoup if competing dealers, without the burden of initial promotional costs, were free to come in quickly at correspondingly lower prices once the demand was created.

It should be noted, however, that even in this case the justification for territorial restrictions is one limited in time. The original dealer does not need and should not get an indefinite protection against competition. Moreover, if after a period of time, dealers selling a new product are unable to stand on their own feet, this means the product has not gained sufficient acceptance and interbrand competition has not, in effect, increased. Though territorial restrictions may help weak firms retain dealers, I have some doubts that it is wise economic policy to preserve in this way companies that have run the competitive race and have fairly been beaten.

Various other arguments have been advanced from time to time in order to justify vertically imposed territorial restrictions. Most if not all rest on the quite erroneous assumption that what benefits the individual manufacturer necessarily benefits the economy as a whole. And to me they are unpersuasive. It has been contended, for example, that territorial restrictions are necessary to prevent one dealer from "skimming the cream" as the phrase goes, from neighboring markets, allegedly leaving dealers in those markets so weakened that they will lose interest in continuing to handle the product. "Skimming the cream" sounds invidious, but I doubt that on careful economic analysis it really is. A dealer can "skim the cream" from a neighboring market if the dealer there is charging too high a price. If the dealer in that market is charging too high a price, normally he should be under-sold. If he cannot survive on the remaining business, what reason is there to keep him in? Why should some buyers be forced to pay a higher price than they would otherwise have to pay in order to subsidize purchases by others?

It also has been argued that territorial restrictions, by providing distributors with higher profits, lead to more investment in distribution facilities. It may well be true that investors are attracted by these high profits but it is not at all clear why profit rates should be artificially raised in order to increase investment in distribution. Profit rates determined in a free market allocate investment according to where it is most needed and most in demand. Insofar as increased profits resulting from restrictive agreements attract investment to distribution, they injure the economy, for they prevent funds from being invested where they would more properly go.

Further, it has been contended that territorial restrictions, by increasing profits in distribution, produce a greater number of distributors and thereby increase a supplier's market coverage. This increased market coverage is achieved, however, at a price. The price is smaller, less efficient distributors and higher distribution costs, and higher prices to the consumer. Whether increased coverage is worth this price to the economy is a question that should be determined by the free market. If consumers prefer a greater number of small distributors to a lesser number of large ones, they will pay for this type of distribution without being forced to do so by territorial restrictions.

If they do not wish to pay for the type of distribution network created by territorial restrictions, such a system should not be imposed upon them by agreements between suppliers and distributors.

It is possible that in a particular case some other justification for a vertically imposed territorial restriction would be shown. It has been claimed, for example, that sometimes a supplier must assure his dealers high profits through the use of territorial restrictions so that the dealers will have ample incentive to retain high quality dealer services essential to maintain the product's reputation. I doubt that territorial restrictions are ordinarily in fact necessary to fulfill this purpose for I suspect that the supplier's objective could be achieved through less restrictive means. Nonetheless, I would not foreclose the possibility that such a defense could be made in a case involving an unusual factual situation.

In sum, while vertically imposed territorial restrictions may sometimes be justified as procompetitive, the circumstances under which they are justified seems to us to be few and far between. Most of the time such restrictions cannot be justified and may cause considerable economic harm. The bill now being considered may well be interpreted by the courts to mean that territorial restrictions are legal in all instances where the provisos apply as long as they are not imposed as a result of pressure brought upon a supplier by a conspiracy among his dealers. Since such immunity for agreements imposing territorial restrictions is far too broad, the Justice Department strongly opposes enactment of the bill.

It is, of course, possible that the proposed bill would be interpreted by the courts simply to mean that the Government cannot establish that territorial restrictions, or particular types thereof are illegal unless it shows that the particular restriction under attack actually restrains trade or tends to create a monopoly. But, for reasons we have set forth, we believe that this is turning the presumption the wrong way around. Under such a reading, the bill would impose a burden of proof on the Government to show that each individual restriction is harmful rather than imposing upon a defendant the burden of showing that its restriction is justified. If, as we believe, many more agreements of this type are harmful than are justified, they should be presumptively unlawful. Even if there is some doubt as to probabilities, a rule imposing a burden upon defendants to justify such a limitation on dealer competition is clearly appropriate because the companies involved are obviously in a better position to explain and document the legitimate purposes that their agreements purport to serve than the Government is to prove that the agreements could serve no legitimate purpose whatsoever.

Before concluding, I should like to point out that the harmful effects of this bill are not overcome by the provisos restricting its application to situations in which there is interbrand competition. Despite the fact that there may be interbrand competition, consumers tend to have brand preferences, and as long as such preferences exist, territorial restrictions will give dealers in a particular brand some market power, thereby producing the harmful effects that I have discussed earlier. In fact, if competition among different brands were so perfect that intrabrand competition were of no consequence, territorial restrictions would not be imposed, for in such circum-

stances neither dealers nor their suppliers would have anything to gain from them. Whenever we find territorial restrictions, then we can be certain that suppliers or dealers believe that they will help to restrict intrabrand competition. And, despite the provisos, the clear intent of this bill is to allow some such restrictions to be imposed.

I would like at this point to insert parenthetically a couple of additional comments.

These provisos, or at least two of them, are identical with the provisos in the McGuire Act which, as you know, permits fair trade in commodities wherever there are valid State fair trade laws in existence, and I believe I could say with considerable confidence that in the area of resale price maintenance, it is clear that they have not served to prevent resale price maintenance from leading to substantially higher prices than would otherwise exist.

There is an enormous amount of documentary evidence indicating that where you have fair trade, prices are considerably higher than where you do not, and the problem is that the proviso, free and open competition, has been interpreted to mean simply that you have other commodities of the same general class, but this is obviously inadequate.

What you get is a competition of sorts but not competition adequate enough to prevent fair trade from increasing prices. And I would suggest that the provisos in this bill would be similarly ineffective.

Now, let me return to my prepared statement and conclude.

The Department of Justice believes this bill would lead to damaging restrictions on competition throughout the distribution area of our economy. It would at worst make legal many harmful anti-competitive agreements, and at best significantly increase the burden on enforcement agencies of attacking invidious agreements in court. I would say that consumers would end up paying higher prices for branded goods. For these reasons, we oppose the bill.

Senator HART. Thank you very much. I have only one question. I think, and I ask it not unmindful that a reading of your statement contains the answer, but hopeful that we can get a more precise response to the particular question. To use this expression you have in your statement, where you argue against the bill saying that the company is in a better position to establish the legitimate purposes in the proposal than you would be to prove that there was no redeeming feature.

What purposes and what facts do you consider in bringing or not bringing a territory case? And to what extent does injury to competition color that decision?

Mr. TURNER. Well, my position, Senator, is that as indicated in my prepared statement here, I think these agreements are presumptively unlawful and I would call anybody in who was using them. I would say, you show me why you think they are necessary. What is the purpose of these? And why is it necessary to impose these kinds of restrictions? And if they could not supply me with what I thought was an adequate justification, I would file a lawsuit or recommend to the Attorney General that we sue them.

Now, as to what legitimate purposes would be, I am frank to say that I don't have the final answer to that. I am firmly convinced,

as I have indicated, that I don't think there are very many. Let me put it more precisely: I think there are very few situations in which it can be said both that a legitimate purpose is being served and that you need the territorial restrictions to carry that purpose out.

Now, I am fairly clear on one that I suggested in the prepared statement, that where territorials are used to effect new entry, or a manufacturer launching a new product, or a new manufacturer coming into the market for the first time, entry is obviously the most important way of promoting and preserving competition, so I think it is perfectly proper competitive justification by traditional terms to be favorably disposed—I mean, to be favorably disposed toward anything that lowers entry barriers. Beyond that, I wouldn't foreclose the possibility because we don't know everything, and we don't know all of the business facts of life. I certainly would not be prepared at this point to suggest that beyond that there are none.

But the position that we have been taking in the Antitrust Division, while we haven't had much occasion to use it, is that these agreements are unlawful unless you can show us why not. And that is the position we would continue to take.

Senator HART. The subcommittee has heard witnesses argue both ways on the question of whether we are moving or have already arrived at a per se position judging these things, and clearly your answer would indicate no.

Mr. TURNER. No. That is right.

Now, I notice—

Senator HART. Would it be in a prima facie position? I haven't heard that one yet.

Mr. TURNER. I wouldn't try to slice the difference between prima facie and lawful and presumptively unlawful. I use perhaps the word "presumption" instead of prima facie because, if I remember my procedure in law school—and I don't remember very much of it—presumption is a little stronger. I mean, in effect, it says you have got to overcome something here. You have got to make a pretty fair case. Prima facie is, well, unless something can be brought forward, it is unlawful. And I really feel if those are the differences between the two terms, I think presumption is more appropriate to this kind of restriction.

Senator HART. Mr. Cohen?

Mr. COHEN. In your statement you say, "I believe that it probably would have the effect of making legal most agreements between suppliers and distributors restricting the territory in which each individual distributor may sell."

My question is, Why?

Mr. TURNER. Well, as I read the bill, it says that such agreements in and of themselves shall not be deemed unlawful where certain conditions are met. The conditions described here, I think probably are fulfilled most of the time, at least. This again raises the question of interpretation, at least in the way that the phrase, free and open competition, has been interpreted in the resale price maintenance area.

Now, as you may know, it has been contended by a good many people that the fair trade exemption should not apply wherever there are oligopoly conditions. It has been suggested free and open competition does not, in fact, exist when there are so few manufacturers or

so few dominant manufacturers that though their commodities compete in the sense that there are alternatives available to the consumers, that manufacturers cannot, in fact, beat very hard on the price.

You know that is a possibility. That argument hasn't had a fair test. But on the assumption that free and open competition continues to mean what it has in the past in the resale price maintenance area, it simply means that there are other goods which are similar being sold in the market. I would say that is true almost all of the time.

So then you are back to the question as to what the bill means by in and of itself. I suggested in my statement that it may even mean that they are per se lawful or that, at the least, the Government is going to have to make an affirmative demonstration of competitive kind.

Now, if the first is true, then there is no doubt this would validate, I think, the vast majority of territory restrictive agreements. If it is the second, I think that the vast majority would still be all right for essential practical reasons. It is extraordinarily difficult to go in and prove as a practical matter, as a factual matter, that a particular set of territorial restrictions has led to significant increases in price because most of them have existed for a long time.

We don't have any benchmark and you are pretty sure that this is what has happened. You can argue logically that this is what has happened, but it is very hard as a practical matter to make a convincing factual demonstration.

I think we could probably do it but it is an enormous burden. And it is a burden that I feel peculiarly inappropriate when, if we are correct, most of the time these agreements are unjustified.

Mr. COHEN. As I understand, for the purposes of the record, what the sponsors at least had in mind in this bill is the second "in and of itself" meaning it shall not be per se unlawful which means that you would have to affirmatively show adverse effect on competition which, of course, might be price, but could be other factors as well, I would assume. So that, in effect, the bill wouldn't be making legal the agreements where there was an adverse effect on competition, but your point is that it would make it very difficult for the Department of Justice to proceed against those kinds of agreements if you had to show the adverse effect in each of these circumstances.

Mr. TURNER. Yes. Every territorial restriction case would be another big case, to use a familiar phrase.

Mr. COHEN. It has been pointed out by some that in the consent decrees you have taken, that you have allowed primary territorial allocations and where those primary allocations are used by a large firm which has the leverage to cancel a franchise on short notice, for instance, that it may have the same effect as a territorial restriction again for all practical purposes.

If Standard Oil has a dealer and he only sells at that location, he is not confined to a territory. But if he goes outside the territory, he knows he can have his lease canceled or not get the products. And if it is the product of a dominant manufacturer, it is probably a product they need. But you may have exactly the same effect under your consent orders as you would have with a legally territorial binding allocation.

Do you have any comment you can make on that point?

Mr. TURNER. That is quite possible. I think it would suggest at the least that decree. I take it what the argument is, as you phrase it, whereas a manufacturer is entitled to cancel a franchise because of an alleged failure on the part of his dealer to use his best efforts within his territory of primary responsibility—

Mr. COHEN. Or, further, where the—

Mr. TURNER (continuing). That the dealer will play it safe. That is, he will say, if I do venture outside my territory, I may get canceled.

Now, there may be some effect of this kind but in any event, I don't think it is going to be the equivalent of a flat territorial restriction because I would suspect that if a manufacturer really was using it for that purpose that he has built a pretty convincing record against this. That is to say, if, over the course of time if a dealer who makes some significant sales outside his territory of primary responsibility is cut off, that manufacturer is going to have a hard time explaining why this is so, particularly when he is operating under the provisions of the decree where he may be the subject of civil contempt.

I would think that he is under considerable pressure not to use it in this way. The psychological effect on dealers, I would suppose there is some of that, but even so, I wouldn't think it would rise to the seriousness of a flat territorial restriction.

The point you make, however, is a pretty good one and it does suggest that the Department should not just casually accept the provision of this kind in the decree, and perhaps we ought to strike the word "territorial" in it; I don't know.

Mr. COHEN. In your statement you get into the question of product and product differentiation. Now, in our experience, and this may not be the same as yours, product differentiation is usually created at a manufacturer's level by a manufacturer who has the financial ability and power to spend large amounts of money for advertising.

That creates the differentiation. A smaller firm, no matter how efficient he may be—it is not a question of having run the competitive race, he is efficient, he is good—but he just doesn't have that kind of money to spend on advertising, and even if he has it, he may not have the opportunity to spend it on network advertising as we learned in our advertising hearings.

Isn't it possible that in that case it might make sense to have a strong dealer have a territorial exclusive so that he is, in fact, doing the pushing of that product which the small manufacturer cannot do himself. That, in fact, in a concentrated product market we might be increasing competition by allowing a method of differentiating a smaller manufacturer's product from that of the larger?

Mr. TURNER. Let me make two or three points on that. This, I think, is a very difficult question.

The first point is, what you are really describing is a situation where, in fact, there are economies of sale and promotion. The larger manufacturer has certain advantages.

Now, then, the next question is, well, are those the kinds of economies of scale that we ought to give any particular regard to, and I think there is very serious doubt about that.

What you are suggesting really is that the smaller manufacturer may use territorial restrictions, territorial franchises as a way of achieving the kind of economies of promotional efforts which his

larger competitor has, say, by advertising, and the like. This is quite possible.

But I don't think it necessarily answers the question as to whether it is a good thing.

Again, this brings you to the question: What is competition and what is the kind of competition you wish to encourage and is the consumer better off by encouraging certain kinds of competition or forgetting about it?

In the situation you have described, the consequence—if in fact this is the situation—the consequence is you may get a somewhat larger number of producers, of small manufacturers, who would otherwise operate at a serious disadvantage, but what is the nature of the contribution they make?

I mean, they come in—the territorials almost certainly would mean their product is being sold at a somewhat higher price than it would otherwise be sold at. Their success hinges on gaining consumer acceptance, diverting consumers away to their product at a somewhat higher price. What you end up with, therefore, is a somewhat larger number of sellers, no lower prices than would otherwise exist. You would simply spread consumer preferences around a little bit.

Now, I think that is the best that you can get out of it.

Mr. COHEN. You are making the assumption—

Mr. TURNER. You know, I wouldn't say that the answer to this problem is clear. And it isn't clear; among other things, because it depends, I suppose, to some extent, on certain value judgments. But I would tend myself to say that, in view of the difficulties you get into creating exceptions of this kind, that probably, as a practical matter on balance, if you did it, the net result would be harmful.

Let me try to explain that a little further.

Let us suppose that the case you describe is one in which you think it is justifiable. You then have to formulate some sort of a rule. What you are suggesting is that the right to impose territorial restrictions should vary with the size of the manufacturer concerned, that if a manufacturer is of a particularly small size, he can use territorials, whereas his larger brethren cannot.

Now, right away you have a very difficult economic and legal problem. One, you immediately have to define market and market definition, as you know, is a very difficult question. You have to formulate some idea of what you mean by small within that market. And once you are off to some rather difficult complex legal questions, the law begins to lose its clarity very significantly, becomes very spongy. Every time that happens you can be pretty sure that a lot more people are going to use territorial restrictions than really should if you had the enforcement resources to track down every case and try to separate the sheep from the goats.

Now, that is a price you pay whenever you try to draw distinctions of this kind and, you know, I think it is a fair matter for dispute.

My tendency would be to say I don't think it is worth it. I don't think it is worth it.

Mr. COHEN. Of course, basic to your answer; in fact, basic to your entire statement, is the assumption that where you have territorial restrictions you are going to have higher prices. It may well be—and I think even a walk through any of the supermarkets in this area would bear it out—that where there is only a Procter & Gamble and a General

Foods, maybe a Colgate-Palmolive competing with each other, you can be pretty sure their prices are not going to be competitive.

Where you have some of the smaller regional companies who are able to break into the market, their prices are likely to be lower even with territorial exclusives which some of them now have. Doesn't the consumer at least have a little better shot at a lower price where you have some independent competitors who have been able to at least enter the race against some of your dominant concerns?

At least there is a possibility there you may get price competition where now you have not.

I just want to make this last comment because it goes to your competitive race analogy.

It is not a question of having entered the competitive race and having been beaten. It is a question of a good athlete who wants to get on the track so he can join the race.

Mr. TURNER. This I am quite willing to permit. In fact, this was the justification that I indicated I would accept almost automatically: the use of territorial restrictions by the manufacturer coming into the market for the first time, or bringing a new product in for a period, a reasonable period necessary to get off the ground. I would support this, and I would consider this an appropriate justification.

That I have no quarrel with. I think the problem I have is with the social appropriateness of allowing these restrictions to continue indefinitely and I begin to wonder, after 3 or 4 or 5 years, whether any real useful purpose is being served if, at that point, the restriction is still necessary to keep the guy in. I begin to question it at that point.

It indicates a very serious weakness, and a weakness so serious that it is probably likely to have zero impact on big competitors concentrated as you suggest.

Mr. COHEN. Of course, in your own book you recognized, at least at that time, that when the company had a certain position—I think 20 percent of the market—and that was the test you used in terms of prohibiting further vertical integration. You have a different problem where you have a firm in a dominant position than one who is not.

Now, do you see any possibilities of writing into this bill that kind of test, the per se rule, which would apply only if a firm has a certain dominant position in a relevant market, but may not apply if they do not?

Mr. TURNER. Well, it is certainly possible to write such a test in. I would object to it myself.

Mr. COHEN. I should have used the word "desirable."

Mr. TURNER. I think it is legitimate and appropriate to distinguish between vertical integration and contractual restrictions.

There are a good many reasons why we might look at the latter more harshly than we do the former. One of the basic reasons is that when somebody puts his money up, when he invests, say, in forward vertical integration, that is about as good proof as any that he at least believes that substantial economies and advantages are to be gained, sort of proof of the pudding, so to speak. The trouble with contractual restrictions is that you can get them without putting money up, so you don't have quite the confidence in the judgment.

Mr. COHEN. Of course, what you are saying is, if the firm has the financial power to set up their own retailing system, fine. If he has to

rely on franchising to get into the stream of distribution, then he has a harsher antitrust test to meet in order to get his goods into the flow of commerce.

Is that basically your position?

Mr. TURNER. Well, it puts it in a rather unfavorable light.

Let me try to restate it a little bit.

In the first place, there may well be situations where vertical integration is economical only if you have a certain minimum volume. I have no doubt that there are some instances of that. I don't think you find it very commonly in the distribution field that we are primarily talking about. By and large, vertical integration is a rare phenomena because, by and large, even the biggest of sellers does not sell sufficient volume to be able to set up on his own a distribution setup which achieves maximum economy, and so I think if you would look over, I think you would find that in most industries, most product lines, not even the big companies would find it economically appropriate to vertically integrate forward.

So I don't think it is that serious a problem.

Secondly, I am only saying that a particular kind of device should not be allowed. That does not eliminate, for the small manufacturer, all of the alternatives, the vertical integration, that he might pursue. It still leaves open the small manufacturers, the possibility of creating a joint venture, a whole group of, say, small manufacturers, going together and setting up a joint distribution system.

It leaves open to him contractual restrictions that are less restrictive than this.

And so, in short, I am just cutting off—I would just cut off for one, and I would not think that this would put the smaller firms at a really serious disadvantage.

Mr. COHEN. The smaller firms come in and tell us it does; that if their dominant competitor wants to integrate vertically, he has that opportunity. They do not have that same opportunity. Without the exclusive territory, they cannot find dealers that are willing to take their product because it is not well known, and this is really, I think, the kind of impasse that has led to the introduction of this bill.

Senator HART. I think this will have to be the final word because the chairman has to get to the White House meeting himself, and there are several statements to be added to the record if there is no objection. As we indicated, it will remain open for Senator Hruska to have an opportunity to review.

Mr. Chumbris advises me that he will reserve questions until that time.

(EDITOR'S NOTE.—Senator Hruska did express a desire to question Assistant Attorney General Turner on several points of his testimony. However, when it became evident that no action would be taken on S. 2549 before the end of the 89th Congress, Senator Hruska declined recalling Mr. Turner in deference to the already overcrowded schedules of subcommittee members and the Assistant Attorney General.)

We are making a request of the Department for a tabulated summary here that can be added to the record if there is no objection.

(The documents may be found in appendix, p. 1122.)

Senator HART. Thank you very much.

Mr. TURNER. Thank you.

(Whereupon, the hearing was recessed at 10:50 a.m. to reconvene subject to the call of the Chair.)

STATEMENT ON S. 2549 BY LEROY F. BALL, CHAIRMAN OF THE BOARD, KING CIGAR CO., FLINT, MICH.

My name is Leroy F. Ball, a resident of Flint, Michigan, and chairman of the board of the King Cigar Company of the same city, a firm with which I have been identified for close to half a century. Our organization distributes a wide assortment of consumer products to and through several thousand retail stores in Flint, Ann Arbor, Port Huron and their environs.

We are typical of many distributors in that we are dependent on a franchise system of distribution for our very existence. We provide our customers with cigarettes, smoking tobacco, cigars, candy, fountain supplies, drug sundries, blades and shaving accessories, watches, clocks, hosiery, and general sundry merchandise. Overridingly, we also perform what may be construed as a "banking" function by extending credit for periods varying from 10 to 60 days to this group of independent merchants—about 95 percent of whom do not have any mercantile rating. In the maelstrom of our competitive economy, we strive to render service just a little bit better than that which our customers can obtain from any other source. To fulfill our function entails the investment and cautious utilization of appreciable funds—ranging between \$50,000 and \$60,000 for each million of sales.

A considerable number of the products that we handle are in the franchise category, which means that we are responsible and accountable for their availability in the largest of the retail outlets in our territory. Except for the challenge implicit in undertaking the commitment and faithfully discharging the obligation to the manufacturer of according these products dynamic promotion and pinpoint distribution, the likelihood of our succeeding or even surviving in business would be in great jeopardy.

The enactment of the legislation under consideration is imperative if we are to safeguard our unique and wholly democratic way of life, which assures every man free and equal opportunity to compete with all others, and is the envy and model of millions of people throughout the world.

Congress, in all of its economic legislation, has uninterruptedly sought to preserve such opportunities by protecting the right of the individual to choose to operate an independent business. From the enactment of the Sherman Antitrust Act, in the twilight of the 19th century to the present, Congress has evinced continuing concern for the preservation of equal opportunity. The Clayton Antitrust Act, the Federal Trade Commission Act, the Robinson-Patman Act, the Interstate Commerce Act, and innumerable other decisive steps have been taken by the Congress with a specific objective in mind—the protection of free and fair competition. The contribution of the franchise system to the maintenance of such freedom has been profoundly beneficial. To illustrate:

My firm is an exclusive distributor of an electrical appliance which is in fierce competition with three or four other appliances, each of which performs a similar service. To obtain a substantial share of the market we have to aggressively and vigorously promote the product. Such aggressiveness on our part prompts and impels our competition to act accordingly. In this way, the potential consumer is assured ease of accessibility to a wide choice of these particular electrical appliances. Conversely, if these competitive appliances were available to all the wholesalers in the area, they would be markedly neglected—and there is ample experience to prove it—with the consequence that (a) the manufacturers would be deprived of proficient distribution service, and (b) the potential customer would be deprived of the opportunity to make a real selection of his preference.

There is a familiar colloquialism, namely "The laborer is worthy of his hire." This hard fact of life applies particularly in the area of our distributive economy. There are many producers of meritorious products who are financially unable to acquaint the populace with the value of such products. Equally, there are producers of rare, specialized, perishable, and unusual products which require peculiar care or attention for their diffusion through marketing channels. The franchise system of distribution is the only catalyst that enables each of these makers of goods—these producers—to harness and utilize the proficient facilities of wholesale distributors for market exploitation. Let us by all means extricate it from the confusion in which it finds itself at present. I thank you.

STATEMENT ON S. 2549 BY J. DONALD BLANKENSHIP, BIANCHI CIGAR CO., MEMPHIS, TENN.

My name is J. Donald Blankenship of Memphis, Tenn. I am owner and general manager of Bianchi Cigar Company of the same city. May I note that my original profession was in the academic world and I practically was drafted into the business realm upon the demise of a member of my family. The inducement and incentive to make the change from the academic world to that of the exciting arena of competitive encounters was that the firm has, for a number of years, fulfilled its commitments on a number of franchised products; that its reputation in the marketplace was, in the main, grounded in the effective manner with which it merited the recognition of well-known suppliers of brand products of excellent character and fine quality.

While I do not regret the shift of scenery, I do feel rather uneasy because the franchise system has become so befuddled and bemuddled. It is quite apropos to point out that the city of Memphis, Tenn., and its environs contains no less than a half dozen wholesale distributors in fierce competition with one another. Each of us is accountable for the distribution and promotion of several brands entrusted to us on a franchise basis. While, in the aggregate, each brand bears a different name in their advertising media each of them may single out extraordinary features of such products, they are all designed to serve the identical purpose.

As an example, an electric shaver is an electric shaver, regardless of the brand name. A five or ten cent cigar is a five or ten cent cigar, regardless of its title. This being the case, at what stage do any special benefits accrue to any one of us—I mean competitors? It redounds to the benefit of our customers, the makers of the product, our sales personnel and our firm, by the focusing of attention and energizing our efforts toward assuring our franchised products maximum exposure and inviting display.

Pricewise, we have to be competitive, otherwise we will lose favor with the consuming public—and that we cannot afford.

All this goes to prove that the healthy competitive mobility which characterizes our economic society is directly traceable to the constant encouragement of ambitious and industrious persons of limited financial resources to engage in business with the reasonable hope of succeeding therein and, in bettering themselves, to thereby also contribute to the enhancement of our all-encompassing industrial horizon. I regard this freedom to embark upon an independent business venture, with equal opportunity for success to all contenders, as our most priceless American economic birthright.

Economists, legislators and statesmen, as well as lay leaders in every walk of life, have found it increasingly urgent in recent years to remind the people of the world as well as our own citizenry that the American way of life is not an illusory philosophy, but rather a tested and proven concept which holds out new hope and promise to all freedom-loving people.

May I stress in closing that franchising products is in full keeping with the American business philosophy.

STATEMENT OF CHAMBER OF COMMERCE OF THE UNITED STATES

(Prepared by John F. Bysset\*)

Many manufacturers of all sizes sell their products through networks of franchised distributors or retailers. Frequently, the franchise agreements will contain some kind of territorial security for the franchisees. For example, an agreement may give the franchisee an exclusive right to sell the manufacturer's product within a defined geographic area—with a restriction against active operations in the areas assigned to other dealers in the same network.

In size, the assigned territories will vary according to such things as population, the nature of the product, and the investment capital available to the franchisees. The territory may be a region, a state, a town, or even a city block. But, in any case, the franchisee is given a fixed area which he may develop according to individual ability and initiative.

The purpose of S. 2549 is to assure that territorial security arrangements of this kind are not automatically illegal. The legislation is proposed because of the tendency of antitrust officials to view most territorial security provisions as automatic or *per se* violations of the antitrust laws—without regard to economic

justification or effect. The Department of Justice took this attitude in the 1963 case of *White Motor Company v. U.S.*<sup>1</sup>

To save territorial security provisions from automatic or per se illegality, this bill would provide that for purposes of the Sherman and Federal Trade Commission Acts, a territorial franchise restriction shall not be unlawful in and of itself where three competitive conditions are met:

1. The products involved are in open competition with "products of like grade and quality produced by persons other than the supplier,"
2. The franchisee is in open competition with other sellers of "like or similar merchandise," and
3. The franchisee is not restricted in his right to sell "like or similar products" of other suppliers.

The bill has a modest objective; it does not intend that all territorial restrictions shall be automatically lawful, but only that they shall not be automatically unlawful. It intends that territorial security provisions should be tested for legality under a *rule of reason* according to purpose and economic justification or effect.

Even if a particular territorial restriction meets all three of the bill's competitive conditions, it could still be unlawful if it restrains trade unreasonably or if it is monopolistic. The bill simply intends that if the three conditions are met, a territorial security provision will not be illegal unless there are other facts to prove actual or probable anti-competitive effects.

#### NATIONAL CHAMBER POSITION

The National Chamber agrees with the principle of the bill that territorial franchise restrictions should not be automatic or per se antitrust violations. However, as presently worded, the bill may not achieve its objective—it may in some instances create rather than avoid a per se rule of illegality. For this reason, we suggest that the Committee consider liberalizing or amendatory language to insure against the unintentional development of such a rule.

In the following discussion we will take up, in order: (1) reasons for supporting the principle of the bill, (2) the present need for legislation, and (3) the question of liberalizing or amendatory language.

The economy functions best when it is free of unwarranted controls, and when business arrangements are judged under the antitrust laws according to competitive effect and economic justification. In terms of this principle, the per se idea for franchise agreements is an unwarranted extension of an established rule—an extension based on faulty reasoning which does not take into account competitive effect and economic justification.

The idea that a territorial security provision is unlawful in and of itself is based (wrongfully, the National Chamber believes) on a long standing rule that agreements to divide the market *horizontally* are automatically unlawful. Agreements of this nature involve market divisions between firms at the *same level* of production or distribution. To illustrate, an agreement among three competing manufacturers that one shall sell only in the South, another in the North and the other in the West would be a horizontal division. Similar agreements among wholesalers or retailers would also be horizontal market divisions.

The per se theorists reason that market divisions imposed *vertically* by a supplier on his franchise holders have the same effect as horizontal agreements since competition between sellers at the same level of distribution is affected. For example, a franchise system which allows a wholesale distributor to sell only in a specified area restricts competition with other wholesalers in the same franchise system.

However, there is a basic difference in competitive effect between competitor agreements to divide the market horizontally and territorial restrictions under a single franchise system. Manufacturer agreements of the horizontal type eliminate *inter-brand* competition and leave the consuming public with no alternative if unreasonable prices or poor quality result. Franchises, on the other hand, can only restrict *intra-brand* competition and the public can turn to other competing brands if the quality is poor or the price too high.

But, it is not enough to say passively that territorial restrictions do not eliminate inter-brand competition; in actuality they encourage competition

<sup>1</sup>John F. Byset, Attorney, Staff of the Chamber of Commerce of the United States. 1372 U.S. 253, 82 Sup. Ct. 696, 1963 Trade Cases Par. 70, 679.

between different brands.<sup>2</sup> A franchisee with his own business to develop under brand identity is motivated to fully promote that identity. For the economy generally, this promotion of inter-brand competition could be considered a prime justification for territorial security.

From its 1965 study, "Distribution Problems Affecting Small Business," the Committee is also familiar with other justifications. For example, territorial security may mean the survival of a failing company, as the Sixth Circuit Court of Appeals found in the case of *Sandura v. FTC*,<sup>3</sup> or it may be the only assurance of adequate service to the customer.<sup>4</sup> And, in his June 27 statement to the Committee, Attorney General Donald F. Turner conceded that security arrangements may be the only means of market entry for a new product or a new company.

These are all specific instances of justification; the franchise system itself is the fundamental justification. The importance of franchising to the economy, and the opportunities it affords to small businesses are matters of general recognition. It should also be recognized that territorial security is almost a necessary ingredient of franchising. Without exclusive rights, the relationship between supplier and franchisee is not much more than the usual relationship between any seller and purchaser.

According to a report prepared by the University of Minnesota for the Small Business Administration, this idea of territorial security is an element of the better franchises which the franchisor is ethically bound to provide.<sup>5</sup> Frequently it is the only way to secure capable and willing dealers. Without territorial security, the capital risk in developing the product may be too great for the dealer.

#### PRESENT NEED FOR LEGISLATION

Even though the Supreme Court has not yet accepted the theory of per se unlawfulness for territorial security arrangements, the need for corrective legislation is nevertheless immediate. The constant threat of a per se rule is as much an effective control as the rule itself would be.

In *White Motors*—the only direct consideration of the issue by the Court—the per se theory was rejected, but the possibility of later acceptance was left open and three of the eight participating justices held out for automatic illegality. Furthermore, the case had no effect on the Justice Department theory; the Department later took a consent decree from *White* forbidding the use of territorial restrictions.<sup>6</sup>

The Department's attitude remains little changed by the concession of Mr. Turner that territorial security provisions may be justified in the case of a new product or a new company. The implication is that the Government will continue to assert the per se theory against all other justifications. And even this new company and new product concession offers no real protection from the Government threat. Mr. Turner said that territorial restrictions would be accepted in those cases for a limited time only.

With this atmosphere of uncertainty, an element of the franchise system becomes a risk which the wary business firm might not wish to assume. Relief through antitrust administration is not in sight; in fact, the recent case of *Brown Shoe Company v. FTC*<sup>7</sup> increases the hazard. While that case did not involve territorial restrictions, it did say that the FTC could strike down franchise arrangements without proof of anti-competitive effects. In these circumstances, new legislation is the only available remedy.

#### AMENDATORY LANGUAGE

The bill is remedial legislation, and it could be expected that it would be interpreted liberally to avert per se illegality for most territorial restrictions in franchise agreements.

<sup>2</sup> Lawrence N. Averill, Jr., *Antitrust Considerations of the Principle Distribution Restrictions in Franchise Agreements*, 15 American University Law Review 28, at pp. 53-54 (Dec. 1965).

<sup>3</sup> 339 F. 2d 847 (CA-6), 1965 Trade Cases Par. 71,332.

<sup>4</sup> *Snap On Tools v. FTC*, 321 F. 2d 825 (CA-7), 1963 Trade Cases Par. 70,861.

<sup>5</sup> *Distribution Problems Affecting Small Business*, Hearings before Antitrust Subcommittee of the Committee on the Judiciary, U.S. Senate, 89th Congress, 1st Session, pages 308-310.

<sup>6</sup> *United States v. White Motor Co.* (D.C. Ohio), 1964 Trade Cases, Par. 71,195.

<sup>7</sup> *FTC v. Brown Shoe Co.* (Sup. Ct.), 1966 Trade Cases, Par. 71,785.

However, as now worded, the bill could produce unintentional per se results. It lists three criteria for testing territorial security provisions; this enumeration may be interpreted as a Congressional intent to outlaw any territorial arrangement that does not meet all three tests. This might arise from the general rule of statutory construction holding that where the intention of the lawmaking body is not otherwise clear, the listing of subjects on which a law is to operate is to be construed as excluding from the law's effect all subjects not listed.<sup>8</sup>

So interpreted, the bill would create rather than avoid a rule of per se illegality—and justifications heretofore accepted by the courts could be rejected. For example, the failing company justification of the *Sandura* case might have seen a different result under a law requiring all three of the bill's enumerated criteria. The Sandura arrangements would have been especially vulnerable under the bill's first criterion which says that the product subject to a territorial restriction must compete with other products of "like grade and quality."

In *Sandura*, the FTC found that the Sandura product faced "substantial competition" from other hard-surface floor coverings. However, the Commission challenged justification for territorial security because there was "distinctive dissimilarity" between the products of Sandura and other manufacturers. By this reasoning, a justification would not be allowed unless competing products are substantially identical. The Sixth Circuit Court disagreed with the Commission, saying that product differentiation increased the need for specialized promotion of the Sandura covering—"to inform the ultimate consumer" of the product's "advantages."

The Court was working under a flexible rule of reason in the *Sandura* case. If a narrow "like grade and quality" test had been in effect, the Court may have felt compelled to accept the Commission's attitude—despite other competitive conditions. From the bill's structure, the Court could have found a Congressional intent to allow only indistinct product differences. In the bill's second and third competitive criteria, the "like grade and quality" language is not used—there, the broader words are "like or similar" merchandise and products.

Thus, it would seem that if the bill had been in effect at the time of *Sandura*, the Court would have concluded that Congress used different language because it intended different results. In these circumstances, the narrow attitude of the FTC on product differentiation might well have been upheld as to the first criteria—and the arrangement would have been illegal since it did not meet all three tests.

Such unintentional results could and should be avoided by appropriate revision of the Bill. Rather than enumerate specific tests, it would be preferable for the Congress to clearly denote an affirmative intent to create a "rule of reason" in general language—to the effect that a territorial restriction should not be automatically unlawful unless it is without reasonable economic or business justification. By this approach, the temptation of enforcement agencies to insist on the inflexible application of mechanical tests could be averted—and the possibility of an unintentional rule of per se illegality would be removed.

In the event that this clarifying approach cannot be considered favorably, we would suggest that the Committee at least amend S. 2549 to allow for product differentiation in all three of the bill's competitive criteria. This could be done by changing the words "like grade and quality" in the first criterion to the "like or similar" wording of the second and third criteria.

#### CONCLUSION

It is logical that as devices for economic regulation, the antitrust laws should be applied according to economic factors rather than mechanical factors. The National Chamber agrees, therefore, with the principle of the bill that territorial security provisions in franchise agreements should not be automatic violations of the antitrust laws.

However, the bill sets up three criteria for testing territorial security provisions which could be interpreted as a Congressional intent to outlaw any arrangement that does not meet all three tests. Clarifying language to create a statutory rule of reason could avoid such an unintentional result.

If a rule of reason in general terms cannot be considered favorably, the National Chamber believes that the bill should at least be amended to allow for territorial security where the franchised product involved is different from competing products.

<sup>8</sup> See 82 C. J. S. Statutes, Sec. 333 et seq.

## 1102 DISTRIBUTION PROBLEMS AFFECTING SMALL BUSINESS

STATEMENT OF HON. DONALD D. CLANCY, U.S. REPRESENTATIVE, STATE OF OHIO

I share the concern of other sponsors of legislation which would make it clear that exclusive territorial franchises are not an unfair method of competition or a restraint of trade under the antitrust laws. I have introduced H.R. 9656 with the hope that passage of this bill will insure that no uncertainty exists over the legal validity of exclusive franchise arrangements.

Territorial franchises have enabled smaller manufacturers who cannot afford to advertise nationally to compete with larger firms. The distributor or dealership approach has provided an effective means of reaching the consumer, but it is to be doubted that the distributor would work as energetically if his territory were not restricted to prevent incursions by other distributors.

The franchise system of distribution is an important feature of our economy and, where competition is not unduly restrained, this form of marketing distribution should not be clouded by antitrust questions. The courts have repeatedly held that exclusive franchise distribution does not constitute a violation of the antitrust laws, and I believe that the Congress should spell this out.

The bills you are now considering will validate the legality of this form of marketing, and I am hopeful that this legislation will be favorably acted upon.

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STATEMENT ON S. 2549 BY WILLIAM EAKIN, PRESIDENT, MODESTO TOBACCO & CANDY Co., MODESTO, CALIF.

My name is William Eakin, president, Modesto Tobacco and Candy Company, Modesto, Calif. I made this trip all the way from the West Coast to appear in person before your honorable body because by experience, by conviction and in principle I am totally sold on our nation's mass distribution system; our nation's franchise system for the encouragement of aspiring people to meet challenges.

How can a manufacturer distribute his product—be it a cigar, a ballpoint pen, a radio, an electric shaver, a flashlight, a pipe, a box of candy or any other item—unless he does so through the American way of franchise distribution. Surely we must not consider only the few corporate giants who, by virtue of their size, could—without the franchise system—create a monopoly.

For example, take a small cigar manufacturer in Melba, Pa., who is desirous of distribution in the San Joaquin Valley where I reside. He is dependent upon a distributor such as myself to create a market and maintain an uninterrupted flow of his franchised product in my area. I, in turn, compete with other distributors who represent similar manufacturers for distribution to the retailer for ultimate consumer sales.

And, gentlemen, distributive competition is the keynote to fair prices, as much as competition on the retail level.

A firm such as ours, engaged in wholesaling franchised items, requires employees who are informed and knowledgeable about the products we distribute. In addition, they have the authority to back up the manufacturer's item. The franchise system is a trust and administered by the distributor in a fair and just manner.

It has served our nation well and should not be permitted to become entangled in a maze of controversy or conflicting interpretations.

I urge your honorable body to act favorably on the bill under study.

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STATEMENT BY HON. JOHN J. GILLIGAN, REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. Chairman and members of the subcommittee, thank you for the opportunity to give this statement in support of S. 2549, which provides that exclusive territorial franchises, under limited circumstances, shall not be deemed a restraint of trade or commerce or a monopoly or attempt to monopolize under the anti-trust laws.

I am the sponsor of similar legislation in the House, H.R. 8314.

To clarify the legitimate role that exclusive franchises, under limited circumstances, plays in our economy is of great importance to the independent manufacturers and distributors of our Nation.

This bill, as I see it, in no way creates a monopoly as only items that are in open competition with similar items, made by other manufacturers and sold by other distributors, could be franchised.

What is distribution? It encompasses the plethora of processes entailed in expediting the movement of goods from the factory platform to the consumer's pantry.

What are those processes? They engulf packaging, transporting, advertising, wholesaling and retailing. In modern-day terminology, these are the functions that add value to distribution.

Do all products require identical services? Generally speaking, all products require, packaging, transporting and retaining—but there is a marked difference in applicability to advertising and wholesaling. Where does it vary? The maker of a product having limited finances cannot compete in the marketplace with a counterpart possessing abundant finances. The survival in the business spectrum of such a maker of the product depends in the main on inducing, recruiting and obtaining an interested and qualified wholesale distributor who, by dint of perseverance, can assure the product maximum exposure.

More often than not, in the absence of the helping hand of "printers ink"—advertising—notwithstanding the maker's blandishments, the distributor cannot and will not make his costly sales organization available to the producer unless he can ultimately reap the benefits stemming from the sale of such product in his territory.

This process of delegating the distributor to do the job is known as franchising. The tangible value of the franchise system scarcely needs any defense because its viability has been established beyond any refutation. Yet, owing perhaps to a misunderstanding, or misinterpretation, the action of certain government agencies tended to becloud the issue, resulting in dire consequences to both the manufacturer and distributor.

The proposed legislation, S. 2549, provides a way to eliminate such confusion.

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STATEMENT ON S. 2549 BY DONALD GREGG, PRESIDENT, FABER, COE & GREGG, INC.

My name is Donald Gregg and I reside in Montclair, N.J. I am grateful for this opportunity to appear before you in behalf of the franchise bill you are considering. I will confine myself in this statement to a few pertinent but perhaps less obvious points about the operation of territorial franchising in the cigar distribution industry.

I am president of Faber, Coe & Gregg, Inc., a New York Corporation, and we have been cigar merchants since 1848. To establish my credentials to appear before you on this important matter, permit me to tell you briefly about this company.

We started in business importing unbranded Havana cigars which met our quality standards. We brought the cigars to New York in barrels and there packed them in our own boxes. As sales grew, we had to go to banding our cigars to protect consumers against cheap refills in our boxes at the retail level. To insure a factory commitment to quality, we eventually moved to factory branded goods. Further on, as we demonstrated our capability to influence key brand building retail outlets, manufacturers offered us major brand distribution franchises. Some of these franchises still in effect date back over four (4) decades. Today we are one of the country's largest merchants of high grade cigars, dealing solely in franchised brands. Yet, we are still a small company employing less than 200 people in our distribution activities and with an annual turnover of around \$21,000,000.

Some of the cigar brands you may recognize in whose public recognition we have played a significant merchandising role are La Corona, Antonio y Cleopatra, Shakespeare, Garcia y Vega, Optimo, La Primadora, Medalist, Webster, Bering, Dutch Masters, El Producto, and, formerly, seven of the nine famous Cuban brands. We distribute directly in the New York, New Jersey, Pittsburgh, Chicago and Miami markets, and in each of these five markets we simultaneously distribute many of the brands I have mentioned. My point is that in varying degrees, each of these famous brands is freely competitive with each of the others and there is no restriction on this internal competition in any of our franchise understandings.

As the listing of brands I have given you indicates, in some one of our branches we are given and operate under franchises from all of the cigar manu-

facturers of any consequence in this country, and each of them sell to us at virtually the same discount. The annual sales of these manufacturers vary from around \$2,000,000 to nearly \$200,000,000. Most of them budget virtually nothing for advertising in accepted media and only the three very largest have advertising budgets that are a meaningful percentage of sales. As a specific case, La Corona is a quality cigar brand, nationally recognized by smokers and non-smokers, men and women alike. Yet, the total media advertising expenditure for La Corona over the last 25 years has averaged on the order of \$2,000 per year. So, my second point is that franchising is in fact a direct alternative to media advertising for manufacturers.

As franchisees, we are, knowingly, a high cost distributor because we perform merchant functions and services a jobber specifically eschews. Our franchise obligations oblige us to sell, not cheaper, but better. For instance, our 50 man sales force is the highest paid—and, we believe, the highest in quality—in our industry. From information requests, from public speaking requests, and from mere imitators, it would appear our sales managers and management also set industry standards. These examples are only to suggest that, as franchisees, we must make a significant personnel investment and financial commitment. Without meaningful and legal franchise protection, these investments could not be justified. Thus, my third point is that the job opportunities we presently offer would be lowered, in the absence of franchises, to those of mere peddlers. And, eventually, our industry's standards and job opportunities would be similarly lowered or disappear.

Our interest in the bill before you is not merely to protect a vested interest in the past. Here is a current example of several I could give you of cigar franchising at work. We were formerly the chief importer and merchant in the United States of H. Uppmann Cigars from Havana. After Castro expropriated the factory in September, 1960, the owners escaped with very little. They, and some of their key personnel, had the courage to seek to establish a brand new cigar manufacturing enterprise outside Cuba. They sought assistance from us and their former English importer and we helped them with credit pledges to re-establish in the Canary Islands. In return, we received a franchise on a new-and-then-unknown non-Cuban brand, Flamenco cigars. Later, as their enterprise got off the ground through sales to us and in some other countries, they sold other brands to several other U.S. importers. So, our Flamenco franchise has not eliminated toe-to-toe competition. However, since we are currently importing five-sevenths of all Internal Revenue Class G. Cigars (those made to retail above 20 cents each), we have some confidence in our ability to meet this competition. My fourth point, then, is that the franchising method is today serving a constructive purpose in the cigar business.

Lastly, there has been considerable discussion in recent years about private brands as a reasonable alternative for the merchant to franchise. It is our judgment that private brands are an illusory answer for the merchant distributor. The long term value of a private brand depends on the calibre and continuing quality of its source, the manufacturer. Sears Roebuck bears witness to this in their system of captive private brand suppliers—a system that may or may not be good for our cherished free enterprise. As in many industries, concentration of cigar manufacturers has continued and, since the larger manufacturers long ago abandoned new private brand manufacture, there is hardly any reliable small private brand manufacturing capacity left. This is not to say that private brands are unobtainable, but they are virtually so from stable manufacturing sources. So, my last point is that private brands are not a practical alternative to franchise brands for the small merchant.

In conclusion, it should be clear by now that we consider franchising in the cigar industry to be inseparable with brand building. Franchising fails of justification in the absence of brand-building results by the franchisee.

#### SUMMARY

1. Franchising of cigar brand distribution as currently practiced permits and encourages brand and manufacturer competition within the distributing outlet.
2. Cigar brand franchising is, in fact, a direct alternative to large mass media advertising expenditures for the cigar manufacturer.
3. Franchise obligations require and enable a distributor to elevate his methods of operation; so without franchises job opportunities and standards in the distribution industry would fall.

4. The franchising method is currently proving its constructive usefulness in the cigar industry.

5. Private brands are not a practical alternative to franchises for any except the very largest merchants.

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STATEMENT ON S. 2549 BY T. MONROE KILDOW, PRESIDENT OF W. H. KILDOW CO. OF TIFFIN, OHIO

My name is T. Monroe Kildow, president of W. H. Kildow Company of Tiffin, Ohio, an establishment pioneered by my late father and perpetuated by my brother and myself.

Even though some of my time is given to other activities, including that of the presidency of The Tiffin Savings Bank, a commercial bank, my primary interest is that of perpetuating the family business. In that context, the franchise system is overriding.

The history of franchised distribution bears striking witness, not only to its intrinsic success, but also to its vital function of maintaining an acid-tested and well-proven marketing system, however, for some incomprehensible reason, it has been subjected to questioning and suspicion on the part of certain Governmental agencies. The painful consequences of such attitudes contribute to a weakening and undermining of this excellent and irreplaceable method of marketing thereby placing in economic jeopardy some of the foremost distribution instrumentalities of this nation.

The franchise system is most vitally needed in marginal trades and industry where continued success of the product line is dependent upon the care and treatment of the product as well as its promotion by the local distributor or dealer. It is in these marginal trades, where the benefits of massive nationwide advertising are denied manufacturers by reason of their lack of financial ability, that the specialized distributor can perform an invaluable service for his supplier. Such service involves a substantial investment of time, effort and money on the part of the distributor. And, in order to sustain his interest, he must be given assurances that this investment will ultimately be financially fruitful.

A distributor will agree to carry a new product, to introduce it into a market area, to promote it and to care for it, to explain its use and accept responsibility for its repair, to advertise it with placards, handbills, circulars, throw-aways and point of sale advertising materials, and to do all within his power to make it acceptable to the consuming public within his market. This means, in effect, that he will often carry the product for a substantial period of time at grave loss to himself in the hope of an ultimate reward when public acceptance is achieved.

However, the distributor feels that it is only fair that he be assured of his rewards when they come due and that nobody be allowed to take advantage of his groundwork. Unless he has such a guarantee he cannot reasonably be expected to carry the line, and therefore the public will be deprived of a worthy item of commerce. It is the system of territorial franchises guaranteeing the distributor reasonable compensation for the services rendered that serves the vital purpose of creating an avenue of distribution for a vast number of the products of our economy.

And it is this avenue of distribution, the franchise system, which has been injured by the confusion created by contradictory judicial decisions, some of which have upheld where others have condemned the territorial franchise system. It is to dispel this confusion and give direction to our business community that S. 2549 is offered as an amendment of the Sherman Antitrust Act which will clearly establish that a territorial franchise is not a violation of the law so long as it is free of other anticompetitive restraints.

In this connection, I ask your indulgence to refer to my banking experience, which, of course, entails loans to business establishments. Among the supporting data to obtain a bank loan, we require a financial statement, knowledge of management qualifications and, when the applicant is a distributor, we are eager to find out his reputation in the industry. In the absence of a solid reputation with suppliers, we sometimes question the stability, liability and prospects of the applicant. We are especially sensitive on this issue because, as distributors, we are keenly aware that our own effectiveness in the market place would be appreciably diminished were we incapable of the performance entailed in the merchandising of a franchised product.

Does fairness and equity prevail? The question answers itself by the fact that our wholesale competitors might even be our bank's customers.

## STATEMENT ON S. 2549 BY JOSEPH KOLODNY, MANAGING DIRECTOR, NATIONAL ASSOCIATION OF TOBACCO DISTRIBUTORS, NEW YORK, N.Y.

My name is Joseph Kolodny. I am managing director of the National Association of Tobacco Distributors, whose membership consists of wholesale distributors engaged in providing an uninterrupted flow of tobacco, confectionery and allied products to approximately one and one-half million outlets throughout the nation. I am also president of the Jersey City Tobacco Company in Jersey City, N.J., a firm which over a half century has attributed its existence to an ability of assuming and discharging the responsibilities implicit in the franchise system of distribution. Thus, in appearing here in a dual capacity, I am, from daily experience in my own business, fully cognizant of the problems confronting our membership. It is my aim to place this issue against a broad historical perspective.

The growth of the American industrial economy in the past century is unique in the history of nations. It has established an enviable standard of living that every country in the free world aspires to emulate. Woven through its very fiber are the resilient threads of the franchise system of distribution.

In the short span of less than a century, American business, with its roots grounded in a soundly conceived free enterprise system, has markedly influenced the life of the whole civilized world. The posture of the most remote areas of the world have been altered forever by the benefits conferred—directly or indirectly—by the American free enterprise system.

Our economic progress did not evolve automatically or capriciously. It is rooted deeply in a cohesive system of production and distribution. As a concomitant of the Industrial Revolution, manufacturers and producers became aware that their ability to make goods was meaningless unless processes were devised to move this merchandise to potential customers rapidly and economically. This need gave birth—concurrently with the movement overland of the first Conestoga wagons—to a rudimentary but comparatively sophisticated distribution system. A distribution system that moved merchandise from the production centers of the East to what were then remote and inaccessible corners of the American continent.

The fact that it met with instant success was possible only because it was grounded in a system of equity which permitted the individual merchant to retain an exclusivity of product on those lines for which he was developing acceptability, good will and volume.

This first manifestation of the franchise system of distribution readily recognized that production of itself was static and only distribution could translate it into sales by moving goods from the factory platform to the market place. As distribution built new markets for goods, and advertising (then in its infancy), concentrated on nurturing of brand names and identities, the problem of getting the goods to the ultimate consumer became sharper and ever more incisive. Even the most aggressive advocates of advertising and promotion were quick to admit that these devices were as static as production and that only distribution could turn the fruit of these efforts into consummated sales.

A vivid illustration of this truism is grounded in the fact that by the end of 1965 more people were employed in distribution and service trades than were involved in the manifold processes of production. Today over 70% of all gainfully employed Americans are, in one way or another, providing distribution-services to the American consumer.

Further testimony to the contribution of distribution is offered by the rapidity with which our economy's Gross National Product is approaching the \$750 billion level. Consumer goods alone move at an annual rate exceeding \$400 billion. The ease with which this huge aggregate of merchandise is available to over 195 million Americans is directly attributable to the flexibility and remarkable efficiency of our nationwide system of distribution which caters to the daily needs of 4,000,000 retail outlets and service establishments.

Throughout the United States manufacturers funnel a prodigious assortment of merchandise units into the warehouses of wholesalers for redistribution to the millions of retailers. These wholesale entities—involved in breaking bulk, soliciting and delivering orders and extending credit—are the propelling force of our constantly expanding industrial complex. In this context it is important to bear in mind that with the exception of some 200 odd corporate giants, American manufacturing is composed of medium sized and small producers who on a direct or sub-contract basis produce the more than 16,800,000 items that are in daily usage. While these manufacturers advertise and promote their products as vigorously as possible, few—if any—are able to totally pre-sell on a national

basis. Thus availability of their products at the point of sale becomes the only measure that determines final marketing success or failure.

Even for the largest producers pre-selling their brands through the expenditure of almost \$16 billion on advertising and promotional materials, product availability becomes the crux, the wherewithal that holds the market fabric together. Regardless of a manufacturer's size, he can barely survive unless what he produces is available in a maximum number of retail outlets so that American consumers may make their purchases conveniently, easily and with dispatch.

Solving the problem of availability has been a constant challenge to American industry. Many methods have been tried, ranging through door-to-door selling, direct-sales to retail outlets, sales through brokers or manufacturers' representatives and sales through distributors of varying categories. All survive in one form or another. However, the ultimate proof of the prime importance of the method which uses the distributor is attested to by the fact that over 85% of the dollar value of the products produced by American industry are sold through wholesalers or distributors of various types.

Among these types is the standard practice whereby a manufacturer entrusts his branded product within a particular market area to a distributor as its custodian; to nurture its growth, quicken its acceptance with and by retailers and consumers, protect it from the invidious winds of competitive elements, and, ultimately, bring it to fruition as a recognized and desired product enjoying a stable and lucrative demand to the mutual benefit of the manufacturer and the distributive custodian.

This marketing process has been variously called a franchise, dealership, representation, agency and a host of other similar names. I prefer to describe it by affixing a label that truly expresses the essence of the arrangement—namely as a "Custodianship" reflecting the element of mutual trust, interdependency and responsibility between manufacturer and wholesaler.

Such an arrangement agrees well with the best interests of manufacturer and distributor alike. Whenever the services of a distributor are brought into play the requirements placed on him in stocking, handling and servicing the manufacturer's product are of such magnitude as to require constant attention and devotion to the needs of the manufacturer's product. The distributor must receive, store, handle, promote, advertise, sell and deliver the product in such quantities as to make the operation worthwhile both to him and to the manufacturer. It has been found that where a number of distributors within the same trading area are given the right to sell a particular manufacturer's product to the retail trade, the value of the business to each distributor is so negligible as to make him indifferent to the manufacturer's needs and to preclude him from giving the product the careful nurture it requires.

Thus, the practice has grown up in many of the great basic industries to confine the custody of the product within a particular territory to a single distributor and to require a certain level of performance from that distributor commensurate with the absorptive capacities of the market involved. Examples of such arrangements are legion. The clothing and needle trades, furniture and furnishings trades and a host of other economic activities come readily to mind as examples of this basic distributive pattern to which may be attributed much of this country's economic growth.

Effective, efficient and low cost distribution must be carefully planned. It is, therefore, not surprising that franchised distribution is the backbone of our distributive economy since only franchising makes a brand or product available within easy access to the preponderant majority of potential customers.

The manufacturer historically faces the problem of inducing distributors to assist him in marketing his products; to take responsibility for shepherding them to retail counters in a defined, specified market area. Manufacturers tried many forms of inducement. Practical as well as legal considerations posed problems. However, the gradual evolution is the method used today which assures the distributor that his efforts and energies—once expended—will be fruitful in the long run.

By affording the distributor this form of equity the manufacturer is able, with a minimum of cost, to secure distribution for a new brand or a new product in a designated marketing area. In his turn the distributor has the responsibility of launching the product, promoting it, caring for it, explaining its usage, and placing point of sale material. Initially, with rare exception, he handles such a product at a substantial loss.

The way in which the distributor performs his role as caretaker, banker, salesman, warehouseman and merchandiser for franchised products was endorsed

overwhelmingly by a former Federal Small Business Administrator who stated: "Franchising permits producers and suppliers of limited financial means to widen their distribution lines with relatively little capital investment." Additionally, it permits manufacturers of unlimited means to supplement and insure the effectiveness of the sums they spend on advertising, pre-selling and public relations by guaranteeing availability of the pre-sold product at every potential consumer point of sale. This latter service provided with maximum efficiency by the franchised distributor is usually the only way in which the huge sum spent by the manufacturer on pre-selling can be validated. Of itself, pre-selling only creates a desire for the product; it cannot deliver the product into the consumer's hands.

To illustrate the impact of franchised distribution on the market place, the NATD undertook two market surveys during the first quarter of 1966:

(I) The first study compared the availability of franchised and unfranchised brands, of a single product, within the confines of a major urban market.

(II) The second study compared the performance of a specific brand in two distinctly separate markets, each having the same average per capita consumption. In market A the manufacturer of the brand sells his product through an exclusive franchised distributor. In market B the manufacturer sells his product on an open basis to all distributors.

(A) *Availability of Non-Franchised vs. Franchised Brands Representing a Single Product Category Within Major Urban Market Area*

*Character of market surveyed*

Population .....	803,000
Retail sales .....	\$1,620,000,000
Disposable personal income .....	\$2,404,000,000
Total retail outlets .....	6,002
Retail outlets handling tobacco or allied products .....	4,058

Wholesaler cooperating in NATD survey is the second largest in the marketing area studied. Firm employs outside route salesmen to call on 3,511 retailers equal to 87% of all retailers handling tobacco or its allied products. Wholesaler stocks 21 franchised brands in product category. Two of the top three sellers are advertised in newspapers and magazines serving the market. One of these receives additional periodic television support.

(a) Franchised brand I (supported by newspaper and magazine advertising only) is available in 99.1% of all outlets served by wholesaler.

(b) Franchised brand II (supported by similar advertising supplemented with television) available in 98.6% of all outlets.

(c) Franchised brand III (receiving no advertising support in market area) available in 93.9% of all outlets.

By independent survey of retail outlets selling tobacco in this market the following was also determined:

(a) Non-franchised brand IV (supported by local newspaper advertising only and distributed on an open basis to all distributors who were willing to handle it) was available in 5.1% of all retail outlets handling tobacco or its allied products.

(b) Non-franchised brand V (supported by national television as well as advertising in leading national magazines and sold through all distributors willing to handle it) available only in 11.7% of retail outlets handling tobacco.

Availability of non-franchised vs. franchised brands of this product category within the studied market is more vividly emphasized when one compares range of availability at retail level with all 21 franchised brands handled by cooperating wholesaler:

(a) Availability of franchised brands in tobacco or its allied retail outlets ranged from a low of 49.9% of all outlets sold to a high of 99.1%.

(b) This performance must be contrasted with the 5.1% and 11.7% availability of non-franchised brands in order to properly appreciate the vital nature of franchising to the maintenance of maximum product availability.

(B) *Comparison of One Brand's Availability in Franchised Market Area vs. Open Market Area*

Cooperating manufacturer surveyed brand availability, by retail census, in major metropolitan area I which is served by wholesaler with full franchise responsibility for the brand's sales. This data was compared to similar census

of major metropolitan area II in which brand was offered on an open basis to all wholesalers and to qualified direct buying retailers.

(a) Market studied had similar per capita consumption figures for the product involved.

(b) Price structure of product in both markets was exactly the same.

(c) In franchised market I manufacturer's brand enjoys availability in 88.6% of all retail outlets handling tobacco and/or its allied products.

(d) In non-franchised market II manufacturer's brand is available in only 15.4% of all retail outlets handling tobacco products.

The lesson again is clear. Only franchised distribution guarantees maximum product availability at consumer point of sale. In the interest of underscoring the impact of franchised distribution on manufacturers and wholesalers of all sizes and affluence, it is important to point out that in the second survey cited the manufacturer whose product was studied is the second largest manufacturer of his product type in the United States and one of America's largest corporations. Unlimited advertising funds are available where circumstances warrant their expenditure. Despite the availability in both markets of budgets of similar size for advertising and sales promotion, the difference in brand availability in the opinion of the prime manufacturer concerned is, as revealed by these studies, "due to the competence of his franchised distributor."

As summarization of this diagnosis, this illustrates beyond peradventure of doubt that the acid and time tested method of franchising products has been a boon for the enhancement of the world wide envied American industrial system. It has served well on the following scores:

(1) It has encouraged and motivated individuals endowed with an element of initiative to exercise it productively.

(2) It has provided for producers of goods an outstandingly efficient vehicle to secure needed performance for the debut, launching and dedicated promotion of their products.

(3) It has provided a glorious opportunity for the growingly affluent American consumer to avail himself and enjoy new products, new packaging, new blends, new sizes which might have gone askew were it not for the enthusiasm of a franchised distributor. It has served as a checkmate on inflationary trends owing to the fact that the franchised distributor could not competitively hike his price to the advantage of his competitor.

(4) It has been instrumental in retaining in the business spectrum a vast number of young executives, who, were it not for the eagerness of preserving the status of the franchised products, would have been diverted into other areas of endeavor.

(5) It is constantly broadening the horizon for manufacturers of modest means to create new products secure in the feeling that they would find encouragement of franchised distributors in most American markets.

(6) It has preserved competition by safeguarding small business at both distributive and manufacturing levels and has assured ease of entry into the market by those lacking massive amounts of capital.

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SUPPLEMENTAL STATEMENT ON S. 2549 BY JOSEPH KOLODNY, MANAGING DIRECTOR,  
NATIONAL ASSOCIATION OF TOBACCO DISTRIBUTORS

This statement is submitted, pursuant to permission granted by the committee, in connection with the current Hearings on S. 2549 and in response to certain observations by Honorable Paul Rand Dixon, Chairman of the Federal Trade Commission in his testimony before this Committee on this subject.

As I understand the gist of Mr. Dixon's comments, he opposes the proposed legislation because of his belief that "the Commission and the Courts, in dealing with cases involving vertical territorial restrictions, will develop a thorough knowledge of the possible competitive effects of such restrictions; at the same time they undoubtedly will acquire an understanding of any possible compensating benefits which may arise from such restrictions."

In effect Mr. Dixon is saying that more time is needed to determine whether or not a territorial franchise which permits competition at manufacturer and distributor levels and which permits vigorous interbrand competition can, under any circumstances, be deemed an undue restraint of trade.

Mr. Dixon requests such additional time for this consideration on the basis of the Supreme Court decision in the case of *White Motor Car*, which held that

not enough was known about territorial franchises to determine that they are inherently bad under the law. That decision came down in 1963. The Commission has had three years to conduct investigations and to try cases involving territorial franchises in order to adduce the additional necessary factual material which the Supreme Court stated was lacking in the *White Motor Car* case. To date, the Federal Trade Commission has completely failed to establish standards adequate to guide manufacturers and distributors in determining whether a territorial franchise is or is not valid.

To the contrary, such determinations as have been made by the Commission have uniformly been rejected by the Courts on appeal. In the *Sandura* case, cited by Mr. Dixon in his testimony, the Commission held that the franchise represented an undue restraint on trade while the Court rejected this finding by the Commission and, as Mr. Dixon himself acknowledged in his testimony, "the Court considered that while the closed territorial arrangement limited intrabrand competition between purchasers of the suppliers, it also promoted interbrand competition by giving economic strength to a small company which was competing in an industry dominated by a few giant corporations. The Court took the position that the evidence showed *Sandura* would have been unable to continue competing in the industry had it not adopted its system of closed territories.

Similarly, in the *Snap-On Tools* case, the Court again rejected the Federal Trade Commission's holding that the franchise system there under scrutiny represented an undue restraint on trade.

How much longer, then must American industry wait beyond the three years which has already elapsed since the Supreme Court first called for clarification of the territorial franchising picture? How much longer must the patient continue to bleed while the learned economic doctors solemnly debate whether some hypothetical circumstances exist under which an exclusive franchise may conceivably be a restraint of competition?

In effect, what Mr. Dixon is arguing for is an additional indefinite period of time to allow the Commission to find "reasons which would justify the adoption of the *per se* rule for vertical territorial restraints."

He has given, in the latter portion of his statement, a number of hypothetical situations which, he stated, might justify striking down a territorial franchise. Not a single one of those hypotheticals fits within the scope of the limited amendment to the antitrust laws proposed by S. 2549.

The law which this Committee is considering provides merely that a territorial franchise shall not be deemed "in and of itself" a violation of the antitrust laws where the manufacturer granting the franchise and the distributor accepting the same are both in free and open competition at their respective economic levels of distribution and where the franchise does not prohibit the distributor from dealing in competitive products.

None of Mr. Dixon's hypotheticals fall within the scope of this amendment. Every one of these hypotheticals adds compelling facts which take that hypothetical out of the category of a situation involving the franchise "in and of itself" within the orbit of the conditions laid down in the proposed amendment to the antitrust laws. Nor has Mr. Dixon suggested any conceivable circumstances where a franchise scheme limited to the form approved by S. 2549 could possibly affect competition unduly.

Despite this utter failure to show any scintilla of economic harm that might accrue from the amendment, Chairman Dixon nevertheless pleads for more time to discover defects in the formula. It is respectfully submitted that three years of wasted effort are time enough. It is further respectfully submitted that this vain search for a *per se* rule to outlaw franchise distribution does not serve the interests of efficient antitrust administration and enforcement.

A *per se* rule is the application of a mechanical device as a substitution for thought. As Mr. Dixon, in his testimony, pointed out, the Supreme Court decision in the *Northern Pacific Railroad* case is that a *per se* rule is applicable only where the agreement, because of its pernicious effects on competition and lack of any redeeming virtues is conclusively presumed to be unreasonable.

Although this honorable Committee of the Senate has amassed, over the past 18 months, a plethora of evidence on franchise distribution, it has as yet collected no evidence that territorial franchises have a pernicious effect on competition and lack redeeming virtues. To the contrary, at these hearings, and at prior hearings conducted by this Committee, the evidence has been abundant to the effect that territorial franchises, often, encourage competition and have the redeeming virtue of encouraging independent business.

The present amendment before this Committee merely implies that where a territorial franchise encourages competition and preserves independent small business, it may not be called illegal by either the Federal Trade Commission or the Courts. Chairman Dixon has presented no substantial reason why such an amendment should not be approved by this Committee and ultimately adopted by the Congress of the United States.

STATEMENT ON S. 2549 BY EDWARD T. LAGONEGRO, PRESIDENT, ELMIRA TOBACCO CO., INC., ELMIRA, N.Y.

My name is Edward T. Lagonegro, president of Elmira Tobacco Company, Elmira, N.Y. I also enjoyed the honor of being mayor of my city for four years. The firm I am heading was established by my late father. Akin to most doting progenitors, my father, for a considerable period of time, questioned the wisdom of encouraging me to perpetuate the company. His resolve to do so was influenced by the following factors:

(A) That, as it pertains to production, this nation is endowed with adequate and proficient facilities.

(B) That, to gratify the insatiable quest of the American public for an ever increasing standard of living, our economy must insure the availability of the prodigious assortment of products turned out by manufacturing firms, which, in turn, will expand the opportunities for a young man in the realm of distribution.

(C) That, to fulfill the distributive function, the entrepreneur has to equip himself with the personnel, market know-how, expertise in quality of product, territorial potential, and, generally, to be primed to provide the dynamic action for the debut exposure and availability of the product he is to sell.

(D) That, to achieve such an objective, the firm must, as a token of good faith, either totally assume or share in the sizeable cost of manpower, credit accommodation and over-all shepherding of the particular item, brand or product.

This has been the firm policy of the founder of my firm; this has been faithfully carried on by me; and, should any of my offspring signify a desire to enter the business, I would, without any qualms, endeavor to influence and guide them in the identical direction.

If we were convinced that the franchise system in this nation has reached a terminal point; that a distributor will become a sort of supply depot, stripped of any character, of any responsibility, picking up any type of merchandise—even some non-descript—and palming it off on an unsuspecting public—I would hesitate to encourage an ambitious young man to enter our distributive economy.

The question that no doubt suggests itself is: Are we in free competition in our territory? A glance at our profit and loss statement would satisfy the most critical individual that ours is a vigorously competitive business. Certainly the fact that the community conferred the honor on me of electing and re-electing me as mayor is proof positive that I am not regarded as a monopolist in my community.

I urge this honorable committee to clear up the confusion surrounding the franchise system.

STATEMENT ON S. 2549 BY MORTON G. MEYER, PRESIDENT, METROPOLITAN TOBACCO CO., L. I. C., NEW YORK

My name is Morton G. Meyer, president of Metropolitan Tobacco Company of New York City, a firm that operates 13 branches in the metropolitan area of greater New York and New Jersey. Coming originally as I do from a manufacturing enterprise, and occupying my present position for only a little over a year, it did not entail any extraordinary education to learn that in the absence of several franchised products our ability to provide an interrupted flow of tobacco, confectionery, and kindred products to more than 40,000 retail outlets of all types, all sizes, and all descriptions would be seriously hampered. Thus, in appearing here in support of S. 2549 I feel that I am acting in the preservation of American freedom of opportunity as signified by the multitude of small and independent merchants.

Our nation's distribution system is acquitting itself creditably and praiseworthy. Occupying a significant position and playing a salient role in this formidable American accomplishment is the highly respected franchise system. Under the franchise system, which has withstood the test of time under all sorts of economic cycles, the manufacturer of the product and his franchised distribu-

tor have a stake in the success of the brand or product by vigorously accelerating its movement, increasing its sale—and accomplishing this remarkable feat at the lowest distribution cost to the consumer. This vehicle of distribution is of particular benefit to the less affluent manufacturer whose financial resources do not permit the commitment of capital to an internal distribution system and/or the luxury of unlimited appropriations for advertising purposes. He, the less affluent manufacturer, to a much greater degree than his more favorably circumstanced competitor, is in dire need of the faithful and time-proven services of his franchised distributor. In confronting the issue of franchise distribution the ugly head of “monopoly” frequently arises. As we understand the meaning of the term, it is utterly alien to our business.

While we enjoy several franchises of cigars, smoking tobaccos, smokers' accessories, and candies, we not only encounter stringent competition in serving our more than 40,000 retail outlets, but we are also involved in vigorous competition with our own products. In this connection, let us not be unmindful that the great majority of our 40,000 customers are in every respect small merchants—sometimes affectionately labeled as “Mom and Pop stores.” If they are not to be swallowed by their more opulent competitors—the department store, the chain store, the corporate supermarket, the discount house, and many others—it is incumbent upon us to provide them with the essential tools to gratify the wishes of their customers. Such tools can only be furnished by a distributor who has a vital interest in and a concern with a product or products entrusted to him for maximum distribution of development.

There is another vital phase to the franchise issue. We employ close to 200 salesmen to canvass this multitude of retail outlets, and 500 warehouse, delivery and office people to serve the needs of our area. They are in the main family men and women bearing the responsibility of rearing children and acquitting themselves in a manner befitting good citizenship. Were we deprived of the opportunity of arming these 700 people with an assortment of products entrusted to us for special exploitation, their chance to earn needed income would be placed in great jeopardy.

We urge this committee to liberate the franchise system of distribution from its untenable predicament.

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#### STATEMENT OF HON. THOMAS G. MORRIS OF NEW MEXICO

Mr. Chairman, I considered it a privilege on August 26, 1965, to introduce H.R. 10713, which would amend the Sherman Antitrust Act to provide that exclusive territorial franchises, *under limited circumstances*, shall not be deemed a restraint of trade or commerce or a monopoly or an attempt to monopolize.

It is highly significant to note that 11 of my Colleagues in the House of Representatives, who were similarly minded, realized the necessity and importance of this legislation and introduced identical bills.

I sincerely believe that this broad manifestation of interest by so many Members of the House is prima-facie evidence of the uneasiness and apprehension that exists regarding the franchise system, and it positively shows concern of the Congress of the United States in this important legal issue.

It is a marked tribute to the Senate that this Subcommittee has taken the initiative in conducting these hearings, thereby providing a forum for all those who are vitally concerned with the problem to be heard.

I hope that a Subcommittee of the Judiciary Committee in the House of Representatives will emulate your example without unreasonable delay.

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#### STATEMENT OF THE NATIONAL ASSOCIATION OF ELECTRICAL DISTRIBUTORS BY ARTHUR HOOPER

This statement by National Association of Electrical Distributors is intended to supplement the statement previously submitted on our behalf by Mr. Herbert McCalley and to reply to the statement of the International Franchise Association dated June 23, 1966.

The statement of the International Franchise Association, while endorsing the basic objective of Senate Bill 2549, proposes that the bill be amended in the following respects:

1. To permit a franchise or to impose upon the franchisee a restriction against dealing in the products of a competitor of the franchisor.

2. To permit the franchisor to limit the number of business establishments which a franchisee could operate within an assigned territory.

3. To include the sale of services as well as the sale of products within the authorized franchising relationship.

National Association of Electrical Distributors is opposed to suggestions 1 and 2. It does not oppose suggestion 3, to include services as well as products.

The statement of the International Franchise Association uses as an example of a franchise arrangement the "soft ice-cream franchiser." Obviously, the statement was prepared to cover precisely this type of franchise arrangement, and the recommended changes would not give full consideration to the general subject of territorial limitations.

In the opinion of this Association it would be a great disservice with a serious anticompetitive impact to grant to a supplier the legal right to restrain any of his customers from dealing in the products of a competitor. Such a proposition would be in direct conflict with Section 3 of the Clayton Act which now makes it a violation of the Clayton Act to impose any such provision where there is an adverse effect on competition.

In the electrical supply business it is necessary for the electrical distributor to carry several lines of products and to permit a supplier to restrict his customer to a single line would be extremely hazardous to the industry and to competition within the industry.

National Association of Electrical Distributors is also opposed to including in this legislation the right to limit a franchisee in the number of business operations he may conduct within an assigned territory. While there may be some justification, in so far as a restriction of this kind is concerned, in the "soft ice-cream" type of franchise arrangement there is no proper justification in the average or usual business relationship between a supplier and his customer. It could have a strong anticompetitive effect to confine the usual businessman in the number of operations which he can lawfully conduct.

Finally, the National Association of Electrical Distributors has no objection to a clarification of the bill indicating that it covers both products and services.

In conclusion, the statement urges adoption of S. 2549 in its present form.

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STATEMENT ON S. 2549 BY JAMES R. NEW, JR., NEW CIGAR CO., INC., GRIFFIN, GA.

My name is James R. New, Jr., of the New Cigar Company of Griffin, Ga. My company has a proud heritage of providing consumer products of a wide and assorted range to most of the retail tobacco outlets in our part of the state of Georgia. We belong in every dimension to the category of small business. As such, we are in keeping with the fundamental precept of the American service capitalism which is the majestic wonder of the world.

It has given us the most envied standard of living ever attained by men on earth. It assures each one of us of our rights and personal dignity as free individuals with a better living and a better life for a constantly increasing number of people.

The American consumer, likewise, is the most earnestly sought after, carefully studied and heavily guarded entity in our economy.

He is observed and charted by consumer analysts, he is courted and persuaded by advertising and motivational experts and yet he is completely protected from excess and abuses by such agencies as the Federal Trade Commission, the Public Health Department, the Food and Drug Administration, the Securities and Exchange Commission and the Federal Deposit Insurance Corporation and by various state and local agencies ranging from Fair Trade Practices Commissions and "Bunco" squads of local police departments, to Credit Bureaus and Better Business Bureaus maintained by private industry.

What then is the great miracle that keeps American service capitalism in motion? What makes such a wide variety of products uninterruptedly available to all of us, everywhere, at moderate prices and, in the main, in generous supply?

Our country's prosperity is built upon a dynamic, nationwide, low-cost mass distribution system that keeps commodities moving swiftly from the factory production lines to the shelves and counters of local stores everywhere. Mass distribution, by linking production and consumption effectively, makes possible the existence of both. Mass distribution is the compelling reason why mass advertising, which costs the fabulous sum of over \$16 billion annually, pays off so handsomely.

Each of us is moved by the lively force of mass-advertising that pays for so much of our mass-entertainment today. We realize that when we see a product advertised on television commercials or in a newspaper chances are it can be effortlessly and immediately obtained at the neighborhood store. Yet, advertising is not the major reason why so many people are able to enjoy so many of the conveniences and luxuries of life. For a product is of no use just because it can be seen on a TV screen or in a newspaper ad; it must be "there", in actuality, on a store shelf, available where it can be easily acquired, picked-up or purchased.

The nation's wholesalers, operating in the distributive middle-zone, perform many time and cost-saving functions for both manufacturers and retailers. As we examine some of the wholesalers' typical operations, it becomes evident that without these key middle "link" men perpetually on the job, our well-ordered system of distribution would quickly disintegrate into turmoil and turbulence.

The multiplicity of products handled by the wholesaler contributes to the elasticity and freedom of choice offered to the American consuming public.

There is nothing mysterious about the freedom of choice implicit in the competitive economic spectrum of our nation. It has been established long ago that it is the unquestionable prerogative of the maker of a product and the owner of a brand to exercise his individual right in choosing the method of distribution best fitted for the care and shepherding of his product.

Thus, some manufacturers elect that their product be handled on what is generally known as an "open market" basis, which means selling to all distributors. Other manufacturers, cognizant of the fact that their products require incessant attention, intensive promotion and tender care, utilize the services of a selected number of distributors. These distributors are entrusted with, and accountable for, surveillance germane to the establishment, exposure and expansion of the manufacturers' products.

Both these methods of distribution have served the American public well. Neither of them should be jeopardized.

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STATEMENT ON S. 2549 BY RICHARD M. RYAN, PRESIDENT AND TREASURER OF THE QUEBEC CIGAR CO., RUTLAND, VT.

My name is Richard M. Ryan, president of the Quebec Cigar Company of Rutland, Vt. Our firm, situated in a predominantly rural and resort area of New England, subject to the vagaries of seasonal fluctuations, performs a service function by making available to retail outlets throughout the Green Mountain State, a vast number of consumer products and items. I am not what one may call an "old timer" in this business. I acquired it from the heirs upon the demise of the principal and I was influenced by the fact that the firm has been enjoying several franchises.

We staked our limited resources in acquiring the business fortified by the feeling that, granted diligent efforts, we would maintain a reasonably secure position in the market.

In the absence of several franchise products that provide the mechanism for effective market exploitation our efforts would be of little avail and the security of our firm threateningly endangered.

In appearing before your honorable body in support of S. 2549, I am governed by the knowledge that more and more the question is being raised in the courts throughout the land as to whether the franchise system is consistent with our form of economic distribution. A judge in California says one thing and another judge in Illinois contradicts his finding. Let us not be unmindful that when the franchise distribution question is causing such tantrums to our courts, it can't help but penetrate in our direction. Unless, therefore, this entire issue which, frankly speaking, ought not be causative of so much uneasiness, is settled by the Congress of the United States, it would leave open to question the feasibility of continuing to operate our business.

It is to us inconceivable how any distribution firm can operate with any measure of success on a hands-off basis. Such a business is stripped of any individuality, personality, or character. A distributive operation acquires reputable status by being recognized as capable and qualified to undertake an assignment and follow through on it without any if's, and's and but's.

A business enterprise, like any worthwhile human endeavor, needs a spark; needs an ignition; it needs a motivating and compelling element. In our indus-

trial economy all these motivating factors are provided by franchised products which are, and I quote, "in free and open competition with products of like grade and quality produced by persons other than the supplier and where agreement or contract is in free and open competition with other vendors of like or similar merchandise within the territorial area."

Our operation is in the category of small business. More than that, it is a family business. I work. My wife works. My sister-in-law works, and our several employees are imbued with this family spirit. We work in unison. We take pride in our work. We accord our franchisees relentless support. Our future hinges on it. We should not be required to operate in the clouds. We should be put on a firmer footing by enactment of this law.

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STATEMENT OF HON. JOE SKUBITZ, U.S. REPRESENTATIVE, FIFTH DISTRICT, STATE OF KANSAS

Mr. Chairman, I would appreciate the opportunity to make the following statement in support of S. 2549, introduced by Mr. McGee and Mr. McCarthy and which provides that exclusive territorial franchises, under limited circumstances, shall not be deemed a restraint of trade or commerce or a monopoly or attempt to monopolize under the anti-trust laws.

Our Nation's distribution system has done an admirable job servicing the people of this country. One of the basic reasons underlying its success is the franchise system. Under this system a distributor, having a stake in the success of a named product strives to increase its sales. For some reason, this system has been subjected to questioning and suspicion by certain governmental agencies.

It seems to me that Congress has a duty to dispel the confusion that has resulted through the unwarranted action on the part of certain governmental agencies, and reassure the business community that the franchise system of distribution is a lawful, essential channel of marketing.

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STATEMENT ON S. 2549 BY HAROLD K. SMITH, DIRECTOR OF MARKETING, JNO. H. SWISHER & SON, INC., JACKSONVILLE, FLA.

My name is Harold K. Smith and I am the Director of Marketing of Jno. H. Swisher & Sons, Inc., Cigar Manufacturers, of Jacksonville, Fla. I speak in support of H.R. 5154 and S. 2549.

Our company started 105 years ago in Newark, Ohio, when the grandfather of the present president and general manager took over a small "hole in the wall" cigar factory in payment of a debt. The firm was incorporated in 1926 with the Swisher family holding the bulk of the stock and is still a closely held corporation.

The current position of leadership in the industry—we are probably third in unit volume and fourth in dollar volume—began in the mid-thirties when the price of our principal brand—King Edward—was reduced from 5¢ to 2 for 5¢ and in a few years grew to the position of the largest selling brand of cigars in America (or in the world for that matter). The present sizes of King Edward still hold that top position today.

Basically the manufacturing philosophy of the firm from the mid-thirties to today has been based on the idea of producing a quality product at the very lowest possible cost. Every type of mass production economy is practiced and new cost cutting machinery and developments are utilized to keep costs low. In addition, the Swisher techniques of procuring, aging, curing, flavoring, and blending tobaccos into cigars is a guarded secret that we feel, and consumer acceptance indicates, produces a most acceptable product for the money.

My father was with the firm and I started working summers with it in the late thirties. After college, where I wrote a paper on the subject, "The Marketing of King Edward Cigars," I joined the firm in 1941, was made assistant sales manager and a director in 1949, sales manager in 1955, and director of marketing in 1961. As winner of the tobacco industry's coveted award as the outstanding young executive serving the nation's tobacco distributors in 1956, as a member of Sales and Marketing Executives International for nearly 20 years, as a sales executive in the tobacco industry, and as a student of consumer goods marketing for a lifetime, I would hope you would feel I was qualified to speak on

the subject of exclusive territorial franchises as they pertain to consumer goods such as cigars.

In our marketing terminology we refer to a "franchise" as the "right to buy" our product on a direct basis. Our primary sales are made to tobacco distributors throughout the 50 states (export sales are made to some 69 foreign countries but constitute only a small part of our volume). These tobacco distributors usually sell a full line of cigarettes, cigars, tobaccos, smoking accessories, plus such various items as candy, paper goods, fountain supplies, sundries, etc. I speak in terms of the typical or average distributor, market, and situation but I feel marketing is not an exact art or science and defies any all-inclusive description. Just as one distributor operates differently from the next, so do we operate differently from other manufacturers. This is the fact that makes it difficult for scholars or legislators to suggest legislation that does not do injury to the free enterprise or free market concept of our economy.

The right granted to one and only one tobacco distributor in a particular market is called an "exclusive franchise" and the market area of that customer as "exclusive franchise territory." In most markets we sell to only one tobacco distributor and our "exclusive territorial franchise" or agreement usually spells out the counties in which he should have exclusive selling rights. In these areas we are enjoying a good and growing business.

In markets where no one distributor sufficiently covers or serves the market (or where a distributor that does cover the market is not interested in selling our cigars), we sell several distributors or wholesalers on an "open basis." In these areas we are finding it difficult to keep our product before the public.

Our selling philosophy like our manufacturing is based on giving the consumer a quality product at a lower price. Since our price reduction in 1934 our cost of goods sold as a percent of selling price has not allowed a margin for more than token advertising. For example, we spent in the low six figures in media advertising in 1965 as compared with approximately ten million dollars by each of our two largest competitors. The largest sells their cigars for approximately twice ours—yet actual tobacco and manufacturing costs differ but slightly.

Since we do not have the margin for advertising and since the history of our business and the cigar industry proves that an increase in the price of an item like ours will kill the sales faster than increased advertising could build them, we cannot count on advertising to sell our product.

The King Edward cigar has been the largest selling brand in America for nearly 30 years. We can continue to provide this product at a low price only as long as we can rely on the franchised tobacco distributor to put the cigar into retail stores so the consumer can see it, try it, recognize its superior value, and buy it regularly. Our own sales force—primarily calling on these distributors—is too small to cover the approximately 800,000 cigar retail outlets in the U. S. A. and our volume and close margin prohibit our increasing it to a size to make such coverage.

Naturally, any tobacco distributor will handle a cigarette which has been "pre-sold" by heavy advertising although price competition may make it non-profitable or even unprofitable and it is conceivable that a heavily advertised cigar brand may become "pre-sold" and sold on an open basis. Naturally it will cost the consumer more.

The marketing of our King Edward cigars is largely dependent on the exclusive franchise system. If we sell two or more of the distributors in an average market they will not work to keep the present packages and certainly not introduce our new packages in all the retail stores or place point of sale advertising pieces or perform the many other services necessary to hold or build sales of a perishable item without advertising. In return for our granting the exclusive franchise which enables the distributor to profit from his work, the franchise distributor makes the brand available to the consumer. *The result is that the consumer is able to buy our cigar at a price lower than that of a comparable cigar sold through advertising.* The proof of the consumer preference is reflected in our large sales volume.

The tobacco distributor may handle competitive brands, and, of course, he competes against other tobacco distributors handling other competitive cigars. Without the territorial agreements our distributors would not only lose interest but we would not know where we were selling our cigars and would lose the benefit of sales analysis—an essential tool of marketing.

Frankly, we just aren't making much progress in many of the large metropolitan cities where no one distributor covers the market. On the other hand, our

business in Washington has doubled in the past 10 years since we have an excellent distributor here who respects the brand, works it hard, and wants to enjoy the profit of his work.

Without the exclusive franchised distributor protected by the exclusive territorial franchise agreement, we, of Swisher, could not give the American public a King Edward Cigar at the price we do and our company could no longer compete against the giants of the industry with their television and other advertising. It has been the very basis of our marketing program for 30 years—an interested distributor putting and keeping our cigars on display in retail stores so the consumer can see them, try them, like them, and buy them—a better cigar for less money.

Thank you.

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STATEMENT ON S. 2549 BY CONGRESSMAN, E. S. JOHNNY WALKER,  
SANTA FE, N. MEX.

In signifying my support for S. 2549, the subject of this public hearing, I am in effect also supporting myself because my bill, on the problem under study, H.R. 9142, is currently pending before the House Judiciary Committee. I hope that we will before long follow on the heels of this hearing and proceed accordingly.

My native state of New Mexico, population-wise, does not measure up to our large sister states with their concentrated urban population. We are what is known as "Country-folk" and this brings us in closer contact with our people and our businessmen.

Thus, I can state from personal experience that the franchise system is the heartbeat in maintaining distribution services; that a large number of businessmen are disturbed because they are placed in a predicament of not being on sure ground in asking for franchises. It behooves the Congress of the United States to take speedy action to rectify the situation.

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[Exhibit and Appendix]

CHRONOLOGICAL EVOLUTION OF THE PER SE DOCTRINE, SUBMITTED BY THE FEDERAL  
TRADE COMMISSION

I. IN GENERAL

Section 1 of the Sherman Act, enacted in 1890 provided that "every contract, combination \* \* \* or conspiracy, in restraint of trade \* \* \* is hereby declared to be illegal." In spite of the absolute language of the statute, the Supreme Court ruled, in *Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1 (1911), that only "undue" restraints were illegal and that in measuring restraints the "standard of reason" should be applied.

"[T]he legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. 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." *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918).

Since it was only unreasonable restraints of trade that were deemed to violate the Sherman Act, a careful economic inquiry into each restraint of trade would be necessary in order to determine its reasonableness.

It was not long, however, before the Court began to shy away from the necessity for economic evidence demonstrating the anticompetitive nature of certain trade restraints. The Court conclusively presumed certain forms of conduct to be illegal by reason of their nature or necessary effect.

"[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 of *per se* unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also 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—an inquiry so often wholly fruitless when undertaken." *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958). Under this "per se" approach, all inquiry under the Rule of Reason was over once it had been decided that the facts constituted the proscribed activity.

From the decisions of the Court, five categories of *per se* violations of the antitrust laws have evolved: (1) price fixing, (2) division of markets, (3) group boycotts, (4) tying arrangements, and (5) exclusion of competitors from a market. These five areas will be discussed in order.

## II. PRICE FIXING

### A. Horizontal

Following the enactment of the Sherman Act in 1890, the Supreme Court, in 1897, decided the case of *United States v. Trans-Missouri Freight Ass'n.*, 166 U.S. 290 (1897). It was there decided that an agreement between a number of railroad companies "for the purpose of mutual protection by establishing and maintaining reasonable rates" was an unlawful restraint of trade. The necessary effect of the agreement, said the Court, was to place a restraint upon trade or commerce. The following year, 1898, the Supreme Court again held a similar agreement to fix railroad rates to be unlawful. *United States v. Joint Traffic Ass'n.*, 171 U.S. 505 (1898). The natural effect of these agreements would be to hinder competition and thus to restrain trade.

Twenty years later the Court was to decide *Chicago Board of Trade v. United States*, 246 U.S. 231 (1918). The agreement under attack was a rule of the Board prohibiting members from purchasing or offering to purchase grain between the closing of the session and the Board's next opening at a price other than the closing bid. The Court did not find the rule to be aimed at price manipulation or the control of market prices, and since it had no appreciable effect upon general market prices it survived as a reasonable restraint of trade.

Nine years later, in *United States v. Trenton Potteries*, 273 U.S. 392 (1927), the Court declared that the reasonableness of the prices fixed is immaterial. A jury need not find the prices fixed unreasonably restrain trade. It is enough that there is an agreement to fix prices.

"The aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves power to control the market and to fix arbitrary and unreasonable prices. \* \* \* Agreements which create such potential power may well be held to be in themselves unreasonable or unlawful restraints, without the necessity of minute inquiry whether a particular price is reasonable or unreasonable as fixed \* \* \*." At 397.

In *Appalachian Coals, Inc. v. United States*, 288 U.S. 344 (1933), the Court, finding no agreement or intent to fix prices, did not hold the creation of a regional sales agency to be a violation of the Sherman Act. But, where the dominant sugar producers, by establishing a Code of Ethics, agreed that no one would sell sugar except at prices he had previously announced, the Supreme Court held the Act to be violated because the announcement of a price change by one trading producer would generally be followed by all or withdrawn by the originator. The evidence showed that the effect was to help maintain higher prices than would otherwise have prevailed. *Sugar Institute, Inc. v. United States*, 297 U.S. 553 (1936).

Thus in 1940, in *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940), the Court was able to say that "for over forty years this Court has consistently and without deviation adhered to the principle that price fixing agreements are unlawful *per se* under the Sherman Act \* \* \*." *Id.* at 218. "Any combination which tampers with price structures is engaged in an unlawful activity". *Id.* at 221.

### B. Vertical

In the realm of vertical agreements affecting price, the Supreme Court has followed the same approach as with horizontal agreements. A naked price fixing agreement between a seller and his distributors establishing the resale price was found unlawful in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). The Court opined that a vertical price agreement restrained competition among dealers and extinguished price competition as effectively as a horizontal price fixing agreement.

The Court did not see the same adverse effect, and thus found no violation of the Sherman Act, in a contract by which a corporation manufacturing dairy

supplies under certain patents, constituted another corporation its exclusive sales agent and established price lists. *Virtue v. Creamery Package Mfg. Co.*, 227 U.S. 8 (1913). That this decision was not a retreat from *Dr. Miles* seems plain in view of *Boston Store of Chicago v. American Graphophone Co.*, 246 U.S. 8 (1918) where the Court held void a contract between a manufacturer of a patent phonograph apparatus and a retailer to maintain minimum selling prices.

Illegal resale price maintenance, in its early days, depended upon an agreement between the seller and the reseller. Thus, in *United States v. Colgate & Co.*, 250 U.S. 300 (1919), an indictment which failed to charge an agreement between a seller and its dealers to maintain resale prices could not support a violation of the Sherman Act where the evidence showed a refusal by the seller to deal with those who did not maintain a suggested resale price. The following year, the Court made clear in *United States v. A. Schrader's Son, Inc.*, 252 U.S. 85 (1920), that *Colgate* did not overrule *Dr. Miles*.

A clear retreat from *Colgate* appeared in the making the next year when the Supreme Court decided *Frey & Son, Inc. v. Cudahy Packing Co.*, 256 U.S. 208 (1921). The Court stated that an agreement to maintain resale prices need not be formal to violate the Sherman Act, but may be implied from a course of dealing or other circumstances. However, the mere facts that the manufacturer indicates a sales plan to his wholesalers and jobbers fixing prices below which they may not sell, calls this plan to their attention frequently, and they do not dissent, but rather cooperate, do not suffice to establish an agreement forbidden by the Sherman Act.

The Supreme Court breathed life into its dicta the next year when it found a violation of Section 5 of the FTC Act when a manufacturer secured the cooperation of parties outside its own enterprise for the purpose of obtaining information that would enable it effectively to carry out a policy of refusing to deal with customers who cut suggested retail prices. *FTC v. Beechnut Packing Co.*, 257 U.S. 441 (1922).

In 1926, the Supreme Court refused to find that the Sherman Act was violated by a valid consignment agreement providing for the sale of products at prices established by the manufacturer. *United States v. General Electric Co.*, 272 U.S. 476 (1926).

The meaning of *Colgate* was further defined in 1960 by the decision in *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960). The Supreme Court there held that an illegal price fixing agreement arises where a manufacturer, in order to effect resale price maintenance, goes beyond a mere announcement of his policy and a simple refusal to deal.

Price maintenance through the use of consignment agreements received a major setback in 1964 by the decision in *Simpson v. Union Oil Co.*, 377 U.S. 13. In that case the Supreme Court called "coercive" a consignment agreement between an oil company and a lessee-dealer which gave the oil company the power to set the retail price of the gasoline. The dealer's lease was not renewed because he had failed to follow the established prices. The Court held that price maintenance achieved through the use of such "coercive" type of consignment agreement is illegal under the antitrust laws.

The decision in *Simpson* leans in the direction of saying that resale price maintenance is illegal per se because of the cloud it throws over the legality of enforcement by refusing to deal.

### III. DIVISION OF MARKETS

A division of markets among competitors has been a per se violation of the Sherman Act from the very beginning. In fact, the impetus for the per se violation doctrine came from the celebrated opinion of Judge Taft in *United States v. Addyston Pipe & Steel Co.*, 85 Fed. 271 (6th Cir. 1898), aff'd. 175 U.S. 211 (1899), a price-fixing and market division case. Taft concluded that the Rule of Reason applied at common law only to covenants in restraint of trade which were ancillary to a main lawful purpose and "necessary to protect the covenantee in the enjoyment of the fruits of the contract, or to protect him against the dangers of an unjust use of those fruits by the other party." On the other hand, a naked restrictive agreement among competitors was considered barren of such a main lawful purpose since its only aim was "to avoid the competition which it has always been the policy of the common law to foster."

Thus, in *Addyston Pipe* the Supreme Court held the Sherman Act to be violated by an agreement among competitors to divide the market, because it elimi-

nates competition even more completely than price-fixing. Similarly, *Timken Roller Bearing v. United States*, 341 U.S. 593 (1951), condemned the allocation of markets between the dominant American and the British and French producers of tapered roller bearings. The Court rejected the defense that the agreement was merely ancillary to an exchange of patent and trademark rights. The same result had been reached in *United States v. National Lead Co.*, 332 U.S. 319 (1947).

#### IV. GROUP BOYCOTTS

The per se rule developed somewhat more slowly in the area of group boycotts than in other areas. Eight years after the enactment of the Sherman Act, the Supreme Court found no violation of the Sherman Act in the rules of The Traders' Livestock Exchange in Kansas City which prohibited members from doing business with non-members or those who did business with non-members. The Court found the rules to be reasonable and fair and to affect interstate trade or commerce only remotely. *Anderson v. United States*, 171 U.S. 604 (1898).

In 1904, however, the Supreme Court found that an association formed in California composed of manufacturers of and dealers in tiles, whereby the dealers agreed not to purchase from non-member manufacturers and the manufacturer agreed not to sell to non-member dealers was a combination in restraint of trade in violation of the Sherman Act. The amount of trade in the commodity was not material, because even though small, it would probably increase but for the agreement. Therefore, it directly effected a restraint of interstate commerce. *Montague & Co. v. Louvy*, 193 U.S. 38 (1904).

In 1908, the Supreme Court went so far as to find a violation of the Sherman Act where a combination of labor unions and their members, in order to compel an interstate manufacturer to unionize his shops, boycotted his goods and prevented their sales in interstate commerce. *Loewe v. Lawlor*, 208 U.S. 274 (1908).

A few years later in *Eastern States Retail Lumber Dealers' Ass'n. v. United States*, 234 U.S. 600 (1914), the Supreme Court found a combination and conspiracy in restraint of trade in violation of the Sherman Act where an association of retail dealers circulated to its members a list of wholesalers who sold directly to consumers. Although there was no express agreement among the retailers to refrain from dealing with the listed wholesalers, the implication was present, and this was enough for the Court.

And in 1923, the Supreme Court readily struck down, as a violation of the Sherman Act, a combination of distributors who conspired to put an exhibitor out of business by refusing to furnish him with motion picture films. *Binderup v. Pathe Exchange, Inc.*, 263 U.S. 291 (1923).

By 1929, the influence of the antitrust laws was felt in other areas. In that year the Court found a boycott of one dealer by other dealers on a livestock exchange to be an unfair practice within the meaning of The Packers & Stockyards Act. *United States v. American Livestock Commission Co.*, 279 U.S. 435 (1929).

In 1930, an agreement by ten distributor-competitors controlling 60 percent of the entire film business to refuse to deal with any exhibitor who failed to observe a uniform contract used by the agreeing distributors was held to be an unreasonable restraint of trade in violation of the Sherman Act. *Paramount Famous Lasky Co. v. United States*, 282 U.S. 30 (1930). And in the same year the Court held that an agreement among film distributors not to deal with exhibitors who refused to assume the obligations of their predecessors conflicted with the Sherman Act. *United States v. First National Pictures, Inc.*, 282 U.S. 44 (1930).

By 1941, it was plain that group boycotts were per se unlawful. The Federal Trade Commission had attacked a combination of manufacturers of women's garments and manufacturers of textiles, used in their making, who had sought to suppress competition by those who copied their designs and sold at lower prices by refusing sales to manufacturers or retailers who dealt in the copies. The Supreme Court affirmed a finding by the Federal Trade Commission that such combination was an unfair method of competition even though it might be tortious under state law to copy the designs. *Fashion Originators' Guild of America v. FTC*, 312 U.S. 457 (1941). Same results on similar facts. *Millinery Creators' Guild, Inc. v. FTC*, 312 U.S. 469 (1941).

The case decided in 1945 seemed to make clear that group boycotts were unlawful regardless of their purpose if they injured competition. That year the Supreme Court held that a conspiracy of producers, wholesalers and retailers

to coerce others into making "fair trade" contracts by boycott violates the Sherman Act. *United States v. Frankfort Distilleries, Inc.*, 324 U.S. 293 (1945).

In 1959, the Supreme Court held that the Sherman Act had been violated when a chain of department stores and ten national manufacturers and their distributors engaged in a concerted refusal to deal with a single retail store in San Francisco, California. *Klor's Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959). It mattered not, said the Court that the public was not directly injured. The mere fact that the public had other stores to which it could turn did not save the conspiracy from being held unlawful. Monopoly would triumph if competitors could be destroyed one at a time.

#### V. TYING ARRANGEMENTS

Of the four areas under discussion, tying arrangements had, perhaps, the most difficult route to travel before reaching the level of a *per se* violation.

In 1912, the Supreme Court allowed a patentee-licensor to extend his monopoly to unpatented items by demanding that a licensee refrain from purchasing and using the goods of a competitor with the licensed-patented item. *Henry v. A. B. Dick Co.*, 224 U.S. 1 (1912).

However, in 1917, the Supreme Court mentioned Section 3 of the Clayton Act, enacted in 1914, in overruling *Henry v. A. B. Dick Co.*, and held that the grant by patent was limited to the invention described and the patent monopoly could not be extended by restrictions. *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1917).

The Court retreated somewhat the following year and held that a clause tying patented items together was within the lessor's patent rights and not in violation of the Sherman Act. *United States v. United Shoe Machinery Co.*, 247 U.S. 32 (1918).

The Supreme Court stood firm in its position in 1920 when it held that a complaint charging a seller with conditioning his sale of steel ties on purchases of jute bagging did not state an actionable unfair method of competition within the meaning of Section 5 of the Federal Trade Commission Act because it did not allege a monopolistic purpose or market control. *FTC v. Gratz*, 253 U.S. 421 (1920).

It took a case involving the use of restrictive tying agreements by a company controlling more than 95% of the business of supplying shoe machinery of the class involved to get the Supreme Court to find a violation of Section 3 of the Clayton Act. Under such conditions the Court held that the tying agreements must necessarily lessen competition and tend toward monopoly. *United Shoe Machinery Corp. v. United States*, 258 U.S. 451 (1922).

The Court's reluctance to find tying arrangements unlawful was evident the following year when the Supreme Court held valid an arrangement conditioning the lease of equipment to service stations on their dispensing only lessor's gasoline through lessor's pumps on the grounds that it merely protected the good will of lessor's brand from debasement of its consumer appeal through the sale of inferior fuels. *FTC v. Sinclair Refining Co.*, 261 U.S. 463 (1923).

In 1936, however, the Court said that the good will exemption of *Sinclair* is confined to cases where the restrictions were in fact needed for the protection of good will. *Int'l Business Machines v. United States*, 298 U.S. 131 (1936). But that same year the Supreme Court also ruled that a contract not to use unauthorized repair parts in repair of manufacturer's automobiles did not violate Section 3, Clayton Act, if its effect has not been in any way to substantially lessen competition or to create a monopoly in any line of commerce. *Pick Mfg. Co. v. General Motors Corp.*, 299 U.S. 3 (1936).

By 1947, however, the tide had turned. In that year the Supreme Court found a violation of both Section 1 of the Sherman Act and Section 3 of the Clayton Act in a tying agreement without a factual finding of an unreasonable restraint of trade within the Sherman Act or a substantial lessening of competition or tendency toward monopoly within the Clayton Act. The foreclosure of competitors from any substantial market is unreasonable *per se*. *Int'l Salt Co. v. United States*, 332 U.S. 392 (1947).

Then in 1953, the Supreme Court summarized the law of tying agreements as follows: A tying arrangement violates Section 3 of the Clayton Act whenever the seller enjoys a monopolistic position in the market for the "tying" product, or if a substantial volume of commerce in the "tied" product is restrained; but both conditions must be met to find a violation of Section 1 of the

Sherman Act. Then the Court ruled that the Government, having elected to proceed under the Sherman Act, and failing to establish the seller's "dominant" position in the newspaper advertising market in New Orleans, did not make out a case of an unlawful tying agreement where the owner of the sole morning paper and competitive paper refused to sell advertising separately. *Times-Picayune v. United States*, 345 U.S. 594 (1953).

All doubts about tying clauses were removed when in 1958, the Supreme Court, in a Section 1, Sherman Act case, said that the "monopoly power" or "dominance" over the tying product necessary for the application of the per se rule meant only "sufficient economic power to impose an appreciable restraint on free competition in the tied product (assuming all the time, of course, that a 'not insubstantial' amount of interstate commerce is affected)," *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1 (1958), and, then in 1962, defined "market dominance" to be simply "some power to control price and to exclude competition, "and stated further that a showing of "market dominance" is not always necessary since "the crucial economic power may be inferred from the tying product's desirability to consumers or from uniqueness in its attributes" which may be "presumed when the tying product is patented or copyrighted." It is, therefore, seldom "necessary in a tie-in sale case to embark upon a full-scale factual inquiry into the scope of the relevant market for the tying product and into the corollary problem of the seller's percentage share in that market. *United States v. Loew's Inc.*, 371 U.S. 38 (1962). This ruling makes virtually all tying arrangements illegal per se.

#### VI. EXCLUSION OF COMPETITORS

Often mistaken for a boycott is the conspiracy or action to exclude competitors from a market. Although certain similarities exist between group boycotts and the exclusion of competitors, the latter will be treated separately in this discussion.

In 1945, the Supreme Court found a violation of the Sherman Act in the by-laws of a cooperative association, engaged in the gathering and sale of news, which prohibited the sale of news to non-members in advance of publication by members and which made membership difficult for those in competition with members. *Associated Press v. United States*, 326 U.S. 1 (1945).

The exclusion, by a tobacco board of trade, of a tobacco warehouse from membership in the board of trade which was essential to successful operation as a tobacco auction warehouse, was held to violate the Sherman Act in 1950 by the Fourth Circuit Court of Appeals. *American Federation of Tobacco Growers, Inc. v. Neal*, 183 F.2d 869 (4th Cir. 1950).

In 1952 the Supreme Court denied certiorari in *Providence Fruit & Produce Bldg., Inc. et al. v. Gamco Incorporated*, 344 U.S. 817 (1952). The First Circuit Court of Appeals had found a violation of the Sherman Act by the lessor of a building habitually used by retail buyers of fruits and vegetables when it excluded from the building a lessee-wholesaler of fruits and vegetables. This building was the most opportune market for the sale of fruits and vegetables. 194 F.2d 484 (1st Cir. 1952).

In 1961, the Supreme Court held that allegations that an association operating testing laboratories had refused to grant its approval to a gas burner manufactured by the petitioner, as a result of a conspiracy between competitors of petitioner, with the result that gas companies would not furnish gas for the burners stated a claim under the Sherman Act. *Radiant Burners, Inc. v. Peoples Gas Light & Coke Co.*, 364 U.S. 656 (1961).

And in the present year, the Supreme Court ruled that joint, collaborative action designed to eliminate discounters from access to a market by pressuring dealers not to sell the manufacturer's cars to or through discounters is a per se violation of the Sherman Act. *United States v. General Motors*, 384 U.S. 127 (1966).

DEPARTMENT OF JUSTICE,  
Washington, August 9, 1966.

HON. PHILIP A. HART,  
Chairman, Committee on the Judiciary,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HART: When Mr. Turner testified on S. 2549 before the Senate Subcommittee on Antitrust and Monopoly on June 27, 1966, he was requested to

supply certain information as to antitrust cases. In response to that request, we enclose two documents designated as follows:

Appendix A: List of antitrust cases instituted by the Government in the period 1956-1965 involving restrictions upon territories or customers pursuant to franchise arrangements.

Appendix B: Summaries of cases listed in Appendix A.

Sincerely yours,

EDWIN M. ZIMMERMAN,

Acting Assistant Attorney General, Antitrust Division.

APPENDIX A

LIST OF ANTITRUST CASES INSTITUTED BY THE GOVERNMENT IN THE PERIOD 1956-65 INVOLVING RESTRICTIONS UPON TERRITORIES OR CUSTOMERS PURSUANT TO FRANCHISE ARRANGEMENTS

*United States v. J. P. Seeburg Corp.*

J. P. Seeburg Corp.

*United States v. J. P. Seeburg Corp., et al.*

J. P. Seeburg Corp.

Ajax Michigan Corp.

American Steel Export Co., Inc.

Atlantic Connecticut Corp.

Atlantic New Jersey Corp.

Atlantic New York Corp.

Atlantic Pennsylvania Corp.

Atlas Music Co. (Chicago)

Atlas Music Co. of Iowa

Atlas Music Co. (Pittsburgh)

Davis Distributing Corp.

Dickson Distributing Co.

R. F. Jones Co. (Salt Lake)

R. F. Jones Co. (San Francisco)

R. F. Jones Co. (Seattle)

S. L. London Music Co., Inc.

S. H. Lynch & Co.

Minthorne Music Co., Inc.

Music Distributors, Inc.

The Musical Sales Co.

Music System, Inc. (Cleveland)

Music System, Inc. (Michigan)

Sammons-Pennington Co.

Shaffer Music Co.

Sparks Specialty Co.

S. L. Stichel Co.

Trimount Automatic Sales Corp.

W. B. Distributors, Inc.

W. B. Music Co., Inc.

Wolfe Distributing Co., Inc.

John H. Lynch and Adrian H. Zander, d/b/a Lynch & Zander Co.

Simon Wolfe and Gordon F. Williams, d/b/a Wolfe Distributing Co. (Jacksonville)

*United States v. Minnesota Mining & Manufacturing Co.*

Minnesota Mining & Manufacturing Co.

*United States v. The Rudolph Wurlitzer Company*

The Rudolph Wurlitzer Company

*United States v. Necchi Sewing Machine Sales Corp., et al.*

Necchi Sewing Machine Sales Corp.

Elna Sewing Machine Co., Inc.

Leon Jolson

Benjamin Krisiloff

1124 DISTRIBUTION PROBLEMS AFFECTING SMALL BUSINESS

*United States v. AMI Incorporated*

AMI Incorporated

*United States v. Volkswagen of America, Inc., et al.*

Volkswagen of America, Inc.  
John Barry Distributors, Inc.  
Brundage Motors, Inc.  
Capitol Car Distributors, Ltd.  
Competition Motors Distributors, Inc.  
Hansen MacPhee Engineering Co., Inc.  
Import Motors, Ltd.  
Import Motors of Chicago, Inc.  
Inter-Continental Motors Corp.  
International Auto Sales & Service, Inc.  
Reynold C. Johnson Co.  
Midwestern VW Corp.  
Riviera Motors, Inc.  
Volkswagen Washington, Inc.  
World-Wide Automobiles Corp.

*United States v. Bostitch, Inc., et al.*

Bostitch, Inc.  
American Type Founders Co., Inc.  
Bostitch-McClain, Inc.  
Henry W. Saari, Inc. T/A Bostitch-Northwest Company

*United States v. Whitin Business Equipment Corp.*

Whitin Business Equipment Corp.

*United States v. Bostitch, Inc.*

Bostitch, Inc.

*United States v. The White Motor Co.*

The White Motor Co.

*United States v. Arnold, Schwinn & Co., et al.*

Arnold, Schwinn & Co.  
Schwinn Cycle Distributors Association  
The B. F. Goodrich Company

*United States v. Audiofidelity, Inc., et al.*

Audiofidelity, Inc., et al.  
Sidney Frey

*United States v. Scott Aviation Corporation*

Scott Aviation Corporation

*United States v. Renault, Inc., et al.*

Renault, Inc.  
Peugeot, Inc.  
Dolphin Motors, Inc.  
Eastern Auto Distributors, Inc.  
Magna Motors, Inc.  
Auto Imports Ltd.  
Delta Imports, Inc.  
John Green Corporation  
John Green Corporation of Northern California  
Integrity Imports, Inc.  
Jarrard Motors, Inc.  
Lake States Imports, Inc.  
Northwest, Inc.  
Renault Corporation  
Southeastern Imported Sales, Inc.  
Sterling Motors, Inc.  
Theodore W. Shidler and Cleo M. Shidler,  
d/b/a The Shidler Motor Company  
George H. Hobbs, d/b/a Imported Motors of Florida

- United States v. Hambro Automotive Corporation, et al.*  
 Hambro Automotive Corporation  
 S. H. Arnolt, Inc.  
 British Motor Car Distributors, Ltd.  
 Crandall-Hicks Company  
 Falvey Motor Sales Company  
 Gough Industries, Inc.  
 J. S. Inskip, Inc.  
 Overseas Motors Corporation  
 Palm Beach Chris-Craft Sales, Inc., d/b/a Ship and Shore Motors  
 Royston Distributors, Inc.  
 Frankie Watts, d/b/a Waco Motors
- United States v. Serta Associates, Inc.*  
 Serta Associates, Inc.
- United States v. Sealy, Inc.*  
 Sealy, Inc.
- United States v. The Spring Air Co.*  
 The Spring Air Co.
- United States v. York Corporation of Delaware*  
 York Corporation of Delaware
- United States v. Roehr Products Co., et al.*  
 Roehr Products, Inc. (Conn.)  
 Roehr Products, Inc. (Del.)  
 Brunswick Corp.
- United States v. Arnold Bakers, Inc., et al.*  
 Arnold Bakers, Inc.  
 Arnold Bread Sales Corp.  
 Chester Plains Distributors, Inc.  
 Robert A. Laurie  
 William F. Scott  
 Roland A. Sherwood  
 Edward J. Ksansnak  
 Gerald J. Perreault  
 Edmond Toder  
 George A. Brown  
 Samuel R. Sollars
- United States v. The Elgin Corporation, et al.*  
 The Elgin Corp.  
 Elgin Sweeper Co.  
 Leach Co.
- United States v. General Motors Corp., et al.*  
 General Motors Corp.  
 Losor Chevrolet Dealers Assn.  
 Dealers Services Inc.  
 Foothills Chevrolet Dealers Assn.
- United States v. Lone Star Cadillac Co.*  
 Lone Star Cadillac Co.
- United States v. Studebaker Corp.*  
 Studebaker Corp.
- United States v. Bay West Paper Co.*  
 Bay West Paper Co.
- United States v. Piper Aircraft Corp.*  
 Piper Aircraft Corp.
- United States v. Beech Aircraft Corp.*  
 Beech Aircraft Corp.

*United States v. United States Rubber Co.*  
United States Rubber Co.

*United States v. Dymo Industries, Inc.*  
Dymo Industries, Inc.

*United States v. Gestetner Corporation*  
Gestetner Corporation

*United States v. Coast Mfg. & Supply, Inc.*  
Coast Mfg. & Supply, Inc.

*United States v. Burlington Industries, Inc.*  
Burlington Industries, Inc.

*United States v. Clark-Schwebel Fiber Glass Corp.*  
Clark-Schwebel Fiber Glass Corp.

*United States v. J. P. Stevens & Company, Inc.*  
J. P. Stevens & Company, Inc.

*United States v. United Merchants & Mfgs., Inc.*  
United Merchants & Mfrs., Inc.

## APPENDIX B

## SUMMARIES OF CASES LISTED IN APPENDIX A

*United States v. J. P. Seeburg Corp.*

Cr. 56 CR 139 (N.D. Ill.)

Blue Book No. 1270

Filed: March 2, 1956

Nolo plea accepted January 15, 1957

Defendant manufacturer was charged with illegally agreeing with its distributors that no distributor would sell outside its allocated territory, and that no distributor would sell phonographs to "location owners." The intention was to require "location owners" to obtain their phonographs on a loan basis from the distributors.

On a nolo contendere plea, defendant was fined \$2,000.00.

*United States v. J. P. Seeburg Corp., et al.*

Civ. 56 C 419 (N.D. Ill.)

Blue Book No. 1271

Filed: March 2, 1956

Judgment: January 31, 1957

Defendant manufacturer and defendant distributors were charged with illegally agreeing that no distributor would sell outside its allocated territory, and that no distributor would sell phonographs to "location owners." The intention was to require "location owners" to obtain their phonographs on a loan basis.

Consent judgment enjoined defendants from imposing any restrictions on the territories within which, or the persons to whom, distributors can sell.

*United States v. Minnesota Mining & Manufacturing Co.*

Civ. 860-56 (D. N.J.)

Blue Book No. 1306

Filed: October 29, 1956

Case dismissed January 19, 1961, by agreement of the parties

Defendant manufacturer of reflex reflective sheeting was charged with illegally imposing territorial and customer allocations on its dealers, and with illegally barring sign makers from selling signs to the Government which were made reflex reflective by using products not manufactured by defendant.

The action was dismissed without prejudice.

*United States v. Rudolph Wurlitzer Company*

Civ. 7337 (W.D. N.Y.)

Blue Book No. 1321

Filed: February 28, 1957

Judgment: April 15, 1958

Defendant manufacturer was charged with illegally agreeing with its distributors that they would sell only on the basis of the territorial allocations made by defendant.

Consent judgment enjoined defendant from imposing any restrictions on the territories within which, or the persons to whom, distributors can sell.

*United States v. Necchi Sewing Machine Sales Corp., et al.*

Civ. 112-69 (S.D. N.Y.)

Blue Book No. 1348

Filed: June 28, 1957

Judgment: February 14, 1958

Defendant Necchi and defendant distributors were charged with illegally agreeing that distributors and dealers would sell only on the basis of the territorial allocations made by Necchi, that they would adhere to the resale prices fixed by Necchi, that they would not handle machines produced by other manufacturers, and that dealers would not sell machines to others for resale.

Consent judgment enjoined defendants from: (a) imposing any restrictions on territories within which, persons to whom, or prices at which distributors or dealers can sell; (b) forbidding distributors or dealers to handle machines produced by other manufacturers; (c) circulating, during a two-year period, any list of suggested resale prices on Necchi machines.

*United States v. AMI Incorporated*

Civ. 3238 (W.D. Mich.)

Blue Book No. 1350

Filed: June 28, 1957

Judgment: June 28, 1957

Defendant manufacturer of coin-operated phonographs was charged with illegally agreeing with its distributors that they would sell only on the basis of the territorial and customer allocations made by defendant.

Consent judgment enjoined agreements allocating customers or markets.

*United States v. Volkswagen of America, Inc., et al.*

Civ. 1232-57 (D. N.J.)

Blue Book No. 1368

Filed: December 4, 1957

Judgment: May 7, 1962

Defendant Volkswagen and defendant distributors were charged with illegally agreeing that they would sell only on the basis of the territorial allocations made by Volkswagen, that they would adhere to the resale prices fixed by Volkswagen, and that they would not handle the automobiles produced by other manufacturers.

Consent judgment enjoined the fixing or resale prices, but provided for the dismissal without prejudice of the other charges in the complaint. Volkswagen was left free to engage in any practice legalized by any act of Congress. Volkswagen stipulated that, following entry of judgment, it would notify the distributors that they could sell and service automobiles produced by other manufacturers.

*United States v. Bostitch, Inc., et al.*

Cr. 184-58 (D. N.J.)

Blue Book No. 1388

Filed: May 21, 1958

Nolo pleas accepted June 27, 1958

Defendant Bostitch was a manufacturer of stitchers and staplers. Bostitch and others were charged with illegally agreeing to allocate customers and territories, to fix resale prices, and to refrain from handling competitive stitchers and staplers.

Upon the acceptance of *nolo* pleas, defendants were fined a total of \$23,000.00.

*United States v. Whitin Business Equipment Corp.*

Civ. 58-567-A (D. Mass.)

Blue Book No. 1391

Filed: May 29, 1958

Judgment: March 30, 1960

Whitin and co-conspirators were charged with illegally agreeing to allocate customers and territories for duplicating machines, to fix resale prices, and to restrict imports and exports.

Consent judgment enjoined defendant from: (a) agreeing to any restrictions on territories within which, persons to whom, or prices at which duplicating machines can be sold; and (b) agreeing to restrict imports or exports (except by means of ordinary patent protection).

*United States v. Bostitch, Inc.*

Civ. 2362 (D. R.I.)

Blue Book No. 1395

Filed: June 19, 1958

Judgment: December 2, 1958

Defendant Bostitch, a manufacturer of stitchers and staplers, was charged with illegally agreeing with co-conspirators to allocate customers and territories, to fix resale prices, and to refrain from handling competitive stitchers and staplers.

Consent judgment enjoined Bostitch from: (a) imposing any restrictions on territories within which, persons to whom, or prices at which stitchers and staplers can be sold; (b) for two years, entering into any resale price maintenance agreements; and (c) forbidding distributors or dealers to handle competitive stitchers and staplers.

*United States v. White Motor Co.*

Civ. 34593 (N.D. Ohio)

Blue Book No. 1399

Filed: June 30, 1958

Judgment: September 8, 1964

Defendant manufacturer was charged with illegally agreeing with its distributors and dealers to allocate customers and territories, to fix resale prices, and to refrain from handling competitive products.

After the trial court had granted the Government's motion for summary judgment, holding each of the challenged restraints unlawful *per se*, the Supreme Court reversed, holding that the legality of territorial and customer allocation should be determined only after trial. Subsequently, a consent judgment enjoined defendant from agreeing to any type of customer or territorial allocation.

*United States v. Arnold, Schwinn & Co., et al.*

Civ. 58-C-272(3) (E.D. Mo.) trfd. to N.D. Ill.)

Blue Book No. 1405

File: June 30, 1958

Judgments: October 3, 1962; January 25, 1965; on appeal to Supreme Court

The defendants were Arnold, Schwinn & Co., Schwinn Cycle Distributors Association, and B. F. Goodrich Company. Defendants and co-conspirators were charged with illegally agreeing to allocate customers and territories and to fix resale prices; and it was charged that, in the case of Goodrich, the agreement barred Goodrich from reselling Schwinn products to anyone other than Goodrich outlets.

Goodrich entered into a consent judgment under which it was enjoined from fixing resale prices or confining its sales to its own outlets.

After trial, the trial court enjoined defendants from agreeing upon territorial allocation but found that Schwinn's over-all distribution plan was not illegal in other respects. The trial court held that it was legal for Schwinn to establish territories of primary responsibility for its distributors, and that Schwinn was entitled to terminate any distributorship when it found that the distributor was not adequately representing Schwinn and adequately promoting Schwinn products in its territory of primary responsibility. The Government has taken an appeal to the Supreme Court.

*United States v. Audiofidelity, Inc., et al.*

Civ. 150-21 (S.D. N.Y.)

Blue Book No. 1475

Filed: August 26, 1959

Judgment: June 30, 1960

Defendant manufacturer was charged with illegally agreeing with its distributors and dealers to allocate territories and fix resale prices.

Consent judgment enjoined territorial allocation and resale price-fixing.

*United States v. Scott Aviation Corporation*

Civ. 84-32 (W.D. N.Y.)  
 Blue Book No. 1476  
 Filed: September 11, 1959  
 Judgment: November 8, 1961

Defendant was charged with illegally agreeing with its distributors and dealers to allocate customers and territories and to fix resale prices.

Consent judgment enjoined allocation of customers and territories and fixing of resale prices. While the judgment did not enjoin defendant from availing itself of state fair trade laws, the defendant was required to specify the areas in which it had effective fair trade contracts, and to notify its distributors and dealers if its right to fair trade in any state or territory should be impaired.

*United States v. Renault, Inc., et al.*

Civ. 154-164 (S.D. N.Y.)  
 Blue Book No. 1488  
 Filed: December 28, 1959  
 Judgment: July 30, 1962

Renault and Peugeot were charged with illegally agreeing with their distributors and dealers to allocate territories, fix resale prices, and refrain from handling automobiles produced by other manufacturers.

Consent judgment enjoined the fixing of resale prices, but provided for the dismissal without prejudice of the other charges in the complaint.

*United States v. Hambro Automotive Corporation, et al.*

60 Civ. 729 (S.D. N.Y.)  
 Blue Book No. 1509  
 Filed: February 19, 1960  
 Judgments: February 19, 1960 and April 21, 1960

Defendant Hambro and eleven distributors of motor vehicles manufactured by British Motors Corporation were charged with illegally agreeing among themselves, and with dealers, to allocate territories, fix resale prices, and refrain from selling BMC products to others for resale.

Consent judgments enjoined defendants from continuing the practices.

*United States v. Serta Associates, Inc.*

60 C 843 (N.D. Ill.)  
 Blue Book 1532  
 Filed: May 31, 1960  
 Case is pending

It was charged that a group of independent mattress manufacturers, all using the Serta name, illegally agreed to allocate territories and fix resale prices.

This case is being continued, pending the outcome of the Government's appeal in *United States v. Sealy, Inc.*, BB 1533.

*United States v. Sealy, Inc.*

Civ. 60 C 844 (N.D. Ill.)  
 Blue Book No. 1533  
 Filed: May 31, 1960  
 Appeal to Supreme Court pending

It was charged that a group of independent mattress manufacturers, all using the Sealy name, illegally agreed to allocate territories and fix resale prices.

After trial, the trial court enjoined resale price-fixing but dismissed such portion of the complaint as dealt with territorial allocation. The Government has appealed to the Supreme Court.

*United States v. The Spring Air Co.*

Civ. 60-C-845 (N.D. Ill.)  
 Blue Book No. 1534  
 Filed: May 31, 1960  
 Judgment: August 16, 1962

It was charged that a group of independent mattress manufacturers, all using the Spring Air name, illegally agreed to allocate territories and fix resale prices.

Consent judgment enjoined territorial allocations and resale price fixing.

*United States v. York Corporation of Delaware*

Civ. 7546 (M.D. Pa.)  
 Blue Book No. 1648  
 Filed: February 9, 1962  
 Judgment: December 19, 1963

Defendant manufacturer, of air conditioning and refrigerating equipment, was charged with illegally allocating territories and markets to the more than 550 members of its nationwide distribution system.

Consent judgment enjoined defendant manufacturer from restricting the persons to whom, the territories in which, or the use for which, any person may sell or put any product of the manufacturer.

*United States v. Roehr Products Co., et al.*

Civ. 9370 (D. Conn.)  
 Blue Book No. 1675  
 Filed: June 26, 1962  
 Judgment: December 30, 1963

Defendant manufacturer, of disposable syringes and hypodermic needles, was charged with illegally allocating territories and customers to its distributors.

Consent judgment enjoined defendant manufacturer from imposing any limitations or restrictions upon its distributors in the resale of the products involved.

*United States v. Arnold Bakers, Inc., et al.*

Civ. 31665 (E.D. Pa.)  
 Blue Book No. 1686  
 Filed: June 29, 1962  
 Pending.

Defendant baker was charged with illegally restricting each of its wholesalers to selling within such wholesaler's allocated territory.

*United States v. The Elgin Corporation, et al.*

Civ. 62C1544 (N.D. Ill.)  
 Blue Book No. 1699  
 Filed: August 9, 1962  
 Judgment: February 5, 1965

The three defendant corporations, manufacturers of street cleaning and garbage machines and trucks, were charged with illegally agreeing that their distributors would be confined to specific allocated territories and customers.

Consent judgment enjoined territorial allocation and required defendants to advise their distributors that they were free to sell the products to anyone, anywhere, at any price they chose.

*United States v. General Motors Corp., et al.*

382 U.S. 936 (1966)  
 Blue Book No. 1707  
 Filed: August 30, 1962  
 Judgment reported at 382 U.S. 936

General Motors and three trade associations of Chevrolet dealers were charged with illegally agreeing that sales would not be made to or through discount houses and referral service outlets.

The Supreme Court reversed the trial court and held that the agreement in question constituted an illegal conspiracy in restraint of trade.

*United States v. Lone Star Cadillac Co.*

Civ. 9277 (N.D. Texas)  
 Blue Book No. 1712  
 Filed: September 24, 1962  
 Judgment: April 10, 1963

Defendant, a Cadillac distributor, was charged with illegally contracting with Cadillac dealers located outside Dallas County, to the effect that they would not sell Cadillacs to residents of Dallas County. It was alleged that defendant reduced the automobile allotments of dealers who violated this condition.

Consent judgment enjoined defendant from entering into any contract which restricts persons, prices, or territory within which a dealer may sell Cadillacs.

*United States v. Studebaker Corp.*

Civ. 01863 (Neb.)  
 Blue Book No. 1765  
 Filed: October 31, 1963  
 Judgment: May 7, 1965

Defendant, a manufacturer of lubricating additives, was charged with illegally agreeing with its distributors that, among other things, no distributor would sell outside its allocated territory.

Consent judgment enjoined agreements allocating customers or markets or fixing prices, and required defendant to notify its distributors that they were free to sell to anyone, anywhere, at any price they chose.

*United States v. Bay West Paper Co.*

Civ. 64-C-86 (E. D. Wisc.)  
 Blue Book No. 1793  
 Filed: April 1, 1964  
 Pending

Defendant paper company was charged with agreeing with its distributors that they would sell only on the basis of the territorial and customer allocations made by defendant, and at the resale prices prescribed by defendant.

*United States v. Piper Aircraft Corp.*

Civ. 8447 (M. D. Pa.)  
 Blue Book No. 1794  
 Filed: April 2, 1964  
 Dismissed without prejudice on June 16, 1965

Defendant was charged with: illegally imposing territorial and customer allocations on its distributors and dealers, forbidding distributors or dealers to sell airplanes of other manufacturers, and fixing resale prices.

*United States v. Beech Aircraft Corp.*

Civ. W-31-29 (D. Kansas)  
 Blue Book No. 1795  
 Filed: April 2, 1964  
 Judgment: November 8, 1965

Defendant was charged with: illegally imposing territorial and customer allocations on its distributors and dealers, forbidding distributors or dealers to sell airplanes of other manufacturers, and fixing resale prices.

Consent judgment enjoined defendant from: (a) imposing any restrictions on territories within which, persons to whom, or prices at which distributors or dealers can sell; and (b) forbidding its distributors or dealers to sell the airplanes of other manufacturers.

*United States v. United States Rubber Co.*

64 Civ. 1949 (S.D. N.Y.)  
 Blue Book No. 1812  
 Filed: June 24, 1964  
 Pending

Defendant was charged with illegally undertaking to maintain retail prices of Keds, and with forbidding retailers from selling Keds to other retail dealers for resale.

*United States v. Dymo Industries, Inc.*

Civ. 42672 (N.D. Calif.)  
 Blue Book No. 1817  
 Filed: August 3, 1964  
 Pending

Defendant was charged with illegally undertaking to maintain retail prices, and with forbidding its United States jobbers, distributors, and retailers to sell embossing tools and tape in foreign commerce.

*United States v. Gestetner Corporation*

64 Civ. 3121 (S.D. N.Y.)  
 Blue Book No. 1824  
 Filed: October 14, 1964  
 Pending

Defendant was charged with illegally undertaking to fix prices and with allocating territories and customers.

**United States v. Coast Mfg. & Supply, Inc.**

Civ. 43028 (N.D. Calif.)  
 Blue Book No. 1828  
 Filed: November 23, 1964  
 Pending

Defendant manufacturer was charged with participating in an illegal agreement with its distributors to fix prices and allocate sales territories.

**United States v. Burlington Industries, Inc.**

64 Civ. 3543 (S.D. N.Y.)  
 Blue Book No. 1829  
 Filed: November 23, 1964  
 Pending

Defendant manufacturer was charged with participating in an illegal agreement with its distributors to fix prices and allocate sales territories.

**United States v. Clark-Schwebel Fiber Glass Corp.**

64 Civ. 3544 (S.D. N.Y.)  
 Blue Book No. 1830  
 Filed: November 23, 1964  
 Pending

Defendant manufacturer was charged with participating in an illegal agreement with its distributors to fix prices and allocate sales territories.

**United States v. J. P. Stevens & Company, Inc.**

64 Civ. 3545 (S.D. N.Y.)  
 Blue Book No. 1831  
 Filed: November 23, 1964  
 Pending

Defendant manufacturer was charged with participating in an illegal agreement with its distributors to fix prices and allocate sales territories.

**United States v. United Merchants & Mfrs., Inc.**

64 Civ. 3546 (S.D. N.Y.)  
 Blue Book No. 1832  
 Filed: November 23, 1964  
 Pending

Defendant manufacturer was charged with participating in an illegal agreement with its distributors to fix prices and allocate sales territories.

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### THE FUTURE OF PER SE IN ANTITRUST LAW

*Jerrold G. Van Cise\**

*The history of the per se concept in antitrust law indicates that two judicial principles have evolved: First, per se categorization depends upon a pattern of universal condemnation; second, per se categorization is not absolute. Applying these principles to the contemporary antitrust scene, Mr. Van Cise concludes that very few current industrial restraints are likely candidates for per se categorization in the near future.*

It has been said that the future is hidden even from those who make it. It is not surprising, therefore, that the future of per se illegality in the field of antitrust law appears to be concealed equally from the prosecutor who institutes, and from the practitioner who defends, the litigation which is to mold tomorrow's approach to this controversial doctrine. Nevertheless, the attorney who advises a client with respect to the antitrust consequences of business transactions extending over a period of years must hazard an educated guess on the application of the per se doctrine to his client's business during this period of time. It is imperative for him to decide, as best he can, whether his client's operations are to be judged subsequently by application of judicial reason or are to be forced through the eye of some arbitrary, per se, legal needle. Such an attorney, more-

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over, is not totally devoid of the legal stuff from which to build a reasonably intelligent forecast of future rulings on this problem. He may at least review the relevant cases of the past, extract therefrom the legal principles which are currently controlling, and with hazardous optimism forecast the role of these principles in the years ahead.

These pages, accordingly, will proceed to employ just such legal divining rods to locate the probable role of the doctrine of *per se* in tomorrow's law of trade regulation. First, the past rulings on this doctrine will be discussed—the cases accepting and those rejecting this doctrine being taken up in their turn. Next, the principles revealed by a close reading of these decisions will then be analyzed. Finally—on the assumption that these past and present principles are a prologue of tomorrow's rulings—a forecast will be made of the antitrust future of *per se*.

#### THE SEARCH FOR CERTAINTY

During the past decades—indeed from the very birth of our federal antitrust laws in 1890—strong forces have urgently sought the evolution of some automatic or *per se* rules of antitrust liability. And these forces are still at work. On the one hand, the business community understandably has been “hot for certainty” in the law in order to be able to plan with assurance its day-to-day transactions. On the other hand, Congress,<sup>1</sup> the enforcement agencies,<sup>2</sup> and the courts<sup>3</sup> have wanted to be able to avoid the complexities and delays resulting from large records in prolonged trials, and accordingly they too have urged the adoption of simplified tests of illegality.

These forces have worked together over the years in contributing to the development of judicial rulings that certain, specified practices are *per se* unlawful under the antitrust laws. As recently explained by the Supreme Court:

“This principle of *per se* unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also 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—an inquiry so often wholly fruitless when undertaken.”<sup>4</sup>

The list of business conduct which has been singled out by the courts as *per se* unlawful has varied from commentator to commentator. Generally recognized as *per se* illegal, however, are arrangements to fix prices,<sup>5</sup> boycotts,<sup>6</sup> divisions of

<sup>1</sup> See Celler, *What's Wrong With "What Is Wrong With the Antitrust Laws,"* 8 ANTI-TRUST BULL., 571, 590-91 (1963).

<sup>2</sup> See Dixon, *Recent Changes in Organization and Procedure of the Federal Trade Commission*, 19 A.B.A. ANTI-TRUST SECTION 252, 259 (1961).

<sup>3</sup> See, e.g., *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 362 (1963).

<sup>4</sup> *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958). The practical consequences of using a *per se* rather than a rule-of-reason approach are beyond the scope of this Article. Generally, however, if the plaintiff alleges facts that constitute *per se* conduct, the defendant must either rebut the facts or the claim that they fit into a *per se* category. He will usually not be heard to explain that the consequences of the conduct given all the facts of his situation, are harmless and reasonable. Rather, they are presumed to be illegally anticompetitive as a matter of law, irrespective of what extenuating circumstances might be disclosed by a full factual inquiry into the economics of the industry, the state of competition, and so on. As the Supreme Court put it:

“[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.”

*Ibid.*

When a plaintiff builds his case on the existence or nonexistence of *per se* conduct the suit is, of course, enormously simplified. The incredibly complex economic inquiry—which makes up the bulk of the often staggeringly long records in antitrust cases—is foregone, and the jury is charged with resolving a fairly simple issue. See, e.g., *United States v. Trenton Potteries Co.*, 273 U.S. 392, 395-402 (1927). Not infrequently, the operative facts will be undisputed, and the question whether they constitute *per se* conduct can be disposed of by summary judgment. See, e.g., *Northern Pac. Ry. v. United States*, *supra* at 7; *White Motor Co. v. United States*, 372 U.S. 253, 259 (1963) (dictum) (summary judgment held inappropriate because vertical territorial division not a recognized *per se* category).

<sup>5</sup> See *Simpson v. Union Oil Co.*, 377 U.S. 13, 17 (1964); *United States v. New Wrinkle, Inc.*, 342 U.S. 371, 377-78 (1952); *United States v. National Ass'n of Real Estate Bds.*, 339 U.S. 485, 489 (1950); *United States v. Masonite Corp.*, 316 U.S. 265, 274-76 (1942); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 221 (1940); *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397-98 (1927).

<sup>6</sup> See *Radiant Burners, Inc. v. Peoples Gas Light & Coke Co.*, 364 U.S. 656 (1961), *per curiam reversing* 273 F. 2d 196 (7th Cir. 1959); *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959); *Fashion Guild v. FTC*, 312 U.S. 457, 467 (1941).

markets,<sup>7</sup> tying arrangements,<sup>8</sup> and monopolistic conduct which is intended to foreclose competitors from a substantial market.<sup>9</sup> Each of these practices has been ruled at one time or another to be amenable to condemnation without any extended analysis of the facts or exhaustive review of the law.

Indeed, in the early days of the Sherman Act, the Government urged, and the Supreme Court seemed to have adopted, a *per se* doctrine which would have outlawed without the necessity of extended argument every agreement which substantially restrained trade—however reasonable or necessary such agreement may have been to the conduct of business.<sup>10</sup> Closer examination of the decision that appeared to take this position and of subsequent decisions indicates, however, that the Court left the door open for justification of restraints based upon competitive necessity.<sup>11</sup> The courts were unwilling to bring certainty into the antitrust laws to the point that the only thing businessmen could be sure of was that they were violating the statutory prohibitions by engaging in a wide range of normal and necessary activities. As the Supreme Court put it:

"In substance, the propositions urged by the Government are reducible to this: That the language of the statute embraces every contract, combination, etc., in restraint of trade, and hence its text leaves no room for the exercise of judgment, but simply imposes the plain duty of applying its prohibitions to every case within its literal language."<sup>12</sup>

Our highest Court then wisely ruled that:

"The error involved lies in assuming the matter to be decided. This is true because as the acts which may come under the classes stated in the first section and the restraint of trade to which that section applies are not specifically enumerated or defined, it is obvious that judgment must in every case be called into play in order to determine whether a particular act is embraced within the statutory classes, and whether if the act is within such classes its nature or effect causes it to be a restraint of trade within the intentment of the act."<sup>13</sup>

#### THE NECESSITY FOR UNCERTAINTY

During these past decades the forces opposed to inflexible "certainty" have been equally strong. This resistance has extended not only to any universal rule of automatic, antitrust condemnation of all restraints of trade, but also to the more limited condemnation of the few, specific *per se* practices listed above. Spokesmen for businessmen, caught in undesirable applications of *per se* rulings, have been quick to urge a relaxation of the automatic condemnation of the restraints involved.<sup>14</sup> And in harsh cases the courts have declined to accept the *per se* classifications of their predecessors as unvarying laws of the Medes and Persians.<sup>15</sup> This collective opposition to *per se* certainty, in essence, has echoed Justice Holmes' classic statement that "certainty generally is an illusion, and repose is not the destiny of man."<sup>16</sup>

<sup>7</sup> See *Timken Roller Bearing Co. v. United States*, 341 U.S. 593, 599 (1951); *United States v. National Lead Co.*, 332 U.S. 319 (1947), *affirming* 63 F. Supp. 513, 523, 527 (S.D.N.Y. 1945); *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211, 241-43 (1899); *United States v. Aluminum Co. of America*, 148 F. 2d 416, 443-45 (2d Cir. 1945); *United States v. Holofothane Co.*, 119 F. Supp. 114 (S.D. Ohio 1954), *aff'd per curiam*, 352 U.S. 903 (1956); *United States v. Imperial Chem. Indus.*, 100 F. Supp. 504, 517-19 (S.D.N.Y. 1951).

In *United States v. Aluminum Co. of America*, *supra*, the Second Circuit was sitting under a statute authorizing its decision "in lieu of a decision by the Supreme Court." The history of the case is recapitulated and the circuit court's holding endorsed in *American Tobacco Co. v. United States*, 328 U.S. 781, 811-14 (1946).

<sup>8</sup> See *United States v. Loew's Inc.*, 371 U.S. 38, 44-45 (1962); *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5-8 (1958); *International Salt Co. v. United States*, 332 U.S. 392, 396 (1947).

<sup>9</sup> See *United States v. Griffith*, 334 U.S. 100, 105-06 (1948); *American Tobacco Co. v. United States*, 328 U.S. 781, 808-15 (1946); *Swift & Co. v. United States*, 196 U.S. 375, 395-96 (1905); *United States v. Aluminum Co. of America*, 148 F. 2d 416, 431-32 (2d Cir. 1945); *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295, 341-46 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954).

<sup>10</sup> See 15 U.S.C. §§ 1-7 (1955).

<sup>11</sup> See *Northern Pac. Co. v. United States*, 193 U.S. 197, 328-32 (1904); *United States v. Joint Traffic Ass'n*, 171 U.S. 505, 573-78 (1898); *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290, 327-32 (1897).

<sup>12</sup> *Standard Oil Co. v. United States*, 221 U.S. 1, 63 (1911).

<sup>13</sup> *Ibid.*

<sup>14</sup> See Dewey, *Antitrust Barriers to Foreign Policy Goals*, CCH ANTITRUST LAW SYMPOSIUM (1961). Editorial, *Suspect on Sight*, Wall Street Journal, Sept. 1, 1964, p. 12, col. 1.

<sup>15</sup> For a general discussion of the wide variations of antitrust rulings over the years, see cases reviewed in VAN CISE, UNDERSTANDING THE ANTITRUST LAWS 65-114 (1963).

<sup>16</sup> Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 466 (1897).

A bill to establish a commission to revise the antitrust laws, recently introduced by one of our most intelligent and liberal senators, illustrates these conflicting desires for both certainty and flexibility. On the one hand, its declaration of policy advocates "clarifying the standards" and "eliminating conflicts in policy and inconsistencies" (*i.e.* certainty); on the other hand, it urges "adjusting" such policies to insure productivity and economic growth and "revising" the laws where their prohibitions impair initiative and business development (*i.e.* flexibility).<sup>17</sup>

The business community appears to register in the primaries for certainty as a matter of principle but, when forced at the polls to make specific choices in specific cases, it votes for flexibility. As aptly summarized by a scholarly former head of the Antitrust Division:

"Businessmen and their spokesmen sometimes claim the antitrust laws are too indefinite and uncertain. They say that this uncertainty makes it difficult or impossible to comply with antitrust standards. On the other hand, some business critics, often the same ones who claim uncertainty, also assert that the laws are too rigid and inflexible. It should be evident that it is impossible for laws to be both flexible and certain at the same time."<sup>18</sup>

As might be expected every practice singled out for per se condemnation has nevertheless been upheld as lawful under the antitrust laws in one or more cases. Thus, the doctrine that a per se offense can "never" be justified has had to be qualified—as by the Captain of the Pinafore—with "hardly ever." For example concerted forms of business activity conducive to price stabilization,<sup>19</sup> and even outright price fixing for limited periods,<sup>20</sup> have been permitted. Similar judicial recognition that special facts may justify disregard of per se rulings has been enunciated in proceedings involving collective refusals to deal,<sup>21</sup> divisions of markets,<sup>22</sup> tying arrangements,<sup>23</sup> and even monopolistic power "thrust upon" the monopolizer.<sup>24</sup> Much as the common-law certainties of old England were softened in due course by the flexible approach of the King's chancellor, so

<sup>17</sup> See S. 1255, 88th Cong., 1st Sess. (1963).

<sup>18</sup> Loevinger, *Antitrust Is Pro Business*, Fortune, Aug. 1962, p. 96, at 126.

<sup>19</sup> See Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933) (common agency for marketing regional coal on the otherwise competitive national market); Cement Mfrs. Protective Ass'n v. United States, 268 U.S. 588 (1925) (price stabilization through exchange of cost data permissible, absent agreement to fix prices); Maple Flooring Mfrs. Ass'n v. United States, 268 U.S. 563 (1925) (exchanging information through association not illegal per se as price fixing).

<sup>20</sup> See Board of Trade v. United States, 246 U.S. 231 (1918) (grain brokers on national exchange permitted to freeze prices when exchange not in session); United States v. Morgan, 118 F. Supp. 621, 680-91 (S.D.N.Y. 1953) (price maintenance agreements permissible in syndicate marketing of securities).

<sup>21</sup> See Ruddy Brook Clothes, Inc. v. British Foreign & Marine Ins. Co., 195 F. 2d 86 (7th Cir.), *cert. denied*, 344 U.S. 816 (1952) (collective refusal of insurance companies to underwrite alleged bad risk); United States v. United States Trotting Ass'n, 1960 Trade Cas. 76954 (S.D. Ohio 1960) (regulation of harness racing not a commercial restraint of trade); Silver v. New York Stock Exch., 373 U.S. 341, 360 (1963) (*dictum*); United States v. Insurance Bd., 144 F. Supp. 684, 696-702 (N.D. Ohio 1956) (*dictum*).

<sup>22</sup> See National Ass'n of Window Glass Mfrs. v. United States, 263 U.S. 403 (1923) (division of union labor among territories permissible as measure to save failing industry); Denison Mattress Factory v. Spring-Air Co., 308 F. 2d 403, 408-10 (5th Cir. 1962) (division of territory permissible when real purpose is to limit and protect trademark); Rogers v. Douglas Tobacco Bd. of Trade, 244 F. 2d 471, 479-81 (5th Cir. 1957) (peculiarities of tobacco trade justified allocation of specific times when warehouses could auction); United States v. E. I. du Pont de Nemours & Co., 118 F. Supp. 41, 218-22 (D. Del. 1953), *aff'd*, 351 U.S. 377 (1956) (territorial restriction of trade secrets permitted as ancillary restraint useful in opening new business); United States v. National Football League, 116 F. Supp. 319 (E.D. Pa. 1953) (elimination of competition between television broadcast and home games was reasonable restraint).

<sup>23</sup> See Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 605-10 (1953) (tying of evening and morning advertising sales not violation in absence of market dominance); Baker v. Simmons Co., 307 F. 2d 458, 467-69 (1st Cir. 1962) (mattress sales to motels tied to advertising requirement); Dehydrating Process Co. v. A. O. Smith Corp., 292 F. 2d 653 (1st Cir.), *cert. denied*, 368 U.S. 931 (1961) (tying arrangement permitted to enforce necessary specification in auxiliary equipment); Electric Pipe Line, Inc. v. Fluid Sys., Inc., 231 F. 2d 370 (2d Cir. 1956) (tying arrangement for component of a patented system covered by performance guarantee); United States v. Jerrold Electronics Corp., 187 F. Supp. 545, 555-58 (E.D. Pa. 1960) (*dictum*) (tying arrangements in support of service guarantee not prohibited under conditions of struggling new business); cf. Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961) (twenty-year requirements contract affecting principal share of local market for coal).

<sup>24</sup> See, *e.g.*, the analysis in United States v. E. I. du Pont de Nemours & Co., 118 F. Supp. 41, 214-17 (D. Del. 1953), *aff'd*, 351 U.S. 377 (1956), where the lower court commented at 214-15: "The decisions state a defendant may lawfully obtain a monopoly position if that position is 'thrust upon it.' Thus the right to normal growth and to enjoy the results of technical achievement and successful competition has been preserved."

the arbitrary absolutes of per se have been tempered by the developments of a degree of "antitrust mercy."

Illustrative of the approach of the courts, in refusing on occasion to follow per se precedent, are the following comments:

On price fixing:

"Despite all the general condemnation of price-fixing, I find nothing in any of these cases which can be regarded as controlling precedent here or which binds me to hold the clauses of these syndicate agreements now under attack to be illegal per se under the Sherman Act."<sup>25</sup>

On division of territories:

"This, therefore, is a clear case of allocating marketing territories among competitors, which is a practice generally held illegal under the antitrust laws. *United States v. Addyston Pipe & Steel Co.*, 6 Cir., 85 F. 271, affirmed 175 U.S. 211 . . . ; *United States v. Aluminum Co. of America*, 2 Cir., 148 F. 2d 416, 427.

"An allocation of marketing territories for the purpose of restricting competition, however, is not always illegal."<sup>26</sup>

#### THE CONTROLLING JUDICIAL PRINCIPLES

The cases which we have just reviewed, when superficially examined, have readily grouped themselves into the "pro" per se and "con" per se classifications of the preceding discussion. A close examination of these cases indicates that there are two per se principles which are generally recognized as controlling today in the field of antitrust law.

The "pro" cases disclose the first of the presently controlling principles which should be helpful in forecasting the general future of per se rules in antitrust law. This principle relates to the manner in which a new per se rule is evolved. When the rule of reason is applied to a restraint of trade, it is ordinarily determined to be lawful or unlawful on the basis of an analysis of its purpose and effect.<sup>27</sup> Where such a practice has been before the courts on numerous occasions and has been uniformly condemned, however, the judicial mind feels that it is unnecessary for a court to continue to weigh carefully its purpose and effect. Rather, in the case of a practice which is such a "hardened offender," the courts take judicial notice that its effect is substantially to restrain trade, and rule that there is an "inference or presumption" that the only intent underlying the practice is to achieve such an anticompetitive effect.<sup>28</sup> Accordingly, the courts thereupon rule that the practice is per se unlawful. However, these cases also show that generally a restraint of trade in the past has been declared to be per se unlawful only after a cumulative series of rulings—adverse to the practice—has given the courts a solid basis for arriving at the per se condemnation.

For example, tying agreements had so frequently been found unreasonably to restrain trade that the courts finally declared that they hardly serve any purpose beyond the suppression of competition. For this reason—in the absence of an affirmative showing of some unusual main purpose—they are today condemned without the necessity for any extended analysis of their purpose or effect.<sup>29</sup>

In contrast, the imposition by a seller of territorial covenants upon dealers has been ruled unreasonably to restrain trade only in a few lower court cases.<sup>30</sup> The Supreme Court, therefore, has refused to assume that such covenants are naked restraints with no purpose or effect except to stifle competition. Necessarily, also, it has declined to rule that these covenants are per se unlawful. In so refusing to extend the per se classification to this practice, the Supreme Court stated:

"Horizontal territorial limitations, like 'group boycotts or concerted refusals by traders to deal with other traders' . . . are naked restraints of trade with no

<sup>25</sup> *United States v. Morgan*, 118 F. Supp. 621, 689 (S.D.N.Y. 1953).

<sup>26</sup> *United States v. National Football League*, 116 F. Supp. 319, 322 (E.D. Pa. 1953).

<sup>27</sup> For good examples of this kind of analysis, see *Sugar Institute, Inc. v. United States*, 297 U.S. 553 (1936); *Appalachian Coals, Inc. v. United States*, 288 U.S. 344 (1933); *Standard Oil Co. v. United States*, 221 U.S. 1 (1911).

<sup>28</sup> *Compare Standard Oil Co. v. United States*, 221 U.S. 1, 58 (1911), with *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959).

<sup>29</sup> See, e.g., *United States v. Loew's Inc.*, 371 U.S. 38 (1962); *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958); *Standard Oil Co. v. United States*, 337 U.S. 293, 305-06 (1949) (dictum).

<sup>30</sup> See, e.g., *United States v. American Linen Supply Co.*, 141 F. Supp. 105, 112-15, (N.D. Ill. 1956).

purpose except the stifling of competition. A vertical territorial limitation may or may not have that purpose or effect. We do not know enough of the economic and business stuff out of which these arrangements emerge to be certain. . . ."

\* \* \* \* \*

"We need to know more than we do about the actual impact of these arrangements on competition to decide whether they have such a 'pernicious effect on competition and lack . . . any redeeming virtue' . . . and therefore should be classified as *per se* violations of the Sherman Act."<sup>31</sup>

The second basic principle, useful in forecasting the future of *per se* antitrust law, can be extracted from the cases which permit a defendant to evade application of recognized *per se* rules under exceptional circumstances.

It has been pointed out that *per se* rules are premised upon an "inference or presumption" that the only intent underlying the practice at issue is to achieve an anticompetitive effect. This "inference or presumption" that the interest is anticompetitive, however, appears to be rebuttable. A careful reading of the second line of cases indicates that when the primary intent of the parties is in fact consistent with competition, the courts feel obligated to set aside the *per se* concept as absurd and to determine—much in the manner of the common-law judges—whether or not the restraint, with its effects, is limited (*i.e.*, reasonably ancillary) to effectuating a lawful main purpose.<sup>32</sup> Should this process of reasoning result in a finding of both a lawful main intent and a reasonably ancillary restraint, the facts are held to justify an exception to the *per se* rule. In short, the courts are unwilling to be bound by *per se* theories where the facts reveal a purpose and effect promotive of a free, competitive economy.

The judicial principle underlying the "exception" cases is that a restraint of trade is presumed to have an unlawful purpose and effect only in the absence of a contrary showing. Once such showing is made, the *per se* doctrine loses its conclusive authority, and the normal rule of reason takes over. As summarized in one case, the courts have taken the position that:

"Where challenged conduct is subservient or ancillary to a transaction which is itself legitimate, the decision is not determined by a *per se* rule. The doctrine of ancillary restraints is to be applied. It permits, as reasonable, a restraint which (1) is reasonably necessary to the legitimate primary purpose of the arrangement, and of no broader scope than reasonably necessary; (2) does not unreasonably affect competition in the marketplace; and (3) is not imposed by a party or parties with monopoly powers."<sup>33</sup>

The courts, in other words, treat a *per se* classification as a rebuttable presumption which is not conclusively binding upon them when injustice would otherwise result:

"Any judicially, as opposed to legislatively, declared *per se* rule is not conclusively binding on this court as to any set of facts not basically the same as those in the cases in which the rule was applied. . . . Therefore, while the *per se* rule should be followed in almost all cases, the court must always be conscious of the fact that a case might arise in which the facts indicate that an injustice would be done by blindly accepting the *per se* rule."<sup>34</sup>

#### A FORECAST OF THE FUTURE

Any forecast of the future of *per se* based on these general principles must be fairly short term, but, for the years immediately ahead, it should be reasonably accurate.

Turning to the first of the *per se* principles, there would appear to be few additional practices which have so repeatedly been condemned by the courts as to merit admission in the near future to the list of *per se* violations. There are, of course, many trade restraints which have on occasion been held to constitute statutory offenses, but these same restraints on other occasions have been approved as lawful. As a result, although many practices have been called *per se* violations in plaintiffs' briefs, few such practices are likely to be chosen as recipients of this dishonor. Thus, government counsel and a minority of the justices of the Supreme Court have sought to single out as presumptively illegal

<sup>31</sup> *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963).

<sup>32</sup> *United States v. Addyston Pipe & Steel Co.*, 85 Fed. 271, 280-83 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899).

<sup>33</sup> *United States v. Columbia Pictures Corp.*, 189 F. Supp. 153, 178 (S.D.N.Y. 1960).

<sup>34</sup> *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545, 556 (E.D. Pa. 1960), *aff'd*, 365 U.S. 567 (1961).

such industrial conduct as integration,<sup>35</sup> joint ventures,<sup>36</sup> and total requirement contracts,<sup>37</sup> but they have done so without success. The judiciary has not had sufficient adverse experience with most of our current forms of industrial restraints to permit it reasonably to rule that their only purposes and effects are presumptively antisocial.

In the absence of unmistakable evidence of an anticompetitive purpose and effect, revealed in repeated proceedings, the judiciary will probably continue to hesitate to condemn—without detailed consideration—many new trade restraints, recognizing that “it is not for courts to determine the course of the Nation’s economic development.”<sup>38</sup>

A few candidates for per se rulings, as nominated by the Government, nevertheless, seem to be approaching this status. Thus, it may be that lower court rulings adverse to territorial covenants imposed by a seller upon dealers,<sup>39</sup> when supplemented by similar rulings of the Federal Trade Commission,<sup>40</sup> will suffice to permit the Supreme Court eventually to condemn, out of hand, this practice. Certainly the eventual disposition of the *White Motor* case points in this direction.<sup>41</sup> In addition, the series of adverse rulings directed at refusal to deal with price cutters<sup>42</sup> and at mergers of substantial competitors<sup>43</sup> portend the eventual peremptory prohibition of such conduct.

The application of our second guiding principle to these possible—as well as to existing—per se violations, however, would indicate that such trade restraints will continue to be viewed for the immediate future as only prima facie unlawful. For, in dealing with these three possible new per se violations, the Supreme Court has in each case stressed the importance of a finding of the underlying motive. Thus, with respect to the most likely candidate for per se status, the merger of substantial competitors, the Supreme Court has emphasized as “most important” the “nature and purpose” of the transaction.<sup>44</sup> It then has spelled out, in detail, purposes which would defeat any per se condemnation of such a horizontal merger:

“The importance which Congress attached to economic purpose is further demonstrated by the Senate and House Reports on H.R. 2734, which evince an intention to preserve the “failing company” doctrine of *International Shoe Co. v. Federal Trade Comm’n*, 280 U.S. 291. Similarly, Congress foresaw that the merger of two large companies or a large and a small company might violate the Clayton Act while the merger of two small companies might not, although the share of the market foreclosed be identical, if the purpose of the small companies is to enable them in combination to compete with larger corporations dominating the market.”<sup>45</sup>

So long as the courts consider an analysis of motive or purpose to be “most important” in judging the legality of such a trade restraint, just so long will

<sup>35</sup> See *United States v. Columbia Steel Co.*, 334 U.S. 495, 519–27 (1948); *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 173–74 (1948).

<sup>36</sup> See *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158 (1964); *Timkin Roller Bearing Co. v. United States*, 341 U.S. 593 (1951).

<sup>37</sup> *Compare Standard Oil Co. v. United States*, 337 U.S. 293 (1949), *with Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961).

<sup>38</sup> *United States v. Columbia Steel Co.*, 334 U.S. 495, 526 (1948).

<sup>39</sup> See text accompanying note 30 *supra*.

<sup>40</sup> See *Snap-On Tools Corp. v. FTC*, 321 F. 2d 825, 830–33 (7th Cir. 1963).

<sup>41</sup> See the judgment entered by consent in *United States v. White Motor Co.*, TRADE REG. REP. (1964 Trade Cas.) ¶ 71195 (N.D. Ohio 1964).

<sup>42</sup> See *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); *FTC v. Beech-Nut Packing Co.*, 257 U.S. 441 (1922); *United States v. A. Schrader’s Son, Inc.*, 252 U.S. 85 (1920).

<sup>43</sup> See *United States v. Continental Can Co.*, 378 U.S. 441 (1964); *United States v. First Nat’l Bank & Trust Co.*, 376 U.S. 665 (1964); *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964); *United States v. Philadelphia Nat’l Bank*, 374 U.S. 321 (1963); *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

While the Supreme Court has not spoken of the merger of substantial competitors in terms of per se illegality, its treatment of such combinations is certainly reminiscent of its action in per se cases. Thus, in a recent opinion the Court stated:

“The issue is whether the merger between Continental and Hazel-Atlas will have probable anticompetitive effect within the relevant line of commerce. . . . Where a merger is of such size as to be inherently suspect, elaborate proof of market structure, market behavior and probable anticompetitive effects may be dispensed with in view of § 7’s design to prevent undue concentration.”

*United States v. Continental Can Co.*, *supra* at 458. Justice Harlan’s dissenting, objected that: “The Court’s spurious market share analysis should not obscure the fact that the court, in effect, laying down a “per se” rule that mergers between two large companies in related industries are presumptively unlawful under § 7.” *Id.* at 476 (dissent by Harlan, J.)

<sup>44</sup> *Brown Shoe Co. v. United States*, *supra* note 43, at 329.

<sup>45</sup> *Id.* at 331. (Footnotes omitted.)

they view any per se inference or presumption of its wrongful intent (the *sine qua non* of a per se classification) to be solely a rebuttable presumption.<sup>46</sup> A showing of a lawful main purpose, when accompanied by proof of an effect limited to carrying out this lawful purpose, should suffice to dispel any per se hostility to the transaction involved.

Indeed, in forecasting a probable per se ruling in the field of substantial horizontal mergers, the Supreme Court has frankly conceded that any such ruling would be prima facie only (although here giving less attention to purpose):

"Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anti-competitive effect."<sup>47</sup>

#### CONCLUSION

In summary, it seems that the list of per se antitrust offenses is—and probably will be in the near future—both short and inconclusive.

Congress has wisely declined, on its part, to provide its own detailed specification of business rights and wrongs on the theory that to do so would, on the one hand, drastically curtail the freedom of businessmen to meet their infinitely varying industrial problems and, on the other hand, too readily permit unanticipated competitive abuses not specifically singled out and condemned. As the Supreme Court observed decades ago, "detailed definitions . . . might either work injury to legitimate enterprise, or through particularization, defeat its purposes by providing loopholes for escape."<sup>48</sup>

It is reassuring that the courts do not seem likely to rush in—and attempt foolishly to supply such a detailed list of per se antitrust sins—where Congress has wisely feared to tread.

<sup>46</sup> For a scholarly criticism of the per se approach suggesting the need for legislative action, see Oppenheim, *Federal Antitrust Legislation: Guideposts to a Revised National Antitrust Policy*, 50 MICH. L. REV. 1139, 1150-51 (1952).

<sup>47</sup> *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363 (1963).

<sup>48</sup> *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 360 (1933).





