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96TH CONGRESS
2d Session

SENATE

REPORT
No. 96–645

SOFT DRINK INTERBRAND COMPETITION ACT

REPORT

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ON

S. 598

together with

MINORITY VIEWS

MARCH 26 (legislative day, JANUARY 3), 1980.—Ordered to be printed

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[96th Congress]

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SOFT DRINK INTERBRAND COMPETITION ACT

MARCH 26 (legislative day, JANUARY 3), 1980.—Ordered to be printed

Mr. BAYH, from the Committee on the Judiciary, submitted the following

REPORT

together with

MINORITY VIEWS

[To accompany S. 598]

The Committee on the Judiciary, to which was referred the bill (S. 598) 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, having considered the same, reports favorably thereon, and recommends that the bill do pass.

I. PURPOSE

The intention of S. 598 is to clarify the application of the antitrust laws to territorial provisions contained in licenses to manufacture, distribute, and sell trademarked soft drink products.

S. 598 provides that the traditional territorial soft drink franchise system is lawful under the antitrust laws so long as there is substantial and effective interbrand competition.[1] If, however, it can be established that there is not substantial and effective interbrand competition the provisions of this bill shall not apply. The committee believes that, in the absence of enactment of this legislation, the effect of the recent decision of the Federal Trade Commission in the soft drink cases will be to cause a restructuring of the industry in such a manner that the legitimate interests of many members of the industry and of the consuming public will be harmed.

[1] Interbrand competition takes place among products of different brands. Intrabrand competition, on the other hand, involves competition among products of the same brand sold by different vendors.

This industry has been functioning for over 75 years under the clear understanding that such arrangements were legally permissible. Therefore, S. 598 includes a section which would provide protection against crippling and excessive treble damages until such time as territorial arrangements might be found unlawful because of the absence of substantial and effective interbrand competition.

The committee is mindful that the Supreme Court has stated that the balancing of complex economic and social values of the kind involved here is the proper function of the Congress and the action of the committee is consistent with this reasoning.[2]

Historically, the Congress has been committed to fostering competition as the most effective means of protecting the public interest and, at the same time, to promoting an economic system of independent local businesses which can effectively compete with one another.[3]

The committee has concluded that the present territorial franchise system in the soft drink bottling industry can foster effective competition. The committee recognizes that the destruction of the system is likely to depress the value of the franchised bottling plants and cause tremendous economic harm to hundreds of small bottlers who have depended on this system for many years. It is the judgment of this committee, based on the record, that the public interest will be protected by the continuation of vigorous interbrand competition among the various soft drink products. This legislation would not only preserve such competition and protect the consumer but also insure the continued opportunity for small local independent business units to survive. Thus, it has approved this legislation, which shall be applicable in those areas where substantial and effective interbrand competition exists.

II. Text of Senate Bill 598

The text of S. 598 is as follows:

A BILL 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

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. This Act may be cited as the "Soft Drink Interbrand Competition Act."

SEC. 2. Nothing contained in any antitrust law shall render unlawful the inclusion and enforcement in any trademark licensing contract or agreement, pursuant to which the

[2] "If a decision is to be made to sacrifice competition in one portion of the economy for greater competition in another portion, this . . . is a decision which must be made by Congress and not by private forces or by the courts. Private forces are too keenly aware of their own interests in making such decisions and courts are ill-equipped and ill-situated for such decision making. To analyze, interpret, and evaluate the myriad of competing interests and the endless data which would surely be brought to bear on such decisions and to make the delicate judgment on the relative values to society of competitive areas of the economy, the judgment of the elected representatives of the people is required." *United States* v. *Topco Associates, Inc.*, 405 U.S. 596, 611–12 (1972) (Marshall, J.)

[3] "Throughout the history of these [antitrust] statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other." *United States* v. *Aluminum Company of America*, 148 F. 2d 416, 429 (2d Cir. 1945) (L. Hand, J.)

licensee engages in the manufacture (including manufacture by a sublicensee, agent, or subcontractor), distribution, and sale of a trademarked soft drink product, of provisions granting the licensee the sole and exclusive right to manufacture, distribute, and sell such product in a defined geographic area or limiting the licensee, directly or indirectly, to the manufacture, distribution, and sale of such product only for ultimate resale to consumers within a defined geographic area: *Provided*, That such product is in substantial and effective competition with other products of the same general class.

SEC. 3. The existence or enforcement of territorial provisions in a trademark licensing agreement for the manufacture, distribution, and sale of a trademarked soft drink product prior to any final determination that such provisions are unlawful shall not be the basis for recovery under section 4 of the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes", approved October 15, 1914.

SEC. 4. As used in this Act, the term "antitrust law" means the Act entitled "An Act to protect trade and commerce against unlawful restraints and monopolies" (the Sherman Act), approved July 2, 1890, the Federal Trade Commission Act, approved September 26, 1914, and the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes" (the Clayton Act), approved October 15, 1914, and all amendments to such Acts and any other Acts in pari materia.

III. NEED FOR LEGISLATION

A. HISTORY OF THE INDUSTRY

Under the trademark licensing system which exists in the soft drink industry, the franchise company produces and sells syrups or flavoring concentrates pursuant to trademark licensing agreements with independent bottlers, participates in advertising and promotional expenditures made in connection with trademarked products, provides advice and technical assistance on production, quality control, management, and sales problems, and assists in development and test marketing of new products and containers.

The bottler, in turn, manufactures, distributes and sells the trademarked products and provides the capital investment necessary for this market. He determines the plant and equipment to be used, the volume of production by size and type of container, the product mix, the wholesale price to be charged, and the manner in which he can maximize his market penetration to secure the widest possible distribution of his products throughout the territory. The bottler delivers soft drinks directly to retail stores and other outlets through what is commonly referred to as the "store-door" system. On a regular basis the bottler makes deliveries, retrieves empty returnable bottles for reuse, and provides merchandising and other services. Route delivery to a combination of large and small volume stops permits the small accounts to be economically serviced, because the bottler is also making deliveries to high volume accounts on the same route.

In June, 1979, this committee heard testimony concerning the structure and dynamics of the soft drink industry. According to the testimony, there were 1,724 soft drink bottling companies competing in the United States in 1978. Of the 2,048 bottling plants in the United States, 1,412 had fewer than 50 employees.[4] Many of these plants are family owned; many of them hire significant numbers of employees in the small communities in which they are located. Moreover, while this industry has been experiencing a trend of acquisitions in recent years, the testimony before the committee indicated that this growth was principally in the number and market shares of moderate sized firms, which reflects efficiency promoting adjustments to economies of scale and new technology by the soft drink industry.[5] As a result, a survey of large metropolitan areas reveals that "most of them are served by between 6 and 12 franchised soft drink bottlers, plus unfranchised operations (e.g., Shasta) and supermarket private labels" and that even in the smaller metropolitan areas "the availability of fewer than 5 or 6 sources of soft drink supply is relatively rare." [6]

In addition, the soft drink industry has low entry barriers and has experienced the successful entry of many new brands in recent years. Entry has been facilitated by the industry practice of "piggybacking," i.e., using the good will, production and distribution of strong local bottlers of other brands. A number of national brands, such as Dr Pepper, Nestea, and Lipton canned ice teas, Welch's Grape Soda, Bubble-Up, Frostie Root Beer, NuGrape, and Suncrest have been able to achieve nationwide distribution in a very short time by means of piggybacking. For example, Nestea canned iced tea was able to obtain distribution in areas serving approximately 90 percent of the population in 3 years by entering into exclusive territorial licenses with 135 established national brand bottlers.[7] The committee is not aware of any significant evidence that in those areas of the United States where a few bottlers carry many brands of soft drinks those bottlers have engaged in shared monopoly or other types of illegal joint conduct.

B. THE FTC PROCEEDING

On July 15, 1971, the Federal Trade Commission filed complaints against seven soft drink syrup companies, alleging that the territorial provisions contained in the trademark licensing agreements between the companies and their bottlers constitute unfair methods of competition.[8] The complaint against Coca-Cola was tried from May 5 through June 11, 1975. The trial record in the *Coca-Cola* proceeding was subsequently incorporated as the record in the *PepsiCo* case.[9]

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[4] Statement of Dr. Lee E. Preston Before the Subcommittee on Antitrust, Monopoly and Business Rights of the Senate Committee on the Judiciary at 6 (June 4, 1979).

[5] Id. at 5.

[6] Id. at 8.

[7] Initial Decision of Administrative Law Judge Joseph P. Dufresne, Findings 155–162 (October 3, 1975) [Findings in the Initial Decision are hereinafter cited as "IDF"]

[8] Crush International, Ltd., et al. (Docket No. 8853), Dr. Pepper Company (Docket No. 8854), The Coca-Cola Company, et al. (Docket No. 8855), Royal Crown Cola Company (Docket No. 8858), and National Industries, Inc., et al. (Docket No. 8859). On March 3, 1972, an eighth complaint issued against Norton Simon, Inc., et al. (Docket No. 8877).

[9] During the six week Coca-Cola trial, 43 witnesses testified—23 called by Complaint Counsel and 20 by Petitioners and Intervenors. The full record developed by the parties consisted of more than 4,000 pages of trial transcript, 14 stipulations encompassing over 500 pages, and approximately 1300 exhibits totalling thousands of pages.

1. The Initial Decision

In the *Coca-Cola* case the Administrative Law Judge (Judge) made 195 detailed findings of fact concerning the soft drink industry and the effects of the territorial system upon competition in the distribution and sale of soft drinks. The Judge ruled that even though territorial provisions eliminate competition among bottlers of the same soft drink product (intrabrand competition), the net effect of the arrangements was to promote competition among bottlers of different soft drink products (interbrand competition). Indeed, the Judge found that elimination of the territorial provisions "would adversely affect competition because it would lead to the business failure of many small and some large bottlers as well to the accelerated growth of large bottlers" and "the contributions to the economies of the area in which small bottlers and their employees now earn their living would certainly diminish substantially and would disappear completely where the bottler was forced out of business." [10]

The specific findings of the Judge revealed a highly competitive industry whose competitiveness was largely caused by the territorial provisions. The Judge found "intense competition in the sale of flavored carbonated soft drinks which stems from the fact that there is a large number of brands available to the consumer in local markets." [11] He found a large number of brands available "in large urban areas, small towns, and rural areas alike." [12] He also found that local and regional brands "have been strong competitors in specific markets for decades" [13] and that private label soft drinks "since the early 1960's have become a substantial competitive force in the soft drink industry." [14]

The Judge found "keen interbrand price competition" which compels Coca-Cola bottlers to price equal to or below their major competitors because even a few cents differential on a six-pack would adversely affect sales.[15] In an effort to reduce prices, bottlers have emphasized returnable bottles, which are "the most economical packages sold . . . in almost every market. . . ." [16] In fact, not only is Coca-Cola in 16-ounce and 32-ounce returnable bottles cheaper than private labels in many local markets,[17] but in July 1971, when the FTC cases were started, "the average retail price of Coca-Cola in the United States in 16-ounce returnable bottles, according to Neilsen sources, was lower than the average price per ounce at which Coca-Cola in the 6½-ounce returnable bottle was sold at retail in 1900." [18]

The Judge found that elimination of the territorial provisions was likely to produce some unfortunate changes in the industry. "Without exclusive territories the use of the returnable bottle by bottlers . . . would be substantially reduced, if not eliminated." [19] This would happen because without territories bottlers would be uncertain whether they could recapture their large investment in returnable bottles and

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[10] *The Coca-Cola Co., et al.*, 91 F.T.C. 517, 587 (1978).
[11] IDF 88.
[12] IDF 89.
[13] IDF 93.
[14] IDF 98.
[15] IDF 104.
[16] IDF 110.
[17] IDF 118.
[18] IDF 116.
[19] IDF 120.

because the loss of the high volume accounts would adversely affect the costs of producing and delivering returnable bottles.[20] Moreover, those bottlers which, as a result of elimination of territories, lost chain store customers "would be obliged to cut back service to small accounts or to raise prices, either of which would reduce volume." [21]

In addition, "a substantial number of soft drink brands and flavors would be eliminated in local markets" and "even better known brands such as Seven-Up and Dr Pepper might not survive in many local markets." The Judge found that smaller companies, such as the Dr Pepper Co. and Thomas J. Lipton Co., "would be placed in economic peril as availability of their products in many markets was reduced or eliminated entirely." [22] Finally, "hundreds of bottlers would go out of business if exclusive territories were determined to be unlawful. The number of bottlers would be reduced to a fraction of the number that would otherwise exist under the present system." [23]

2. The Opinion of the Federal Trade Commission

Complaint counsel for the Federal Trade Commission appealed the decision of the Administrative Law Judge to the Commission. Because of numerous changes in the membership of the Commission, oral argument before the Commission was held on two different occasions, in March and July 1976. In April 1978, 2½ years later, the Commission in a two-to-one decision, reversed the Judge and held that the territorial arrangements in question were unreasonable restraints of trade.

Both the Commission and respondent soft drink companies recognize that the governing legal principles are those recently enunciated in *Continental T.V., Inc.* v. *GTE Sylvania Inc.*[24] There the Supreme Court held that the correct standard for judging vertically imposed nonprice restrictions, such as the territorial restrictions in bottlers' contracts, is the rule of reason, rather than a rule of per se illegality. The Court observed that "[v]ertical restrictions [on *intra*brand competition] promote *inter*brand competition by allowing the manufacturer . . . to compete more effectively against other manufacturers" [25] and that *inter*brand competition "is the primary concern of antitrust law." [26] *Sylvania* thus established that the mere fact that a vertical restriction eliminates *intra*brand competition is the starting point, not the conclusion, for legal analysis; the question is whether the overall effect of the restraint is to promote interbrand competition.

The Committee believes that the Commission based its opinion in the *Coca-Cola* and *PepsiCo* proceedings simply on the intrabrand effects which are inherent in any territorial restriction. Thus, the effect of the Commission's decision has been to impose a rule of per se illegality which in the committee's opinion is not consistent with *Sylvania.* It is difficult to imagine territorial restrictions in any industry surviving the rationale found in the Commission opinion.

For example, the Commission acknowledges only that the soft drink market is "not devoid of interbrand competition." [27] The Commission

[20] IDF 121–122.
[21] IDF 175.
[22] IDF 179–181.
[23] IDF 183.
[24] 433 U.S. 36 (1977).
[25] *Id.* at 54–55 (emphasis added).
[26] *Id.* at 52 n. 19.
[27] 91 FTC at 619.

also observed that the large number of brands available is "no measure of the intensity of the competitive interaction among the brands."[28] This observation is a departure from the Commission's usual emphasis upon levels of concentration.[29] It concluded that the significant effect of piggybacking was, not that it facilitated market entry of many new products, but that it enabled too few local bottlers to control the distribution of too many brands.[30] The committee believes that these are but a few of the instances in which substantial record evidence relating to the effects of the territorial restrictions was inadequately treated by the Commission.

The Commission opinion relies principally on the intrabrand effects of the restraint. It finds that intrabrand competition is almost completely foreclosed.[31] It finds that interbrand competition is also restrained because bottlers may not compete outside their territories with bottlers of the other brands.[32] However, that conclusion would apply to any situation in which a licensee is prohibited from selling outside of its territory. The Commission finds that some prices to chain stores might be reduced by elimination of the restraint.[33] The committee believes that in reaching these findings the Commission may have failed to take into consideration certain aspects of the record. For example, the Commission appears to have paid little attention to the unanimous, uncontroverted testimony that "there is no assurance that the chain stores would pass this reduction on to the consumer" and that "chain stores are not likely to reduce their retail prices for national brands." [34]

The Commission's decision was appealed by the companies to the U.S. Court of Appeals for the District of Columbia, where the cases are now pending. Oral argument in the *Coca-Cola* and *PepsiCo* cases before a panel of the court of appeals was held in October 1978. Whatever the court of appeals decides, it is probable that this case will continue either via petitions for certiorari to the Supreme Court or via remand to the FTC. If there is a remand to the FTC a new trial could be held with another round of briefing, oral argument and time consuming decision making. The more protracted the proceedings the more likely it is that the continuing uncertainty will cause disintegration of the existing industry structure which will be irremediable even if the franchise system is eventually vindicated. The committee be-

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[28] 91 FTC at 635.

[29] In its opinions the Commission has commonly drawn inferences about the state of competition from the levels of market concentration or increases in market concentration. *E.g.,* Beatrice Foods Co., 86 FTC 1, 70 (1975) ("unless the market share data placed in the record by complaint counsel is flawed and substantially overstates the degree of concentration in these markets, the only reasonable conclusion to be drawn from the record is that this merger lessened competition. . . ."); British Oxygen Co., 86 FTC 1241 (1975); Warner-Lambert Co., 87 FTC 812, 878 (1976) ("The high level of concentration and the substantial market shares involved outweigh any countervailing considerations. . . ."); Liggett & Meyers, Inc., 87 FTC 1074, 1165 (1976) *(quoting U.S. v. General Dynamics Corp.* that "the effect of adopting this approach to a determination of a 'substantial' lessening of competition is to allow the government to rest its case on a showing of even small increases of market share or market concentration. . . ."); RSR Corporation, 88 FTC 800, 887 (1976) ("Quite clearly, concentration figures of the magnitude of those present in this case must give rise to a presumption . . . of illegality. . . ."); Jim Walter Corp., 90 FTC 671, 720 (1977) ("The Congress made it clear that its primary concern . . . was to forestall, insofar as possible, reductions in competition. . . ."); Retail Credit Co., 92 FTC 1, 143 (1978) ("Concentration ratios and market share data may alone suffice to establish illegality. . . .").

[30] 91 FTC at 636–639. Compare extensive findings relating to the fact that piggybacking has facilitated market entry and that the elimination of territories will result in the dropping of many brands by bottlers. IDF, 158–162; 179–180.

[31] *Id.* at 618–21. Compare, however, the extensive evidence of competition in the soft drink industry cited in IDF 88–131.

[32] *Id.* at 623.

[33] *Id.* at 642–43.

[34] IDF 170–173; 193.

lieves that passage of this bill will clarify the status of bottler franchises and as a result eradicate the uncertainty caused by the current proceedings.

C. IMPACT OF THE RULING BY THE FEDERAL TRADE COMMISSION

The Administrative Law Judge made detailed findings regarding the consequences of elimination of the territorial provisions. These consequences would be felt by bottlers,[35] by soft drink franchise companies,[36] by various retail accounts,[37] and by consumers.[38] Elimination of territories would affect survival of returnable bottles,[39] ease of market entry,[40] the level of services offered to retailers,[41] advertising and promotion,[42] and pricing.[43] The committee believes that the Judge correctly described the probable effects of elimination of territories.

Store door delivery has been utilized successfully by bottlers for many years to assure quality control, to handle returnable bottles and to provide other services to large and small customers. However, most large food chains distribute products from central warehouses located in large metropolitan areas. Consequently, such food chains prefer that soft drinks be delivered to their warehouses rather than to individual stores. Since large metropolitan areas are generally served by large bottlers,[44] these large bottlers would have the most direct access to the chain warehouses and, therefore, would be most likely to acquire the warehouse accounts should the territorial system be eliminated. As a result, smaller bottlers would lose the chain store accounts, which represent a large portion of their sales and profits and would be left with the smaller, less profitable accounts.

Sales volume is a crucial factor in the financial viability of a bottling operation. If a small bottler loses his chain store accounts his sales volume will decrease significantly and his unit costs will increase sharply. In such a circumstance, the bottler would have to increase prices, or reduce service to customers, or both. However, such actions will result in the loss of more customers who are unwilling to pay higher prices or to tolerate decreased service. With the loss of these customers the bottler will be unable to remain viable. The committee believes that this scenario will be repeated hundreds of times in this industry if the decision of the Federal Trade Commission is permitted to stand.

The Administrative Law Judge found that "[i]f the chain stores converted to a system of warehouse delivery, the chain stores would eliminate returnable bottles entirely because the returnable bottle is incompatible with warehouse delivery." [45] This incompatibility results from the facts that returnable bottles involve extra handling costs and compete vigorously in price with the private label soft drinks sold by the food chains (which are sold almost entirely in non-returnable con-

[35] IDF 183–190.
[36] IDF 179–182.
[37] IDF 175.
[38] IDF 194–195.
[39] IDF 120–122.
[40] IDF 179–180.
[41] IDF 176–178.
[42] IDF 174.
[43] IDF 169–171; 176.
[44] IDF 185.
[45] IDF 120.

tainers).[46] If the food chains do eliminate returnable bottles when they adopt a warehouse delivery system for soft drinks the cost of delivering returnables to other customers will increase dramatically. The committee believes that the ultimate result will be the abandonment of the route delivery system and, therefore, the demise of the returnable bottle.

The opinion of the Federal Trade Commission does not disagree with the conclusion of the Administrative Law Judge that many small bottlers would not survive if territories are eliminated.[47] The demise of these bottlers will affect the choices of soft drinks available to consumers because many of the newer soft drink brands have succeeded in particular markets by being piggybacked by bottlers of the older franchised brands. According to the Administrative Law Judge "[t]he chains already want fewer brands and flavors and would cut out slower moving brands if they had warehouse delivery . . ." [48] These preferences of chain stores and the obvious need for surviving bottlers to deal only in high volume brands will, the committee believes, result in fewer consumer choices among competitive soft drink brands.

If territories are eliminated, wholesale prices for non-returnable packages may fall temporarily for large volume accounts, principally chain stores. However, it is the committee's opinion that it is unlikely that chain stores will pass on these reduced prices to their customers because their past practice has been to maintain a retail price differential between their own private label soft drinks and the franchised brands.[49] Moreover, it is clear that prices in non-chain stores, which account for 55–60 percent of sales, would rise and the cheaper returnable bottles would be more difficult to find.[50]

Regardless of the short term effects of the elimination of territories the committee believes that within a few years the soft drink industry would become concentrated in the hands of a few, extremely large, regional soft drink bottlers. These few surviving bottlers would raise wholesale prices to all customers including food chains. Consequently, retail prices to consumers would increase. Simultaneously, the surviving bottlers will offer fewer brands in fewer types of packages to significantly fewer accounts than are presently served. The committee therefore believes that the public policy stated in the antitrust laws would be better served by retention of the existing, competitive structure of the soft drink industry under the standards of this bill.

IV. Legislative History

Legislation to permit territorial agreements has been introduced in the 92d (S. 3133), 93d (S. 978), and 94th (S. 3421) Congresses. There were 5 days of hearings in the Senate in those Congresses. The bill was reported from the full committee twice and passed the Senate by a voice vote once. On March 8 of this year, Senators Birch Bayh and Thad Cochran introduced S. 598, the Soft Drink Interbrand Competition Act, along with 77 of their colleagues in the Senate. H.R. 3567, the House companion bill, was also introduced shortly thereafter with

[46] *Id.*
[47] 91 FTC at 654.
[48] IDF 180.
[49] IDF 173.
[50] IDF 110.

310 cosponsors now on the legislation. On June 4 and September 26, hearings were held before the Antitrust and Monopolies Subcommittee and on November 27 the subcommittee agreed to consideration of S. 598 by the full committee by a vote of 8 to 1.

On December 18, 1979, the full committee reported S. 598 by a vote of 14 to 2 with a recommendation that it be passed by the Senate. The report was filed on March 26, 1980.

V. Section-by-Section Analysis

A. Section 1: Title

The title of this act is the "Soft Drink Interbrand Competition Act."

B. Section 2: Test of Legality

This act amends the antitrust laws to clarify the circumstances under which exclusive territorial licenses to manufacture, distribute, and sell trademarked soft drink products shall not be deemed unlawful. It is the committee's intent and purpose to provide that if the requirements of this bill are met, the relevant territorial provisions are not only lawful, but also enforceable through judicial proceedings. Nothing in this bill is intended to protect any other provisions in such trademark licenses, or any other practice or conduct of licensors or licensees of trademarked soft drink products, from challenge under the antitrust laws. For example, nothing in this bill protects agreements among bottlers or among syrup companies as to prices to be charged for trademarked soft drink products, or as to joint refusals to deal with any person or entity, or as to the allocation of territories. This legislation applies to situations in which a trademark owner grants licensees the right to manufacture, distribute, and sell trademarked soft drink products only in specifically defined geographic areas.

Consistent with the committee's purpose to preserve the present system of local manufacture, distribution, and sale, the bill makes lawful license provisions which have the effect of precluding indirect evasions of the license agreement. Thus, the exclusive territorial rights of one licensee are protected from the direct or indirect sales by the licensor or any of its other licensees into his defined geographic area, unless the plaintiff can establish that there is not substantial and effective competition within the territory and this evidence is not rebutted by the defendant.

Substantial and effective competition requires that there be competition from other products. This phrase, like other phrases of general connotation used in the antitrust laws, gives the courts flexibility to deal with specific situations. In determining whether substantial and effective interbrand competition exists, this committee recognizes that there is no single, universally reliable indicator of the existence or the absence of interbrand competition.

Whether or not there is substantial and effective competition within a licensee's defined geographic area from other brands depends upon such factors as: The number of brands, types, and flavors of competing products available in the licensee's territory from which consumers can choose; persistence of long-run monopoly profits; the number of retail price options available to consumers; the persistence of inefficiency and waste; the degree of service competition among vendors; ease of entry into the market; the failure of output levels to respond to consumer demands; the number and strength of sellers of competing products in the territory; and a lack of opportunity to introduce more efficient methods and processes. The committee intends to prescribe no hard and fast rule for determining substantial and effective interbrand competition from among these factors, but rather to allow the courts discretion to give appropriate weight to these economic indicia of competition as they deem necessary in each distinctly unique local market.

In the committee's opinion, this clarification of the application of the rule of reason to the soft drink industry is necessary because the Federal Trade Commission based its decision on the impact of the absence of intrabrand competition rather than the existence of vigorous interbrand competition. In the *Sylvania* case the Supreme Court 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." [51] and that "when interbrand competition exists . . . it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product." [52] The FTC's Administrative Law Judge found that this type of situation exists in the soft drink industry, that is, despite the lack of intrabrand competition, there "is intense competition in the sale of flavored carbonated soft drinks which stems from the fact that there is a large number of brands available to the consumer in local markets." [53] In the committee's opinion the FTC's decision does not reflect either the numerous findings of the Administrative Law Judge concerning the existence of "intense" interbrand competition [54] or the Supreme Court's admonition in *Sylvania* that "[i]nterbrand competition . . . is the primary concern of antitrust law." [55] Thus, the committee believes that this legislation is consistent with traditional notions of rule of reason analysis and will ensure that primary analytical emphasis is given to the existence of substantial and effective interbrand competition rather than to the absence of intrabrand competition.

C. SECTION 3: PROSPECTIVE DAMAGES

Section 3 precludes treble damage exposure for members of the soft drink industry prior to any final determination that exclusive territorial provisions in soft drink franchise contracts are unlawful. The committee believes that an examination of all of the relevant circumstances leads to the conclusion that this provision is equitable and is consistent with legal precedents.

Territorial provisions in soft drink bottling contracts have been in existence for more than 75 years. In 1920 such provisions were held not to be unreasonable restraints of trade. *Coca-Cola Bottling Co.* v. *The Coca-Cola Co.*[56] The industry reasonably relied on that court

[51] 433 U.S. at 51–52.
[52] Id. at 52 n. 19.
[53] IDF 88.
[54] *See*, e.g., Nos. 36, 88, 91, 103, 108, 127, 130, 139, 140, 146, 146, 147, 148, 149, 154, 155, 156 and 157.
[55] 433 U.S. at 52 n. 19.
[56] 296 Fed. 796 (D. Del. 1920).

decision and continued to abide by their contractual obligations. Bottlers acquired new plants and equipment at enormous capital costs.

When the Federal Trade Commission issued its complaint in 1971 charging that the territorial provisions in soft drink franchise contracts violate section five of the FTC Act that action tolled the statue of limitations for treble damages. Thus, the industry faces treble damage exposure back to 1967.

In 1975 the Administrative Law Judge dismissed the FTC's complaint. Moreover, in 1976 a Federal court again upheld such a provision noting that it "enhances, rather than has a detrimental effect on competition." *Tomac, Inc.* v. *Coca-Cola Co.*[57] In another Federal court case, after a 7-week trial a jury upheld territorial restrictions in Royal Crown soft drink trademark licenses.[58] However, in April 1978, the Federal Trade Commission, in a two-to-one decision, reversed the Administrative Law Judge. The defendants appealed and oral argument was heard before the U.S. Court of Appeals for the District of Columbia Circuit in October 1978. That court has not yet announced its decision.

Thus, an entire industry is currently exposed to potential treble damages of hundreds of millions of dollars because of the decision of the Federal Trade Commission which is inconsistent with all prior decisions reached by those who have examined the industry.

In *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*[59] the Supreme Court stated that "treble damages play an important role in penalizing wrongdoers and deterring wrongdoing . . ." The committee believes that neither of these materials for the imposition of treble damages applies here.

Because, from their inception until the Federal Trade Commission's decision in 1978, exclusive soft drink territorial provisions have been deemed to be legal, the imposition of treble damages on those who have utilized such provisions could not, the committee believes, be fairly characterized as the penalizing of wrongdoing or as the deterring of wrongdoing. On the other hand, when and if such provisions are finally determined to be unlawful the imposition of treble damages on a prospective basis would be consistent with the purposes of treble damage awards.

This position is consistent with legal precedents relating to the standards relating to the retroactive application of new rules.

In Retail, Wholesale and Department Store Union v. *NLRB*,[60] the court set down five factors which are used to determine whether the retroactive application of a new regulatory provision [61] is so inequitable as to overwhelm any statutory interest in enforcing the new rule retroactively. These five factors are:

"(1) [W]hether the particular case is one of first impression,

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[57] 418 F. Supp. 359, 362 (C.D. Cal. 1976).

[58] *First Beverages, Inc.* v. *Royal Crown Cola Co.*, Civil No. CV-74-2896-MML (C.D. Cal. Oct. 8, 1976).

[59] 429 U.S. 477, 485 (1977).

[60] 466 F. 2d 380, 390 (D.C. Cir. 1972).

[61] Whether the final determination that the exclusive territorial provisions violate the antitrust laws is made by a Federal court or an administrative agency in an adjudicative or rulemaking proceeding is irrelevant to the practical effect of such a determination. "Every case of first impression has a retroactive effect, whether the new principle is announced by a court or an administrative agency." *SEC* v. *Chenery Corp.*, 332 U.S. 194, 203 (1947).

(2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law,

(3) the extent to which the party against whom the new rule is applied relied on the former rule,

(4) the degree of the burden which a retroactive order imposes on a party, and

(5) the statutory interest in applying a new rule despite the reliance of a party on the old standard." [62]

Applying these five factors to this particular provision, the committee finds the arguments for limiting treble damages to prospective conduct to be persuasive.

Until the 1978 FTC opinion, the use of territorial arrangements in the soft drink industry had invariably been upheld,[63] a fact upon which soft drink industry members reasonably relied. Moreover, the state of the law relating to vertical territories remained clouded for the past decade largely because of the since-overruled *Schwinn* decision.[64]

Beyond this the burden of a retroactive application of the treble damage provision of the antitrust laws would be immense, and since the threat of prospective treble damage actions would be a more than sufficient incentive to ensure that soft drink manufacturers cease enforcing exclusive territorial provisions should those provisions be found illegal, retroactive application of this finding would be superfluous.

In addition to being consistent with the existing legal and equitable principles, this provision is consistent with prior congressional action. When Congress passed the Newspaper Preservation Act, 15 U.S.C. § 1801 et seq. in 1970, it eliminated treble damage exposure for joint arrangements utilized by the industry:

> In view of the prolonged period in which the participants had engaged in these joint newspaper operating arrangements in the belief that such activities were lawful, and in view of the prolonged period in which the Department of Justice permitted the arrangements to operate without challenge, the Committee in consideration of all of the equities has concluded that the antitrust standards established in this bill shall apply to all antitrust actions that involve existing joint newspaper operating arrangements that are pending on the date of enactment.[65]

It could be contended that since the *Schwinn* decision in 1967, the members of the industry have had notice that exclusive territorial provisions might be illegal, and that, therefore, they should not object to treble damage exposure back to that year. However, such a conten-

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[62] Followed in *Standard Oil* v. *Department of Energy*, 596 F. 2d 1029, 1064 (Tem. Emergency Ct. App. 1978).

[63] *See, e.g., Coca-Cola Bottling Co.* v. *Coca-Cola Co.*, 296 Fed. 796 (D. Del. 1920) ; *Tomac, Inc.* v. *Coca-Cola Co.*, 418 F. Supp. 359 (C.D. Cal. 1976) : *First Beverages, Inc.* v. *Royal Crown Cola Co.*, Civil No. CV–74–2896–MML (C.D. Cal. Oct. 8, 1976) (jury verdict upholding territorial restrictions).

[64] In *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36, 47–48 (1977), the Court observed: "*Schwinn* has been the subject of continuing controversy and confusion, both in the scholarly journals and in the Federal courts. The great weight of scholarly opinion has been critical of the decision, and a number of the Federal courts confronted with analogous vertical restrictions have sought to limit its reach."

[65] House Report No. 91–1193 (June 15, 1970).

tion fails to take into account the facts that in 1975 and 1976 such provisions in this industry were expressly declared to be lawful. In 1978 the FTC caused confusion and uncertainty by its decision which was inconsistent with relevant precedents. The committee believes that it would be fundamentally inequitable to impose treble damages before a final determination of illegality.

In the opinion of the committee the double blow of treble damages and loss of territories would assure the demise of many bottlers to the detriment of the consuming public. Prospective application of such a determination is entirely adequate to insure that exclusive territorial provisions are not enforced and is consistent with judicial standards which determine whether or not a new rule will be enforced retroactively.

D. SECTION 4: DEFINITION OF "ANTITRUST LAW"

This section defines the words "antitrust law" to include the Sherman, Clayton, and FTC Acts, all amendments to such acts, and any other laws pertaining to the same subject. This definition is consistent with similar definitions in section 1 of the Clayton Act and section 4 of the FTC Act.

VI. Minority Views of Senators Howard M. Metzenbaum and Edward M. Kennedy

The antitrust laws are based on the principle that unrestrained competition in the marketplace maximizes consumer welfare. Free and fair competition among businesses, where possible, spurs innovation and increased productivity and inevitably leads to the highest quality goods and services for the lowest possible prices.

There are, of course, pockets in the economy in which market conditions are such that effective competition may not be possible. In these rare instances, exemptions or immunities from the antitrust laws, coupled with governmental regulation of some form, may be warranted. But, as the President's National Commission for the Review of Antitrust Laws and Procedures (the "Antitrust Commission") concluded, exceptions from free market competition "should only be made where there is compelling evidence of the unworkability of competition or a clearly paramount social purpose," and "where such an exception is required, the least anticompetitive method of achieving the regulatory objective should be employed." Report to the President and the Attorney General of the National Commission for the Review of the Antitrust Laws and Procedures 177 (1979).

Recognizing the important benefits of free and fair competition, Congress has not enacted a major antitrust immunity for the past thirty years. *Id.* at 185. In addition, the Antitrust Commission, following the growing consensus of antitrust experts, recommended that "many of the existing immunity schemes should be discarded or substantially modified." *Id.* at 189.

Despite this widespread recognition that exemptions from the antitrust laws usually hurt the consumer, the soft drink industry has asked that Congress exempt its ironclad territorial restrictions from the antitrust laws and immunize its members from any damage liability for competitive injury that these restrictions have caused in the past and might cause in the future. S. 598, the Soft Drink Interbrand Competition Act, is the Senate's version of the soft drink industry's proposed antitrust exemption. If S. 598 becomes law, it will be the only single-industry exception to the antitrust laws of its type.

In our view, the proponents of S. 598 have fallen far short of showing "a convincing public interest rationale for abandoning [intrabrand] competition" in the soft drink industry. *Id.* at 186. We believe that the courts should remain the final arbiters of the reasonableness of the existing territorial restrictions in the soft drink industry under the Sherman Act. If these restrictions promote interbrand competition to a greater extent than they retard intrabrand competition, they will ultimately be held lawful under the rule of reason test adopted by the Supreme Court in *Continental T.V., Inc.* v. *GTD Sylvania, Inc.*, 433 U.S. 35 (1977) (*Sylvania*). If, however, these restrictions on balance retard competition, allowing them to remain in effect, as S. 598

would do, will impose significant costs on the American economy and the American consumer. Innovation and productivity will be stifled, efficiency will be sacrificed and the consumers will pay higher prices for their soft drinks than they would if competition, instead of privately-imposed restrictions, ruled the marketplace.

The soft drink industry's challenge to the Federal Trade Commission's determination that the industry's ironclad territorial restrictions are unreasonable restraints of trade has been argued and is now awaiting decision in the Court of Appeals for the District of Columbia. *Coca-Cola Company* v. *FTC*, Docket Nos. 78–1364, 78–1544 and 78–1545 (D.C. Cir., appeal filed April 24, 1978). We agree with Richard J. Favretto, Deputy Assistant Attorney General, Antitrust Division, who testified that "[l]egislative action at this time, while the factual record is still under review, would . . . be at least premature." Statement of Richard J. Favretto Before the Subcommittee on Antitrust, Monopoly and Business Rights, September 26, 1979 at 3 (hereinafter "Favretto").

Further, we believe that whatever the result of the Court of Appeals case, the same rule of reason test should be applied to the soft drink industry as is applied to all other industries in the economy. "Under the flexible rule of reason, courts take into account all of the circumstances in order to determine whether, on balance, the exclusive territories enhance or impair competition. The defendant is afforded a full opportunity to present economic justifications." Favretto at 4. Our examination of the soft drink industry has revealed nothing that warrants the "narrow approach" taken by S. 598. Accordingly, we oppose S. 598 because it represents an unjustified departure from our Nation's commitment to free and fair competition in the marketplace. If we exempt the practices of the soft drink industry from the antitrust laws, we can expect a parade of industries seeking exemptions from the antitrust laws for their own practices. In the end, the antitrust laws may well be made meaningless by a patchwork of special interest exemptions like S. 598.

The Soft Drink Industry

The proponents of S. 598 argue that the "structure and dynamics" of the soft drink industry and the 75-year existence of some of these restrictions warrants Congressional blessing of the soft drink industry's territorial restrictions. These restrictions absolutely prohibit one bottler from selling a soft drink brand in any territory assigned to another bottler of the same soft drink brand. There is, however, nothing unique about the structure of the soft drink industry or about the history of the territorial restrictions which justifies this special treatment. Indeed, an examination of the structure and dynamics of each of the industry's two levels—the bottling companies and syrup manufacturing companies—suggests that the territorial restrictions present a serious threat to competition.

A. Competition Among Bottling Companies

The soft drink bottling industry is becoming more concentrated with each passing day. From over 6,000 bottling plants in 1950, bottling companies have disappeared, in large part through acquisition, at an alarming rate. In 1970, there were about 3,000 plants and in 1978, just over 2,000 plants remained. In June, 1977, an industry publication, Beverage Industry, stated that this trend is irreversible. Statement of Mark Silbergeld Before the Subcommittee on Antitrust, Monopoly and Business Rights, September 26, 1979 at 4–5 (hereinafter "Silbergeld").

The nationwide decline in the number of bottling operations only partly suggests the uncertain fate of competition at the bottling level. The ironclad territorial restrictions limit competition to local markets usually dominated by a very few bottlers. The restrictions, coupled with the bottling company's piggybacking practice, assures that each local market for soft drinks is the fiefdom of a small number of bottlers.

> According to the Bureau of the Census, the four largest bottlers in nine large metropolitan areas had, on the average, 68 percent of the market in 1964. Although the number of brands available to the consumer in local markets is generally large, concentration among bottlers is high because of "piggybacking," a practice which involves the production and sale by a bottler of soft drink brands trademarked by two or more syrup companies. Piggybacking is used extensively in the soft drink industry—so extensively, in fact, that despite the proliferation of brands, a small number of bottlers usually account for over 50 percent of any metropolitan market. Zelek, et. al., "A Rule of Reason Decision Model After Sylvania", p. 45 (footnotes omitted) (article to be published in the California Law Review) (hereinafter "Zelek, et. al.").

Concentration figures at the levels present in the local soft drink bottling markets mean that these markets are tight-knit oligopolies. Tight-knit oligopolies are usually characterized by little or no price competition. This appears to be the case in the soft drink industry. "Evidence indicates that prices in the industry are uniform among the major brands within particular territories." (*Id.* at 46) A Michigan soft drink retailer, Thomas M. North, described in a letter to Senator Metzenbaum his experience with soft drink pricing by bottling companies as follows:

> The beverage industry is also telling us that they compete between the different brands. I cannot follow this when in my area, the wholesale price of all products are exactly the same and *if one increases his prices, all of the others will follow within a couple of weeks.* Transcript of Hearing before the Subcommittee on Antitrust, Monopoly and Business Rights, September 26, 1979 at 52–53 (emphasis added) (hereinafter "Transcript").

The uniformity of prices at the bottling company level seems to be reflected in profits. For example, J. F. Koons, President of the Ohio State Pepsi-Cola Bottling Association, testified that his own bottling operations earned about 20 percent on equity and that the industry is generally profitable. Transcript at 77–78. Also, Mr. Koons' company has reported to its stockholders that it will be in a favorable position if the territorial restrictions are ultimately found to be unlawful. Transcript at 76–77.

In the face of these high levels of concentration and the consequent absence of price competition in local soft drink markets, it is particularly inappropriate to tamper with the antitrust laws as they apply to the soft drink industry. This is especially so in view of the fact that some of the Nation's biggest companies are acquiring increasingly more important roles in soft drink bottling. Testifying against the bill. Mark Silbergeld, Washington Director of the Consumers Union, pointed out that S. 598 would protect from competition the bottling operations of companies like Beatrice Foods, IC Industries, General Cinema, and Warner Communications—all Fortune 500 companies. In addition, some of the so-called independent bottling companies are giants. For example, Coca-Cola Bottling Co. of New York ranks in the Fortune 500 and owns bottling companies in Maine, Kentucky, Kansas, Nebraska and Colorado as well as in New York. Silbergeld at 6–7.

Perhaps more importantly, the Coca-Cola Company and Pepsico, Inc., the two giant syrup companies, are also "the Nation's two largest soft drink bottlers." *Id.* at 6. S. 598 would insulate the bottling operations of these two companies from competition from independent bottlers.

All of this clearly suggests that competition at the bottling level of the soft drink industry is not especially vigorous, despite the contrary assertion in the Majority Report. Majority Report at 2. In these circumstances, the presence of privately-created barriers to competition such as the industry's ironclad territorial restrictions further retards competition at the consumers' expense.

The bottling companies claim that the territorial restrictions serve several legitimate business purposes. For example, they argue that they could not continue to serve low volume customers if restrictions were eliminated. What guarantee do consumers have that soft drink bottling companies will use extra revenues extracted because of these territorial restrictions to provide these services? The answer is none. *See* Favretto at 7. Putting aside for a moment the equally serious question whether territorial restrictions are *necessary* to achieve legitimate business purposes, the Majority Report probably describes the bottling companies' objective in seeking this antitrust exemption more accurately: "the destruction of the system is likely to depress the value of the franchised bottling plants." Majority Report at 2. To the extent that "the value of the franchised bottling plants" is based on monopoly profits earned as a result of unlawful territorial restrictions, the soft drink bottling companies have no greater right to such ill-gotten gains than do companies in any other industry.

B. COMPETITION AMONG SYRUP COMPANIES

The soft drink industry's ironclad territorial restrictions eliminate intrabrand competition; this means one Coca-Cola bottling company simply cannot compete with another Coca-Cola bottling company. The same restriction on competition prevails for virtually all other soft drinks.

Under the rule of reason test adopted by the Supreme Court in the *Sylvania* case, the elimination of intrabrand competition caused by the territorial restrictions must be measured against the effect of the restrictions on interbrand competition. In some circumstances, such restrictions may promote interbrand competition. "For example, new manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer. Established manufacturers can use them to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products." *Sylvania* at 55.

As far as we know, none of the major soft drink syrup manufacturers whose products are distributed through a system of exclusive territories are "new manufacturers" or "manufacturers entering new markets." Product safety is not a concern with respect to soft drinks, but product quality is because of the possibility that soft drinks which remain on the shelf for a lengthy period of time, will become stale.

> However, quality control can be accomplished through a less restrictive alternative. [The syrup manufacturers] could increase [their] sampling programs in retail outlets and each bottler could place an identification mark on its products so that it can be traced. Also, bottlers could employ a container dating system which consumers and retailers could decipher with ease, thus permitting them to monitor and detect product age. Finally, there is nothing to prevent [the syrup manufacturing companies] from insisting that as part of [their] franchise arrangements, bottlers must assume the responsibility for the quality of their products all the way through to the ultimate consumer, irrespective of the delivery system employed. Zelek, et. al., at 52 (footnote omitted).

In short, none of the characteristics of interbrand competition that the Supreme Court indicated might justify territorial restrictions is present in the soft drink industry. In fact, all indices of market power suggest that interbrand competition—competition among the syrup manufacturing companies—is severely limited:

> Although there are more than 50 firms that manufactured soft drink concentrates in 1977, the five major firms had a combined market share of 77 percent.
>
> * * * * * * *
>
> By the traditional standards, these concentration levels are relatively high and suggest considerable market power. Moreover, concentration has increased in recent years.
>
> A more important index is the level of profitability. . . . The average rate of return for these five firms was 21.6 percent in 1977 which can be compared to the average rate for all manufacturing of 14.2 percent. Indeed, over the past 15 years these firms have earned an average rate of return after taxes on stockholders equity exceeding 21 percent, compared to an average return for all manufacturing of 12.0 percent. Statement of William S. Comanor before the Subcommittee on Antitrust, Monopoly and Business Rights, September 26, 1979 at 6–7.

In these circumstances—a mature industry with the major firms exhibiting substantial market, or monopoly, power—any limitation on competition may well have substantial adverse impact on consumers.

We believe that Congress should not ratify any privately-imposed limitations on intrabrand competition, as S. 598 would do, in light of the apparent absence of effective interbrand competition.

C. HISTORY OF THE SOFT DRINK INDUSTRY'S TERRITORIAL RESTRICTIONS

The Majority Report states that the soft drink industry "has been functioning for over 75 years under the clear understanding that such arrangements were legally permissible." Majority Report at 2. The evidence simply does not support this statement; instead, it demonstrates that the industry knew that the legality under the antitrust laws of its ironclad territorial resrictions has always been, at best, questionable.

The Supreme Court first looked closely at vertically-imposed territorial restrictions in *White Motor Co.* v. *United States*, 372 U.S. 253 (1963). The Supreme Court reversed a summary judgment in favor of the party challenging the restrictions, noting that "[w]e do not know enough of the economic and business stuff out of which [vertical territorial restrictions] emerge. . . . 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 and within the 'rule of reason'." *Id.* at 263 (citations omitted). Accordingly, the Court reversed the district court's grant of summary judgment, holding that the merits of the territorial restrictions should be determined after trial. Although the question of the legality of any territorial restrictions remained unanswered by the Supreme Court, *White Motor* certainly signalled that the Court believed the question was a substantial one.

In *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), the Court took a clear position, holding that the imposition of vertical restrictions posed by a manufacturer on distributors who have title to the products was a *per se* violation of Section 1 of the Sherman Act. The Court said that "[u]nder 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." *Id.* at 379 (citations omitted).

Thus, after *Schwinn*, a 1967 decision, the soft drink industry's territorial restrictions were plainly unreasonable restraints of trade and hence unlawful under the Sherman Act. The syrup manufacturers "part with dominion over" the syrup and the bottling companies are absolutely prohibited by the restrictions from selling to customers beyond the borders of their assigned territories. Even prior to *Schwinn*, as the *White Motor* case indicates, the legal issue relating to territorial restrictions was whether a rule of reason test should be applied or the restrictions should be declared *per se* illegal. In these circumstances, it is inconceivable that the soft drink industry had a "clear understanding" that its territorial restrictions "were legally permissible."

The Supreme Court's *Sylvania* decision abandons the *per se* rule in favor of a rule of reason examination of territorial restrictions. The Federal Trade Commission, of course, has determined that the industry's restrictions, in part, do not pass muster under the rule of reason test. *Coca-Cola Co.*, 91 F.T.C. 517 (1978). As we have mentioned, that decision is now on appeal to the Court of Appeals for the District of Columbia.

Whatever the outcome of the pending litigation, it is clear that these territorial restrictions are of doubtful legality under the rule of reason test for several reasons. Vigorous competition appears absent at both the bottling and syrup manufacturing levels of the industry; the restrictions are imposed by the dominant companies, not new or struggling companies like Sylvania; these territorial restrictions are not necessary to assure product safety or achieve any quality assurance objective; and the territorial restrictions which characterize the soft drink industry have limited competition to a greater extent than those facing the Supreme Court in Sylvania. *Sylvania* "required each franchisee to sell his Sylvania products only from the location or locations at which he was franchised. A franchise did not constitute an exclusive territory, and Sylvania retained sole discretion to increase the number of retailers in an area in light of the success or failure of existing retailers in developing their market." 433 U.S. at 38 (footnote omitted). In contrast, the territorial restrictions that are part and parcel of the soft drink industry's franchises do constitute exclusive territories.

Despite the dubious legality of these territorial restrictions, the soft drink industry has steadfastly declined to change them in any respect which would make them more likely to conform with the antitrust laws. Instead, after the FTC filed its complaint in 1971, when the *Schwinn per se* rule still prevailed, the industry mounted an aggressive campaign in Congress for special treatment under the antitrust laws. S. 598 is just the most recent, and probably the most offensive to the antitrust laws, of the four principal Senate bills that the industry has promoted.

The chief proponents of S. 598 before the Subcommittee on Antitrust, Monopoly and Business Rights were the bottling companies, not the syrup manufacturers. Under the rule of reason test as set forth in *Sylvania*, it is the manufacturers' interests in being more effective competitors, assuring product safety, and maintaining adequate quality control or service which might justify particular territorial restrictions. When it is the distributors', in this case the bottling companies', interests which the territorial restrictions are protecting, the restrictions are little more than a subterfuge for a horizontal market division scheme. Such schemes are naked restraints of trade and are *per se* unlawful under Section 1 of the Sherman Act. The noticeable absence of support from syrup manufacturers like the Coca-Cola Company and PepsiCo, Inc., in marked contrast to the strong support for S. 598 aggressively and continually voiced by representatives of the bottling companies, strongly suggests that the soft drink industry's territorial restrictions no longer promote interbrand competition, but instead give cloaks of legitimacy to clearly illegal horizontal market divisions. Professor Eleanor M. Fox of the New York University School of Law focused on this problem in her testimony:

> Given the historical setting, it is probably shortsighted to look at the restraints in this industry as vertically-imposed by the licensor pursuant to the licensor's current plan for most efficient distribution of its product. The restraints were imposed by licensors in perpetuity three-quarters of a century

ago. Since that time, many more efficient distribution methods and systems have arisen. Were it not for the territorial barrier, bottlers could much more efficiently serve supermarket central warehouses, which serve stores located in more than one territory, and the more efficient bottlers and distributors could compete for sales, and expand their sales, across territory lines. The insulated territory is a wall against efficiency, and its very existence prevents the growth of dynamic, new, lower-cost forms of competition.

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[I]t seems clear that *the territorial barrier is preventing the consumer from realizing the benefits of the cost-savings promised by the dynamic, new competition that is being shunted aside.* Statement of Professor Eleanor M. Fox before the Subcommittee on Antitrust, Monopoly and Business Rights, September 26, 1979 at 5–6 (emphasis added) (hereinafter "Fox").

Analysis of S. 598

As Mr. Favretto emphasized, S. 598 is "special interest legislation" which would "confer a special antitrust exemption on exclusive territorial agreements between soft drink manufacturers and bottlers." Favretto at 1. Professor Fox pointed out that "[s]ince the general antitrust principles [like *Sylvania's* rule of reason test] are designed to promote consumer welfare, the bill leans against consumer welfare and toward protection of existing business establishments." Fox at 3.

In general, the bill does two things. It makes legal any territorial restriction affecting the distribution of "a trademarked soft drink product" if "such product is in substantial and effective competition with other products of the same general class." Second, even if the soft drink industry's territorial restrictions are held unlawful either under the rule of reason test or, if possible, under S. 598's substitute test, the bill in effect eliminates any rights injured persons may have to recover compensation for their injuries.

A. Substantial and Effective Competition

Under S. 598, the soft drink industry's territorial restrictions are automatically legal under the antitrust laws if a party challenging the restrictions fails to prove that "substantial and effective competition with other products in the same general class" does not exist. As Mr. Favretto pointed out, interbrand competition is only one of the factors, albeit a very important one, that is part of the rule of reason test. "[T]he FTC carefully considered the vigor of interbrand competition in its [soft drink industry] decision." Favretto at 5. (footnote omitted). The FTC concluded that the vigor of interbrand competition in the soft drink industry is suspect at best and that the territorial restrictions impair interbrand competition.

In view of the seeming lack of vigorous interbrand competition, the proponents of S. 598 must believe that it will be difficult for a party challenging the industry's territorial restrictions to show that "substantial and effective competition" does not exist. Otherwise, the bill would not serve their purposes. Mr. Favretto pointed out that a similar test in the so-called "fair trade" statutes which Congress repealed in the Consumer Pricing Act of 1975 was interpreted "very broadly" by the courts "so that it offered consumers little protection." Favretto at 6. Professor Fox added the " '[s]ubstantial and effective competition' may be taken to refer simply to existing numbers of competitors, rather than the dynamics of price and related competition as it is with the restraint compared with what it would be without the restraint." Fox at 9.

Not only does the "substantial and effective competition" test sacrifice consumer welfare in order to protect business interests, but the Majority Report says that S. 598 *places the burden of proof on the party challenging the restriction to prove that there is not substantial and effective competition.* Majority Report at 10. This construction of S. 598 is at odds with the language of the statute and virtually assures that any challenge to the soft drink industry's territorial restrictions is unlikely to succeed, despite the apparent absence of vigorous interbrand competition.

The Majority Report states that the "substantial and effective competition" test refers to "interbrand competition." "Interbrand competition," according to the Report, "takes place among products of different brands." Majority Report at 1 and n. 1. From a competitive standpoint, competition among brands is meaningless. Only if the different brands are produced by different companies is effective competition possible. If one syrup manufacturing company has six brands which are distributed by the only bottling company in any geographical area, a soft drink monopoly exists in the area although there are six brands distributed. In the industry today, twenty or more brands may be distributed in an area although there are only three or four bottling companies and the top three syrup manufacturers have 70 percent or more of the market. The Coca-Cola Co., which had 36.6 percent of the national market in 1977, distributes at least six different soft drink brands; PepsiCo, Inc.'s five or more brands had 22.3 percent; Seven-Up's three brands had 7.2 percent; and Dr. Pepper's two brands had 6.3 percent. In short, interbrand competition is a meaningful test only insofar as it focuses on the number of producers of the different brands, not on the number of different brands.

The "products of the same general class" language also confirms the bill's antitrust exemption character. As Professor Fox emphasizes, it simply cannot be construed to refer to such drinks as iced tea, milk and orange juice if the bill is meant to have any effect as a limitation on anticompetitive conditions. Fox at 9.

B. IMMUNITY FROM DAMAGE LIABILITY

Under Section 3 of S. 598, "[t]he victims [of illegal territorial restraints] have no right to compensation unless the defendants ignored a court order [declaring the restraints illegal]. There is simply no justification for this provision. . . . It means that the victim of such anticompetitive restraint could not recover any damage, much less treble damages, no matter how serious the injury suffered." Favretto at 10. Mr. Favretto and Professor Fox further point out that this section entirely removes the incentive for a private party to challenge an illegal restraint. Favretto at 11; Fox at 10. This section frees the soft drink industry from the threat of all private antitrust actions, not just treble damage suits. The Supreme Court has said that "the purposes of the antitrust laws are best served by insuring that the private action will be an ever-present threat to deter anyone contemplating behavior in violation of the antitrust laws." *Perma-Life Mufflers, Inc.* v. *International Parts Corp.*, 392 U.S. 134, 139 (1968). This provision—effectively eliminating the private antitrust action—can only be characterized as special interest overreach.

Conclusion

In view of the pending Court of Appeals case, it is particularly inappropriate for the Senate to pass S. 598 at this time. Moreover, the evidence suggests that vigorous competition is not now present in the soft drink industry. S. 598 would legalize the industry's territorial restrictions in perpetuity. This will surely deprive the consumers of the multiple benefits of free and fair competition. We cannot subscribe to any bill which has this result.

Howard M. Metzenbaum.
Edward M. Kennedy.

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