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Anna Bilden Parker

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Notes and Comments

The Soft Drink Act: Soft on Vertical Restraints?

I. Introduction

Vertical restraints,[1] imposed by manufacturer on his distributor,[2] restrict the distributor's freedom to sell the manufacturer's product[3] and frequently prevent distributors of the same

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1. Vertical restraints can be broadly placed into two categories: vertical *sales* restrictions and vertical *price* restrictions. ABA ANTITRUST SECTION, *Vertical Restrictions Limiting Intrabrand Competition* 2 (Monograph No. 2, 1977) [hereinafter cited as *Monograph*]. Vertical price restrictions, often referred to as resale price maintenance, are restrictions imposed by the manufacturer on the distributor's pricing of the product for resale. A manufacturer would typically set a minimum or maximum resale price. Resale price maintenance is a per se violation of the antitrust laws. *See* Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373, 404-09 (1911). Vertical price restrictions are not within the scope of this comment. For a discussion of their treatment, *see generally Monograph, supra.*

Vertical restraints, as used in this comment, refer to vertical *sales* restrictions, in which the manufacturer imposes non-price restrictions on the sale of his product. Vertical restraints of this nature are frequently imposed through a bilateral agreement between manufacturer and distributor or manufacturer and retailer. For a discussion of the various forms which vertical sales restrictions may take, *see infra* the discussion in Part II of this comment and accompanying notes.

2. Restraints which are imposed by a manufacturer on his distributor are *vertical* because they exist between persons on different levels of the market structure, e.g., between manufacturer and distributor or manufacturer and retailer. *Horizontal* restraints exist between persons who are on the same level of the market structure and who would normally be in competition with one another, e.g., between distributor and distributor. It is important to distinguish between vertical and horizontal restraints due to the respective legal consequences. Horizontal restraints are illegal per se. *See infra* note 63. On the other hand, vertical restraints are judged according to the rule of reason and may or may not be legal, depending on the circumstances.

3. One common means of restricting a distributor's freedom to sell is through an agreement containing territorial restrictions. Under such an agreement, the distributor promises that he will not sell the goods outside a defined geographic area. *See* Note, *Restricted Channels of Distribution Under the Sherman Act,* 75 HARV. L. REV. 795 (1961) [hereinafter cited as *Restricted Channels*]. His sales will therefore be limited to customers who live or maintain their places of business within that area. *Id.* at 796. This comment will focus primarily on territorial restrictions in its discussion of vertical re-

brand of product from competing with one another.[4] Thus, vertical restraints limit intrabrand competition. But since vertical restraints create efficiencies in a manufacturer's distribution system, they enable him to compete more effectively with manufacturers of other brands of products. Thus, vertical restraints promote interbrand competition.

Because of their simultaneous anticompetitive and procompetitive effects, vertical restraints have been closely scrutinized by the courts to determine whether they violate the antitrust laws. The courts have applied two standards in their examination of vertical restraints: the per se rule[5] and the rule of reason.[6] An application of the per se rule requires vertical restraints

straints as employed in the soft drink industry.

4. If a manufacturer sets up his entire distribution system with territorial restrictions, all of his distributors will confine their sales to their designated area. Therefore, they will not compete with each other for any retail accounts or compete for the same retail customers. If a retailer wishes to purchase that brand of product, he must purchase it from the distributor in his area, at that distributor's price.

5. The per se rule was announced in Northern Pac. Ry. Co. v. United States, 356 U.S. 1 (1957). The rationale of the per se rule was as follows: "However, 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." *Id.* at 5.

One justification which has been proposed in support of application of the per se rule to vertical sales restrictions is that all such agreements have a collusive aspect. "Distributors who are parties to such agreements are generally aware that parallel arrangements are being made with their potential competitors; thus, the granting of an exclusive franchise to a distributor is an implicitly collusive quid pro quo for his acceptance of a limited territorial or customer outreach." Preston, *Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards*, 30 LAW & CONTEMP. PROBS. 506, 510 (1965).

6. The rule of reason was first introduced as a legal standard by which to analyze possible violations of the antitrust laws in Standard Oil Co. of New Jersey v. United States, 221 U.S. 1, 63-70 (1911). The factors which are to be considered in a rule of reason analysis were aptly stated by Justice Brandeis in Board of Trade of Chicago v. United States, 246 U.S. 231 (1918):

> The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts perculiar to the business to which the restraint is applied: its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual and probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.

Id. at 238.

to be declared illegal without further inquiry. An application of the rule of reason requires the factfinder to weigh all the circumstances peculiar to the case in determining whether vertical restraints impose an unreasonable restraint on trade and therefore violate the antitrust laws. Congress recently introduced what has been perceived as another standard into this controversial area of antitrust law by enacting the Soft Drink Interbrand Competition Act.[7]

The Soft Drink Act sets a standard to judge the legality of certain vertical restraints contained in agreements between soft drink companies and their trademark licensees. It states that territorial restrictions in the distribution of soft drink products will not violate the antitrust laws[8] "*[p]rovided:* That such product is in substantial and effective competition with other prod-

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7. 15 U.S.C.A. §§ 3501-03 (West Supp. 1982) [hereinafter cited as Soft Drink Act or Act]. The Soft Drink Act was controversial and hotly debated by Congress. Critics of the Act labeled it "special interest legislation in its worst form." H.R. REP. No. 1118, 96th Cong., 2d Sess. 1, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 2373, 2385. They insisted that it "would introduce an unnecessary and uncertain element into the law of vertical restraints, and would unfairly tip the scales in favor of the soft drink industry at the expense of the consuming public." *Id.* at 2381.

Furthermore, although the Soft Drink Act relates specifically to only one industry, it is likely to be the predecessor of future legislative proposals by other industries. During the Senate debates on the Soft Drink Act, Senator Metzenbaum, opposing the Act, expressed his view on the likelihood of this domino effect:

> Others will say "We should not have to comply with the antitrust laws either."
>
> They will say that automotive dealers ought to be protected in their territorial rights.
>
> They will say that television manufacturers or refrigerator makers, or any one of a host of other manufacturers of products that are on the market, need protection, need territorial restrictions, and that the antitrust laws should not be applicable.
>
> And if they hire the best lobbyists, and if they organize back home, get enough people to call, they will again prevail upon the Congress to provide that exemption once the pattern has been set.

126 CONG. REC. S5409 (daily ed. May 15, 1980) (statement of Sen. Metzenbaum).

The Soft Drink Act was, in fact, the predecessor to similar legislation in at least one other industry. The Malt Beverage Interbrand Competition Act, introduced by Congressman Jack Brooks of Texas in late April, 1981, would provide the brewing industry the same protections as the soft drink industry. Malt Beverage Interbrand Competition Act, H.R. 3269, S. 1215, 97th Cong., 1st Sess. (1981).

8. Section 5 of the Soft Drink Act states: "As used in this Act, the term 'antitrust law' means the Sherman Act [15 U.S.C. §§ 1-7 (1976)], the Clayton Act [15 U.S.C. §§ 12, 13, 14-19, 20, 21, 22-27 (1976) and 29 U.S.C. §§ 52, 53 (1976)], and the Federal Trade Commission Act [15 U.S.C. §§ 41-58 (1976)]." Soft Drink Act, *supra* note 7, § 5, 15 U.S.C.A. § 3503.

ucts of the same general class in the relevant market or markets."[9] Thus, the standard of the Soft Drink Act for judging the legality of vertical restraints focuses on the quantity and quality of interbrand competition.

Congress enacted the Soft Drink Act to codify the rule of reason,[10] which the Supreme Court, in *Continental T.V., Inc. v. GTE Sylvania Inc.*,[11] held to be the standard applicable in determing the legality of vertical restraints.[12] Soon after the *Sylvania* decision, but before passage of the Act, the Federal Trade Commission applied the rule of reason to antitrust proceedings brought against Coca-Cola[13] and Pepsico, Inc.[14] The Commission, ruling that the territorial exclusivity provisions in agreements between these soft drink companies and their licensees[15]

9. Soft Drink Act, *supra* note 7, § 2, 15 U.S.C.A. § 3501.

10. The House Report (Judiciary Committee), reporting on and recommending passage of the Soft Drink Act, stated that the "legislation restates the rule of reason approach followed by the Supreme Court in *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977)." H.R. REP. No. 1118, 96th Cong., 2d Sess. 1, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 2373 (footnote omitted). Likewise, President Carter, when signing the Act into law, stated that its purpose was to "reaffirm[] legislatively the rule of reason approach . . . ." 16 WEEKLY COMP. OF PRES. DOC. 1334 (July 14, 1980).

11. 433 U.S. 36 (1977) *Sylvania* is a seminal case in the area of vertical restraints. It overruled a previous case which had determined vertical restraints to be illegal per se and established the rule of reason as the standard to be applied in judging the legality of vertical restraints. For a detailed discussion and analysis of the *Sylvania* decision, *see infra* Part III of this comment and accompanying footnotes.

12. *Id.* at 59.

13. Coca-Cola Co., 91 F.T.C. 517 (1978).

14. Pepsico, Inc., 91 F.T.C. 680 (1978). Although the cases against Coca-Cola Co. and Pepsico, Inc. were two separate proceedings, the factual circumstances of both cases were so similar that for expediency, the trial record of Coca-Cola Co. was incorporated into the proceeding against Pepsico, Inc. *See id.* at 686 (stipulation 5(c)). The discussion in this comment relates specifically to the Coca-Cola Co. case, but it applies equally to Pepsico, Inc.

15. The agreements typical in the soft drink industry combine both exclusive franchises and territorial restrictions. The manufacturer sells syrups to a designated bottler and grants him an exclusive license to manufacture, distribute and sell the trademarked beverage within a specified area. In turn, the bottler agrees not to sell outside his defined geographic area. For instance, a typical agreement between Coca-Cola and its bottlers provides as follows:

> COMPANY agrees to furnish to BOTTLER, and only to furnish for the territory herein referred to, sufficient syrup for bottling purposes to meet the requirements of BOTTLER in the territory herein described.
>
> . . . . COMPANY does hereby select BOTTLER as its sole and exclusive customer and licensee for the purpose of bottling the Bottlers' bottled syrup, COCA-COLA, in the territory described.

constituted unreasonable restraints on trade and unfair competition,[16] entered cease and desist orders.[17] Subsequent to the enactment of the Soft Drink Act, however, the Court of Appeals for the District of Columbia[18] set aside those orders, holding that they were "based upon legal standards which differ from those in the . . . Soft Drink Act."[19] The court of appeals reasoned that, rather than codifying the rule of reason standard, the Soft Drink Act introduced a new standard into the analysis of vertical restraints. To date, no court has analyzed or applied

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> [BOTTLER agrees] . . . not to use trade-marks COCA-COLA or COKE, nor bottle nor vend said product except in the territory herein referred to. This limitation, however, is not to prevent BOTTLER from acquiring similar rights for other territory . . . .

Coca-Cola Co., 91 F.T.C. 517, 521 (1978).

16. *Id.* at 674. In 1971, the Federal Trade Commission issued administrative complaints against the Coca-Cola Co. and Pepsico, Inc., stating that the agreements between these two companies and their trademark licensees included territorial exclusivity provisions which constituted unreasonable restraints on trade and therefore violated § 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (1976). An administrative law judge, after making detailed findings of fact and applying the rule of reason test, held that the territorial restrictions did not constitute unreasonable restraints on trade and were therefore legal. Coca-Cola Co., 91 F.T.C. 517, 589 (1978) (initial decision of Administrative Law Judge). Thus, the complaint filed by the Federal Trade Commission was dismissed.

On appeal, the Federal Trade Commission conducted a de novo review of the record and applied *Sylvania* to conclude that the provisions granting exclusive territories *did* constitute an unreasonable restraint of trade and unfair competition. *Id.* at 674 (Opinion of the Federal Trade Commission). The Federal Trade Commission reasoned that the restrictive agreements prevented intrabrand competition and that there were no counterbalancing legitimate business justifications for the restraint. *Id.*

17. Coca-Cola Co., 91 F.T.C. at 674; Pepsico, Inc., 91 F.T.C. at 697.

18. Coca-Cola Co. v. F.T.C., 642 F. 2d 1387 (D.C. Cir. 1981).

19. *Id.* at 1390. In light of the court of appeals decision, complaints against five other soft drink manufacturers were dismissed by a Federal Trade Commission administrative law judge and upheld by the Federal Trade Commission, presumably because they agreed with the court of appeals that the situation was now governed by a different standard. Crush Int'l Ltd., No. 8853; Dr. Pepper Co., No. 8854; The Seven-Up Co., No. 8857; Royal Crown Cola Co., No. 8858; Norton Simon Inc., No. 8877 [July-Dec.] ANTITRUST & TRADE REG. REP. (BNA) No. 1025, at A-17 (July 21, 1981). The complaints against these companies were similar to those issued against Coca-Cola and Pepsico. The Federal Trade Commission charged that the territorial exclusivity provisions which were contained in the licensing agreements between the companies and their bottlers reduced or destroyed competition in the distribution system, thereby denying the benefits to the consumer. *Id.*

These dismissals were upheld by the Federal Trade Commission. Crush Int'l Ltd., No. 8853; Dr. Pepper Co., No. 8854; The Seven-Up Co., No. 8857; Royal Crown Cola Co., No. 8858; Norton Simon, Inc., No. 8877 [July-Dec.] ANTITRUST & TRADE REG. REP. (BNA) No. 1032, at A-22 (Sept. 17, 1981).

the standard of the Soft Drink Act, thus leaving unanswered the questions: what is the standard, and how, if at all, does it differ from the rule of reason?

This comment answers those questions and explains the differences, if any, between the two standards. Part II discusses various product distribution systems, the economic advantages and disadvantages of vertical restraints, and their present use in the soft drink industry. Part III traces the legal treatment of vertical restraints from 1948 to the present. Part IV analyzes the standard of the Soft Drink Act for determining the legality of vertical restraints by defining it, applying it, and comparing it to the rule of reason. This comment concludes that the standard of the Soft Drink Act, although its approach is significantly different, is a positive restatement of the rule of reason.

II. Product Distribution Systems and Vertical Restraints

A manufacturer, balancing the amount of control which he wants to maintain over his product against the resulting costs, may choose among a variety of distribution systems for his product.[20] He may choose a vertically integrated system whereby the manufacturer maintains complete control over the product from its manufacture to sale to the ultimate consumer.[21] This option, although costly,[22] is appealing to the manufacturer who is concerned with controlling his product's price, distribution, quality, and image.

A manufacturer may also choose to distribute his product through a completely independent distributor, whereby he

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20. *See generally Restricted Channels, supra* note 3; Note, *Vertical Restrictions and the Distribution Process: A Practical Review of Economics and the Rule of Reason After Sylvania,* 38 LA. L. REV. 1022 (1978) [hereinafter cited as *Vertical Restrictions*]; Preston, *Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards,* 30 LAW & CONTEMP. PROBS. 506 (1965); Posner, *Antitrust Policy and the Supreme Court: Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions,* 175 COLUM. L. REV. 282 (1975). Each article contains a general discussion of the various types of vertical restrictions and their economic usefulness and business justifications.

21. Vertical integration is defined as "[o]wnership or control of network of production and distribution of goods from raw materials to sale to ultimate consumer." BLACK'S LAW DICTIONARY 1401 (5th ed. 1979). *See also Vertical Restrictions, supra* note 20, at 1033.

22. *See Vertical Restrictions, supra* note 20, at 1033.

transfers total control of his product to the distributor.[23] Once the manufacturer sells his product to the distributor, the distributor is free to price the product and choose the method of resale. Under such a distribution system the manufacturer forfeits control over his product, but shifts many of the costs of distribution and merchandising to the distributor,[24] such as providing warehouse and service facilities, training and maintaining personnel, and maintaining inventory.[25] The manufacturer's choice of a distribution system will be a business decision, based on several factors including cost efficiencies,[26] capital availability,[27] and the product's character.[28]

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23. *Id.*

24. *See id.*

25. *Restricted Channels, supra* note 3, at 806.

26. The use of independent distributors lowers the costs to a manufacturer in several ways. First, by limiting the number of buyers of his product, the manufacturer reduces his selling costs. *Id.* at 805. Second, the manufacturer is able to lower his credit risk and resulting cost by designating a solvent and fiscally responsible distributor. *Id.* Finally, a good distributor is able to forecast sales of the product, thus allowing for more efficient output planning by the manufacturer. *Id.* These advantages were recognized by the administrative law judge in Coca-Cola Co., 91 F.T.C. 517 (1978), when he found: "Territorial restrictions . . . facilitated the licensor's production planning by enabling greater accuracy in calculating the forthcoming demand for syrup in a territory; they reduced the selling cost of the product by avoiding duplication of sales effort in a territory . . . ." *Id.* at 532.

27. All of the distribution costs which were noted in the text require a capital outlay which will fall either upon the manufacturer or the distributor. Thus, a manufacturer may choose to distribute his product through an independent distributor if the manufacturer does not have the capital available to meet these distribution costs. The administrative law judge in Coca-Cola Co., 91 F.T.C. 517 (1978) described, in the findings of fact, the soft drink bottlers as "independent businessmen who are required to make substantial and continuing investments in plant, equipment, packaging and warehouse space." *Id.* at 532.

28. If a product is characterized as a convenience good or impulse good, it is "generally sufficiently standardized for the customer to accept another brand if the one he prefers is not in stock." *Vertical Restrictions, supra* note 20, at 1032 n. 62. With this type of product, a manufacturer will use *intensive* distribution, attempting to get the product into as many retail outlets as possible, thereby increasing the product's exposure. *See id.* Soft drinks are impulse goods and they have certain marketing requirements:

> Constant sampling is necessary to maintain demand for a brand, and total availability of a brand at a multiplicity of outlets is essential to provide constant sampling necessary to successful marketing of that brand. The soft drink industry is also different from other industries in the broad range of flavors and package sizes and types required to be made available to satisfy customer demand, in the need for frequent local store-door service, the importance of in-store merchandising, and the requirement of a store-door delivery system to sustain the use of a return-

If a manufacturer chooses to distribute his product through an independent distributor, but still wants to maintain some control over his product, he may then choose among a "variety of contractually arranged vertical restrictions."[29] The vertical restrictions may take the form of an exclusive franchise, territorial restrictions, or customer restrictions.[30] Under an exclusive franchise agreement, the manufacturer promises the distributor or retailer that he will not sell his product to other outlets within the latter's exclusive territory.[31] In conjunction with the granting of an exclusive franchise, the manufacturer often imposes territorial restrictions on the distributor or retailer, whereby the latter promises that he will not sell the product outside of a defined geographic area.[32] Customer restrictions require a promise by the distributor or retailer that he will not sell the product to certain customers who may be within his geographic area, but are excepted for some other reason. For example, the manufacturer may prohibit the distributor from selling to certain large customers who the manufacturer wants to reserve for himself.[33]

A distribution system containing some vertical restraints is an intermediate form of distribution between the vertically integrated system and a system with completely independent distributors. It allows the manufacturer to maintain control over certain aspects of the product's distribution,[34] while relinquish-

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able container.

Coca-Cola Co., 91 F.T.C. 517, 532-33 (1978) (initial decision of Administrative Law Judge).

29. *Vertical Restrictions, supra* note 20, at 1033-34; *See* the discussion of vertical sales restrictions, *supra* note 1.

30. *Restricted Channels, supra* note 3, at 796.

31. *Id.*

32. *Id.* Territorial restrictions generally take two forms. One is the location clause, where an authorized retailer promises to sell the product only from one retail outlet at a designated location. Under such an agreement, the retailer's sales will be limited to customers who live within close enough proximity to the retailer's outlet to feasibily travel to it. *See id.*

Territorial restrictions placed on a distributor require a promise that he will not sell to retail outlets outside of a defined geographic area. The size of his area depends solely on the contract he has with the manufacturer. *See id.*

33. *Id.*

34. One important control which the manufacturer may wish to maintain is quality control. In the soft drink industry, the syrup company manufactures the soft drink syrup and sells it to the bottler, who in turn manufactures, bottles, and distributes the finished

ing control over other aspects to the distributor.[35] It also allows the manufacturer and distributor to share in the distribution costs.[36]

This intermediate form of distribution represents a compromise which a manufacturer feels he must make in order to get aggressive distributors.[37] The granting of an exclusive franchise, with territorial restrictions to protect it, is a recognition by the manufacturer of the capital expenditure and risk which a distributor undertakes in accepting and financing a franchise. An exclusive franchise, with territorial restrictions, provides some assurances to the distributor that his investment will be recovered. This encourages distributors to market the products of a new manufacturer or market the new products of an established manufacturer.[38]

A franchise contract between the manufacturer and his distributor will often require the distributor to meet certain standards and to perform certain duties to protect the product's name and to ensure the product's performance.[39] Some of the

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product. The bottling process must, however, comply with the syrup manufacturer's quality standards and specifications. *See* Coca-Cola Co., 91 F.T.C. 517, 533 (1978).

35. Under his distribution agreement with Coca-Cola Co., "[t]he bottler decides on the plant and equipment to be used, the volume of production by size and type of container and product mix, as well as the price to be charged and the manner in which he can maximize his market penetration and secure the widest possible distribution of trademarked soft drinks throughout his territory." *Id.*

36. The syrup manufacturer and the bottler frequently engage in joint advertising and promotional programs. *Id.*

37. *Restricted Channels, supra* note 3, at 805.

38. The Supreme Court in Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 55 (1977), recognized this fact as one of the positive effects of vertical restrictions. In Coca-Cola Co., however, the Federal Trade Commission properly noted that this argument offers support only to the "new entrant or a failing or faltering firm." Coca-Cola Co., 91 F.T.C. at 626. It stated that in the case of Coca-Cola Co.:

> [T]erritorial restrictions are not serving the interests of competition in aid of an aspiring new entrant or a failing or faltering firm which cannot otherwise find investors to put up the distribution capital necessary to market its product. In this instance, the restraint is reducing the entrepreneurial risk of investment by lessening competition among the firms which wholesale one of the most popular consumer product lines in American industry.

Id. at 627.

39. *See Restricted Channels, supra* note 3, at 806. Contractual requirements might be as follows:

1) Distributor required to meet certain standards in his building and warehouse facilities in order for the product to be sold in attractive surroundings;
2) Distributor required to carry a certain amount of inventory;

common requirements are for servicing,[40] merchandising,[41] and quality control.[42] A distributor will also often perform certain services and engage in costly activities aimed at establishing goodwill.[43] Without territorial restrictions, one distributor may be able to take a "free-ride" on another distributor's efforts to comply with these requirements which promote the product's name and promote goodwill in the distributor's territory.[44] The distributor who has spent considerable money to provide services and merchandising might be undersold in his own territory by a competing distributor who is able to reduce his overhead, and thus his prices, by not providing these services and merchandising.[45] Territorial restrictions prohibit the free-riding distributor from transshipping[46] into another distributor's territory and thus encourage the latter distributor to provide services and merchandising by making it profitable for him to do so.[47]

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3) Distributor required to carry on a certain amount of promotional activity. *Id.* at 806-07.

40. Service has been described as an extremely important factor in promoting interbrand competition. *See* Coca-Cola Co., 91 F.T.C. 517, 566 (1978). Service in the soft drink industry includes: frequency of delivery by route salesmen, including weekends; cleaning and filling coolers; sorting empty bottles, repairing vending machines. *Id.* Also, soft drink bottlers "service unprofitable accounts to have the product available in as many outlets as possible. *Id.* at 546.

41. Soft drink bottlers merchandise the product by competing in food store outlets for adequate shelf space and for placement of point-of-sale advertising. The obtainment and proper placement of vending machines is also an important merchandising tool in this industry. *Id.* at 565.

42. One of the major concerns of the bottler and syrup manufacturer is that the consumer obtain a fresh and good-tasting product. To this end, soft drink bottlers are required to maintain quality control over the product by means of proper stock rotation. If old product is discovered in a retail account, the salesman will replace it with new product and dispose of the old. *Id.* at 545. Furthermore, "[f]ailure on the part of a bottler to meet the quality standards it has established may trigger one of the few contingencies justifying the forefeiture of a bottler's bottling rights." *Id.* at 608.

43. Soft drink bottlers "build demand for Coca-Cola . . . by generating good will in the community, and have become identified with their products in their communities." *Id.* at 540. Bottlers generate this good will by supplying soft drinks for special events, such as school picnics and football games. *Id.* at 565.

44. *See* Note, *Vertical Territorial Restrictions Judged Under Rule of Reason*, 52, TUL. L. REV. 389, 394 (1978) [hereinafter cited as *Vertical Territorial Restrictions*].

45. *Id.*

46. "Transshipping" is a term which describes a practice whereby one distributor sells products outside of his designated geographic territory, into another distributor's territory, thus violating the latter distributor's exclusive franchise rights.

47. *Vertical Territorial Restrictions*, *supra* note 44, at 394.

Although the business justifications for vertical restrictions are great, the effect of their use is widely debated. The debate centers on vertical restraints' effects on competition. One school of economic thought maintains that a manufacturer should be allowed to decide how to market his product.[48] Another school of economic thought, arguing for pure competition, maintains that consumers and the law of supply and demand should determine what and where goods will be sold.[49] The courts have also entered into this debate, ruling both for and against vertical restraints. The legal treatment of vertical restraints reflects the courts' recognition of the potential anticompetitive effects of, as well as the business justifications for, vertical restraints.

III. Legal Treatment of Vertical Restraints

A. *White Motor Co.*

In 1948, the Justice Department issued a policy statement in which it contended that territorial and customer restrictions were illegal per se.[50] Most companies accepted the government's contention and litigation on these issues ended in consent decrees.[51] Therefore, *White Motor Co. v. United States,*[52] decided in 1963, was the first case in which the Supreme Court examined vertically imposed territorial restrictions. The Court refused to declare vertical restraints illegal per se, noting that they may or may not produce unacceptable restraints on trade.[53] It did not, however, "know enough of the economic and business stuff out of which these arrangements emerge to be certain."[54] The Court

48. *See Vertical Restrictions, supra* note 19, at 1036 (citing Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath,* 81 HARV. L. REV. 1419, 1427-32 (1968)).

49. *Id.* (citing Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division* (pt. 2), 75 YALE L. J. 337, 403 (1966)).

50. *See Hearings Before the Subcommittee on Automobile Legislation of the House Committee on Interstate and Foreign Commerce,* 84th Cong., 2d Sess. 362 (1956).

51. *Monograph, supra* note 1, at 7. For a list of citations to numerous consent decrees in various industries *see id.* at 7 n. 17.

52. 372 U.S. 253 (1963). This case involved the distribution system of a truck manufacturer which included territorial clauses which limited or restricted "the territories within which the distributors . . . may sell and [included] limitations . . . on the persons or classes of persons to whom they may sell." *Id.* at 255.

53. *Id.* at 263.

54. *Id.* The Court stated that more should be known about the impact of vertical

also refused to apply the rule of reason, but held merely "that the legality of the territorial and customer limitations should be determined only after a trial."[55] Although the Supreme Court did not specifically apply either the per se rule or the rule of reason, it has been suggested that the Court, by implication, preferred the rule of reason.[56]

B. *Schwinn*

Departing from the uncertainty of *White Motor Co.*, the Supreme Court held in *United States v. Arnold, Schwinn & Co.*[57] that certain vertical restrictions in Schwinn's distribution system constituted a per se violation of the Sherman Act.[58] Schwinn marketed its bicycles through 22 wholesale distributors who were assigned specific territories. Schwinn also designated its franchise retail dealers and required them to obtain their bicycles from an authorized distributor. Schwinn's distribution method had three variations: 1) Schwinn *sold* bicycles to the wholesalers for resale to the retailers; 2) Schwinn sold bicycles to the retailers on consignment or by agency arrangements with the distributors; and, 3) Schwinn sold the bicycles to the retailers under the "Schwinn Plan" whereby Schwinn shipped the bicycles directly to the retailer, extended him credit, and paid the distributor a commission on the sale. The charge was that Schwinn's distributors, instructed to sell only to franchised retailers within a certain geographic area,[59] did not compete with

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restraints in order to determine whether they justify application of the per se rule; to determine whether they have such a "pernicious effect on competition and lack . . . any redeeming virtue." *Id.* (quoting Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958)).

55. 372 U.S. at 264. The Supreme Court reversed the grant of summary judgment, stating that summary judgment was improper for vertical restraints. *Id.*

56. *Vertical Restrictions, supra* note 20, at 1042. The author stated:

> The majority noted that the restrictions might be allowable against aggressive competitors or if they were the only practicable means a small company had for breaking into or staying in business. Justice Brennan specifically noted several justifications for vertical restrictions. Both opinions imply a rule of reason approach since allowing justifications is inconsistent with the per se test.

Id. at 1042 n. 135 (citation omitted).

57. 388 U.S. 365 (1967).

58. *Id.* at 372.

59. *Id.* Although there was not specific proof that Schwinn terminated the franchises of retailers or distributors who violated the territorial exclusivity agreements,

one another, and therefore were in conspiracy with Schwinn to restrain trade in violation of section 1 of the Sherman Act.[60]

The Court found that the key factor in justifying application of a per se rule was whether the manufacturer retained title, dominion, and risk with respect to the product. It held that "where a manufacturer *sells* his products to his distributor subject to territorial restrictions upon resale, a *per se* violation of the Sherman Act results."[61] This was the first time the per se rule had been applied to vertical restraints. Prior to *Schwinn*, only the following stituations had invoked this rule: price fixing,[62] tying arrangements,[63] group boycotts,[64] and horizontal

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the Court concluded that Schwinn had been " 'firm and resolute' in insisting upon observance of territorial and customer limitations." *Id.*

60. *Id.* at 371. Section 1 of the Sherman Act provides in part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.

15 U.S.C. § 1 (1976).

61. 388 U.S. at 379 (following the district court's decision). The Court noted:

> Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it. Such restraints are so obviously destructive of competition that their mere existence is enough.

Id. (citation omitted). On the other hand, the Court retained the rule of reason as the standard to be applied when the manufacturer retains title, dominion and risk with respect to the product. *Id.* at 380.

62. *See, e.g.*, United States v. Parke, Davis & Co., 362 U.S. 29 (1960); Kiefer-Steward Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211 (1951); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); *cf.* United States v. Bausch & Lomb Optical Co., 321 U.S. 707, 728-29 (1944) (restrictive practices which are ancillary to price fixing are not allowed). Price-fixing is defined as "[t]he cooperative setting of price levels or ranges by competing firms." BLACK'S LAW DICTIONARY 1070 (5th ed. 1979).

63. *See, e.g.*, Fortner Enter. Inc. v. United States Steel Corp., 394 U.S. 495 (1969); Northern Pac. Ry. Co. v. United States, 356 U.S. 1 (1958); Times-Picayune Publishing Co. v. United States, 345 U.S. 594 (1953); Standard Oil Co. of Cal. v. United States, 337 U.S. 293 (1949). A tying arrangement exists when a manufacturer requires the buyer to purchase one good in order to get another. The latter good is usually the one that is particularly in demand and may be patented so that the buyer may be forced to buy from that particular manufacturer in order to get the product he wants. *See also Antitrust Law-Tying Arrangements and Per Se Illegality*, 38 U.M.K.C. L. REV. 483 (1970) (casenote on the *Forner* decision).

64. *See, e.g.*, Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959). Group boycott is defined as "[a] concerted refusal by traders to deal with other traders. Such is unlawful per se because it restrains freedom of parties to the boycott independently to decide whether to deal with boycotted party." BLACK'S LAW DICTIONARY 633 (5th ed. 1979).

divisions of markets.[65]

C. *Sylvania*

Ten years after *Schwinn*, the Supreme Court in *Continental T.V., Inc. v. GTE Sylvania Inc.*,[66] examined a distribution system indistinguishable from Schwinn's in "intent and competitive impact."[67] Sylvania distributed its televisions through a limited number of franchised retail outlets in a geographic area.[68] The franchisee was prohibited from selling Sylvania's products from any location other than his designated outlet.[69] The franchisee was not granted an exclusive territory and Sylvania reserved the right to designate additional retailers in an area.[70] When Sylvania franchised a new outlet in an area already serviced by Continental T.V., Continental objected and advised Sylvania of its intent to expand its operation to a location not authorized by Sylvania.[71] Sylvania reduced Continental's line of credit, and Continental retaliated by withholding money it owed to the finance company in charge of credit relations between Sylvania and Continental.[72] Sylvania terminated Continental's franchise agreement, and the finance company sued Continental for the payments due.[73] Continental cross-claimed against Sylvania, charging that Sylvania's marketing system violated section 1 of the Sherman Act in that it restricted the locations from which retailers could resell the products.[74]

The district court instructed the jury pursuant to the per se

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65. *See, e.g.*, United States v. Sealy, Inc., 388 U.S. 350 (1967) (restraints that appear vertical on their face, but upon closer examination are really horizontal, are illegal); Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951) (horizontal restraints exist when persons who would normally be in competition with one another conspire to divide up the territory among themselves); *cf.* United States v. General Motors Corp., 384 U.S. 127, 142-45 (1966) (territorial restrictions which initally were vertically imposed by the manufacturer, may with time take on a dominant horizontal character and become illegal).

66. 433 U.S. 36 (1977).

67. *Id.* at 46.

68. *Id.* at 38.

69. *Id.* (footnote omitted). *See supra* note 32 for a discussion of location clauses.

70. *Id.* at 38.

71. *Id.* at 39.

72. *Id.* at 39-40 (footnote omitted).

73. *Id.* at 40.

74. *Id.* (footnote omitted).

rule enunciated in *Schwinn*.[75] It charged that "regardless of the reasonableness,"[76] *any* effort by Sylvania to restrict locations from which its retailers could sell Sylvania's products was a violation of the Sherman Act.[77] The jury found that Sylvania had entered into a contract, combination, or conspiracy in restraint of trade by virtue of its location clauses.[78]

On appeal, the Court of Appeals for the Ninth Circuit [79] stated that *Schwinn* was "readily distinguishable"[80] and held that "an instruction incorporating the 'rule of reason' should have been given to the jury."[81] The district court's judgment was therefore reversed and remanded.[82] The Supreme Court granted certiorari, stating that "the need for clarification of the law in this area justifies reconsideration."[83]

Unable to distinguish *Schwinn*, the Supreme Court in *Sylvania* overruled the per se rule,[84] and held that the legality of vertical restraints should be determined by applying the rule of reason.[85] The Court reasoned that the rule of reason was the proper standard because of the unique effects of vertical restrictions. It noted that "[t]he market impact of vertical restrictions is complex because of their potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition."[86] The Court further stated that the rule of reason is appropriate for an analysis of vertical restrictions because it allows the factfinder to weigh "all of the circumstances of a case

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75. 433 U.S. at 40-41 (citing the district court opinion).

76. *Id.* at 41.

77. *Id.*

78. *Id.*

79. GTE Sylania Inc. v. Continental T.V., Inc., 537 F. 2d 980 (9th Cir. 1976).

80. *Id.* at 997.

81. *Id.* at 1001. The court of appeals noted that ". . . Sylvania presented substantial evidence from which the jury might have reasonably concluded that Sylvania's location practice, rather than unreasonably restricting competitive market forces, actually had a procompetitive effect . . ." *Id.*

82. *Id.* at 1004.

83. Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 47 (1977).

84. *Id.* at 58.

85. *Id.* at 59. The Supreme Court affirmed the decision of the court of appeals and the case was remanded to the district court for further proceedings. On remand, the district court granted Sylvania's motion for summary judgment, holding that its chosen method of distribution "was not an unreasonable restraint of trade." Continental T.V., Inc. v. GTE Sylvania Inc., 461 F. Supp. 1046, 1052 (N.D. Cal. 1978).

86. 433 U.S. at 51-52 (footnotes omitted).

in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition."[87] Under this standard the factfinder may consider the business justifications for vertical restraints as well as their effects on competition.

D. *Post-Sylvania*

Since *Sylvania*, courts presented with distribution systems containing territorial restrictions have begun their analyses by determining whether the restraints were vertical or horizontal.[88] When the restraint was classified as vertical, the courts applied the rule of reason to judge its legality.[89] In applying the rule of reason the courts have narrowed their focus to the effects of vertical restraints on interbrand competition.

Even while restricting their analyses to vertical restraints' effects on interbrand competition, the courts have reached ambiguous conclusions with regard to their legality.[90] This ambigu-

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87. *Id.* at 49 (footnote omitted).

88. *See, e.g.*, Muenster Butane, Inc. v. Stewart Co., 651 F. 2d 292, 295 (5th Cir. 1981); Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001, 1004 (5th Cir. 1981).

89. *See, e.g.*, Muenster Butane, Inc. v. Stewart Co., 651 F. 2d 292, 295 (5th Cir. 1981); Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001, 1004 (5th Cir. 1981); Lamp Liquors, Inc. v. Adolph Coors Co., 563 F.2d 425, 432 (10th Cir. 1977); Adolph Coors Co. v. A & S Wholesalers, Inc., 561 F. 2d 807, 813 (10th Cir. 1977).

90. *See, e.g.*, cases applying the rule of reason and holding that the vertical restraints were legal, Muenster Butane, Inc. v. Stewart Co., 651 F.2d at 295; Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d at 1004; Del Rio Distributing, Inc. v. Adolph Coors Co., 589 F.2d 176, 178 (5th Cir. 1979); JBL Enter., Inc. v. Jhirmack Enter., 519 F. Supp. 1084, 1088-89 (N.D. Cal. 1981).

In Norman Williams Co. v. Rice, 108 Cal. App. 3d 348, 166 Cal. Rptr. 563 (1980) *cert. granted*, ___U.S. ___, 102 S. Ct. 632 (1981), however, the California Court of Appeal struck down a California statute which enforced vertical restrictions prohibiting state importers of alcoholic beverages from purchasing any brand of distilled spirits unless designated by the distiller as the authorized brand representative. With the statute invalidated, unauthorized importers were able to procure national brand spirits from another state, transship them into California, and undersell the California wholesalers designated by the distiller. The distillers were unable to enforce the controls on their distribution system and the authorized wholesalers were unable to protect their status or investment. The court applied the rule of reason and distinguished *Sylvania* by noting that in this case, the state was providing authority for the distillers to prohibit the wholesalers from trading with each other. *Id.* at 356, 166 Cal. Rptr. at 570.

The Supreme Court reversed the California Court of Appeal, stating: "It is irrelevant for our purposes that the distiller's ability to restrict intrabrand competition in

ity is apparent in the results reached in the soft drink cases. An administrative law judge and the Federal Trade Commission, each applying the rule of reason, examined the effects of vertical restraints on interbrand competition in the soft drink industry and reached opposite conclusions: One court held that the territorial restrictions did not unreasonably restrain competition,[91] and the other court held that they did.[92]

The Soft Drink Act was enacted partially in response to the ambiguity concerning the legality of certain vertical restraints in the soft drink industry. It was enacted to "clarify the circumstances under which territorial provisions in licenses to manufacture, distribute and sell trademarked soft drink products are lawful under the antitrust laws."[93]

IV. Analysis

A. *The Standard Defined*

Section 2 of the Soft Drink Act states:

> Nothing contained in any antitrust law shall render unlawful the inclusion and enforcement in any trademark licensing contract or agreement, pursuant to which the licensee engages in the manufacture . . ., distribution, and sale of a trademarked soft drink product, of provisions granting the licensee the sole and exclusive right to manufacture, distribute, and sell such product in a defined geographic area or limiting the licensee, directly or indirectly, to the manufacture, distribution, and sale of such product only for ultimate resale to consumers within a defined geographic area: *Provided*: That such product is in substantial and effective competition with other products of the same general class in the relevant market or markets.[94]

California has the imprimatur of a state statute." Rice v. Norman Williams Co., 50 U.S.L.W. 5052, 5054 (U.S. June 29, 1982) (Nos. 80-1012, 80-1030, 80-1052) (citation omitted). The Supreme Court held that a state statute will not be facially incompatible with the federal antitrust laws unless it mandates behavior which would be in all instances per se illegal. *Id.* The California statute does not compel behavior which is per se illegal since non-price vertical restraints, under the *Sylvania* ruling, are judged by the rule of reason. *Id.*

91. Coca-Cola Co., 91 F.T.C. at 589 (initial decision of Administrative Law Judge).

92. *Id.* at 674 (final order).

93. Preamble to the Soft Drink Act, *supra* note 7.

94. Soft Drink Act, *supra* note 7, § 2, 15 U.S.C.A. § 3501.

The Soft Drink Act sets a standard to determine when agreements granting an exclusive franchise to, or imposing territorial restrictions on, soft drink bottlers will be lawful under the antitrust laws. The standard is whether there is substantial and effective interbrand competition. The Act states specifically that these agreements will be legal provided there is "substantial and effective"[95] competition among "products of the same general class."[96]

In determining the effects of vertical restraints on interbrand competition in the soft drink industry, courts should examine competition among *all* brands and types of soft drinks. Courts, however, should also narrow their analyses and examine competition among *each* type of soft drink. For instance, they should examine competition among all available colas, separately from an analysis of competition among other flavored soft drinks. For this analysis, colas would become the "products of the same general class." Even though interbrand competition in the soft drink industry in general is strong, lack of competition in one particular flavor of soft drink might make the vertical restraints imposed by the manufacturer of that flavor unreasonable.

An analysis of interbrand competition might focus on several factors. Manufacturers of different brands compete in the following ways:

1) Pricing and price promotions;
2) Service;
3) Product availability in fountain accounts, vending machines, sports and other special events;
4) Package availability;
5) Merchandising; including shelf-space, on and off-premise point-of-sale;
6) Advertising.

Congress, discussing the standard of the Soft Drink Act, noted the following additional factors as relevant to an analysis of interbrand competition:

> [T]he number of brands and types of flavors available of soft

95. *Id.*
96. *Id.*

drinks; the persistence of long-run anti-comptetitive profits; the number of retail price options available to consumers; the existence of inefficiency and waste; . . . ease of entry into the market; the number and strength of sellers of directly competing products in a relevant market; . . . ."[97]

Although it is clear that the standard of the Soft Drink Act is interbrand competition, it is not clear how much competition is necessary to make the vertical restrictions in agreements between syrup manufacturers and their bottlers lawful. The language of the Act states that competition must be "substantial and effective."[98] Courts may find guidance in defining this requirement by examining previous cases which applied the rule of reason standard. In such cases, the courts have considered the significance of relative market share, or market power.[99] One court noted, "if a firm lacks market power, it cannot affect the price of its product; and thus any vertical restraint could not be anticompetitive at the interbrand level."[100] Thus, the amount of market share possessed by a company is linked to its ability to adversely affect interbrand competition. Presumably, at some point when one manufacturer's market share becomes too large, interbrand competition will no longer be "substantial and effective." But no court has suggested a formula indicating how much market share is necessary before a company has the ability to adversely affect interbrand competition. Courts must still examine all the facts and circumstances peculiar to the case.

The Soft Drink Act also states that interbrand competition must be substantial and effective "in the relevant market or markets."[101] Therefore, courts should identify the relevant markets when considering a manufacturer's market share. For example, a syrup manufacturer may have a de minimus nationwide market share, while at the same time have a very large market

97. H.R. Rep. No. 1118, 96th Cong., 2d Sess. 1, *reprinted in* 1980 U.S. Code Cong. & Ad. News 2373, 2377.

98. Soft Drink Act, *supra* note 7, § 2, 15 U.S.C.A. § 3501.

99. *See, e.g.*, Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977); Muenster Butane, Inc. v. Stewart Co., 651 F. 2d 292, 298 (5th Cir. 1981); JBL Enter., Inc. v. Jhirmack Enter., 519 F. Supp. 1084, 1090-91 (N.D. Cal. 1981).

100. Muenster Butane, Inc. v. Stewart Co., 651 F.2d at 298 (quoting Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per se Legality*, 48 U. Chi. L. Rev. 6, 16 (1981)).

101. Soft Drink Act, *supra* note 7, § 2, 15 U.S.C.A. § 3501.

share in one particular geographic area. In such a situation, interbrand competition in that particular geographic area may not be substantial and effective and therefore the vertical restraints between the manufacturer and the bottlers in that area would not be lawful. If examined in light of the nationwide market, however, interbrand competition would be substantial and effective and the vertical restraints therefore lawful.

B. *The Standards Compared*

The Supreme Court in *Sylvania*, applying the rule of reason, stated that "interbrand competition . . . is the primary concern of antitrust law."[102] In applying the rule of reason, courts have focused on interbrand competition, to the exclusion of almost all other factors, and have accepted the legality of vertical restraints which eliminate intrabrand competition, but promote interbrand competition.[103] Yet opponents of the Soft Drink Act contend that an analysis under the rule of reason must also examine the effects of vertical restraints on intrabrand competition.[104] Their contention, however, is not supported by case law. For example, in *Sylvania*, the Court, describing the marketing strategy and distribution system of GTE Sylvania, noted that "[a]n acknowledged purpose . . . was to decrease the number of competing Sylvania dealers."[105] Even though Sylvania's marketing strategy eliminated intrabrand competition, the Court accepted it as a reasonable business practice. Similarly, in *Muenster Butane, Inc. v. Stewart Co.*,[106] the Court of Appeals for the Fifth Circuit observed: "although Stewart's practices may have reduced intrabrand competition between . . . [two Zenith retailers] somewhat, interbrand competition between Zeniths and other brands remained strong; indeed, it increased."[107]

The above examples indicate that the standard of the Soft

102. 433 U.S. 36, 52 n. 19 (1977).

103. *See, e.g.*, Muenster Butane, Inc. v. Stewart Co., 651 F. 2d at 296-98; Del Rio Distributing, Inc. v. Adolph Coors Co., 589 F. 2d 176, 177-78 (5th Cir. 1979); JBL Enter., Inc. v. Jhirmack Enter., 519 F. Supp. 1084, 1088 (N.D. Cal. 1981).

104. *See* H.R. Rep. No. 1118, 96th Cong., 2d sess. 1, *reprinted in* 1980 U. S. Code Cong. & Ad. News 2373, 2387 (dissenting views of Reps. Edward, Conyers, and Drinan).

105. Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 368 (1977).

106. 651 F.2d 292 (5th Cir. 1981).

107. *Id.* at 296.

Drink Act and the standard of the rule of reason, as applied, are no different. Both standards focus on interbrand competition and consider the same factors in their analyses of vertical restraints. Yet the approaches of the two standards are significantly different. The application of the rule of reason standard requires a negative approach: Here the courts examine the vertical restraints to determine whether they produce any adverse effects on interbrand competition. The application of the standard of the Soft Drink Act requires a posititve approach: Here the courts accept the legality of vertical restraints provided there is "substantial and effective" competition among "products of the same general class." Under the former standard the courts must look for competition which has become weak; under the latter standard the courts must look for competition which has remained strong.

The standard of the Soft Drink Act further reflects a positive approach because it recognizes the business justifications for vertical restraints and positively states the validity of their use in the current distribution systems of the soft drink industry. An analysis under the Soft Drink Act begins with the assumption that there are valid business justifications for vertical restraints, and focuses directly on their effects on interbrand competition to determine whether they are lawful. Under the rule of reason standard, vertical restraints are slightly more suspect than they are under the Soft Drink Act. Under the rule of reason, the business justifications are neither presumptively valid, nor presumptively invalid. The court must first make detailed findings of fact and closely examine the circumstances peculiar to the case, to determine whether there are valid business reasons to justify the vertical restraints. This often results in lengthy trials and an arduous fact finding process.[108]

C. *The Standard Applied*

With its emphasis on interbrand competition, the territorial exclusivity provisions embodied in soft drink distribution systems are likely to survive the application of the Soft Drink Act

108. For example, the findings of fact in the initial decision of the administrative law judge in Coca-Cola Co. were contained in 53 pages. The bulk of these findings centered on the business justifications for the restrictions in the soft drink industry.

standard. Courts applying that standard will note that interbrand competition among major manufacturers is stiff.[109] Further, regional brands are in healthy competition with national brands.[110] The consumer is presented with many retail options in both packaging and pricing, which reflect the existence of products "in substantial and effective competition with other products of the same general class."

Nothing assures the soft drink industry of permanent acceptance of its territorial restrictions. The market could change,[111] reducing the nature and extent of interbrand competition. Nothing precludes further examination of the market and a determination that the industry does not conform to the standards of the Soft Drink Act. Because of this, contrary to its critics' contention, the Soft Drink Act does not totally exempt the soft drink industry from the antitrust laws.[112]

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109. In Coca-Cola Co., 91 F.T.C. 517 (1978), the administrative law judge noted the existence of interbrand competition in the soft drink industry, stating: "[Coke] [b]ottlers compete within their territories against national brands of soft drinks such as Pepsi-Cola, Seven-Up, Royal Crown, Canada Dry, Dr. Pepper, and Shasta, and against regional brands such as Rock Creek, Faygo, and Vernor's private label brands." *Id.* at 542.

110. One practice which stimilates competition from regional brands in the soft drink industry is "piggybacking", whereby local bottlers become licensees for more than one syrup manufacturer. This practice allows a new manufacturer to take advantage of the marketing expertise of the bottler, and the bottler to test a new product without extensive additional capital expenditure. The incidence of piggybacking is widespread, as evidenced by the fact that in 1971, 438 of the 726 domestic Coca-Cola bottlers also handled at least one other brand. H. R. Rep. No. 1118, 96th Cong., 2d Sess. 1, *reprinted in* 1980 U.S. Code Cong. & Ad. News 2373, 2374.

111. At present, the large multiplant bottler dominates the industry with 70% of the total soft drink sales. In 1950, there were over 6,000 bottling plants. In 1980, there were approximately 2,000 plants, run by 1,700 companies. In 1972, the largest 50 bottlers controlled 45% of the domestic soft drink sales. *Id.* These figures are certainly subject to change. If the courts find in the future that the large bottlers have gained an even greater share of the market and are monopolistic in their practices, their distribution systems might be held invalid under the Soft Drink Act standard. Since one of the stated purposes of the Act was to prevent the demise of the small bottlers and small distributors, any trend tending to negate this purpose would receive close scrutiny.

112. Section 3 of the Soft Drink Act specifically states:

> Nothing in this Act shall be construed to legalize the enforcement of provisions described in section 2 [15 U.S.C.A. § 1501] of this Act in trademark licensing contracts or agreements described in that section by means of price fixing agreements, horizontal restraints of trade, or group boycotts, if such agreements, restraints, or boycotts would otherwise be unlawful.

Soft Drink Act, *supra* note 7, § § 6, 3, 15 U.S.C.A. § 3502.

V. Conclusion

The Soft Drink Act standard is a positive restatement of the rule of reason. Although its approach is significantly different, the result of its application is the same. Both standards require an examination of the marketplace and a detailed examination of the facts peculiar to the case to determine the effects of vertical restraints on interbrand competition. If the vertical restraints have an adverse effect on interbrand competition, they will be invalid under either standard.

The Soft Drink Act is significant because of its positive approach. First, it gives the soft drink industry some assurance that the distribution systems which it has employed for 75 years will be lawful. Second, it aids the soft drink manufacturers and bottlers in economic planning by letting them know beforehand whether their marketing and distribution systems will be valid. Without such knowledge, the manufacturer risks extensive and expensive litigation, a frequent occurrence in the soft drink industry.[113] Third, a bottler who makes a substantial investment to become a franchisee with the promise of an exclusive territory will know ahead of time if his investment will be protected. This is particularly important if the bottler is a representative for a single manufacturer and the very existence of his business depends on the legality of his arrangement with that manufacturer. These reasons clarify the importance and need for the soft drink industry to have a positive statement regarding the legality of their distribution systems.

The Court of Appeals for the District of Columbia, an administrative law judge, and the Federal Trade Commission each expressed their belief that the standard of the Soft Drink Act differed from that of the rule of reason. Yet they did not define or apply the Soft Drink Act standard. It will be interesting to see how they define the standard in the future and what the result of its application will be. It is very likely that all will conclude that, in practice, the two standards are not different after all.

Anna Bilden Parker

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113. *See supra* notes 16 and 19.