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RESTRICTED DISTRIBUTION AT THE FTC: RULE OF REASON OR REIGN OF CHAOS?

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INTRODUCTION

In 1977, the Supreme Court propounded a new approach to the legality of territorial restrictions imposed by a manufacturer upon its distributors. Reversing a ten-year old landmark case,[1] the Court in *Continental T.V. v. G.T.E. Sylvania*,[2] declared that the legality of these restraints were henceforth to be judged under the rule of reason, an approach requiring a broad inquiry into the effect the restraint has upon competition.[3] Prior to *Sylvania*, these restraints had been deemed unlawful *per se* without regard to their competitive effect.[4] In part the product of a change in membership,[5] the Court rested its *Sylvania* decision upon a conviction that these restraints have procompetitive aspects.[6] However, the Court provided little guidance on how to apply the rule of reason to the practice of territorial restraints.

Since 1977, the courts have struggled in applying the new standard. The various circuits have developed different approaches and guidelines making the law far from uniform.[7] A similar phenomenon exists at the Federal Trade Commission (FTC). While this body generally speaks with only one voice, it

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1. United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

2. 433 U.S. 36 (1977). Sylvania, a T.V. manufacturer, had attempted to limit the number of franchises in an area and to restrict retailers from selling Sylvania products outside their designated location.

3. *Id.* at 59.

4. Arnold, Schwinn & Co., 388 U.S. at 379.

5. *See* Redlich, *The Burger Court and the Per Se Rule*, 44 ALB. L. REV. 1 (1978).

6. 433 U.S. at 54-57.

7. The various approaches taken by the circuit courts differ greatly. For instance, the Second Circuit takes a tough approach to vertical restraints in Eiberger v. Sony Corp. of Am., 622 F.2d 1068, 1081 (2d Cir. 1980), concluding that an anticompetitive impact on intraband competition can alone support a finding that § 1 of the Sherman Act has been violated. However, in Borger v. Yamaha Intern. Corp., 625 F.2d 390, 397 (2d Cir. 1980), the Second Circuit used a more lenient approach to vertical restraints stating

has in the years since *Sylvania* produced two opinions expressing divergent points of view. The first opinion was rendered in a case involving the practices of the Coca-Cola Company,[8] while the second involved Beltone, the nationally known manufacturer of hearing aids.[9] These opinions, which are the subject of this article, have added little to the development of a rational body of law in this complex area. The first two parts of this article will discuss, respectively, the FTC's decisions in the two cases. The third part will then attempt to accomplish that which the FTC did not: develop a rational and useful approach to vertical restraint cases through comparison of the problems presented by these two cases.

PART I: *COCA-COLA*

Only a year after *Sylvania*, the Federal Trade Commissioners were confronted with a challenge to the territorial restraints imposed by the Coca-Cola Company on its distributors.[10] Reversing the administrative law judge's finding of reasonableness,[11] the FTC concluded that Coca-Cola's system violated section 5 of the Federal Trade Commission Act.[12] Commissioner Dole, writing for the majority, analyzed the competitive benefits and burdens of the Coca-Cola scheme. Her conclusion

that the purpose or effect of the restraint must be harmful to both interbrand competition and intrabrand competition for a finding of illegality.

The Fifth and Ninth Circuits adopted a different approach. Both circuits relied heavily on the effects on interbrand competition through analysis of market share. For decisions in the Fifth Circuit *see, e.g.*, Mendelovitz v. Adolph Coor Co., 693 F.2d 570 (5th Cir. 1982); Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292 (5th Cir. 1981); Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001 (5th Cir.) *cert. denied*, 454 U.S. 827 (1981). For decisions in the Ninth Circuit *see, e.g.*, Ron Tonkin Gran Turismo, Inc. v. Fiat Distrib., Inc., 637 F.2d 1376 (9th Cir.) *cert. denied*, 454 U.S. 831 (1981); Cowley v. Braden Indus., Inc., 613 F.2d 751 (9th Cir.) *cert. denied*, 446 U.S. 965 (1980). The Seventh Circuit agreed with the Fifth and Ninth Circuits. Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742, 745 (7th Cir. 1982).

In further contrast, the Sixth Circuit deals with vertical restraints by analyzing the nature of the restraints. *See, e.g.*, Davis-Watkins Co. v. Service Merchandise, 686 F.2d 1190 (6th Cir. 1982); Clairol, Inc. v. Boston Discount Center of Berkeley, Inc., 608 F.2d 1114 (6th Cir. 1979).

Evidencing yet another approach to vertical restraints, at least one court emphasized the existence of reasonable justification of the restraint such as the free rider and new entrant rationales. *See* Donald B. Rice Tire Co. v. Michelin Tire Corp., 483 F. Supp. 750 (D. Md.), *cert. denied*, 454 U.S. 864 (1980).

8. In re Coca-Cola, Inc., 91 F.T.C. 517 (1978).
9. In re Beltone Electronics Corp., 100 F.T.C. 68 (1982).
10. In re Coca-Cola, Inc., 91 F.T.C. 517 (1978).
11. *Id.* at 609-10.
12. *Id.* at 609.

was that the restraints produced an unreasonable reduction in competition in the market; the practice therefore had to be stopped.[13]

The Coca-Cola Company, since the time it began to sell the rights to bottle its product and license its trademark, had done so only through exclusive territories granted to bottlers.[14] The bottlers, after purchasing the necessary soft drink syrups from Coke, would add carbonated water, put the product in containers, and distribute it to the various retail establishments, vending machines and other sales outlets.[15] By granting exclusive territories, the bottlers, who are independent from Coke,[16] were precluded from competing with each other in the sale of bottled, canned and pre-mixed soft drink products made from syrup manufactured by Coca-Cola.[17] Other major soft drink manufacturers engaged in a similar system of territorial exclusivity.[18]

Commissioner Dole, after rejecting the suggestion that the restraints were illegal *per se* under *United States v. Topco Associates, Inc.*,[19] addressed the relationship between the question of reasonableness and a firm's market power.[20] Coca-Cola had argued that without "excessive market power," its restraint could not affect the resale price of its product; therefore, re-

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13. *Id.*

14. *Id.* at 608. At the beginning of this century, the Coca-Cola Company sold its right to bottle Coca-Cola and licensed its trademark to private investors who owned and operated their own plants within their assigned territories. *Id.* at 607.

15. *Id.* at 627. Coca-Cola refused to yield the secret Coca-Cola syrup formula to the bottlers, which would have enabled them to produce the syrup themselves. *Id.* at 608. It later adopted a similar policy for its allied products as they were introduced. *Id.* Therefore, the Coca-Cola Company is the bottlers, only source of the Coca-Cola and allied products syrup.

16. The Coca-Cola Company now operates 27 bottling plants of its own, resulting from the reacquisition of the bottling rights which had been previously granted to local bottlers. *Id.* at 607. These plants operate in exclusive territories subject to the same limitations previously imposed upon the acquired bottler. *Id.* at 613. Thus, Coca-Cola "merely replaced an independent bottler within a preexisting distribution scheme." *Id.* This had no significant effect on the restraints or the territorial relationships of existing bottlers. "The rest of [the] bottlers are . . . independent businessmen who conduct [their businesses] as they see fit." *Id.* at 608.

17. *Id.* at 609.

18. *Id.* at 640-41; *see* In re Pepsico, Inc. 91 F.T.C. 680, 698-99 (1978) (competitor ordered to cease practice of territorial exclusivity).

19. 405 U.S. 596 (1972). *Topco* involved a conspiracy among firms at the same level of competition, a so-called "horizontal" restraint. These restraints continue to be treated as illegal *per se*, even after *Sylvania*. *Sylvania*, 433 U.S. at 57 n.27. On the other hand, the *Coca-Cola* case, as well as *In Re* Beltone Electronics Corp., 100 F.T.C. 68 (1982) (*see infra* text accompanying note 82), involved agreements between firms at different levels of the distribution system. These restraints are denominated "vertical."

20. *Coca-Cola*, 91 F.T.C. at 618-19.

duced competition amongst sellers of Coke could not be economically harmful.[21] Commissioner Dole rejected the argument as contrary to the precepts of *Sylvania*.[22] The fact that the Supreme Court had not approved Sylvania's location clause[23] suggested to Commissioner Dole that market power was not a prerequisite to a finding of illegality.[24] Even though Sylvania's share of the market was relatively small,[25] the Court nevertheless remanded the case to the lower court for consideration under the rule of reason.[26] If a finding of excessive market power had been required for a finding of unreasonableness, then remand would have been unnecessary. Absence of market power, said Commissioner Dole, was important to a finding of reasonableness. Absence of that power, however, did not automatically produce exoneration.[27] Nevertheless, it was noted that some market power was present, particularly because the Coca-Cola trademark has great competitive significance in the soft drink industry. The market power was sufficient such that the restraints constituted, "a serious impediment to free market forces and [tended to] diminish competition in the [market place]."[28]

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21. *Id. Coca-Cola* argued that since it had not been proven to have "dominant or monopoly" power, interbrand competition would prevent changes in the price of its product. *See Answer Brief for Respondent*, at 12-16, 45, 47, 49, 54; In re Coca-Cola, Inc., 91 F.T.C. 517 (1978) [hereinafter cited as Respondent's Brief].

22. *Coca-Cola*, 91 F.T.C. at 619.

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

24. *Coca-Cola*, 91 F.T.C. at 618-19. Commissioner Dole referred to the case of United States v. Columbia Pictures Corp., 189 F. Supp. 153, 178 (S.D.N.Y. 1960), in which the court summarized the doctrine of reasonable restraints and listed the absence of monopoly power merely as a prerequisite to, but not a definitive determinant of, a finding of reasonableness.

25. 433 U.S. at 38. Sylvania's market share had declined to 1% to 2% of national television sales when they instituted the new franchise plan which brought their market share up to 5% in three years. *Id.*

26. *Id.* at 59. *See* Continental T.V., Inc. v. GTE Sylvania, Inc., 461 F. Supp. 1046 (1978), *aff'd*, 694 F.2d 1132 (9th Cir. 1982).

27. *Coca-Cola*, 91 F.T.C. at 618-19. The FTC refers to *Sylvania* as a case in point, where "a less sweeping restraint" was tested for reasonableness despite the fact that Sylvania did not possess dominant or monopoly power but had only a very small market share.

28. *Id.* at 618-19. The restraints imposed by Coca-Cola, according to the FTC, have successfully suppressed, if not eliminated, intrabrand competition in several important soft drink product lines. This has resulted in a distortion of the competitive dynamics of the industry and a disruption of the natural economic forces which would have caused significant changes in the geographic market boundaries of bottlers. *Id.* at 622-23. It was noted that originally the boundaries were probably a reflection of natural geographic boundaries due to transportation and technological barriers inherent in the early 20th century. However, with improvements in transportation and technological advances these boundaries have become

After looking closely at the effects of the territorial divisions by Coca-Cola, the FTC found a substantial lessening of competition.[29] The opinion stated that the territorial plan, formulated at the turn of this century, did not produce the economies of scale which bottlers require. The currently drawn territories were too small for some bottlers to reap the advantages of modern technology.[30] Geographic expansion would permit these bottlers to reach optimal size, allowing them to realize production, transportation and marketing efficiencies.[31] Therefore, the effect of the territorial division was to stifle the growth of these bottling companies.

Coca-Cola had argued that it was desirable to keep these territories small, asserting that a company with "a limited field to till obviously has to till it better in order to get the most out of it."[32] Greater market penetration would then be assured, with Coke products appearing in every conceivable location.[33] As the

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obsolete. The result was a network of artificially maintained territories impervious to the benefits of market evolution and expansion. *Id.*

29. *Id.* at 644. The FTC pointed specifically to the lessening of competition in the delivery services bottlers offered to their customers. The bottlers used a route-delivery system, or a store-to-store delivery system as it was called, in which the bottler brought the product directly to the customer's store. With the growth of the chain store and use of nonrefillable containers, this method of distribution has become unnecessary and in many cases undesirable. Retailers have expressed a great demand for alternative methods of distribution such as central warehousing and plant pick-up by central warehousing customers. The bottlers were unable to provide these services under the territorial restraints imposed by Coca-Cola. The bottlers testified that they preferred store-to-store delivery because it allowed them to maintain some control over the merchandising of their products. *Id.* at 624. Implicit in that contention is their desire to maintain their exclusive territories. It is clear, therefore, that the territorial restrictions impeded the growth of an important aspect of nonprice competition in the soft drink industry, competition in delivery services offered.

30. *Id. See supra* note 28.

31. *Coca-Cola*, 91 F.T.C. at 622. Coca-Cola argued that geographic expansion was not a necessary prerequisite to realizing these efficiencies because the bottling industry has clearly taken advantage of the benefits of technological advancements. *See Coca-Cola*, 91 F.T.C. at 622 (citing Respondent's Brief, *supra* note 21, at 81.) Coca-Cola pointed to improvements in transportation and production of their products which had resulted in markedly greater production efficiency and potential capacity. The products were delivered by trucks and the production line was fully automated. There were machines to mix the syrup, wash the bottles and fill and cap them. However, the opinion stated that even with this potential, growth in production had not been fully exploited because of the territorial restrictions placed on the bottlers. *Coca-Cola*, 91 F.T.C. at 622.

32. *Id.* at 628 (quoting Transcript 696, Respondent's Proposed Findings 84). This statement was made by the President of the Coca-Cola Company in explanation of why exclusive territories encourage market penetration.

33. *Coca-Cola*, 91 F.T.C. at 627. According to Coke officials, the belief that deep market penetration was crucial in selling soft drinks had led bottlers to service numerous unprofitable "vending machine accounts, small

FTC pointed out, however, a portion of this market is often unprofitable for the bottlers,[34] with the benefits of extreme market penetration inuring mostly to the manufacturer.[35] But the costs of this penetration fell on the bottlers, and often produced price distortions at the retail level.[36] Commissioner Dole termed this phenomenon "free riding" by Coca-Cola on its bottler's efforts.[37]

This reverse free rider analysis is unique to rule of reason cases. The usual free rider analysis justifies market division by postulating the effect a non-promoting seller has upon those who promote and service a product.[38] The seller who does not expend efforts to promote his product can sell at a lower price than his intrabrand competitor, thus reducing the latter's incentive to engage in such promotions. One with an exclusive territory, however, need not fear the free riding discounters, thus raising the seller's incentive to promote the product involved.

Coca-Cola, like Sylvania, tried to use the free rider analysis to defend its exclusive territories.[39] The FTC rejected the argument.[40] While bottlers may be reluctant, absent the exclusive grants, to engage in certain image-enhancing promotion, there was no reason to believe that consumer recognition of Coca-

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outlets and 'special events'," so that coke products would always be within an "arm's-reach of desire." *Id.* at 627-28.

34. Although the majority of "special events" the bottlers serviced were unprofitable, the bottlers claimed such events were necessary in order to develop a market training people to drink Coca-Cola and to develop "product awareness to make the larger accounts profitable." *Id.* at 628.

35. *Id. See infra* text accompanying notes 163-64.

36. *Coca-Cola*, 91 F.T.C. at 628-29. The FTC explained that the bottlers charged the same price to each of their customers irrespective of the actual cost to service that customer. That is, despite differences in delivery costs each customer was charged a level price. This resulted in the subsidizing of the overall cost of market penetration by those retailers who cost bottlers less to service than other retailers. This added cost would eventually be passed on by retailers to the consumer in the form of higher prices. *Id. See infra* text accompanying notes 162-64.

37. *Coca-Cola*, 91 F.T.C. at 628.

38. *Id. See also Sylvania*, 433 U.S. at 55. Commissioner Dole believed that the elimination of exclusive territories would cause bottlers to abandon level pricing in exchange for a system where the price charged to retailers more closely reflected the actual cost of servicing each individual retailer. She further suggested that bottlers could institute minimum volume requirements or encourage plant pick-up delivery for those accounts that would otherwise be unprofitable. *Coca-Cola*, 91 F.T.C. at 629.

39. *Coca-Cola*, 91 F.T.C. at 629-31.

40. *Id.* at 631. The FTC noted that in this case the burden of the restraint exceeded the advertising benefits it was said to encourage. For the past 75 years Coca-Cola and its bottlers had operated under the present system of exclusive territories. The promotional activities, however, had not yet produced the expected benefits, namely lowering retail prices and eliminating barriers to entry. The record clearly showed that intrabrand competition was necessary to produce the pressure to achieve these benefits. *Id.* at 629-30.

Cola would suffer greatly as a result.[41] The well established company of Coca-Cola is not as dependent upon distributor advertising as a newcomer or a faltering firm.[42] Furthermore, it was likely that the bottlers would continue to promote Coca-Cola products as a way to stimulate sales.[43] However, the focus of that promotion might change. For example, pricing, sales terms and related services would become more prominent in advertising, enhancing customer knowledge, and therefore intrabrand competition.[44] The effect of the territorial division was exactly the opposite, and the FTC believed that a change would be procompetitive.[45] Similarly, the FTC rejected the argument that the restraint was necessary to ensure the quality of the bottler's product. Less restrictive alternatives are available, and the restraint on competition was not "reasonably necessary to ensure [the quality of the product]."[46]

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41. *Id.* at 631.

42. *Id.* For an extended discussion on the legality of these defenses, see REDLICH, *supra* note 5, at 1.

43. *Coca-Cola*, 91 F.T.C. at 631. The FTC stated that without exclusive territories "the bottlers would have every incentive to price promote their products in competition with intrabrand bottlers and to convey information relating to the terms of sale or the competitive packaging or service alternatives they may offer to their potential purchasers, the soft drink retailer." *Id.* at 630-31. Thus, advertising might not diminish. Rather, there would merely be a shift in the focus of the advertising from image enhancement to price and informational promotion. *Id.*

44. *Id.* at 630-31.

45. *Id.* at 631.

46. *Id.* at 634. The respondents contended that the territorial restrictions were necessary to maintain quality control in both manufacturing and distribution. They argued that limiting the number of the bottlers' potential customers would force the bottlers to uphold product quality to minimize the risk of losing customers. Moreover, the respondents contended that the restrictions allowed them to monitor each bottler's product quality. *Id.* at 631-32.

The FTC rejected these arguments because the nature of the restraint was unconnected to quality control and because less restrictive alternatives existed. The Coca-Cola Company engaged in unscheduled routine inspections of both the bottling plants and the bottled products. There is no reason to think that these inspections could not take place without the territorial restrictions. The inspections were totally unrelated to the area in which the bottled products were retailed. Although facilitated by the restraints, quality control at the retail level can be maintained by requiring each bottler to identify itself on the product. The FTC decided that in this case "quality control and intrabrand competition [were] not incompatible." *Id.* at 634. The FTC referred to Mendelovitz v. Adolph Coors Co., 693 F.2d 570 (1982) for clarification. *Id.* at 633. In *Coors*, the court stated that the territorial restrictions used by the brewer were "essential to the efficient functioning of its quality control procedures." *Id.* at 576. Thus, the court noted a standard for quality justification of territorial restraints. However, application of this standard to the Coca-Cola system of restraints yielded the decision that the restraints are not reasonably necessary to maintain quality control.

Having completed the analysis of the restraint's effect upon intrabrand competition, the FTC's discussion turned to interbrand effects. Previously, the administrative law judge upheld the market division relying on *Sylvania* for the proposition that the presence of vigorous interbrand competition would serve as a check on intrabrand restraints.[47]

The administrative law judge stressed the existence of large numbers of soft drink brands.[48] The FTC, however, differed with the judge on how to properly assess the level of interbrand checks. An accurate assessment requires a careful study of competitive interaction amongst competing bottlers, not merely a superficial look at the number of competitors.[49]

For example, Commissioner Dole analyzed the effect of a practice known as "piggybacking," a bottler's production and sale of the soft drinks of two or more companies.[50] This practice has the effect of limiting interbrand price competition because a bottler would prefer to price all of his brands at relatively equal prices, rather than engage in price competition with himself.[51] Furthermore, piggybacking increases concentration at the bottler level.[52] Thus, simply naming and counting brand names is not an accurate measure of the degree and intensity of interbrand competition.

The FTC attempted to assess the level of interbrand competition. While some interbrand competition within each territory did subsist with these territorial restraints,[53] bottlers of beverages which compete with Coca-Cola products were insulated from competition from all but one Coca-Cola bottler. Actual and

47. *See Sylvania*, 433 U.S. at 52 n.19.

48. *Coca-Cola*, 91 F.T.C. at 635. The judge relied on a lengthy list of brands or trade names of beverages all of which compete to some degree with Coca-Cola. *Id.* at 549-53. The Coca-Cola bottlers who testified demonstrated, however, that flavored carbonated soft drinks offered the most intense competition to Coca-Cola products. *Id.* at 635. Thus, it was the interbrand competition with suppliers of those products that the FTC considered.

49. *Id.* at 635-39.

50. *Id.* at 636-39. The FTC noted that piggybacking is used extensively in the soft drink bottling industry. The respondents argued that it evidences intense interbrand competition, rationalizing that when consumers buy soft drinks they are confronted with the various brands, each in competition with the other, regardless of who the bottler was. The FTC rejected the argument asserting that the practice worked a substantial reduction of competition at the bottler level. *Id.*

51. *Id.* at 637.

52. *Coca-Cola*, 91 F.T.C. at 638. In each territory observed there were a large number of brands available to the public; however, the bottling of those brands was controlled by only a few bottlers, making the intensity of interbrand competition questionable. *Id.*

53. *Id.* at 636-37.

potential interbrand competition were thus largely curtailed.[54] The problem was compounded by the fact that Pepsi, Coca-Cola's largest competitor, engages in a similar practice.[55] The typical result was that pricing levels, or at least pricing policies, varied markedly from territory to territory.[56] Removal of the territorial restraints would cause these pricing policies to clash in a competitive environment.[57] Thus, the complete elimination of intrabrand competition by Coca-Cola had, in fact, produced less vigorous competition.[58] Commissioner Dole thus concluded that intrabrand competition must be injected into the market.

Commissioner Clanton dissented.[59] Although he was unable to identify any specific procompetitive effects, his opinion is punctuated with calls for additional evidence.[60] He conceded, as did the respondent, that the territorial divisions worked a complete elimination of intrabrand competition.[61] Nevertheless, Commissioner Clanton believed that the majority did not employ the kind of analysis mandated by *Sylvania*.[62] According to his opinion, there was insufficient consideration given to possible interbrand benefits and too much emphasis on anticompetitive effects.[63]

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54. *Id.* at 639-43.

55. *Id.* at 640.

56. *Id.* Respondents argued that disparities in wholesale prices were not indicative of limitations on interbrand competition but are due to alternative pricing policies of the bottler. *Coca-Cola*, 91 F.T.C. at 641 (citing Respondent's Brief, *supra* note 21, at 75 & 88). The FTC rejected this argument theorizing that the real reason pricing policies vary from territory to territory is that the level of interbrand competition varies from territory to territory depending upon a variety of factors. *Coca-Cola*, 91 F.T.C. at 639-40.

57. *Coca-Cola*, 91 F.T.C. at 642. The FTC regards the uncertain outcome of such a confrontation as the "essence of competition which the present system of territorial restrictions . . . eliminates." *Id.*

58. *Id.* at 644. Since Coca-Cola is the nation's leading flavored carbonated soft drink brand, interbrand price competition is highly sensitive to the effects of Coca-Cola's intrabrand price competition. *Id.* The elimination of that intrabrand price competition has an adverse effect on interbrand competition in the industry as a whole. *Id.*

59. *In re* Coca-Cola, 91 F.T.C. 517, 589-06 (1976) (Clanton, C., dissenting).

60. *Id.*

61. *Id.* at 592.

62. *Id.* at 595. The analysis mandated by *Sylvania* entails a delicate balancing of the effects of the restriction on competition, weighing the benefits to interbrand competition against the harm done to intrabrand competition. 433 U.S. at 54-55. The Supreme Court elaborated upon this standard in National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679 (1978), where it stated that the rule of reason requires a balancing of procompetitive and anticompetitive effects in an effort to determine net competitive effect.

63. *Coca-Cola*, 91 F.T.C. at 594 (Clanton, C., dissenting). Commissioner Clanton feels that the FTC wrongfully stressed that "the restraints are no longer justified primarily because of changed conditions affecting distribution," rather than concentrating on "the reasons advanced for imposing

According to the dissent, the record lacked sufficient detail on the effects the restraint had upon pricing.[64] While Commissioner Clanton agreed with Commissioner Dole that the level pricing used in bottler sales can be harmful to competition, a detailed inquiry into Coke's market power and cost structure would be necessary to support such a finding.[65] Removal of the restraint might produce more intrabrand competition, but Commissioner Clanton believed that this fact did not, in itself, dictate a finding of unreasonableness.[66] The dissent reasoned that the level pricing structure could be the most efficient method of producing the high availability and market penetration which respondent claimed was crucial to its business success.[67] Lifting the exclusivity of the territories would, as the majority had argued, change the nature of the bottler advertising and put the onus of promoting the image of the brand on the syrup manufacturer.[68] But Commissioner Clanton was unable to agree that such a shift would necessarily produce greater efficiency in advertising.[69] Unlike the majority, he seemed undisturbed by the burden thus placed upon the bottlers.[70]

The dissent accused the majority of substituting its view of what is in the consumer's best interest for that of the company.[71] Commissioner Clanton was unwilling to go as far as

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such restraints and their effect on interbrand competition," as mandated by *Sylvania*. *Id.* at 592-93.

64. Commissioner Clanton believed the record was insufficient concerning the actual cost incurred by the bottlers for each retailer. Thus, the effects of level pricing were indeterminant because it was unknown "whether . . . cost differentials reflect[ed] legitimate promotional considerations or represent[ed] a form of price discrimination . . . ." *Id.* at 595. Furthermore, if the restriction were enjoined then the actual effect on the consumer would be unknown. Would the consumer benefit from variable pricing and alternate means of distribution more so than he would suffer from less competition over availability? *Id.* at 595-96.

65. *Id.* at 604-05.

66. *Id.* at 598. Commissioner Clanton believed that such an analysis does not satisfy the requirements set forth in *Sylvania*. He asserted that further inquiry must be made "concerning the procompetitive aspects of the challenged restrictions and their overall effect on interbrand competition." *Id.* at 595.

67. *Id.* at 597-98.

68. *Id.* at 631.

69. *Id.* at 595. Commissioner Clanton believed that the record conveyed no evidence that the advertising strategy of Coca-Cola was currently inefficient. The FTC's belief, that much of Coca-Cola's advertising was unnecessary due to widespread recognition of the Coke trademark, was merely an opinion unsupported by factual analysis. Lifting the exclusivity of territories, Clanton revealed, may simply result in "a shift to less efficient methods of obtaining the same promotional effects." *Id.* at 596 (quoting Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 56 n. 25 (1977).

70. *See infra* text accompanying notes 163-64.

71. *Coca-Cola*, 91 F.T.C. at 597.

Commissioner Dole without more guidance from the record. Commissioner Clanton stated:

> To conclude, as the majority seems to imply, that the availability of suitable marketing approaches less restrictive of intrabrand competition is sufficient to find a violation, places the Commission in the difficult position of having to make its own judgment about the commercial merits of various strategies without regard to their impact on interbrand competition.[72]

Economic theory states that the manufacturer will be punished by the market place for inefficient marketing strategies.[73] Commissioner Clanton, endorsing this theory, apparently believed that there was no need for the FTC to intervene.

Commissioner Clanton took issue with the majority over the significance of soft drink brand piggybacking.[74] While he admitted that the practice leads to less price competition, it may be that piggybacking is a response to high entry barriers or vigorous competition for bottler's services. In fact, the dissenter asserted that piggybacking may actually lower barriers to new entry for manufacturers unable to meet the steep capital requirements of bottling.[75] Thus, piggybacking may actually be beneficial to competition. It was therefore asserted that the true effect of piggybacking in particular, and the territorial restraint in general, cannot be analyzed without more evidence.[76] Even though wholesale prices would in some instances be lower if the exclusivity were enjoined, Commissioner Clanton asserted that it is still impossible to discern properly the pricing relationship between Coke, Pepsi and other soft drinks without market definition and evidence of Coke's market share.[77] Therefore, Commissioner Clanton would have remanded the case for further study of Coke's market power.[78]

Following the FTC's decision, Coca-Cola and the soft drink industry stepped up their campaign for federal legislation which would permit them to engage in restricted distribution and territorial restraints. A new statute was passed, requiring an antitrust complainant, such as the FTC, to prove that interbrand competition in the market for soft drinks is less than "substantial and effective."[79] The FTC's order in *Coca-Cola* was then set aside by the courts, and remanded to the Commission for addi-

72. *Id.*

73. *See generally*, Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981).

74. *Coca-Cola*, 91 F.T.C. at 601-02.

75. *Id.* at 602.

76. *Id.*

77. *Id.* at 602-03.

78. *Id.* at 606.

79. Soft Drink Interbrand Competition Act, 15 U.S.C. § 3501-3503 (1980).

tional proceedings.[80] To date, there have been none.

PART II: *BELTONE*

The FTC again confronted the issue of the legality of territorial restraints in *In re Beltone Electronics Corp.*[81] *Beltone* dealt with the practices of manufacturers of hearing aids. The hearing aid industry had generally sought to confine distributors of hearing aids to exclusive territories. Several companies, such as Beltone, engaged in a scheme of product exclusivity, prohibiting their dealers from selling the hearing aids of other manufacturers. Four of the major companies had signed consent decrees with the FTC barring exclusivity, but Beltone refused and a proceeding against it followed.[82] Administrative Law Judge Miles Brown followed the *Sylvania* decision and ruled that Beltone's system was unreasonable.[83] Judge Brown found an adverse impact on both intrabrand and interbrand competition.[84] An appeal to the FTC followed.

Beltone's system of restraints did not produce "air tight" exclusivity.[85] The FTC, however, considered the restraint a traditional territorial division because the restraint significantly reduced intrabrand competition.[86] Nevertheless, the FTC held

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80. Coca-Cola Co. v. FTC, 642 F.2d 1387 (D.C. Cir. 1981). Vertical restraints imposed by Royal Crown Cola also became the subject of litigation, in which that company's practices were declared lawful under the rule of reason. *See* First Beverages, Inc. v. Royal Crown Cola Co., 612 F.2d 1164 (9th Cir. 1980). That case was decided by a jury under the traditional rule of reason standard, not under the approach contained in the new statute.

81. *In re* Beltone Electronics Corp., 100 F.T.C. 68 (1982).

82. *Id.* at 223 (Bailey, C., concurring).

83. *Beltone*, 100 F.T.C. at 146.

84. *Id.* at 179. Administrative Law Judge Brown had previously rendered a decision of illegality in this case applying the *per se* rule as demanded by United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967). However, in 1978 when *Sylvania* overruled *Schwinn*, the case was remanded for further inquiry under the rule of reason in order to assess properly respondent's appeal to the Commission.

85. *Beltone*, 100 F.T.C. at 193.

86. *Id.* Beltone's dealership agreements were not expressly restrictive; however, the ALJ treated them as traditional restraints because they "created an atmosphere of intimidation and coercion which has produced *de facto* exclusive dealing as well as territorial and customer restrictions. . . ." *Id.* at 183.

The Beltone system "has been sustained primarily through the efforts of supervisory personnel known as 'home office field executives' or HOFES." *Id.* The HOFES ensure that each dealer attains his given sales goal, or "potential," within his "Area of Primary Marketing Responsibility" (APMR). *Id.* HOFES are instructed by Beltone that termination of a dealership agreement cannot be based on a dealer's selling of a Beltone competitive brand nor on a dealer's selling of Beltone products outside his APMR. *Id.* However, a dealer's failure to achieve deep market penetration within his APMR, evidenced by his failure to achieve his potential, is viable that the practice was reasonable.[87] Interbrand considerations were declared to be of primary importance.[88] Writing for the FTC, Commissioner Clanton found that interbrand competition was sufficiently vigorous to alleviate any negative effect on intrabrand competition.[89]

The *Beltone* case is not particularly noteworthy for its emphasis upon interbrand competition. *Sylvania* and a good portion of its progeny had similar emphasis,[90] even if *Coca-Cola* had not. But the *Beltone* opinion expressly required that a complainant demonstrate an adverse impact on interbrand competition, a step the FTC did not take in any previous cases.[91] Under

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grounds for dealership termination. *Id.* Dealers are encouraged and advised by the HOFES to concentrate their efforts on achieving or increasing their potential. *Id.* Several dealers testified that this goal could only be achieved by selling Beltone products exclusively and each within his assigned APMR. *Id.* Thus, the system results in *de facto* vertical restraints. Beltone argued, however, that "the voluntary decision by the majority of its dealers to devote primary attention to Beltone products is not legally equivalent to exclusive dealing." *Id.* at 183-84. The ALJ rejected this argument concluding that the "*de facto* exclusivity is unlawful because it raises entry barriers and exacerbates the loss of intrabrand competition caused by customer and territorial restrictions." *Id.* at 185.

87. *Id.* at 218.

88. *Id.* at 196. Commissioner Clanton reviewed the post-*Sylvania* case law to point out the importance of interbrand effects in cases concerning vertical restrictions. *See* Red Diamond Supply Inc. v. Liquid Carbonic Corp., 637 F.2d 1001, 1006 (5th Cir.) *cert. denied*, 454 U.S. 827 (1981) (court observed that vertical restraints might have increased rather than injured competition); Cowley v. Braden Indus. Inc., 613 F.2d 751 (9th Cir.) *cert. denied*, 446 U.S. 965 (1980) (court found restraints reasonable in absence of evidence of injury to interbrand competition); Eiberger v. Sony Corp. of America, 622 F.2d 1068 (2d Cir. 1980) (court found no basis in *Sylvania* for the position that adverse intrabrand effects alone cannot support a violation of Section 1 of the Sherman Act); Borger v. Yamaha Int'l Corp., 625 F.2d 390 (2d Cir. 1980) (court held reversible error to instruct the jury to find defendant liable solely on intrabrand competition); Donald B. Rice Tire Co. v. Michelin Tire Corp., 483 F. Supp. 750 (D. Md. 1980) *aff'd*, 638 F.2d 15 (4th Cir.) *cert. denied*, 454 U.S. 864 (1981) (court demanded more rigorous analysis of the competitive effects of non-price vertical restraints).

89. *Beltone*, 100 F.T.C. at 218.

90. *See supra* note 7.

91. *Beltone*, 100 F.T.C. at 208. For example, in *Coca-Cola* the FTC condemned the vertical restraint based on its elimination of intrabrand competition and the existence of less restrictive alternatives. *Coca-Cola*, 91 F.T.C. at 633, 644. There was no lengthy analysis of the level of interbrand competition or of the effects the restraint had on interbrand competition. It is interesting to note that Commissioner Clanton wrote the dissenting opinion of the case, calling for a further inquiry into the level of interbrand competition. *Id.* at 589 (Clanton, C., dissenting). *See supra* text accompanying note 59-78.

The FTC in *Beltone* cited one prior FTC opinion, *In re* Amway Corp., Inc., 93 F.T.C. 618 (1979), an opinion by then-Commissioner Pitofsky. *Beltone*, 100 F.T.C. at 194. It is ironic, for two reasons, that Commissioner Clanton cites this case in support of his *Beltone* standard. First, the case was decided under the *per se* rule, not the rule of reason which Mr. Clanton the articulated standard, a showing of a reduction of intrabrand competition is necessary in order for the complainant to prevail, no matter how great the reduction.[92]

The *Beltone* opinion discussed in significant detail the question of how to assess the level of interbrand competition in a rule of reason case.[93] Initially, Commissioner Clanton focused the analysis on three potential anticompetitive interbrand effects: (1) promotion of actual collusion among competitors; (2) promotion of interdependent behavior; and (3) enhancement or creation of market power on the part of one or more sellers.[94] The most extreme case is the first category which is typically dealt with as a horizontal conspiracy under *Topco*,[95] *i.e.*, as a *per se* violation. The second and third categories, however, must be addressed through the rule of reason, and the FTC proceeded to do so.[96]

Regarding interdependence, Commissioner Clanton drew from "available economic literature" those factors which characterize a market susceptible to that type of behavior.[97] Foremost are the number of sellers and the degree of concentration in the market. The opinion stated that the hearing aid industry is not highly concentrated, and that the number of sellers is increasing.[98] Other enumerated characteristics of interdependent be-

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so vigorously espouses. Second, Commissioner Pitofsky is one of the remaining stalwarts who finds fault with most territorial restraints. *See* Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions*, 78 COLUM. L. REV. 1 (1978).

92. *Beltone*, 100 F.T.C. at 196, 208. In writing the majority opinion, Commissioner Clanton attempted to facilitate application of the *Sylvania* decision by forging a procedural analysis of "interbrand effects and the contribution (positive or negative) that . . . [on-price vertical restraints] make to that level of competition." *Id.* at 206.

93. *Id.* at 197.

94. *Id.* at 206-07.

95. United States v. Topco Associates, Inc., 405 U.S. 596 (1972). There remains some question as to the viability of *Topco* after *Sylvania*. *See* Redlich, *supra* note 5, at 51 n. 397.

96. *Beltone*, 100 F.T.C. at 207-13. For analysis by the courts of such interbrand considerations as market concentration and market power see Red Diamond Supply Inc. v. Liquid Carbonic Corp., 637 F.2d 1001, 1005-06 (5th Cir.) *cert. denied*, 454 U.S. 827 (1981); Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292 (5th Cir. 1981); Donald B. Rice Tire Co. v. Michelin Tire Corp., 483 F. Supp. 750 (D. Md. 1980) *aff'd* 638 F.2d 15 (4th Cir.), *cert. denied*, 454 U.S. 864 (1981); Valley Liquors, Inc. v. Renfield Importers, Ltd., 1982-2 Trade Cases (CCH) ¶ 64,744 at 71,606 (7th Cir. 1982).

97. *Beltone*, 100 F.T.C. at 210-11.

98. *Id.* at 211. Complaint counsel argued that the changes in the market have resulted from the consent orders signed by other companies precluding them from using exclusive dealing arrangements. Thus, barriers to entry were lowered and the industry experienced growth and expansion. The FTC rejected this argument based on evidence that recent market trends were due to independent factors. *But see infra* text accompanying note 157.

havior, such as product homogeneity, barriers to entry, rising demand and others, indicated that this market is not overly susceptible to industry coordination.[99] However, the FTC did not consider, as it had in *Coca-Cola*, the mechanics by which the territorial restraint might facilitate interdependent behavior.

The FTC considered the argument that exclusivity enhanced Beltone's market power and restricted consumer choice at the buyer level.[100] But the argument was rejected.[101] There was no proof that Beltone had been able to extract "inordinately higher prices" for its product; in fact Beltone's market share had actually declined in recent years.[102] Had this not been the case, the FTC would have looked further into Beltone's market power.[103] In this case, however, such an inquiry was deemed unnecessary. Even Beltone's requirement that its dealers sell only Beltone products, a stricture which admittedly produces some foreclosure of competing sellers, was insufficient to necessitate such an inquiry.[104]

Having concluded that the restraint could not have reduced interbrand competition, Commissioner Bailey, in a concurring opinion,[105] stated that the inquiry should have ceased at that point.[106] Nevertheless, Commissioner Clanton went on to ad-

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99. *Beltone*, 100 F.T.C. at 207, 211 n.59. The products and sales terms of hearing aid manufacturers and dealers were found to be heterogeneous, evidenced by diverse costs, market shares, objectives and other significant factors. The FTC further noted that, though the demand for hearing aids is evidently finite, the market "has not yet been fully tapped," making new entry very possible and collusion less profitable. *Id.* at 211. Despite the inelastic demand caused by low price sensitivity in the hearing aid industry, there is vigorous non-price competition which is, as the FTC pointed out, highly responsive to the "special needs of buyers." *Id.* at 212.

100. *Id.* at 212.

101. *Id.*

102. *Id.* Although Beltone was still the leading firm in the market at that time, its market share dropped from 21% to 16% inbetween the years of 1972 to 1977. *Id.* at 210. This decline can be attributed to Beltone's failure to fully penetrate the recently expanding professional referral market (discussed *infra* text accompanying notes 108-10) and the success of new entrants into the hearing aid industry.

103. The FTC explained that, in the instance that Beltone's prices were found to be "inordinately higher" than its competitors, a further inquiry into the non-price promotional activity of such a "service oriented market" as the hearing aid industry would prove to be very enlightening. *Id.* at 212.

104. *Id.* at 209-10. The actual amount of foreclosure produced by Beltone's exclusive dealing arrangements was found to be 16% of market sales or 7 to 8% of dealers. *Id.* Such a degree of foreclosure is "neither clearly *de minimus* nor clearly indicative of significant market power," the FTC explained, and is therefore highly inconclusive. *Id.* at 204. However, the FTC found that further inquiry into Beltone's market power was unnecessary due to vigorous interbrand competition and the occurrence of new entry and destabilizing growth.

105. *Id.* at 221.

106. *Id.* at 221-22.

dress the validity of Beltone's purported justification.[107] In order to do so, he had to study the methods of competition employed by industry members. In the case of hearing aids, several marketing techniques are in general use. Historically, the principal technique was lead advertising; where advertisements are placed in local, regional and national media to attract the attention of potential customers.[108] Customers remove a coupon from the ad and return it to the manufacturer, who then turns the "lead" over to the dealer assigned to that customer's territory.[109] Hearing aid dealers, including those franchised by Beltone, often engaged in their own lead advertising. Leads, however, account for only a quarter of Beltone dealer's sales.[110]

The remaining sales are generated through walk-ins, user repurchases, and professional referrals by doctors and audiologists.[111] In recent years, the referral method has been encouraged due to Food and Drug Administration rulings requiring dealers to advise potential customers to seek examination by a professional prior to purchasing a hearing device.[112] As a result, the referral method increased in importance, causing the significance of lead advertising to decline.[113] In spite of the foregoing, Beltone had difficulty penetrating the referral segment of the market, undoubtedly a cause of its declining market share.[114] The FTC stated, "We are not interested so much in whether Beltone's practices ultimately help it to prevail in the marketplace; rather, our concern here is whether the restrictions reasonably serve Beltone's market objectives."[115] On this last point, Commissioner Bailey observed that a manufacturer's after-the-fact justifications do not deserve great attention when the question is net competitive effect.[116] Nevertheless, the inquiry continued.

Beltone sought to justify its restraint based upon the free

107. *Id.* at 180-81.

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.* at 181.

112. *Id.* at 211 (citing 42 Fed. Reg. 9295 (1978)). When a doctor or audiologist issues a patient a professional referral it is treated by hearing aid dealers as a prescription. The dealer is not allowed to supply the patient with any type or brand of hearing aid other than that which the referral specifies. *Id.* at 181. Thus, with increasing use of this method, hearing aid firms are turning their marketing efforts toward persuasion of hearing professionals and away from direct persuasion of users.

113. *Id.* at 181-82.

114. *Id.* at 182.

115. *Id.* at 214.

116. *Id.* at 224-25 (Bailey, C., concurring).

rider analysis.[117] Lead advertising is subject to such analysis because the finder of a lead needs protection from free riders. A referral, on the other hand, is less susceptible because less local effort is required.[118] Complaint counsel argued, however, that in either method there is little comparative shopping by consumers, especially on the matter of price. Complaint counsel reasoned that free riding is not a problem under either marketing method.[119] However, the FTC determined that under both methods, pre-sale promotion is necessary for effective market penetration. Protection from free riders is therefore deemed necessary. But if consumers do not shop around, protection is not needed.

Removal of the restraint might yield duplication or overlap of efforts, reducing a dealer's incentive to advertise.[120] Although Commissioner Clanton conceded that the manufacturer's desire to avoid duplication is only "related to the free rider issue,"[121] he stated that the desire to avoid duplication does concern the question of efficient utilization of resources. The FTC stated that such a question is a legitimate concern of the manufacturer.[122] Furthermore, it was asserted that the chosen restraint is rationally related to the desired goal.[123] Complaint counsel's argument that there existed less onerous means to that end was rejected by the FTC as contrary to industry experience.[124]

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117. *Id.* at 188, 214-17. Beltone asserted that the restraints are necessary in order to prevent "non-service-oriented dealers [from freeriding] on the substantial investment of those dealers who undertake the costly and painstaking process of identifying and following up leads." *Id.* at 214. They also asserted that the restraints allow the lead advertising system to operate efficiently; dealers selling only Beltone products to Beltone leads and devoting primary attention to their areas of primary marketing responsibility. *Id.*

118. Less local effort is required because in referral sales, the only advertising that is worthwhile is advertising and promotion directed to professionals. This type of advertising can be done on a national level, whereas lead advertising cannot. *See infra* note 124.

119. *Beltone*, 100 F.T.C. at 215.

120. *Id.* at 216.

121. *Id.*

122. *Id.*

123. *Id.* at 213. The FTC stated that the restraints that were part of Beltone's marketing plan had a "rational and efficient connection" to its competitive objective, *i.e.*, protecting its lead promoting activity. *Id.* at 216.

124. *Id.* at 214-17. Complaint counsel contended that Beltone could maintain its national lead advertising simply by allocating leads to pre-selected dealers and insisted that only Beltone products be sold to Beltone leads. *Id.* at 216. However, another hearing aid manufacturer testified that it had to abandon its national lead advertising program because it became too difficult to assign leads after signing a consent agreement barring its usage of exclusive territories. *Id.* at 215 n.63.

Complaint counsel further contended that there is sufficient incentive for dealers to penetrate and serve the market. *Id.* at 216. However, the FTC

Finally, the FTC determined that the "complicated combination of hardware and service . . . [and the] considerable education and selling effort required to persuade prospective customers of their need for a hearing aid" made the protection of exclusivity important to Beltone.[125] The FTC noted that the hearing aid market is not one "where products are homogenous and easily accessible to buyers, with brand recognition and price the principal selling points."[126] In such an industry, greater antitrust scrutiny presumably would be necessary. The soft drink industry, it appears, might be so characterized. Nevertheless, the FTC concluded that given the peculiarities of the hearing aid market, the complainant had not met its burden of proving that the Beltone practices actually impaired interbrand competition.[127] The complaint was dismissed accordingly.[128]

PART III: CHAOS REIGNS

When the Supreme Court abandoned the *per se* approach to vertical territorial restraints, the rule of reason was substituted because of the desire to determine illegality based upon "objective benchmarks."[129] While the Court offered little guidance as to what these benchmarks are, the *Sylvania* case did pose some hypothetical situations in which vertical territorial restraints could be used procompetitively.[130] Of course, it was conceded that these restraints suppress intrabrand competition.[131] Perhaps that is why the Court did not bless all these restraints. In fact, the Court did not approve of Sylvania's system, but rather, remanded the case to the lower court for application of the rule of reason.[132] The Supreme Court thus left the lower courts virtually on their own to fashion an approach to territorial restraints.

A similar change took place at the FTC. In *Coca-Cola*, the FTC followed the *Sylvania* lead and applied the rule of reason to Coca-Cola's system of territorial restrictions. The FTC found

disagreed, saying that the incentive does not necessarily foster promotion of a particular manufacturer's product. Beltone's current marketing system is designed to insure that dealers are encouraged to specifically promote its brand of hearing aid, and not other brands. *Id.*

125. *Id.* at 216-17.

126. *Id.* at 216.

127. *Id.* at 218.

128. *Id.*

129. *Sylvania*, 433 U.S. at 53 n.21.

130. *Id.* at 54-56.

131. *Id.* at 54.

132. *Id.* The Supreme Court in actuality affirmed the remand order of the lower court. Sylvania v. Continental T.V., Inc., 537 F.2d 890 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

that the restraints in the soft drink industry had the potential to produce significant anticompetitive effects on both the intrabrand and interbrand levels.[133] The FTC indicated that it would continue to scrutinize these restraints carefully. A few years later, however, the FTC turned in the other direction and went beyond the dictates of *Sylvania* by virtually granting carte blanche to manufacturers who engage in territorial restraints.

A comparison of the *Coca-Cola* and *Beltone* opinions, however, indicates more than a shift to a new standard of liability. *Beltone* typifies the growing influence of those antitrust scholars who believe that vertical restraints should seldom be prohibited.[134] Even though Coca-Cola and its competitors are now free to engage in those restraints found unreasonable by the FTC,[135] there is reason to believe that the soft drink industry and the consuming public would both be better off without these restraints. The same can be said about other industries. But the sad truth is that with *Beltone* as precedent, the FTC probably will not prohibit most vertical restraints and needed competition will never be injected into the soft drink industry.

Even if this is not the case, the FTC has missed an opportunity to shed light upon the evasive standard under which the legality of these restrictions is assessed. Instead of using *Coca-Cola* as a starting point and building upon the base established in that case, the FTC announced a new approach to these problems and completely ignored the precedent.[136] As a result, the law remains as confused as ever, and lawyers and business persons are left with little guidance on this troublesome issue.

Commissioner Clanton, the dissenter in *Coca-Cola* and the author of the *Beltone* opinion, conceded the reduction in intrabrand competition. He stated that complaint counsel must demonstrate a reduction of interbrand competition in order to succeed.[137] Although interbrand competition is of primary concern, the FTC now seems to have elevated it to the only concern. If interbrand competition exists in an industry, restricted distribution systems will be granted approval.

The Supreme Court has stated that the rule of reason requires a balancing of procompetitive and anticompetitive effects.[138] The FTC has modified the rule by eliminating from

133. *See In re* Coca-Cola, 91 F.T.C. 517, 619, 640 (1978).

134. *See, e.g.*, R. BORK, THE ANTITRUST PARADOX 288 (1978); Posner, *supra* note 73, at 6.

135. *See supra* note 79 and accompanying text.

136. The *Coca-Cola* case was not cited or even distinguished in *Beltone*.

137. *Beltone*, 100 F.T.C. at 218.

138. National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 691 (1978); Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918).

consideration the obvious anticompetitive effect of intrabrand competition. The FTC's approach is thus at odds with the Court's.

Nevertheless, the FTC's attempt to develop a new approach is not entirely without merit. It is difficult, if not impossible, to actually balance competition in different sectors of the marketplace. In fact, it is the competitive interaction in that marketplace which must produce the proper balance between intrabrand and interbrand competition. A better formula for analysis of net competitive effect is therefore welcome. Because territorial restraints invariably eliminate intrabrand competition, it may actually be best to remove that factor from the analysis. It is quite different from the *Sylvania* standard, however, to eliminate the intrabrand factor and then to demand that the complainant also demonstrate an adverse effect upon interbrand competition. To do so ignores much of the anticompetitive potential of vertical territorial restraints. The new rule of reason thus grants to would-be restrainers a great advantage when they stand before the FTC.

In *Beltone*, the FTC focused its analysis upon a search for the most likely anticompetitive interbrand effects. Among these evils are horizontal collusion, attainment or abuse of inordinate market power and pricing interdependence.[139] Neither collusion nor market power was seen as a significant problem in the hearing aid industry.[140] Rather, the inquiry concentrated on interdependence, a not uncommon but pernicious practice in our competitive economy. Interdependence, or tacit coordination, often results in prices which tend to remain stable, largely unaffected by free market forces.[141]

In *Beltone*, Commissioner Clanton searched for the various structural indicia of industries most susceptible to interdependent behavior. Among these indicia are the extent of concentration, product homogeneity, and barriers to new entry.[142] The greater the possibility that interdependence exists, the greater the potential becomes for restricted distribution to harm competition. Also, the need increases for interbrand competition to provide the necessary stimulus.[143]

Based upon these indicia, the hearing aid market was found

139. *In re* Beltone Electronics Corp., 100 F.T.C. 68, 206-07.

140. *Id.* at 211-13.

141. *See* L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST, 330-343 (1977).

142. *Beltone*, 100 F.T.C. at 211.

143. *Id.* at 212.

to be largely unsusceptible to industry coordination.[144] The industry was not sufficiently concentrated.[145] No guidelines were offered to indicate what concentration levels would cause concern to the FTC. Entry into the field was deemed not to be overly difficult;[146] in fact, there had been several new entrants in recent years. The FTC also observed that the various hearing aid brands are not always interchangeable;[147] a fact which was offered as proof that interdependence was unlikely.

Nevertheless, certain features of the market did indicate a potential for interdependence. For instance, the fact that demand for hearing aids is inelastic and that buyers are not price-sensitive causes the industry to be fertile ground for interdependence.[148] Furthermore, entry was not as easy as the FTC had indicated. But, in the final analysis, the FTC's assessment of the nature of interbrand competition in the hearing aid industry spelled victory for the respondents.

How does the soft drink industry fare under this analysis? While there is a great proliferation of soft drink brands, a deeper look into the market leads one to conclude that interdependence, or at least price insensitivity, reduces competition at the bottler level. The number of bottlers in each region is greatly reduced. Already one can see an unhealthy situation.

A deeper look into precisely how these bottlers' decisions interact raises even greater concern. Bottlers who sell a multiplicity of soft drink brands have a disincentive to cut prices. A bottler who cuts prices on one or a number of brands will increase his sales volume in those brands, but only at the expense of his other brands. A bottler who cuts prices on all his brands may improve his sales volume in the short run, but in the long run, his rivals will also have to cut their prices. This would result in lower profits for the industry as a whole. Because the bottlers wish to avoid this self-destructive price cutting, they refrain from cutting prices at all. Instead, the bottler must seek other methods of expanding his sales, such as advertising and other forms of product promotion. He cannot seek out new customers in other areas because of the territorial restraints. As a

144. *Id.*

145. This was true even though the top four and eight firm concentration ratios were 50% and 70% respectively. *Id.* at 182.

146. *But see*, *infra* notes 158-60 and accompanying text.

147. *Beltone*, 100 F.T.C. at 181, 216. Interchangeability is low for two reasons: (1) professional referrals take the form of prescriptions, and the brand prescribed cannot be altered by either the customer or the dealer; and (2) certain hearing aid brands are better for some maladies and not effective for others. *Id.* at 181.

148. *Id.* at 212.

result, advertising budgets grow and inelastic demand causes prices to rise.[149]

Remove the restraints, and the situation changes dramatically. With the ability to enter new territories, the bottler has a practical way to improve his business. He will do so by challenging neighboring competitors with new entry and lower prices. Even if he does not actually enter the neighbor's territory, his presence as a potential competitor will have a positive effect upon the entire market. Prices in the territory will thus remain at competitive levels in order to dissuade entry by neighbors. Uncertainty and the challenge of competition will stimulate free market forces and insure proper resource allocation. Insulation from uncertainty and competition is dangerous, and the FTC in *Coca-Cola* was well advised to inject intrabrand competition into the marketplace.[150]

The same is not necessarily true for hearing aids. Important distinctions exist between that market and the market for soft drinks. Soft drink sales are clearly price sensitive,[151] while the evidence in the hearing aid industry was to the contrary.[152] The various brands of hearing aids are more effective than others for certain maladies.[153] Soft drink brands generally are interchangeable. Furthermore, unalterable prescriptions often dictate the hearing aid brand to be purchased.[154] Shopping convenience greatly affects the location where that purchase will take place.[155] And while injection of intrabrand competition into the hearing aid market would undoubtedly increase the options available to some purchasers,[156] the net effect on all purchasers is likely to be small. Evidence indicated that most consumers of hearing aids base their purchase upon non-price considerations, and would continue to do so even if the restraints were removed.[157]

149. Where demand is inelastic, a small change in price will produce a smaller reduction in the quantity consumers will purchase. In such a case, the large part of cost increases are passed on to the public. The reverse would be true of products with elastic demand. *See generally*, P. SAMUELSON, ECONOMICS, 381-82 (10th ed. 1976). In this sense, the advertising distortion acts as an excise tax.

150. *But see* Posner, *supra* note 73, at 16.

151. *See In re* Coca-Cola, 91 F.T.C. 517, 640-42 (1978).

152. *In re* Beltone, 100 F.T.C. 68, 212 (1982).

153. *See Beltone*, 100 F.T.C. at 181, 217.

154. *Id.*

155. *See id.* at 213.

156. This would be for those purchasers who would shop around. *See id.* at 213-14.

157. *Id.*

The *Beltone* opinion, however, has several fundamental flaws, at least some of which are rooted in the superficiality of the FTC's inquiry. For instance, it is observed that entry into the hearing aid market has not been overly difficult.[158] But much of this entry was the product of the marketing method, *i.e.*, professional referrals. Some new firms have been able to penetrate this new section of the market, often at the expense of existing firms. Yet as firms settle into the new marketing approach, entry will become more difficult.

Other characteristics of the industry indicate that entry could be a problem. Professionals generally make the decision as to which hearing aid brand will be purchased; they are unlikely to be overly sensitive to price. Advertising and other nonprice promotions are made all the more important, a condition observed in *Coca-Cola*.[159] Where that is the case, the minimum capital required for entry is pushed higher. Therefore, entry into the hearing aid market is actually more difficult than the FTC believed.

The system of product exclusivity engaged in by Beltone only exaggerates the difficult entry by forcing new manufacturing entrants to simultaneously enter on the distribution level. Dual entry is always expensive, often impossible, and can be the product of restricted distribution. Yet, in the final analysis, the existence of Beltone's restraints was unlikely to produce significant anticompetitive effects, although this had little to do with the level of interbrand competition in the marketplace. Rather it is because Beltone is the only major manufacturer of hearing aids who may engage in territorial restraints and product exclusivity. Other major competitors are precluded from doing so by an FTC consent order.[160] Beltone accounts for only 16% of hearing aid sales and only 8% of the dealers nationwide.[161] Thus, the amount of actual and potential competition foreclosed is really somewhat small. A large enough segment of the market remains open to all firms. Beltone's restraint is thus less likely to be anticompetitive than if the entire industry were engaged in the scheme. This rather simple observation is also lacking from the FTC's analysis.

An industry-wide system of vertical restraints can produce other undesirable effects. Emphasis on nonprice competition is often the result of these arrangements. Commissioner Dole in *Coca-Cola* found that this emphasis resulted in unprofitable ac-

158. *Id.* at 184, 211.

159. *See Coca-Cola*, 91 F.T.C. at 628-30.

160. *Beltone*, 100 F.T.C. at 223 (Bailey, C., concurring).

161. *Id.* at 210.

counts and unnecessary dealer services.[162] Intrabrand monopoly causes some buyers to purchase a product and its related service even when the service is unwanted if all sellers are offering both. A new entrant could take advantage of these consumers, but new entry is not always feasible and is almost always subject to a time lag. If, however, a neighboring bottler could enter the territory, then he could provide the product without the undesired service.

The usual response to this argument is that the invaders would take a free ride on the existing firm's point-of-sale services. This argument, however, is not always meritorious, as a comparison of *Coca-Cola* and *Beltone* indicates. In the latter case, lead advertising was encouraged by the restrictions on location. It is important to note that the dealer who engages in this practice is the dealer most likely to benefit from his efforts.

The same is not true of *Coca-Cola*. While it is true that the restraints did encourage product promotion by dealers, the FTC found that at least some of these promotions were unprofitable for the dealer.[163] The dealers, therefore, did not benefit from the promotional activities. That benefit inured either to the manufacturer or to other dealers. This practice of free riding by the manufacturer was condemned by Commissioner Dole. She stated that there was little reason to permit a healthy competitor,[164] such as Coca-Cola, to engage in such burden-shifting activities.[165]

Another crucial difference between the cases lies in the nature of the product sold. Compared to soft drinks, hearing aids are a more complicated product, requiring greater selling effort.[166] Commissioner Clanton concluded that in the hearing aid industry, "there is more justification for manufacturers to seek ways of motivating dealers"[167] than in a market where the price of the product and familiarity of the brand are the major selling

162. *See Coca-Cola*, 91 F.T.C. at 627-28 (unprofitable activities) and 623-25 (delivery services).

163. *Id.*

164. *Id.* at 631. *Compare* Continental T.V. v. G.T.E. Sylvania, 433 U.S. 36, 38 (1977) and Sandura Co. v. F.T.C., 339 F.2d 847, 854, 858 (6th Cir. 1964) *with In re* Coca-Cola, Inc., 91 F.T.C. 517 (1978).

165. The argument presented here is not a simple "less restrictive alternative" analysis. Rather, Commissioner Dole found no evidence that Coke "must depend upon its bottlers for funds to sponsor . . . advertising." *Coca-Cola* at 631. Her argument seems more akin to a "reasonably necessary" standard, which Coca-Cola obviously could not meet.

166. *Beltone*, 100 F.T.C. at 216. *See supra* note 125 and accompanying text.

167. *Id.* at 217.

points. Yet this observation is made by Commissioner Clanton only in passing, and is not expanded upon at all.

From these distinctions, Commissioner Clanton and the FTC could have identified the "objective benchmarks" the Supreme Court deemed necessary and those we seek. Instead, we are left with a new approach, an inconsistent precedent, and another *sui generis* decision. What we are not left with is an understanding of how to properly apply the elusive rule of reason to manufacturer-imposed territorial restraints. It has been suggested by some that the FTC is now taking or should take the view that restrictive distribution be deemed lawful *per se*.[168] If this is true, the FTC should say so rather than hide behind the guise of so revered a rule as the rule of reason.

CONCLUSION

The foregoing analysis demonstrates some of the clear distinctions which could have been drawn between the soft drink and hearing aid industries. Courts should draw upon these distinctions in order to develop a rational approach which will provide guidelines for business. The FTC has not done so. By approaching the *Beltone* case *sui generis*, the FTC said little of what it will do in the future. In such a complex area as this, we need to know more about how the Commission will decide a case. The *Beltone* opinion does not satisfy this need.

168. *See, e.g.*, Posner, *supra* note 73. *See also* Axinn & Stoll, *Vertical Non-Price Restrictions—The Move Toward Per Se Legality*, N.Y.L.J., Jan. 12, 1983, at 1, col. 7.