SOFT DRINK INTERBRAND COMPETITION ACT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON MONOPOLIES AND COMMERCIAL LAW

OF THE

COMMITTEE ON THE JUDICIARY HOUSE OF REPRESENTATIVES

NINETY-SIXTH CONGRESS

FIRST AND SECOND SESSIONS

ON

H.R. 3567 and H.R. 3573

SOFT DRINK INTERBRAND COMPETITION ACT

OCTOBER 24, AND NOVEMBER 15, 1979;
MARCH 19, APRIL 24, AND 29, 1980

Serial No. 66

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SOFT DRINK INTERBRAND COMPETITION ACT

WEDNESDAY, OCTOBER 24, 1979

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON MONOPOLIES AND COMMERCIAL LAW
OF THE COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met at 9:45 a.m., in room 2141, Rayburn House Office Building, Hon. Peter W. Rodino, Jr. (chairman) presiding.

Present: Representatives Rodino Mazzoli, Hughes, Volkmer, McClory, Railsback, Fish, and Butler.

Staff present: William Sippel and Joel Ginsburg, counsel; and Charles Kern, associate counsel.

Chairman RODINO. The subcommittee will come to order.

This morning, the Subcommittee on Monopolies and Commercial Law meets to consider bills to amend the antitrust laws to establish a different standard for determining the legality of exclusive territorial restrictions in the soft drink bottling industry.

As a former member of the President's National Commission to Review Antitrust Laws and Procedures, I agree with the conclusion of the commission there should be "a strong presumption from allowing exemptions from competition and, specifically, against immunity from antitrust laws."

The commission recommended that the burden of proof for obtaining a special exemption should be on the proponents to show that "a convincing public interest rationale exists for abandoning competition."

The subcommittee will, therefore, carefully examine whether there is, indeed, a need for a special standard for the soft-drink bottling industry. We must ask: What are the costs to the consumer of this legislation? Will this legislation protect inefficient firms at the expense of the public?

Members of the subcommittee should be aware that consideration of this legislation for special treatment of the bottling industry under the antitrust laws is occurring while the question of the legality of these arrangements is in the courts.

I am unaware of any antitrust exemption granted by the Congress while the courts were considering the legality of such conduct. I think that is an important consideration. Congress is being asked to act before the courts have had an opportunity to act.

This is particularly disturbing to me since, if Congress acts before the courts, it might enact an antitrust standard broader than that which the court might ultimately adopt. For this reason, I believe these hearings are especially important and that this subcommittee should scrupulously study the testimony and facts before it and take into consideration what the ultimate result will be of any action taken by this committee.

This is not to say that the Congress cannot legislate on this matter if it finds that this legislation is exceptionally necessary. Even if we find that the soft drink industry does need a special exemption, and that it would be in the public interest, we must, nevertheless, take every step possible to limit the exemption to what is essential to obtain a legitimate objective, and not beyond that.

Again, to restate the conclusion of the National Commission here, all exemptions to the antitrust laws should be no broader than are absolutely required by the special circumstances that create the need for the exemption. Any exemption considered by the subcommittee should be as specific and as limited in application as possible.

I would like to invite the ranking minority member, Mr. McClory, to make such remarks as he may.

Mr. McClory. Thank you. I have a very brief statement, Mr. Chairman.

I am pleased we are having this hearing today on legislation in which more than 300 of our colleagues have evidenced an interest by cosponsoring one of the bills before us, whose principal sponsor, the gentleman from Texas, we will hear from in a moment.

Undeniably, this is controversial legislation. The claims and counterclaims which I have heard in the earlier hearings and which I have read about since that time strongly dispute the merits and demerits of the territorial franchise system and its impact on competition, the consumer, the environment, and the bottling business itself.

These and other factors must be considered to determine whether or not we can resolve the differences and arrive at an appropriate legislative response. We must inquire, I am certain, into the relative competitve effects of subjecting the territorial franchise system to the rule of reason, as mandated by the Supreme Court in the *GTE-Sylvania* case, or virtually insulating the absence of intrabrand competition from antitrust scrutiny in order to preserve the advantages of the existing marketing structure.

One question which occurs to me is whether or not we should have one rule for the large soft drink bottlers and another rule for small bottlers or for other types of industries that also market beverages and other substances on a territorial basis and in similar types of arrangements which they have by contract.

I am certain our witnesses will enlighten us on these subjects so that we can augment the testimony that we heard earlier when we considered similar legislation in an earlier Congress and I am hopeful that we can reach a solution which is satisfactory, which is useful, and from which the entire Nation can benefit.

Thank you very much, Mr. Chairman.

[Text of H.R. 3567 and H.R. 3573 follows:]

96TH CONGRESS
1ST SESSION

H. R. 3567

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.

IN THE HOUSE OF REPRESENTATIVES

APRIL 10, 1979

Mr. HALL of Texas (for himself, Mr. MOLLOHAN, Mr. SHELBY, Mr. VANDER JAGT, Mr. BROYHILL, Mr. MOORHEAD of California, Mr. ABDNOR, Mr. ADDABBO, Mr. AKAKA, Mr. ALBOSTA, Mr. ALEXANDER, Mr. AMBRO, Mr. ANDREWS of North Carolina, Mr. ANDREWS of North Dakota, Mr. ANTHONY, Mr. APPLEGATE, Mr. ARCHER, Mr. ASHBROOK, Mr. ASPIN, Mr. ATKINSON, Mr. BADHAM, Mr. BAFALIS, Mr. BAILEY, Mr. BARNARD, Mr. BEVILL, Mr. BIAGGI, Mr. BLANCHARD, Mr. BONIOR of Michigan, Mr. BONKER, Mrs. BOUQUARD, Mr. BOWEN, Mr. BREAUX, Mr. BRINKLEY, Mr. BRODHEAD, Mr. BROOKS, Mr. BROWN of California, Mr. BUCHANAN, Mr. BURGENER, Mr. BUTLER, Mr. CAMPBELL, Mr. CARNEY, Mr. CHAPPELL, Mr. CHENEY, Mrs. CHISHOLM, Mr. CLAUSEN, Mr. CLAY, Mr. CLINGER, Mr. COELHO, Mr. COLLINS of Texas, Mr. CONABLE, Mr. CORCORAN, Mr. COUGHLIN, Mr. DANIEL B. CRANE, Mr. ROBERT W. DANIEL, JR., Mr. AUCOIN, Mr. DASCHLE, Mr. DAVIS of South Carolina, Mr. DE LA GARZA, Mr. DELLUMS, Mr. DERRICK, Mr. DEVINE, Mr. DICKINSON, Mr. DICKS, Mr. DIXON, Mr. DORNAN, Mr. DOUGHERTY, Mr. DOWNEY, Mr. DUNCAN of Tennessee, Mr. EDGAR, Mr. EDWARDS of Alabama, Mr. EMERY, Mr. ENGLISH, Mr. ERTEL, Mr. EVANS of Georgia, Mr. EVANS of Delaware, Mr. FAZIO, Ms. FERRARO, Mr. FISH, Mr. FLIPPO, Mr. FLOOD, Mr. FLORIO, Mr. FOLEY, Mr. FORD of Michigan, Mr. FORSYTHE, Mr. FOUNTAIN, Mr. FOWLER, Mr. FRENZEL, Mr. FUQUA, Mr. GARCIA, Mr. GAYDOS, Mr. GEPHARDT, Mr. GIBBONS, Mr. GILMAN, Mr. GINGRICH, Mr. GINN, Mr. GLICKMAN, Mr. GOODLING, Mr. GRADISON, Mr. GRAMM, Mr. GRASSLEY, Mr. GRAY, Mr. GRISHAM, Mr. GUDGER, Mr. GUYER, Mr. HAGEDORN, Mr. HAMILTON, Mr. HANCE, Mr. HANLEY, Mr. HARKIN, Mr. HAWKINS, Mr. HEFNER, Mr. HIGHTOWER, Mr. HILLIS, Mr. HINSON, Mr. HOLLAND, Mr. HOLLENBECK, Mrs. HOLT, Mr. HOPKINS, Mr. HORTON, Mr. HOWARD, Mr. HUBBARD, Mr. HUCKABY, Mr. HUTTO, Mr. HYDE, Mr. ICHORD, Mr. IRELAND, Mr. JEFFRIES, Mr. JENKINS, Mr. JENRETTE, Mr. JOHNSON of California, Mr. JONES of Tennessee, Mr. JONES of North Carolina, Mr.

KAZEN, Mr. KELLY, Mr. KEMP, Mr. KILDEE, Mr. KINDNESS, Mr. KRAMER, Mr. LAFALCE, Mr. LATTA, Mr. LEACH of Louisiana, Mr. LEATH of Texas, Mr. LEDERER, Mr. LEE, Mr. LEHMAN, Mr. LELAND, Mr. LENT, Mr. LEVITAS, Mr. LOEFFLER, Mr. LONG of Louisiana, Mr. LOTT, Mr. LOWRY, Mr. LUJAN, Mr. LUNDINE, Mr. LUNGREN, Mr. MCCLOSKEY, Mr. MCCORMACK, Mr. MCDONALD, Mr. MCEWEN, Mr. MCHUGH, Mr. MCKAY, Mr. MCKINNEY, Mr. MADIGAN, Mr. MARKS, Mr. MARLENEE, Mr. MARRIOTT, Mr. MARTIN, Mr. MATHIS, Mr. MATTOX, Mr. MAVROULES, Mr. MAZZOLI, Mr. MILLER of Ohio, Mr. MITCHELL of New York, Mr. MOAKLEY, Mr. MONTGOMERY, Mr. MOORE, Mr. MURPHY of Pennsylvania, Mr. MURPHY of New York, Mr. MURPHY of Illinois, Mr. MURTHA, Mr. MYERS of Indiana, Mr. MYERS of Pennsylvania, Mr. NEDZI, Mr. NOLAN, Mr. NOWAK, Mr. O'BRIEN, Mr. OTTINGER, Mr. PATTEN, Mr. PAUL, Mr. PEPPER, Mr. PERKINS, Mr. PEYSER, Mr. PICKLE, Mr. PRICE, Mr. PURSELL, Mr. QUILLEN, Mr. RAHALL, Mr. RICHMOND, Mr. RINALDO, Mr. ROBERTS, Mr. ROBINSON, Mr. ROE, Mr. ROSE, Mr. RUDD, Mr. SAWYER, Mr. SEBELIUS, Mr. SENSENBRENNER, Mr. SHARP, Mr. SHUMWAY, Mr. SHUSTER, Mr. SLACK, Mr. SOLOMON, Mrs. SPELLMAN, Mr. SPENCE, Mr. STANGELAND, Mr. STEED, Mr. STENHOLM, Mr. STOCKMAN, Mr. STRATTON, Mr. STUMP, Mr. SYMMS, Mr. SYNAR, Mr. TAUKE, Mr. TAYLOR, Mr. TRAXLER, Mr. TREEN, Mr. TRIBLE, Mr. VAN DEERLIN, Mr. VENTO, Mr. VOLKMER, Mr. WALKER, Mr. WATKINS, Mr. WEAVER, Mr. WHITE, Mr. WHITEHURST, Mr. WHITLEY, Mr. WHITTAKER, Mr. WHITTEN, Mr. WILLIAMS of Ohio, Mr. BOB WILSON, Mr. CHARLES WILSON of Texas, Mr. CHARLES H. WILSON of California, Mr. WINN, Mr. WOLFF, Mr. WRIGHT, Mr. WYATT, Mr. WYLIE, Mr. YATRON, Mr. YOUNG of Alaska, Mr. YOUNG of Missouri, Mr. ZEFERETTI, Mr. PANETTA, Mr. RITTER, Mr. ROSTENKOWSKI, Mr. FASCELL, Mr. ROUSSELOT, Mr. BONER of Tennessee, Mr. SNYDER, Mr. HAMMERSCHMIDT and Mr. COLEMAN) introduced the following bill; which was referred to the Committee on the Judiciary

---

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 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.

96TH CONGRESS
1ST SESSION

H. R. 3573

To clarify the status of territorial provisions in licenses to manufacture, distribute, and sell trademarked soft drink products, to protect the environment from adverse effects which would result from the elimination of returnable, refillable bottles, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

APRIL 10, 1979

Mr. LUKEN (for himself and Mr. MICA) introduced the following bill; which was referred jointly to the Committees on the Judiciary and Interstate and Foreign Commerce

---

A BILL

To clarify the status of territorial provisions in licenses to manufacture, distribute, and sell trademarked soft drink products, to protect the environment from adverse effects which would result from the elimination of returnable, refillable bottles, and for other purposes.

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

SHORT TITLE

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

FINDINGS; DECLARATION OF POLICY

SEC. 2. (a) The Congress hereby finds that—

(1) trademarked soft drink products traditionally have been manufactured and distributed under a system of trademark licensing arrangements under which the licensee has been granted an exclusive territory within which to manufacture and distribute the product;

(2) the territorial features of such system have helped to promote competition between and among brands of trademarked soft drink products and to permit relative ease of entry into the market for new products;

(3) elimination of exclusive territories will cause a centralization of the manufacturing and distribution of soft drink products leading to concentration in the soft drink industry, the elimination of many small businesses, and the loss of billions of dollars in small business investment;

(4) elimination of exclusive territories will result in the drastic reduction or total elimination of the percentage of soft drink products sold in returnable, refillable bottles, which are economically impractical to use in large centralized distribution systems; and

(5) elimination or reduction of the use of returnable, refillable bottles in soft drink packaging will have major energy, environmental, and economic consequences, because such elimination or reduction—

(A) will add many billions of one-way nonrefillable containers to the solid waste stream of the Nation every year;

(B) will significantly increase consumption of scarce oil, natural gas, and coal reserves in the process of manufacturing such additional containers;

(C) will require the consumption of vast additional quantities of raw materials;

(D) will contribute significantly to inflation, since none of the cost of packaging can be recovered through the use of returnable, refillable bottles and since soft drink products historically have been as much as 100 per centum more expensive in one-way nonrefillable containers; and

(E) will significantly reduce the range of competitive choices available to consumers.

(b) The Congress hereby declares that it is the policy of the Congress—

(1) to preserve the scarce energy resources of the Nation and to protect the environment from serious ad-

verse consequences which will result from the elimination of returnable, refillable bottles as a major form of container in the soft drink industry;

(2) to foster small business opportunities and to protect the investment of small businesses in facilities for the manufacture and distribution of trademarked soft drink products;

(3) to prevent undue concentration in the manufacture and distribution of trademarked soft drink products;

(4) to preserve for the consumer the broadest possible choices in the consumption of trademarked soft drink products;

(5) to promote competition between and among brands of trademarked soft drink products; and

(6) to prevent and control inflation.

EXCLUSIVE RIGHTS UNDER LICENSING AGREEMENTS

SEC. 3. The provisions of the Federal Trade Commission Act and the Federal antitrust laws shall not be construed to render unlawful or otherwise prohibit the inclusion or enforcement in any trademark licensing agreement for the manufacture, sale, or distribution of a trademarked soft drink product, of any provision granting the licensee the exclusive right to manufacture, distribute, or sell such product in a defined geographic area, or limiting the licensee to the manufacture, distribution, and sale of such product within such a defined geographic area, unless it is established in the case of such agreement that—

(1) other products of the same general class, produced or distributed by other manufacturers or distributors, are not generally available to consumers in the defined geographic area; and

(2) elimination of the territorial provisions in such agreement will not—

(A) adversely affect the quality of the environment;

(B) significantly increase energy consumption;

(C) cause inflation in the cost of soft drink products in any section of the country; or

(D) lead to concentration of economic power in the soft drink industry.

SEC. 4. This Act shall apply to any proceeding which is pending on or commenced after the date of the enactment of this Act and which involves the lawfulness under antitrust law of the existence or enforcement of any territorial provision included in a trademark licensing agreement, or contract, for the manufacture, distribution, or sale of a trademarked soft drink product.

O

Chairman RODINO. Thank you.

We are pleased to welcome this morning as the first witness the major proponent for this legislation, and a distinguished member of the House Judiciary Committee, the honorable member from Texas, the distinguished Sam Hall.

Mr. VOLKMER. Mr. Chairman, may I make a unanimous consent request?

Chairman RODINO. The gentleman from Missouri may make his request.

Mr. VOLKMER. I ask unanimous consent that the subcommittee permit the meeting this morning to be covered in whole or in part by television broadcast, radio broadcast, or still photography, pursuant to rule 5 of the committee rules.

Chairman RODINO. Without objection, it is so ordered.

The gentleman from Texas.

TESTIMONY OF HON. SAM B. HALL, JR., REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. HALL. Thank you, Mr. Chairman, and members of this committee. I would like to take this opportunity to thank you for having these hearings on H.R. 3567.

This bill, as Mr. McClory pointed out, now has 309 cosponsors. It is designed to prevent the use of the antitrust laws to restructure an entire industry.

This industry has operated in the same way for more than 75 years. The purpose is to prevent the destruction of hundreds of small businesses, thousands of jobs, and all with no benefit to consumers or to anyone else.

Mr. Chairman, I believe that swift, inevitable concentration can only follow the final Federal Trade Commission decision here. Such a monopolistic structure cannot benefit the American consumer and certainly will hurt small businessmen in the soft drink industry. Some would say this legislation benefits only the large bottlers. This is an insupportable argument. Does anyone seriously contend that, with or without H.R. 3567, Coke and Pepsi will not still continue to exist? Obviously, they will, but hundreds of bottlers will not.

Some would say that Congress should not interfere in the judicial process. In response, I would say it is in the province of Congress to determine if the antitrust laws should be used to restructure an industry. Further, if we do not act and the courts do, the entire industry system could begin to fall apart beyond any ability to save it. Thus, Congress might be precluded from any effective action.

Mr. Chairman, I look forward to having these and other issues explored in the hearings to come and I appreciate the chairman's indulgence in allowing me to participate in these hearings.

I might add that I feel very strongly about this bill. I believe that some of the arguments that will be put forth by those who are in opposition to this measure will admit that vertical territorial arrangements do not always decrease the overall competition but I think it must be admitted that the Supreme Court of the United States has recognized that such restraints in many instances will enhance competition.

That is the purpose of this entire measure; to try to enhance competition and I believe that this bill is a very effective way to do that.

I thank this committee.

Chairman RODINO. Thank you very much, Mr. Hall.

Any questions?

Thank you.

Our next witness is Mr. Richard J. Favretto, Deputy Assistant Attorney General for Antitrust.

Mr. Favretto, we will include your entire statement in the record, without objection. You may proceed.

TESTIMONY OF RICHARD J. FAVRETTO, DEPUTY ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. FAVRETTO. Mr. Chairman, with your permission, I would like to not read the entire statement but go over it in some detail to set my remarks in context and lay the foundation for any questions that may result.

Chairman RODINO. All right, proceed.

Mr. FAVRETTO. Thank you.

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear before you today to present the views of the Department of Justice on H.R. 3567 and H.R. 3573. These bills are part of a series of bills designed to confer a special antitrust exemption on exclusive territorial agreements between soft drink manufacturers and bottlers.

The Department of Justice has consistently opposed this type of special legislation over the years and we continue to believe that it is both unnecessary and undesirable. These bills and similar bills now pending unnecessarily impinge on our fundamental national policy of reliance on robust and uninhibited competition. This legislation would also create an unfortunate precedent by encouraging every industry to seek specialized exemptions from the antitrust laws. And it is fundamentally inconsistent with the steps Congress has taken in recent years to strengthen antitrust enforcement.

It may be helpful to begin by placing this legislation in context. Over the years, a series of bills has been introduced to establish a special standard for territorial agreements in the soft drink industry. The first bills were introduced after the Federal Trade Commission issued a compaint alleging that exclusive territorial licensing agreements maintained by major soft drink manufacturers and their bottlers violated section 5 of the FTC act.

The bottlers originally argued that legislation was necessary to allow them a fair oportunity to present all the economic evidence in favor of such agreements. At the time, there was some belief the practice in question was subject to a per se standard of illegality. Subsequently, the Supreme Court changed the applicable standard for testing these restraints under the antitrust laws to the rule of reason standard.

Throughout the litigation, the defendants have had a full hearing on the claimed economic justifications. Even though the soft drink industry has gotten all that it originally sought back in 1971, it has continued to press for special legislation.

Moreover, the legislative efforts are now continuing, despite the fact that it is not yet clear what the final outcome of the judical process will be. The FTC has rendered its decision, but the case is now on petition for review before the District of Columbia Circuit, which will give further consideration to the bottlers' arguments in the course of determining whether the FTC's decision was supported by substantial evidence. Legislative action at this time, while that factural record is still under review, would, we believe, be at the least premature.

I would now like to discuss the principal features of H.R. 3567 and 3573. Both bills would change the legal standard by which exclusive territorial arrangements in the soft drink industry are judged. In addition, H.R. 3567 would virtually eliminate damage liability for the illegal use of exclusive territory agreements. I will discuss each of these subjects in turn.

H.R. 3567 would substitute for the current standard of liability a "Substantial and effective competition" standard. Under this bill, territorial agreements between soft drink manufacturers and bottlers would be legal provided that the products covered by the agreements are in, "Substantial and effective competition" with other products of the same general class.

H.R. 3573 would establish an even narrower standard of liability. It provides that such agreements are legal unless it is established first that other competing products of the same general class are not generally available to consumers in the relevant territory and, second, that elimination of the agreements would not have various adverse energy-related, environmental and economic consequences.

To decide whether either of these changes in the current legal standard is useful or beneficial, it is necessary to ask two questions. First, what, if anything, is wrong with the current standard? And, second, how, if at all, do these bills improve that standard?

As I have indicated, the legal standard by which vertical exclusive territory agreements in the soft drink industry are currently judged is the rule of reason. Under this flexible rule, 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 all economic justifications.

For this sensible and comprehensive rule of reason aproach, these two bills would substitute a narrow approach which focuses exclusively on interbrand competition. Under H.R. 3567, if interbrand competition is "substantial and effective," the agreement on exclusive territories is automatically legal. H.R. 3573 would also immunize such agreements solely on the basis of interbrand competition, although it would provide other grounds for immunity as well.

How does this test compare with the rule of reason? The rule of reason does not limit antitrust analysis to this single factor involving the current strength of interbrand competition. Rather, it takes into account not only interbrand competition, but also other factors relevant to the overall competitive effects of the particular arrangement at issue.

The rule of reason does not ignore or downplay the significance of interbrand competition. To the contrary, the courts place great weight under existing law on the vigor of interbrand competition, which the Supreme Court in the *Sylvania* case called "the primary concern of antitrust law." And the FTC carefully considered the vigor of interbrand competition in its decision concerning vertical restraints in the soft drink industry.

In short, current law accords interbrand competition all the weight it deserves. There is no need to change the law in this respect. The effect of this legislation will simply be to preclude consideration of other factors that may be equally important.

The narrow focus of these bills on interbrand competition is not their only defect. The meaning of their standards is unclear. How robust and vigorous must interbrand competition be before it becomes "substantial and effective" within the meaning of H.R. 3567? Or how available must competing products be before they are "generally available" within the meaning of H.R. 3573? The bills do not answer these questions, and to work out their meaning through litigation would take years and divert the courts and the FTC from their other important responsibilities.

By pointing out potential dangers from exclusive territories, I do not mean to imply that vertical territorial arrangements always decrease overall competition. To the contrary, as the Supreme Court has recognized, such restraints may sometimes enhance competition. For example, they may help small but aggressive businesses enter a market and compete effectively. My only point is that we cannot afford to neglect the potential dangers of vertical restraints by focusing only on their potential benefits. Under the rule of reason, the positive as well as negative effects of exclusive territories are fully taken into account.

If these agreements foster interbrand competition more than they hinder intrabrand competition, they are legal as the law now stands. We see no reason to change the law to legalize agreements that cannot meet that standard.

The asserted purpose of the pending legislation is to enhance competition, as Representative Hall said. If vertical territorial restraints have that effect in the soft drink bottling industry, the existing law is well equipped to take that into consideration and to find those restrictions reasonable under the current applicable standard.

Finally, I want to comment on some of the differences between H.R. 3567 and H.R. 3573. Our objections to both bills are fundamental ones involving their basic philosophy and we do not believe that our objections could be cured by any changes in the language of the bills.

Nevertheless, H.R. 3573 is even more unacceptable to the Department of Justice than H.R. 3567. Although H.R. 3573 nominally conditions immunity on the existence of interbrand competition, the standard of the bill is so weak that it apparently immunizes vertical territorial restraints even if interbrand competition in the territory is not significant.

The rigid rule immunizing restraints whenever a competing product is "generally available" provides no reliable guarantee that this exemption will be available only where the competing product exerts substantial competitive pressure. Thus, H.R. 3573 would apparently permit the elimination of interbrand competition even where a bottler enjoys a near monopoly of sales in the territory, so long as some other product is "generally available." Any protection for the consumer is even more illusory than the inadequate safeguard afforded by the "substantial and effective competition" standard of H.R. 3567.

In addition, H.R. 3573 seems to suggest that the plaintiff in any antitrust case challenging the legality of exclusive territories in the soft drink industry would have the burden of proof to establish that the defendant is not entitled to immunity under the standards of the bill. The normal rule is that the party claiming a special exemption must prove that it is entitled to it. That should be the rule here as well. If there is a justification for the restriction, it should be up to the party relying on it to assert and prove it. Requiring the plaintiff to prove the negative proposition that no possible economic, energy-related or environmental justification exists could effectively insulate even the most clearly harmful restraints from the antitrust laws.

I again emphasize that by pointing out these particular defects in H.R. 3573, I do not mean to imply that H.R. 3567 is an acceptable alternative. The Department strongly opposed both bills.

Let me sum up my comments thus far. The comprehensive rule of reason analysis allows consideration of all the relevant circumstances in order to determine whether, on balance, a vertical territorial retraint is procompetitive or anticompetitive. H.R. 3567 and H.R. 3573 do not give adequate recognition to the acknowledged potential of such restraints to produce higher prices without compensating benefits, and H.R. 3573 would create what may amount to an almost absolute rule of legality that would deprive consumers of their protection under the antitrust law.

Private plaintiffs, the FTC, and the Department of Justice already bear the burden of proving that the particular vertical territorial restraint is unreasonable. These bills could make that burden even heavier and unfairly tip the scales in favor of the soft drink industry, leaving consumers to pay the price. There has been no showing that existing law is unfair or deficient. Congress should reject these proposed standards just as it rejected similar proposals in previous sessions.

My statement also goes on to discuss our opposition to that part of H.R. 3567 that deals with limiting damage claims in cases involving vertical territorial restraints. I think I will stand on the statement on that issue and not repeat any of the items I have mentioned there.

I would just like to end my statement by mentioning some of the broader issues that we feel are raised by these bills. The antitrust laws embody Congress commitment to competition as the best means to assure that consumers can buy the best possible products at the lowest possible price. In recent years, Congress has taken important steps to strengthen these laws and to narrow immunities from them. Through unhappy experience, we have learned that broad exemptions enacted in response to short-term economic conditions or to the pleas of special interests often persist long after they have served any useful purpose.

For these reasons, it is vital that Congress take a long, hard look at the claims made by proponents of antitrust exemptions and immunities. It should be up to the proponents to support their claims with solid evidence that some unusual characteristic of an industry requires special antitrust standards.

Because the traditional rule of reason standard is designed to be flexible enough to accommodate a range of industrial structures and practices, the burden must rest on proponents of immunities to justify those special immunities by clear and convincing factual evidence. As the National Commission to Review Antitrust Laws and Procedures recently concluded, unrestrained competition—not special immunities—generally offers the surest guarantee of consumer welfare.

When the arguments advanced by the soft drink industry are tested under this approach, they must be found wanting. No need for the passage of these bills has been demonstrated. Moreover, modifying the already extremely flexible law on exclusive territories for the benefit of this industry would only encourage other industries to demand equal treatment.

H.R. 3567 and H.R. 3573 represent an unjustified effort by special interests to remove themselves from the application of antitrust rules under which firms in other industries prosper. The Department of Justice, therefore, recommends that this legislation not be enacted.

Thank you, Mr. Chairman.

[The full statement of Richard J. Favretto follows:]

PREPARED STATEMENT OF RICHARD J. FAVRETTO, DEPUTY ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. Chairman and members of the subcommittee: I appreciate the opportunity to appear before you today to present the views of the Department of Justice on H.R. 3567, the "Soft Drink Interbrand Competition Act," and H.R. 3573, the "Soft Drink Energy Conservation and Interbrand Competition Act." These bills are part of a series of bills designed to confer a special antitrust exemption on exclusive territorial agreements between soft drink manufacturers and bottlers.

The Department of Justice has consistently opposed this type of special legislation over the years, and we continue to believe that it is both unnecessary and undesirable. These bills, and similar bills now pending, unnecessarily impinge on our fundamental national policy of reliance on robust and uninhibited competition. This legislation would also create an unfortunate precedent by encouraging every industry to seek specialized exemptions from the antitrust laws. And it is fundamentally inconsistent with the steps Congress has taken in recent years to strengthen the antitrust laws and their enforcement.

It may be helpful to begin by placing this legislation in context. Over the years, a series of bills has been introduced to establish a special standard for territorial agreements in the soft drink industry.[1] The first such bills were introduced after the Federal Trade Commission issued a complaint alleging that exclusive territory licensing agreements maintained by major soft drink manufacturers and their bottlers violated Section 5 of the FTC Act. The bottlers originally argued that legislation was necessary to allow them a fair opportunity to present all the economic evidence in favor of such agreements. As it turned out, though, the Supreme Court subsequently decided that vertical nonprice restraints generally are to be evaluated under the rule of reason, a flexible standard which permits consideration of all of the circumstances.[2] And throughout the litigation, the defendants have had a full hearing on the claimed economic justifications. Even though the soft drink industry has gotten all that it originally sought, it has continued to press for special legislation.

Moreover, the legislative efforts are now continuing despite the fact that it is not yet clear what the final outcome of the normal administrative and judicial process

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[1] See S. 978 (93d Cong., 1st Sess.); H.R. 16916 (93d Cong., 2d Sess.); H.R. 6684 (94th Cong., 1st Sess.); S. 3421 (94th Cong., 1st Sess.); S. 1483 (95th Cong., 1st Sess.); S. 598 (96th Cong., 1st Sess.); H.R. 1224 (96th Cong., 1st Sess.); H.R. 1611 (96th Cong., 1st Sess.).

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

will be. The FTC has rendered its decision but the case is now on petition for review before the District of Columbia Circuit, which will give further consideration to the bottlers' arguments in the course of determining whether the FTC's decision was supported by substantial evidence.[3] Legislative action at this time, while that factual record is still under review, would we believe, be at the least premature.

I would now like to discuss the principal features of H.R. 3567 and 3573. Both bills would change the legal standard by which exclusive territorial arrangements in the soft drink industry are judged. In addition, H.R. 3567 would virtually eliminate damage liability for the illegal use of exclusive territory agreements. I will discuss each of these subjects in turn.

H.R. 3567 would substitute for the current standard of liability a "substantial and effective competition" standard: under this bill, territorial agreements between soft drink manufacturers and bottlers would be legal provided that the products covered by the agreements are in "substantial and effective competition" with other products of the same general class. H.R. 3573 would establish an even narrower standard of liability. It provides that such agreements are legal unless it is established, first, that other competing products of the same general class are "not generally available to consumers" in the relevant territory and, second, that elimination of the agreements would not have various adverse energy-related, environmental, and economic consequences. To decide whether either of these changes in the current legal standard is a useful, beneficial one, it is necessary to ask two questions: first, what, if anything is wrong with the current standard? And, second, how, if at all, do these bills improve that standard?

As I have noted, the legal standard by which vertical exclusive territory agreements in the soft drink industry currently are judged is the rule of reason.[4] Under this flexible rule, 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.

For this sensible and comprehensive rule of reason approach, these two bills would substitute a narrow approach which focuses exclusively on interbrand competition. Under H.R. 3567, if interbrand competition is "substantial and effective," the agreement on exclusive territories is automatically legal. H.R. 3573 would also immunize such agreements solely on the basis of interbrand competition, although it would provide other grounds for immunity as well. How does this test compare with the rule of reason? The rule of reason does not limit antitrust analysis to this single factor involving the current strength of interbrand competition. Rather, it takes into account not only interbrand competition, but also other factors relevant to the overall competitive effects of the particular arrangement at issue.

The rule of reason does not ignore or downplay the significance of interbrand competition. To the contrary, the courts place great weight under existing law on the vigor of interbrand competition, which the Supreme Court in the *Sylvania* case called "the primary concern of antitrust law." And the FTC carefully considered the vigor of interbrand competition in its decision concerning vertical restraints in the soft drink industry.[5]

In short, current law accords interbrand competition all the weight it deserves; there is no need to change the law in this respect. The effect of this legislation will simply be to preclude consideration of other factors that may be equally important.

The narrow focus of these bills on interbrand competition is not their only defect. The meaning of their standards is unclear. How robust and vigorous must interbrand competition be before it becomes "substantial and effective" within the meaning of H.R. 3567? Or how available must competing products be before they are "generally available" within the meaning of H.R. 3573? The bills do not answer these questions, and to work out their meaning through litigation could take years and divert the courts and the FTC from their other important responsibilities. I would note that our experience with a similar standard in the Miller-Tydings and McGuire Acts was not encouraging.[6] Those statutes legalized resale price maintenance sanctioned by state law where commodities were in "free and open" competition with commodities of the same general class. The courts interpreted that standard very broadly, so that it offered consumers little protection.[7]

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[3] The Coca-Cola Co., 91 F.T.C. 517 (1978), appeal docketed, No. 78-1364 (D.C. Cir. Apr. 24, 1978).

[4] Continental T.V., Inc. v. GTE Sylvania, Inc., *supra*.

[5] The Coca-Cola Co., *supra*, 91 F.T.C. at 634-644.

[6] The "fair trade" statutes were repealed by the Consumer Pricing Act of 1975. Pub. L. No. 94-145, 89 Stat. 810.

[7] See Bowen v. New York News, Inc., 366 F. Supp. 651, 661-662 (S.D.N.Y. 1973), aff'd on this ground, rev'd on other grounds, 552 F.2d 1242, 1249 (2d Cir. 1975), cert. denied, 425 U.S. 936 (1976). The standard was criticized for its vagueness. Herman, "Free and Open Competition," 9 Stan. L. Rev. 323, 327-332 (1957).

We cannot afford to water down the protection that the rule of reason provides to the consumer. The dangers of a weakened standard become clear when one considers the arguments generally suggested in favor of territorial restraints on competition. The heart of those arguments usually is that bottlers need the additional profits that they could earn if they were sheltered from interbrand competition. These additional revenues, the bottlers assure us, would be well spent and would benefit the consumer because the bottlers would be able to make greater capital investments and to provide superior products and service. But what guarantee do consumers have that the bottlers would use their artificially inflated revenues for these purposes? If, for example, those capital investments are profitable, they would normally be undertaken under a system of free competition. Indeed, the spur of competition from other bottlers of the same brand may be necessary to give bottlers the incentives to perform efficiently and to innovate in such areas of competition as service and packaging.

By pointing out these dangers from exclusive territories, I do not mean to imply that vertical territorial arrangements always decrease overall competition. To the contrary, as the Supreme Court has recognized, such restraints may sometimes enhance competition. For example, they may help small but aggressive businesses enter a market and compete effectively. My only point is that we cannot afford to neglect the potential dangers of vertical restraints by focusing on their potential benefits. Under the rule of reason, the positive as well as negative effects of exclusive territories are fully taken into account. If these agreements foster interbrand competition more than they hinder interbrand competition, they are legal as the law now stands. We see no reason to change the law to legalize agreements that cannot meet that standard.

I also want to note that these bills would legalize the most extreme form of territorial restraint, which completely precludes a bottler from making sales outside the assigned area. In many situations, a more limited restraint may be sufficient to achieve any positive results claimed for territorial agreements. For example, so-called "area of primary responsibility" clauses permit each distributor to make sales outside his area of primary responsibility provided that he covers his assigned territory effectively. H.R. 3567 and 3573 give bottlers and manufacturers a license to deprive consumers completely of the benefits of interbrand competition even when less restrictive alternatives may be sufficient. Existing law, in contrast, considers whether exclusive territories are reasonably necessary to achieve legitimate business goals in light of the available marketing alternatives. This, we believe, is the better approach.

The Department of Justice recognizes that many proponents of H.R. 3567 and especially H.R. 3573 see these bills as a way to encourage the use of returnable bottles and thereby to conserve energy and protect the environment. Certainly, these energy and environmental goals are important. The question is whether the enactment of either of these bills represents an efficient solution. Neither bill contains any provison which requires, or even encourages, bottlers to use returnable bottles. Both bills offer them immunity from the antiturst laws even if they make no effort to market returnable bottles. Furthermore, the standard of H.R. 3573 may create antitrust immunity even if the injury to competition caused by territorial restraints is much more significant than the energy and environmental benefits. If the soft drink industry should make a special effort to market returnable bottles as a means to save energy and keep the environment clean, and if the industry will not make that effort without special federal legislation, that special legislation should deal directly with the problem. Giving soft drink manufacturers and bottlers an unrestricted license to eliminate intrabrand competition in the hope that some of them may voluntarily choose to offer more returnable bottles is not an efficient solution to energy or environmental problems.

Finally, I want to comment on some of the differences between H.R. 3567 and H.R. 3573. Our objections to both bills are fundamental ones involving their basic philosophy, and we do not believe that our objections could be cured by any changes in the language of the bills. Nevertheless, H.R. 3573 is even more unacceptable to the Department of Justice than H.R. 3567. Although H.R. 3573 nominally conditions immunity on the existence of interbrand competition, the standard of the bill is so weak that it apparently immunizes vertical territorial restraints even if interbrand competition in the territory is not significant. The rigid rule immunizing restraints whenever a competing product is "generally available" provides no reliable guarantee that this exemption will be available only where the competing product exerts substantial competitive pressure. Thus, H.R. 3573 would apparently permit the elimination of intrabrand competition even where a bottler enjoys a near monopoly of sales in the territory, so long as some other product is "generally available." Any protection for the consumer is even more illusory than the inadequate safeguard afforded by the "substantial and effective competition" standard of H.R. 3576.

In addition, H.R. 3573 seems to suggest that the plaintiff in any antitrust case challenging the legality of exclusive territories in the soft drink industry would have the burden of proof to establish that the defendant is not entitled to immunity under the standards of the bill. The normal rule is that the party claiming a special exemption must prove that it is entitled to it.[8] That should be the rule here, as well. If there is a justification for the restriction, it should be up to the party relying on it to assert and prove it. Requiring the plaintiff to prove the negative proposition that no possible economic, energy-related, or environmental justification exists could effectively insulate even the most clearly harmful restraints from the antitrust laws.

I again emphasize that by pointing out these particular defects of H.R. 3573, I do not mean to imply that H.R. 3567 is an acceptable alternative. The Department of Justice strongly opposes both bills.

Let me sum up these comments on the standards of legality that H.R. 3567 and H.R. 3573 would establish. The comprehensive rule of reason analysis allows consideration of all the relevant circumstances in order to determine whether on balance a vertical territorial restraint is procompetitive or anticompetitive. H.R. 3567 and H.R. 3573 do not give adequate recognition to the acknowledged potential of such restraints to produce higher prices without compensating benefits, and H.R. 3573 would create what may amount to an almost absolute rule of legality that would deprive consumers of their protection under current law. Private plaintiffs, the FTC, and the Department of Justice already bear the burden of proving that the particular territorial restraint is unreasonable. These bills could make that burden even heavier and unfairly tip the scales in favor of the soft drink industry, leaving consumers to pay the price. There has been no showing that existing law is unfair or deficient. Congress should reject these proposed standards just as it rejected similar proposals in previous sessions.

H.R. 3567 would also change the law concerning damages. Under Section 3 of the bill, a soft drink manufacturer or bottler could, without fear of damage liability, participate in an illegal territorial restraint on competition until a court ruled that the restraint was illegal. The victims would have no right to compensation unless the defendants ignored a court's ruling. There is simply no justification for this provision.

It is important to understand what this provision means. It means that the victim of such anticompetitive restraint could not recover any damages, much less treble damages, no matter how serious they suffered. And he would be denied compensation even if the illegal agreement that caused the injury was used for the worst of motives—to raise prices and restrain competition—and even if the defendants faced no interbrand competition at all, much less "substantial and effective" interbrand competition. H.R. 3567 would theoretically permit such victims to recover for any injury inflicted after a court ruled that the agreement was illegal, but the practical effect of this provision would be virtual immunity from damage liability even for clearly anticompetitive and illegal territorial restrictions in this industry.

This drastic restriction on damage liability for vertical restrictions illegal even under the modified standard of legality of H.R. 3567 would leave victims uncompensated and wrong-doers undeterred. Without the incentive of damages, the victims of these conspiracies would not sue. H.R. 3567 would cripple in this industry private enforcement of the antitrust laws, which Congress has made a vital supplement to enforcement by the Justice Department and the FTC.

Proponents of this provision claim that it would be unfair to subject members of the soft drink industry to damage liability because some cases suggests that certain types of territorial agreements in the industry are legal.[9] That argument just is not persuasive. A victim of illegal practices should not be denied compensation simply because another plaintiff once lost another antitrust case involving related issues in the same industry. The soft drink industry is a sophisticated industry with sophisticated legal advice. Its members realize that both the legal standards applicable to vertical restraints and the economic conditions which determine their effect on competition have changed since those old cases were decided, just as they have for every other industry. Holding companies in the soft drink industry responsible for the consequences of their actions creates no special surprise or unfairness that justifies singling them out for a damage immunity not afforded other industries.

[8] See, e.g., United States v. First City National Bank, 386 U.S. 361, 366 (1967) (burden of proof on claim of exemption from prohibition of Bank Merger Act).

[9] For example, proponents often point to Coca-Cola Bottling Co. v. Coca-Cola Co., 269 F. 796, 813–814 (D. Del. 1920).

In conclusion, I want to mention some of the broader issues raised by these bills. The antitrust laws embody Congress' commitment to competition as the best means to assure that consumers can buy the best possible products at the lowest possible price.[10]

In recent years, Congress has taken important steps to strengthen these laws and to narrow immunities from them. Through unhappy experience, we have learned that broad exemptions enacted in response to short-term economic conditions or to the pleas of special interests often persist long after they have served any useful purpose.

For these reasons, it is vital that Congress take a long, hard look at the claims made by proponents of antitrust exemptions and immunities. It should be up to the proponents to support their claims with solid evidence that some unusual characteristic of an industry requires special antitrust standards. Because the traditional rule of reason standard is designed to be flexible enough to accommodate a range of industrial structures and practices, the burden must rest on proponents of immunities to justify those special immunities by clear and convincing factual evidence. As the National Commission to Review Antitrust Laws and Procedures recently concluded, unrestrained competition, not special immunities, generally offers the surest guarantee of consumer welfare.[11]

When the arguments advanced by the soft drink industry are tested under this approach, they must be found wanting. No need for the passage of these bills has been demonstrated.

Moreover, modifying the already extremely flexible law on exclusive territories for the benefit of this industry would only encourage other industries to demand equal treatment. H.R. 3567 and H.R. 3573 represent an unjustified effort by special interests to remove themselves from the application of antitrust rules under which firms in other industries prosper. The Department of Justice, therefore, recommends that this legislation not be enacted.

Chairman RODINO. Thank you very much.

Mr. Favretto, to your knowledge, has Congress ever enacted an antitrust exemption while the courts are considering whether the conduct in question violates antitrust laws or violates any law?

Mr. FAVRETTO. I know of no such action by Congress, Mr. Chairman, and I think that to do so in this instance would be particularly unwise.

I think what the situation now reveals is a decision by an administrative law judge in favor of the industry on the legality of the restraints in question, a 2-to-1 decision by the Commission on review of that decision, and a full argument and submission to the court of appeals, which is now considering the appropriateness of the decision below

I think that the process ought to be permitted to run its course to enable this body to focus on what the ultimate standard and ultimate application of that standard may be as enunciated by the court of appeals or perhaps by the Supreme Court, if the case goes on review to the Supreme Court. I think that is one of the basic objections we have to the bill right at the outset: It is essentially untimely and premature. I don't know of any situation where that has occurred in the past.

Chairman RODINO. Let me ask, then, if Congress were to change the standard for determining legality of anticompetitive restraints in the soft drink bottling industry, wouldn't the Federal Trade Commission then have to relitigate the issue under the standards which would be set forth under the new legislation here? Wouldn't the subsequent relitigation create uncertainty?

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[10] See, e.g., National Society of Professional Engineers v. United States, 435 U.S. 679, 695 (1978); Northern Pacific Ry. v. United States, 356 U.S. 1, 4–5 (1958).

[11] Report of the National Commission for the Review of Antitrust Laws and Procedures 177–189 (1979).

Mr. FAVRETTO. I believe that is a key factor in addressing any argument about removing uncertainty or clarifying what the law may be as it applies to this industry. I believe that if the legislation were enacted, the Federal Trade Commission would then have to determine whether to proceed with the litigation and to litigate the issues posed by enactment of this legislation and that, I believe, would likely result in renewed litigation of the underlying merits of the case and would further delay resolution of the issue.

I believe the best approach, the wisest approach, is to allow the courts to apply and interpret the flexible antitrust rule that now applies to these restrictions and to see how that decision comes out before any legislative action is proposed.

Chairman RODINO. What restraints of trade does this bill permit that the rule of reason would deny?

Mr. FAVRETTO. Well, I think the imbalance in the test that is established by the bill is simply that it focuses only on interbrand competition. With H.R. 3567, the only test is whether or not there is substantial and effective interbrand competition. It doesn't focus on what may, in any particular situation, be important elements of intrabrand competition. It does not focus on the degree of market power which the bottler may have in the particular territory, and doesn't permit any analysis of less restrictive alternatives.

It is conceivable that if some interbrand competition which could be characterized as substantial and effective existed in the territory, a vertical restraint could be considered lawful even though its intrabrand effects—the pricing effects in the particular brand in question—were substantially detrimental to the consumer. This legislation would permit that kind of restriction to be deemed lawful because interbrand competition existed.

Chairman RODINO. Would you say that the bill, as written, would also permit a restraint of trade resulting from the assignment of exclusive territorial arrangements, even though the parties could not justify the restraint of trade under the rule of reason test?

Mr. FAVRETTO. I think that is true as well, Mr. Chairman. The rule of reason requires such a justification. It strikes a balance between what may be procompetitive about the restriction in question and what may be anticompetitive about the restriction in question. The court makes the balance after listening to all relevant facts and arguments and hearing the evidence as to whether it enhances or restricts competition.

Under the proposed legislation, there would be no such balance required. The legality would simply turn on the existence of substantial and effective interbrand competition.

Chairman RODINO. We are going to recess until we answer the record vote.

[Recess.]

Mr. VOLKMER [presiding]. The subcommittee will come to order.

I will now recognize the gentleman from Illinois, Mr. McClory, for 5 minutes.

Mr. MCCLORY. Thank you, Mr. Chairman.

Your testimony is that you think that this legislation is premature and I would judge that you are standing off to the side awaiting the outcome of pending litigation and that you would adopt a policy following the decision of either the court of appeals or the Supreme Court.

However, you come down rather strongly on behalf of the position which is being advanced by the Federal Trade Commission, so I judge that you are not just an unbiased bystander; you are a bystander who is rooting for one side in this litigation.

Mr. FAVRETTO. Mr. McClory, I would like if I may, not to indicate where my rooting interest lies on this particular piece of litigation but simply say that the prematurity of the legislation is one aspect of why I think it should not be enacted at this time.

I say that because no one questions Congress authority to legislate where it feels there is a bad rule of law as reflected in a particular court decision but that process has not spun its entire web at this point. That's why I say it is premature.

Mr. MCCLORY. Whatever the ultimate court ruling is, it will be your policy, will it not?

Mr. FAVRETTO. The standard applicable is the rule of reason standard. The courts may or may not agree with the application by the FTC.

Mr. MCCLORY. You will abide by the court.

Mr. FAVRETTO. Yes.

Mr. MCCLORY. Unless we would change the law following a ruling which might be adverse to the Government.

Mr. FAVRETTO. Adverse to the Government or maybe not totally adverse, or conceivably, this body might feel the standard was unwisely applied in favor of the Government in this particular case or something of that sort.

My basic point is that the legislation is unnecessary because the rule of reason already contemplates a full hearing in the appropriate tribunal where facts are offered and where theories are tested by those facts, and this permits consideration of all the concerns expressed by the proponents of these bills.

Mr. MCCLORY. Aside from the pending litigation, isn't it a fact that what this legislation undertakes to do is to continue in effect a policy and arrangement that applied for 75 years or more to the manufacture and distribution of soft drinks?

Mr. FAVRETTO. The legislation would exempt from the antitrust laws that system of distribution, the existing system, that's correct.

Mr. MCCLORY. You make the statement that consumers will benefit if we don't pass this legislation. How do you know there will be any benefit to the consumers? You do not know that, do you?

Mr. FAVRETTO. I don't make a categorical statement one way or the other that the consumers would benefit. I am saying the potential benefit to the consumers from the abolition of these restrictions as against potential benefit to the consumers by the retention of them ought to be something left to be balanced under the existing standard by the courts.

This legislation need not preempt what is now a flexible antitrust standard that is meant to take those considerations into account in any particular case.

Mr. MCCLORY. As I interpret your statement on pages 11 and 12, the top of page 12, it says this legislation would be anticonsumer and the consumers will be protected and benefited if we do not pass this legislation. How can you say that?

Mr. FAVRETTO. It is anticonsumer because, no matter what the price level exacted by a bottler in a particular area where he has exclusive rights, no matter what that price level may be and its impact upon the consumer, the legislation would hold that restriction legal. The restriction that gave him the power to exact that price would be legal if there was substantial and effective interbrand competition, without any definition of the full extent of that competition or the nature of it or the scope of it.

Mr. MCCLORY. If these arrangements result in a lower price and a better method of marketing and producing, and if the consumers benefit pricewise, you are not against that, are you?

Mr. FAVRETTO. If they can be demonstrated to have that effect, they would be lawful under existing law. That is what the court is presently considering.

Mr. MCCLORY. You are not against that.

Mr. FAVRETTO. No, I would not be against that. What I am saying——

Mr. MCCLORY. How do you feel about this: As I understand PepsiCo and Coca-Cola have taken over some of the bottling franchises now, so they have one great big integrated operation. What would prevent more bottling companies from surrendering or selling out to (sic) parent, the sirup manufacturing company? Do you think that would benefit competition?

Mr. FAVRETTO. I am not sure whether it would benefit competition or not. If that trend is anticompetitive, if that can be demonstrated to be anticompetitive, existing law can take that into consideration in assessing whether or not the restrictions are valid.

I might indicate that the trend you refer to has existed even with the existence of territorial restrictions in the bottling industry. It is not clear to me that vertical restrictions have any impact one way or the other on the trend.

Mr. MCCLORY. You do not have plans to force divestiture of the Pepsi Cola companies in New York, Boston, and Philadelphia, where PepsiCo bought up the franchises?

Mr. FAVRETTO. I am not aware of any Department of Justice investigation of those transactions. There may be FTC interest in them, but I am not aware of Department of Justice interest.

Mr. MCCLORY. Is there any violation of the antitrust laws by reason of their doing that?

Mr. FAVRETTO. I am not prepared to comment one way or the other on that point without studying the context of the transactions and the acquisitions. It would be measured by existing laws dealing with mergers and acquisitions.

Mr. MCCLORY. Do you have any idea of what the effect would be on the returnable bottle system, which has some very extensive environmental aspects to it, if we destroy or permit the destruction of these bottling franchises of the bottlers?

Mr. FAVRETTO. My reaction to that is that the FTC itself, in the very case that created this controversy, held that there were good and legitimate reasons for territorial restraints covering returnable bottles. Even the decision against the industry on some issues permitted the existence of those restraints when dealing with returnable bottles.

I think, as a general matter, if the legislative concern is environmental, it ought to be addressed directly in a piece of legislation by this body. There is nothing in the existing legislation that requires any bottler to bottle his beverages in returnable bottles.

Mr. McCLORY. The concern ought to be comprehensive as far as the public interest is concerned, including environmental, price, competition, investment already made, existing business practices—the fact is that there is extensive and keen competition between Pepsi and Coke and RC and a lot of others—that there is a lot of competition in the soft drink business, isn't there?

Mr. FAVRETTO. That may be. The primacy of that competition between brands is recognized by existing law and has been recognized by the Supreme Court in *Sylvania,* a case which you made reference to. This bottling case is the first major test of the application of that principle to an important industry, and it is before the Court of Appeals in the District of Columbia right now, fully submitted and awaiting decision.

It just makes good policy sense to the Department that this body, whose authority to legislate in this area we don't question, await the court of appeals' decision to narrow and focus the issues and that it not embark upon trying to fashion a test which will stand for all time rigidly unless this body then agrees at some later date that it was a bad idea and ought to be repealed.

We had that experience with the fair trade laws, where the same arguments were made that, to protect small businesses and permit effective servicing, some exemption from the rules against resale price maintenance was required. This body, 30 years after, had to repeal those laws in the face of evidence that those laws had a very bad consumer impact.

Mr. VOLKMER. The time of the gentlemen has expired.

Mr. McCLORY. All right, but I make one point?

Mr. VOLKMER. Yes.

Mr. McCLORY. Your point is that we ought to avoid legislation at this time and await the outcome of the court action and then adopt a policy.

Mr. FAVRETTO. I would reserve my right to come back after the decision and argue to this body that the decision was proper and appropriate application of a flexible and good rule and ought to be left that way, and that legislation of this sort is always a bad idea. But, with that reservation, I agree with you.

Mr. VOLKMER. The Chair now recognizes the gentleman from New Jersey.

Mr. HUGHES. Thank you, Mr. Chairman.

Thank you, Mr. Favretto. I have just a few questions.

Proponents of the legislation will argue that in your testimony you have not considered the historical situation of the bottling industry relative to franchising. Do you believe it would be fair, after more than 75 years of exclusive territorial agreements, to apply new standards in this industry?

Mr. FAVRETTO. I would quarrel with the characterization of new standards. I think this industry is in no different position than any other industry in the American economy that is subject to the antitrust laws. Industry contexts may have evolved and circumstances may have changed, but it is clear this is a sophisticated industry with good legal advice.

In 1967, the Supreme Court cast all vertical territorial and customer restraints in substantial doubt when, in the *Schwinn* case, it held those restrictions to be per se unlawful. Ten years later, in *Sylvania*, the court reconsidered its rule and made a change in favor of the industry by saying they are subject to a less stringent, more flexible rule of antitrust analysis.

I think, under those circumstances, there is no unfairness to say to the industry that it is going to be held to what the law is and has been for a substantial period of time. There is no change in the law that is in any way different than the change which confronts any other element of American industry.

Mr. HUGHES. Are you saying that exclusive territorial agreements at one one time might have promoted competition, yet at another time might be anticompetitive?

Mr. FAVRETTO. That's possible. They may promote competition right now; I just don't know. The court of appeals is considering that question. The FTC found to the contrary. But the court of appeals is considering that question.

If they promote competition, they are lawful restrictions within the context of this industry, but that analysis has to be performed very carefully, very specifically, and has to be made in such a fashion as to protect the interests of the industry as well as the interests of the consumer in effective competition, low prices, and good products.

That's what the antitrust laws are designed to do. I think they are effective in this industry under the existing standard that applies to these practices.

Mr. HUGHES. I share your concern about the legislation being somewhat premature in that the court of appeals has not decided the issue. Can you tell us what is the particular posture of that case at the present time? Has it been briefed? Is it ready for argument? What is its current status?

Mr. FAVRETTO. My understanding is that the case has been argued, fully submitted, and is awaiting decision. The argument occurred about a year ago, I believe, and the court of appeals has been considering the case for that period of time.

I would anticipate a decision is most likely imminent, given the normal waiting period for cases of this type. This is a complex case which involves important issues. It doesn't surprise me that the court of appeals is taking that amount of time to consider the application of the rule of reason to these types of restrictions so soon after the *Sylvania* case, which was only decided, I believe, 2 years ago.

Mr. HUGHES. If Congress enacted antitrust exemptions which are more generous than the rule of reason standard existing in the law, the courts can ultimately hold the Federal Trade Commission misapplied the rule of reason. Would Congress granting a broader exemption of the rule of reason then be justified? In other words, if the fact that the court of appeals reverses and holds that the rule of reason was misapplied, would all this have been necessary since the rule of reason has obviously worked fairly well from your testimony and from the facts presented to us previously?

Mr. FAVRETTO. I think it clearly would have been unnecessary in that case for this body to have acted. My position, however, is that it would be unnecessary for Congress to have acted even if the court of appeals affirms the FTC decision. My basic philosophical position would still be the same.

Let me make the point that I am not trying to strike any posture of insensitivity to the concerns raised by proponents of this legislation as to the state of the industry and the condition of the bottlers in the industry and what will happen to competition if these restrictions are removed. We are not insensitive to those concerns.

What we are saying is that the current law that has been fashioned to apply to these kinds of restrictions will take those concerns into consideration and will resolve the tensions between the conflicting procompetitive and anticompetitive effects that these vertical restrictions may have.

Now, if, on balance, the court of appeals says the rule of reason was applied appropriately and, on balance, these restrictions are anticompetitive and, therefore, unreasonable and illegal, that decision becomes final.

But if, because of some other social purpose, this body feels retention of those restrictions if, nevertheless, desirable, it can then take up the legislation at that point and consider it. We may be here disagreeing vigorously with the social balancing going on, but that is still well within your power.

Mr. HUGHES. In essence, what you have said is that H.R. 3567 and H.R. 3573 actually are providing exemptions never enjoyed by the industry and you feel, in essence, it would be premature to try to change the law at this time, to try to anticipate the court of appeals, and even if the court of appeals upholds the decision of the FTC, you feel that the rule of reason would still be in the public interest in deciding competition and lack of competition in the marketplace in this franchise area.

Mr. FAVRETTO. That's correct.

Mr. VOLKMER. The time of the gentleman from New Jersey has expired.

I have a couple of questions. You are not directly involved in the suit, itself.

Mr. FAVRETTO. No; I'm not.

Mr. VOLKMER. Your testimony, then, derives from your understanding of the antitrust laws more than from knowledge about the bottling industry and the economics of it, is that correct?

Mr. FAVRETTO. I think that's fair. I would not feel very comfortable being cross-examined on specific knowledge of the bottling industry.

Mr. VOLKMER. You are relying, then, upon the FTC and the staff's presentation to the Commission of the full scope of the economics of the soft drink bottling industry.

Mr. FAVRETTO. I would like to avoid commenting on the merits of that lawsuit.

Mr. VOLKMER. You are relying on that in your testimony, are you not? You are saying you are sure it was a fair and full hearing.

Mr. FAVRETTO. I am not in a position to make a judgment that everyone on both sides in that litigation has done as good and complete a job as possibly could have been done to bring the issues to the forefront and let them be decided the way they are supposed to be. What I am saying is the process contemplated permits everyone a fair and equal opportunity to address the issues that are of concern to the industry and that have given rise to these pieces of legislation.

Mr. VOLKMER. Did you ever see a breakdown in that process, whether it is the FTC or any other agency?

Mr. FAVRETTO. As with all processes that involve people, I think there is a possibility of that at any time.

Mr. VOLKMER. Then, not having knowledge of the bottling industry, you are not in a position to give a subjective viewpoint as to the effect of the court decision in favor of the FTC decision. You are not in a position to say whether it would lead to monopolistic bottling in certain areas or not, is that right?

Mr. FAVRETTO. I am not in a position to say that, nor would I wish to. The judiciary, is equipped with the rule of law and the process to take into account all facts necessary to make those determinations and to decide what the ultimate competitive consequences may be of permitting or not permitting the restrictions to exist in this industry.

The process and the rule of law are there. That is the forum for that debate to take place in; not in Congress, particularly at a time when the matter is still under submission.

Mr. VOLKMER. Now, do you have any disagreement—or any agreement, either way—as to the prematurity of congressional action with respect to agency proceedings being reviewed by the Federal courts? What I am trying to say is: Let's say that an agency—let's stay with the FTC—has instituted proceedings on this matter and it had not been in court. What would your position be on that?

Mr. FAVRETTO. I think the situation might be different if what we were arguing about was clearly defined. We would then be able to debate.

The situation might be different if the proceeding had been instituted but not litigated and if there was some real question about whether the rule of law to be applied was a good rule. That is how these bills started up. The initial case was filed when there was a per se rule that applied to these restrictions under *Schwinn* and the industry came in and said, "Look, we can't live with a per se rule because our industry has unique and peculiar characteristics which make these restrictions reasonable; if we only had the chance to present this evidence, we would be happy with that chance and we would live with the results."

So this body was asked to carve out an exemption from the *Schwinn* doctrine for the bottling industry and to make it a rule of reason industry. Well, before that got anywhere, *Sylvania* changed the rules and said, "Look, across the board, the rule of reason applies to these restraints because they are potentially procompetitive. It depends upon the structure of the market, the industry involved, and the characteristics."

So if we were debating about some rule of law here where you could say, "Look, your rule is too stringent; we want a more flexible rule," then we would have a focus in the area, even though litigation had never taken place.

But if this case had been filed and the rule of reason was to apply to it right from the beginning, I would say to you the rule is flexible enough. The process is designed to make those judgments. That's the forum where it should be.

Now, if, after the decision comes down, this body disagrees for some social reason with the impact of that decision, it can then legislate in a narrow, defined way. But it should not try to anticipate what the effects of the ruling may or may not be when the facts have been presented to the judiciary and the judiciary is in the process of trying to make the judgment as to what the facts demonstrate, not what the theories may be. That's why it should not be considered now.

Mr. VOLKMER. You don't believe two people can disagree on what the facts provide, the result of the facts?

Mr. FAVRETTO. People can disagree. That's what we have the court system for, to resolve that. If the court system makes that resolution——

Mr. VOLKMER. And some of us disagree.

Mr. FAVRETTO. Then we are faced with a "given." This body has reversed the impact of Supreme Court decisions before.

Mr. VOLKMER. Take *Illinois Brick*.

Mr. FAVRETTO. Or created exemptions.

Mr. VOLKMER. The Antitrust Division is up here trying to get us to overturn that decision because that was supposedly a bad decision.

Mr. FAVRETTO. There, we have a process that ran to its conclusion. We knew what we were dealing with there.

Here, we don't. Even if the process ran to its conclusion and a decision came out against the bottlers, we would be here saying, as a matter of philosophy and basic approach and commitment to competition as a fundamental national objective, that legislation of this variety exempting an industry from the application of the antitrust laws would be a bad idea, and we would be against it.

What I am saying is that I recognize this body's prerogatives, but, at the very least, this legislation is untimely at this time.

Mr. VOLKMER. Thank you, my time has expired.

Any further questions?

Thank you very much.

Now we have a panel. I would ask all four to come up to the table. We have Sidney P. Mudd, Charles Sandahl, Jr., Richard Caudill, and Peter Chokola. Each one of you, I suppose, have prepared statements. Those statements will be made a part of the record. If you wish to read your statement, you can do so. However, for the sake of timing, if you wish to summarize your statement, we may be able to conclude a lot faster.

I would appreciate it if you would proceed in the order in which your names were called. That would be Mr. Mudd, Mr. Sandahl, Mr. Caudill, and Mr. Chokola.

Mr. MCCLORY. Could we have the fifth gentleman identified?

Mr. MUDD. The fifth is Charles Ruttenberg of Arent, Fox, Kintner, Plotkin & Kahn, special counsel for NSDA.

TESTIMONY OF SIDNEY P. MUDD, CHAIRMAN OF THE BOARD, JOYCE BEVERAGES, INC., NEW ROCHELLE, N.Y., ACCOMPANIED BY CHARLES RUTTENBERG

Mr. MUDD. My name is Sidney P. Mudd. I am past president of the National Soft Drink Association, the national organization representing soft drink bottlers throughout the country. I am currently chairman of NSDA's Special Franchise Committee. This committee is concerned with the implications of the Federal Trade Commission's challenge to the soft drink industry's territorial system and with the proposed remedial legislation now pending before this subcommittee. I am also a Seven-Up soft drink bottler in New Rochelle, N.Y.

I appreciate this opportunity to appear here today in order to present the subcommittee with whatever information it desires regarding the structure and performance of the soft drink industry and with regard to the need for enactment of H.R. 3567.

One thing that becomes immediately clear as one looks at the soft drink industry is its tremendous diversity. While most bottlers are small, some are quite large. Local markets vary greatly in population, in geographic size, in transportation characteristics, and with respect to a host of other factors that determine the competitive nature of the market.

The company with which I am associated, Joyce Beverages, Inc., is not a small bottler. My company has annual sales approaching $200 million. It serves portions of Connecticut, New York, New Jersey, Illinois, Wisconsin, Maryland, Virginia, and all of the District of Columbia. By anybody's reckoning, I am a large bottler. Nevertheless, I fully support H.R. 3567, as do the vast majority of bottlers, large and small.

There are basically two reasons why I, a large bottler, support the bill. The first reason is that I firmly believe that the elimination of soft drink territories would have profoundly unfortunate effects upon the industry and upon the consuming public. I support H.R. 3567 because I believe that the soft drink territorial system has served the consumer extremely well, has functioned in a truly competitive way, and that the system should not be changed unless it can clearly be shown that the use of territories precludes effective competition.

By any of the generally accepted criteria of performance, the industry deserves high marks: widespread, effective distribution; consistent maintenance of quality; development of new flavors and containers; effective price competition; and adaptation to changing commercial realities.

My second reason for supporting the bill concerns the effect of elimination of territories upon my company. Obviously, the effect of the elimination of territories would be felt initially by small bottlers. But there is a real possibility, which I will expand upon later in my statement, that franchise companies, food chains, and other large marketing corporations will move into the bottling industry with dire effects upon all industry members.

I would like first to describe briefly the structure and operation of this industry. The soft drink industry consists of more than 2,000 soft drink manufacturers. Most of these are local bottlers who are licensed by a franchisor to manufacture, distribute, and sell a trademarked soft drink product within a specific geographic area. In addition, there are many local and regional bottlers who own their own trademarks and who manufacture, distribute, and sell soft drinks under those trademarks, such as Rock Creek in Washington, D.C., as well as national shippers such as Shasta.

The practice of licensing local bottlers to manufacture, distribute, and sell soft drinks under a particular trademark in a defined territory began more than 75 years ago. The territorial exclusivity of the license agreement is critical to the soft drink franchise system. Because of the substantial capital investment required to manufacture and distribute soft drinks, it was and is necessary to grant the bottlers exclusivity in order to persuade them to make such investments. It also induces them to develop their territories intensively, with the result that trademarked soft drinks are available in virtually every retail outlet in each territory and are supported by a high degree of customer service.

We believe that the territorial system has performed efficiently and has benefited the consumer. Bottlers are subject to severe interbrand competition. Price reductions and premium promotions are common competitive devices in this industry. Moreover, no other food product is distributed as extensively. Indeed, soft drinks are convenience items which consumers desire and can find available virtually everywhere.

The territorial system has enabled the industry to be broadly responsive to consumer desires for different kinds of containers. Thus, local bottlers respond to the demand for returnable containers, convenience containers, single-service and large economy-size containers. In contrast, soft drink companies without local bottlers, like Shasta, commonly do not offer such a variety of containers. Usually, they offer only 12-ounce cans.

Historically, the territorial system has adapted to changing economic conditions. Bottlers are able to expand either by further developing their own markets, by adding additional plants or by merger with or acquisition of other bottlers, or by consolidation with other bottlers. Moreover, the territorial system does not maintain the existence of those businesses which fail due to incompetence, undercapitalization or other shortcomings. Instead, the record of mergers and consolidations in this industry is indicative of the adaptability of the industry to the natural competitive flux of the marketplace.

This adaptation through mergers and consolidations is accomplished with much more equity and responsibility under the traditional franchise system than would occur under the FTC order. Instead of having small bottlers simply driven out of business, which is what the FTC order would accomplish, the traditional system permits those bottlers which are undercapitalized or otherwise cannot perform effectively to sell their companies and obtain a fair return on their investment.

At the same time, the purchaser assumes the seller's franchise responsibilities in the territory. Under the FTC order, on the other hand, there would be no such allocation of responsibility. Distant bottlers would be free to ship soft drinks wherever and whenever they wished with no obligation toward small accounts and no obligation to provide any customer service at all.

Mr. Chairman, the Federal Trade Commission proceedings have hung over the soft drink industry for 8 years and are not yet resolved. In 1971 the Federal Trade Commission brought charges against eight industry franchisors, alleging that exclusive territorial provisions in their contracts with local licensees constituted unfair methods of competition.

After 6 weeks of hearings in 1975, Administrative Law Judge Dufresne ruled in the *Coca-Cola* case that the territories in the industry fostered, rather than constrained, competition. A similar decision was reached in the *Pepsi-Cola* case on largely the same evidence.

In April 1978, the Federal Trade Commission, in a 2-to-1 decision, rejected all of the administrative law judge's findings and, with very little recognition of the undisputed evidence in the record of substantial and effective interbrand competition, held that the territories are unlawful because they restrain intrabrand competition.

The Commission's rulings are on appeal to the U.S. Court of Appeals for the District of Columbia Circuit and, I might add, as a further example of how long this administrative and judicial process has been drawn out, that tomorrow will mark the first anniversary of the oral arguments before the court.

As you might expect, Mr. Chairman, the pendency of the Federal Trade Commission cases over these many years has been a major impediment to business decisions within the industry. Bottlers are uncertain as to whether they can justify additional capital expenditures for franchises whose value might suddenly be sharply reduced. For other bottlers who have invested a lifetime of work and savings in their bottling operations, the value of their assets is compromised by the prospect that the market they have cultivated these many years may be taken without payment.

Nor is the uncertainty that has afflicted the industry about to be dissipated. Whatever the court of appeals decides here—and I think this is important in view of the earlier testimony, Mr. Chairman—whatever the court of appeals decides, it is probable that the parties before that court will continue to litigate. In addition, suits against other franchise companies are pending at the Federal Trade Commission. Furthermore, the possibility of treble damage suits is very real. It is time, therefore, that the legal standard for testing these arrangements be clarified by the Congress.

The operations of the soft drink industry and the merits of the territorial system have been aired extensively over the years. This, again, is important. The members of the soft drink industry are proud of the competitive performance of the industry. Industry members presented facts supporting the territorial system in the Federal Trade Commission proceedings, and while the administrative law judge fully agreed with the industry's contentions, the Commission practically ignored them in its ruling. Under the circumstances, we feel it appropriate for us to be here since the futility of dissuading the Federal Trade Commission of their preconceived conclusions is perfectly clear.

I think we should also make it clear that in supporting H.R. 3567 we are not asking for antitrust exemption. Rather, H.R. 3567 is remedial in scope and fully consistent with traditional antitrust statutes. What it does is to require the Commission and the courts to test soft drink industry territorial franchises in terms of the extent of interbrand competition in the market.

As a layman, I understand that the effect of H.R. 3567 is to test bottlers' territorial provisions by requiring a determination as to whether the bottlers' products are in "substantial and effective competition" with other soft drink products. I am not a lawyer and I leave it to Mr. Ruttenberg to answer questions about the meaning of that term and of the bill generally. However, to me, that test is one which I believe most bottlers would recognize as fair and understandable.

It also seems to me that passage of H.R. 3567 is in accordance with the public interest. The administrative law judge who heard the evidence in the *Coca-Cola* and *Pepsi-Cola* cases found that the markets examined by him were subject to extensive interbrand competition. Passage of H.R. 3567 would require the FTC and the courts to determine whether such competitive conditions exist in this industry.

This is also a time when Congress is very much concerned about industrial concentration and retention of the territorial franchises would tend to preserve the local, unconcentrated structure of the soft drink industry.

On the other hand, elimination of the soft drink territories would rapidly cause this industry to become highly concentrated. This could happen in a number of ways. The most obvious way would be for large bottlers who have the best access to food chain warehouses to capture these accounts and, thereby, supply all of the chain stores served by the warehouse, including those in other bottlers' territories. Thus, small bottlers would lose the chain stores which account for a large portion of their sales and profits. This is the first step toward the small bottler's demise.

In addition, all bottlers, large and small, are certain to be jeopardized as a result of vertical integration by the franchise companies and the food store chains. If territories are eliminated, franchise companies can easily integrate forward into the bottling level of the industry by competing with their own bottlers until they capture the market. Food store chains could also integrate backward by either acquiring existing bottlers or by acquiring franchise rights from the syrup manufacturers and then shipping to unlimited areas. Because of the enormous leverage which the franchise companies and the food chains could apply, the soft drink industry would quickly become concentrated.

I do not think that my prediction of rapid industry concentration is fanciful. One need only recall how quickly the brewing industry went from a condition of numerous local and regional brewers throughout the country to an industry dominated by a few large national brewers to know that this can readily happen in the soft drink industry.

Section 3 of H.R. 3567 would free the industry from treble damage exposure for enforcing exclusive territorial provisions in a trademarked soft drink agreement prior to the date when and if a final determination is made that such products are not in substantial and effective interbrand competition.

I think that this is an appropriate provision. As I mentioned earlier, territorial provisions have been in effect for more than 75 year. Indeed, the industry has had abundant reason over the years to believe in their lawfulness. Prior to the FTC ruling, every court which examined the soft drink territorial provisions held them to be lawful, beginning with the *Coca-Cola* case in 1920.

In light of that good faith reliance and of the competitive nature of the soft drink industry, Congress should relieve the industry from treble damage exposure for having territories before a possible finding of illegality under H.R. 3567.

In summary, Mr. Chairman, let me briefly restate the points I have made.

One, the soft drink industry is populated by local independent bottlers who face intense interbrand competition and who provide the consumer with a wide range of soft drink choices.

Two, the territorial limitations have provided incentives to bottlers to make investments for production, distribution, and marketing, which have resulted in substantial and effective interbrand competition. At the same time, the territorial system has not prevented adaptation to changing economic and demographic factors.

Three, H.R. 3567 does not confer an antitrust exemption. It merely clarifies the competitive standard under which exclusive territories are to be judged.

We believe that with the passage of H.R. 3567, the law relating to bottler territories will be clarified; the soft drink industry will continue to serve the public efficiently and competitively; the soft drink industry will be responsive to competitive changes; and the industry will continue to have the local, unconcentrated structure which for so long has typified this national small business industry.

That concludes my statement. Thank you, Mr. Chairman.

[The full statement of Mr. Mudd follows:]

STATEMENT OF SIDNEY P. MUDD, NEW YORK SEVEN-UP BOTTLING CO., INC., NEW ROCHELLE, N.Y.

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Although the number of bottlers has decreased in recent years, the industry remains essentially localized. A breakdown of industry plants by size and by state is attached for your review. This local character of the industry is the result of the exclusive territorial provision. One of the virtues of this provision is that it has limited forward integration into the manufacturing process by the large trademark owners and prevented backward integration by large national retail food chains.

With the elimination of the territorial provisions, the industry would soon be dominated by a handful of giant national companies. In contrast, in local markets a franchised bottler competes with other local bottlers with national brand franchises, as well as with regional brands, private label brands, such as Safeway's Cragmont, and with nationally shipped brands, such as Shasta. In the Washington metropolitan area, for example, there are more than a hundred soft drink products regularly marketed by twenty-five different companies in competition with each other.

Mr. Chairman, the Federal Trade Commission proceedings have hung over the soft drink industry for eight years and are not yet resolved. In 1971 the Federal Trade Commission brought charges against eight industry franchisors, alleging that exclusive territorial provisions in their contracts with local licensees constitute unfair methods of competition. After six weeks of hearings in 1975, Administrative Law Judge Dufresne ruled in the *Coca-Cola* case that the territories in the industry fostered, rather than constrained, competition. A similar decision was reached in the *Pepsi-Cola* case on largely the same evidence. In April 1978, the Federal Trade Commission, in a two-to-one decision, rejected all of the Administrative Law Judge's findings and, with very little recognition of the undisputed evidence in the record of substantial and effective interbrand competition, held that the territories are unlawful because they restrain intrabrand competition. The Commission's rulings are on appeal to the United States Court of Appeals for the District of Columbia Circuit. I might add, as a further example of how long this administrative and judicial process has been drawn out, that tomorrow will mark the first anniversary of the oral arguments before the Court.

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Nor is the uncertainty that has afflicted the industry about to be dissipated. Whatever the Court of Appeals decides, it is probable that the parties before that Court will continue to litigate. In addition, suits against other franchise companies are pending at the Federal Trade Commission. Furthermore, the possibility of treble damage suits is very real. It is time, therefore, that the legal standard for testing these arrangements be clarified.

The operations of the soft drink industry and the merits of the territorial system have been aired extensively over the years. The members of the soft drink industry are proud of the competitive performance of the industry. Industry members presented facts supporting the territorial system in the Federal Trade Commission proceedings, and while the Administrative Law Judge fully agreed with the industry's contentions, the Commission practically ignored them in its ruling. Under the circumstances, we feel it appropriate for us to be here since the futility of dissuading the Federal Trade Commission of their preconceived conclusions is perfectly clear.

I think we should also make it clear that in supporting H.R. 3567 we are not asking for an antitrust exemption. Rather, H.R. 3567 is remedial in scope and fully consistent with traditional antitrust statutes. What it does is to require the Commission and the courts to test soft drink industry territorial franchises in terms of the extent of interbrand competition in the market.

As a layman, I understand that the effect of H.R. 3567 is to test bottlers' territorial provisions by requiring a determination as to whether the bottlers' products are in "substantial and effective competition" with other soft drink products. I am not a lawyer and I leave it to Mr. Ruttenberg to answer questions about the meaning of that term and of the bill generally. However, to me, that test is one which I believe most bottlers would recognize as fair and understandable.

It also seems to me that passage of H.R. 3567 is in accordance with the public interest. The administrative Law Judge who heard the evidence in the *Coca-Cola* and *Pepsi-Cola* cases found that the markets examined by him were subject to extensive interbrand competition. Passage of H.R. 3567 would require the FTC and the courts to determine whether such competitive conditions exist in this industry.

This is also a time when Congress is very much concerned about industrial concentration. Retention of the territorial franchises would tend to preserve the local, unconcentrated structure of the soft drink industry. On the other hand, elimination of the soft drink territories would rapidly cause this industry to become highly concentrated. This could happen in a number of ways. The most obvious way would be for large bottlers who have the best access to food chain warehouses to capture these accounts and thereby supply all of the chain stores served by the warehouse, including those in other bottlers' territories. Thus, small bottlers would lose the chain stores which account for a large portion of their sales and profits. This is the first step toward the small bottler's demise.

In addition, all bottlers—large and small—are certain to be jeopardized as a result of vertical integration by the franchise companies and the food store chains. If territories are eliminated, franchise companies can easily integrate forward into the bottling level of the industry by competing with their own bottlers until they capture the market. Food store chains could also integrate backward by either acquiring existing bottlers or by acquiring franchise rights from the syrup manufacturers and then shipping to unlimited areas. Because of the enormous leverage which the franchise companies and the food chains could apply, the soft drink industry would quickly become concentrated.

I do not think that my prediction of rapid industry concentration is fanciful. One need only recall how quickly the brewing industry went from a condition of numerous local and regional brewers throughout the country to an industry dominated by a few large national brewers to know that this can readily happen in the soft drink industry.

Section 3 of H.R. 3567 would free the industry from treble damage exposure for enforcing exclusive territorial provisions in trademarked soft drink agreements prior to the date when, and if, a final determination is made that such products are not in substantial and effective interbrand competition. I think that this is an appropriate provision. As I mentioned earlier, territorial provisions have been in effect for more than seventy-five years. Indeed, the industry has had abundant reason over the years to believe in their lawfulness. Prior to the FTC ruling, every court which examined the soft drink territorial provisions held them to be lawful, beginning with the *Coca-Cola* case in 1920. In light of that good faith reliance and of the competitive nature of the soft drink industry, Congress should relieve the industry from treble damage exposure for having territories before a possible finding of illegality under H.R. 3567.

In summary, let me briefly restate the points I have made:

1. The soft drink industry is populated by local independent bottlers who face intense interbrand competition and who provide the consumer with a wide range of soft drink choices.

2. The territorial limitations have provided incentives to bottlers to make investments for production, distribution and marketing, which have resulted in substantial and effective interbrand competition. At the same time, the territorial system has not prevented adaptation to changing economic and demographic factors.

3. H.R. 3467 does not confer an antitrust exemption. It merely clarifies the competitive standard under which exclusive territories are to be judged.

We believe that with the passage of H.R. 3467 the law relating to bottler territories will be clarified; the soft drink industry will continue to serve the public efficiently and competitively; the soft drink industry will be responsive to competitive changes; and the industry will continue to have the local, unconcentrated structure which for so long has typified this national small business industry.

Soft Drink Industry, State Profiles, 1978

(By the National Soft Drink Association)

National Summary

The soft drink industry is a major category of the food industry. Soft drink manufacturers' sales in the United States in 1978 were an estimated $13,344.6 million. The industry employed 129,778 persons nationally and had a payroll of $1,529.3 million.

There were 2,043 soft drink plants in the country in 1978. Most of the plants were owned by 1,500 small businesses considered the backbone of the industry. There were 1,409 plants that employed less than 50 persons. Soft drink plants were located in every state, in all major cities, and in many small towns serving rural areas.

Soft drink manufacturers purchased goods and services from other firms valued at $8,065 million. The soft drink producers were significant contributors to the areas in which they operated, as they paid state and local taxes estimated at $263 million in 1978.

1978 U.S. soft drink profile

Number of plants	2,043	Number of cities with plants	1,261
Domestic owned plants	1,746	Payroll (millions) [1]	$1,529.3
Number of firms	1,728	Number of employees [2]	129,778
Domestic owned firms	1,541	Sales—wholesale (millions)	$13,344.6
Single-plant firms	1,410	Cost of materials (millions)	$8,065.0
Plants by number of employees:		Value added (millions)	$5,279.6
1 to 49	1,409	Taxes, State and local (millions)	$263.0
50 to 99	373		
Over 100	261		

[1] Payroll figures are for 1976 and 1977.
[2] Employment figures are from 1976 updated to 1978 by NSDA Sales Survey estimates.

Sources: 1975 and 1976 County Business Patterns; U.S. Department of Commerce 1972 Census of Manufacturers, U.S. Department of Commerce; 1974 Source Book Statistics of Income, Internal Revenue Service; 1977 National Soft Drink Association State Profiles; 1976, 1977 and 1978 National Soft Drink Association Sales Surveys.

SOFT DRINK MANUFACTURING INDUSTRY STATISTICS BY STATE, 1978

State	Total employees	Industry sales (million)	Cost of material (millions)	Taxes paid (thousand)
Alabama	3,337	208.4	125.0	3,300
Alaska	244	29.4	17.6	500
Arizona	1,601	123.4	74.0	2,000
Arkansas	2,405	135.7	81.4	2,200
California	7,439	1,307.3	784.4	21,000
Colorado	2,150	165.9	99.5	2,700
Connecticut	834	130.1	78.1	2,100
Delaware	232	43.8	26.3	700
Florida	4,912	421.1	252.7	6,800
Georgia	4,579	256.9	179.8	4,100
Hawaii	425	54.6	32.8	900
Idaho	442	30.1	18.1	500
Illinois	5,117	584.1	350.5	9,400
Indiana	3,594	369.6	221.8	5,900
Iowa	1,403	159.6	95.8	2,600
Kansas	1,558	119.1	71.5	1,900
Kentucky	3,056	366.9	220.1	5,900
Louisiana	3,646	339.4	203.6	13,100
Maine	2,931	62.0	37.2	1,000
Maryland	2,730	337.7	202.6	5,400
Massachusetts	2,011	254.4	152.6	4,100
Michigan	5,170	591.6	355.0	9,500
Minnesota	2,285	256.9	154.1	4,100
Mississippi	2,107	132.9	79.7	2,100
Missouri	4,139	325.1	162.6	5,200
Montana	415	61.0	36.6	1,000
Nebraska	873	143.1	85.9	2,300
Nevada	125	39.1	23.5	600
New Hampshire	313	80.2	48.1	1,300
New Jersey	2,530	380.5	228.3	6,100
New Mexico	809	81.7	49.0	1,300
New York	6,561	1,225.1	857.6	19,600
North Carolina	5,401	357.8	214.7	27,700
North Dakota	322	27.9	16.7	400
Ohio	7,299	720.0	381.6	11,500
Oklahoma	2,348	203.8	122.3	3,300
Oregon	1,018	89.0	53.4	1,400
Pennsylvania	5,720	664.9	398.9	10,700
Rhode Island	268	35.4	21.2	600
South Carolina	1,911	190.0	114.0	14,700
South Dakota	444	28.3	17.0	500
Tennessee	4,386	372.6	223.6	6,000
Texas	11,274	987.6	592.6	15,800

SOFT DRINK MANUFACTURING INDUSTRY STATISTICS BY STATE, 1978—Continued

State	Total employees	Industry sales (million)	Cost of material (millions)	Taxes paid (thousand)
Utah	811	56.0	33.6	900
Vermont	164	14.8	8.9	200
Virginia	3,241	273.6	164.2	4,400
Washington	1,221	162.8	97.7	2,600
West Virginia	1,410	93.7	56.2	9,100
Wisconsin	2,454	240.5	137.1	3,900
Wyoming	113	9.2	5.5	100
Total	129,778	13,344.6	8,065.0	263,000

SOFT DRINK MANUFACTURING INDUSTRY STATISTICS BY STATE, 1978

State	Soft drink plants	Soft drink firms	Plants with less than 50 employees	Cities with soft drink plants
Alabama	42	33	23	27
Alaska	4	4	3	4
Arizona	22	20	15	8
Arkansas	33	24	23	23
California	109	83	76	68
Colorado	25	21	19	15
Connecticut	36	35	28	28
Delaware	5	5	3	3
Florida	58	42	31	30
Georgia	63	40	40	44
Hawaii	9	7	6	4
Idaho	14	14	10	7
Illinois	65	54	48	38
Indiana	51	43	34	33
Iowa	29	28	20	19
Kansas	29	22	21	17
Kentucky	43	36	26	28
Louisiana	43	35	28	26
Maine	17	16	14	13
Maryland	32	26	18	18
Massachusetts	63	61	51	45
Michigan	56	46	38	30
Minnesota	48	41	32	32
Mississippi	40	39	25	32
Missouri	48	44	33	38
Montana	18	18	17	12
Nebraska	26	25	20	15
Nevada	10	10	5	4
New Hampshire	11	11	7	9
New Jersey	39	35	26	30
New Mexico	22	20	16	13
New York	106	87	74	58
North Carolina	78	57	54	47
North Dakota	9	9	6	8
Ohio	75	52	37	35
Oklahoma	38	35	27	21
Oregon	30	22	26	16
Pennsylvania	130	120	101	85
Rhode Island	11	11	10	6
South Carolina	33	29	21	26
South Dakota	10	8	7	7
Tennessee	55	45	33	30
Texas	136	114	89	71
Utah	20	20	17	9
Vermont	6	6	4	4
Virginia	46	35	27	28

SOFT DRINK MANUFACTURING INDUSTRY STATISTICS BY STATE, 1978—Continued

State	Soft drink plants	Soft drink firms	Plants with less than 50 employees	Cities with soft drink plants
Washington	34	31	27	19
West Virginia	36	30	27	24
Wisconsin	73	73	60	49
Wyoming	7	6	6	5
Total	2,043	1,728	1,409	1,261

SOFT DRINK MANUFACTURING INDUSTRY STATISTICS BY STATE, 1978

State	Domestic owned plants	Domestic owned firms	Single plant firms	Multiplant firms
Alabama	39	30	24	9
Alaska	4	4	4	0
Arizona	17	15	14	6
Arkansas	28	22	19	5
California	95	76	68	15
Colorado	22	18	14	7
Connecticut	33	33	30	5
Delaware	3	3	2	3
Florida	46	33	29	13
Georgia	53	34	24	16
Hawaii	5	5	5	2
Idaho	14	14	14	0
Illinois	61	58	41	13
Indiana	37	35	34	9
Iowa	24	24	24	4
Kansas	19	19	15	7
Kentucky	36	32	28	8
Louisiana	39	32	28	7
Maine	16	15	13	3
Maryland	16	16	15	11
Massachusetts	55	55	55	7
Michigan	45	41	39	7
Minnesota	45	38	33	8
Mississippi	38	37	36	3
Missouri	40	38	37	7
Montana	17	17	17	1
Nebraska	21	21	21	4
Nevada	8	8	8	2
New Hampshire	8	8	8	3
New Jersey	28	27	25	10
New Mexico	22	20	18	2
New York	99	82	73	14
North Carolina	68	54	47	10
North Dakota	9	9	8	1
Ohio	55	43	38	14
Oklahoma	36	34	33	2
Oregon	27	19	16	6
Pennsylvania	116	113	106	14
Rhode Island	9	9	9	2
South Carolina	30	26	35	4
South Dakota	10	8	7	1
Tennessee	44	39	34	11
Texas	125	105	97	17
Utah	17	17	17	3
Vermont	5	5	5	1
Virginia	35	28	27	8
Washington	30	28	26	5
West Virginia	28	25	22	8
Wisconsin	63	63	62	11

SOFT DRINK MANUFACTURING INDUSTRY STATISTICS BY STATE, 1978—Continued

State	Domestic owned plants	Domestic owned firms	Single plant firms	Multiplant firms
Wyoming	6	6	6	1
Total	1,746	1,541	1,410	330

SOFT DRINK MANUFACTURING INDUSTRY STATISTICS BY STATE, 1978

State	Plants with 50–99 employees	Plants with more than 100 employees	Payroll (million)	Value added by manufacture (million)
Alabama	11	8	$29.8	$83.4
Alaska	0	1	4.5	11.8
Arizona	3	4	16.0	49.4
Arkansas	7	3	19.4	54.3
California	21	12	109.0	522.9
Colorado	1	5	20.3	66.4
Connecticut	7	1	10.2	52.0
Delaware	1	1	3.1	17.5
Florida	14	13	57.0	168.4
Georgia	16	7	45.0	77.1
Hawaii	1	2	4.9	21.8
Idaho	4	0	5.3	12.0
Illinois	9	8	85.1	233.6
Indiana	10	7	46.3	147.8
Iowa	7	2	16.6	63.8
Kansas	4	4	16.9	47.6
Kentucky	9	8	35.1	146.8
Louisiana	8	7	34.5	135.8
Maine	2	1	5.3	24.8
Maryland	7	7	37.9	135.1
Massachusetts	5	7	30.5	101.8
Michigan	8	10	63.1	236.6
Minnesota	9	7	32.4	102.8
Mississippi	11	4	16.7	53.2
Missouri	9	6	55.6	162.5
Montana	1	0	4.4	24.4
Nebraska	5	1	9.4	57.2
Nevada	5	0	1.6	15.6
New Hampshire	4	0	4.9	32.1
New Jersey	7	6	38.4	152.2
New Mexico	5	1	7.8	32.7
New York	20	12	90.8	367.5
North Carolina	12	12	51.3	143.1
North Dakota	3	0	3.1	11.2
Ohio	16	22	98.5	338.4
Oklahoma	7	4	20.8	81.5
Oregon	2	2	16.0	35.6
Pennsylvania	20	9	80.8	266.0
Rhode Island	1	0	2.9	14.2
South Carolina	3	9	25.8	76.0
South Dakota	3	0	4.1	11.3
Tennessee	12	10	45.3	149.0
Texas	30	17	110.8	395.0
Utah	2	1	8.2	22.4
Vermont	2	0	1.6	5.9
Virginia	9	10	35.5	109.4
Washington	4	3	19.0	65.1
West Virginia	7	2	16.2	37.5
Wisconsin	9	4	30.3	103.4
Wyoming	0	1	1.3	3.7
Total	373	261	1,529.3	5,279.6

Mr. VOLKMER. Thank you very much.

We will now hear from the other witnesses in sequence.

Mr. Sandahl, we will now hear from you.

TESTIMONY OF CHARLES L. SANDAHL, JR., PEPSI-COLA BOTTLING CO., AUSTIN, TEX.

Mr. SANDAHL. Thank you, Mr. Chairman.

Mr. Chairman, members of the subcommittee, my name is Charles Sandahl, Jr., and I reside in Austin, Tex. I am president of Pepsi-Cola Bottling Co., Inc. and I welcome this opportunity to appear before you in support of H.R. 3567.

With your permission, I will tell you about our plant and our operation, what type of change the FTC ruling will bring about in the marketplace, and the deleterious effect of this change on our plant, our customers, and the consuming public.

My father, due to health reasons, moved his family to Texas from Iowa in 1937. With improved health in 1939, he entered the soft drink business in a very inauspicious way. His franchise line consisted of Hire's Root Beer, Mission Orange and Clicquot Club Mixers. However, Clicquot Club was a disaster. Texans couldn't spell it, they couldn't pronounce it, and they did not know what to do with it. [Laughter.]

Texans then drank only branch water as a mixer and largely still do.

The plant consisted of four route trucks and seven employees. Sandahl Beverages, as it was then called, had a modest entry in the soft drink industry. Dad served some 10 counties outside Austin but, by the same token, Austin was also somewhat modest in size, having 87,000 good citizens and another 164,000 in the remainder of our territory, which was then—and still is—rural in nature.

Those four route trucks were brandnew Chevies costing $750 apiece and he bought some used soda water beds costing $100 each for a total unit cost of $850. I will refer to this a little later on.

The war years that brought on sugar and gas rationing were a trying time and a testing time for Sandahl Beverages, but we survived, though just barely. Others were not so fortunate. The Pepsi-Cola Bottling Co. did not survive the times and the fierce competition and it went under. There was no Pepsi-Cola in the Austin market for some 2 years.

The Pepsi-Cola parent company was also having its troubles and could not finance bottling plants, delivery trucks, and local manpower, so it, like other beverage producers, had to find local bottlers. In 1950, it chose us, probably because there were no other Austin bottling companies that had a plant, a few trucks, and some expertise that wanted the franchise.

It was not a question of money, for the franchise cost us nothing. And the Pepsi-Cola Co. provided us with some advertising funds of a limited nature to get started. In the beginning, each of the parent beverage makers faced a similar decision: How to obtain distribution with very little capital. The solution was to get local entrepreneurs to invest in the tools of the trade, provide the manpower and the management. This is the genius of the soft drink industry, for only in this way was a national market created. What other industry can say the same?

I worked in the plant afternoons while in high school until I lost a bout with polio in 1940. While attending the University of Texas, I worked part time in the office and, after graduation from the University of Texas School of Business and Law School, I joined dad full time and, little by little, we grew and somehow prospered.

Following World War II, the Government encouraged veterans to enter the soft drink business by providing them with special sugar allocations and some six new plants entered the Austin marketplace. but, even with this Government assistance, the interbrand competition proved too tough and, one by one, they all threw in the towel.

Starting from ground zero, we worked and scratched our way until we were accepted by the consumer and by the retailer, and, quite frankly, this did not come easy. Year after year, any profits we made were plowed back into the business to purchase new trucks, equipment, a new building in 1947, advertising, vendors, racks and, above all, manpower.

In 1953, we incorporated the business and it changed from a sole proprietorship, Sandahl Beverages, to the Pepsi-Cola Bottling Co. of Austin, Inc. and dad gave my sister and me a part of the business. Throughout the years, as our three children and my sister's two entered the scene, dad increased our equity in the business. The family nature has continued to this day and my oldest son, Scott, worked during his high school years in every capacity until graduating from the Universtiy of Texas with a degree in business and a specialization in mechanical engineering; a perfect combination for a soft drink bottling company.

This is a very diversified business, for you are, at one time, a manufacturer, an advertiser, a route sales company, a vending company, and a promotion entity. Scott is now our vice president and general manager. My youngest son, Mark, has joined us after playing football at Southwest State University, and my daughter, Lisa, after a short stay at Texas Tech, is now the supervisor of our new data processing department.

I hope you will forgive me for this travel through time and perhaps understand my pride in the family participation, and I like to think that, because of this dedication, we have grown and, yes, prospered. That first 7-man crew is now a 108-person team, and the 4 route trucks are now 20 route trucks, 2 tractor semitrailers, and some 30 support vehicles. I do not know what the annual payroll was in 1939 but in 1979 it will be close to $1,500,000.

Our plant has always been in east Austin and our employees have been taken mainly from this area, which has a high percentage of blacks and Chicanos. Our staff reflects this and we are happy that, besides our unskilled and semiskilled employees, our supervisory corps is strong in this minority representation.

During the years, our franchise line has changed and now is comprised of the Pepsi line of Pepsi-Cola, Diet Pepsi, Pepsi Light, and Mountain Dew. Also, Orange Crush, Country Time Lemonade, and Mason's Root Beer. Instead of 10 counties of 251,000 people, it is 8½ counties of some 536,000 central Texans.

I might add that, were it not for the strong Pepsi line, the flavor lines could not exist. They just do not command that large a part of the product mix. Our market is made up of chain stores, supermarkets, and convenience stores, Mom and Pop stores, gas stations, bars, and numerous offices and small businesses, in addition to vending machines, and here is where the economics begin to become sticky.

The chainstores in our sales territory number 240 and our local nonvending accounts number 1,100, but these 240 units account for 46 percent of our total business. Vending does 15 percent and the 1,100 other customers sell 39 percent of our annual sales volume.

Each of the chainstores operate out of regional warehouses; some as close as Temple, Tex., 60 miles; San Antonio, 70 miles; or Houston at 165 miles; Dallas at 200; and Corpus Christi at 220 miles from Austin. I would like to emphasize that there are no chain warehouses anywhere in our franchise area.

Currently, our product mix is 46 percent returnable bottles and 54 percent nonreturnable bottles and cans, and this is almost identical to the first 8 months of last year.

So, at least in the Austin market, the trend to nonreturnables has slowed to a halt, largely through the efforts of the bottlers of this area, who promote the returnable packages much more than cans or nonreturnable bottles, and the consumers, who, in this time of inflation, quite correctly perceive the returnable bottle as the value package in the soft drink market.

For example, a 6-pack of Pepsi quarts will sell on special at about $1.49 for 192 ounces, or roughly three-fourths of 1 cent per ounce, while a 6-pack of cans on special at $1.29 for 72 ounces is about 1¾ cents per ounce.

This is the Austin, Tex., market. I do not purport to know about the marketplace in California, New York, or in the offices of the FTC in Washington, but I do understand central Texas, and it is with this perspective that I offer my opinion of the consequences that will result if the FTC complaint on exclusive territories is allowed to prevail.

There is an old saying that goes something like this: "If it ain't broke, don't fix it." Let me submit that the soft drink industry and its system of local ownership and store-door delivery do not need fixing by FTC or any other Government agency.

As you all well know, the Government of the United States is very, very large, and very, very unwieldy, and often miscalculates the results of its actions. I realize that bureaucracies feel the need to act just for the sake of acting, and then try to rationalize their position, so I urge each of you to consider the ramifications if you allow the FTC to destroy an industry with results that will be just the opposite of what the FTC proposes. The soft drink industry is characterized by high volume and very low unit profit, so that if you tinker with that volume you very quickly find yourself in red ink, and the local entrepreneurs of the soft drink industry have no deficit financing.

What happens if territorial exclusivity is abolished by the FTC in Austin, Tex.?

One, the chainstores with warehouses out of the territory—remember, 46 percent of our business is in these chainstores—will proposition bottlers in other areas to sell to their warehouses at lower prices for a large volume drop shipment, and the sales market that we have built over the years at a great expense of time, money, effort and, I hope, expertise, will be raided and subverted.

Two, the loss of even a modest percentage of the chains will leave us with the remaining 1,100 low-volume customers. The economics of our system is that we make more money from large sales to chains per call than we do the smaller local accounts, but the cost to each is the same, and this gives the Mom and Pop store the same price as the others so that they can compete on equal terms. Now lose the chains from our sales mix and the cost of serving the local accounts goes up dramatically, and that added cost would have to be added to the price. This would be at a time that chainstores are buying through their warehouse for less, and the result is that the local Mom and Pop store could never compete with giant chains. Is this the result desired by the Federal Trade Commission? I would hope not.

Three, warehouse delivery cannot operate on a returnable package system. They have none in their operation now and they do not want one in their operation in the future. With the store-door delivery by the bottler, some 50 percent of their sales are now in returnable packages, and that would be eliminated.

If you will recall my figures previously of the value package returnable at three-fourths of a cent an ounce and cans at 1¾ cents, you can see that the consumer who is given only the option of buying the higher priced package would pay substantially more for soft drinks. Would Government attempt to destroy the bottlers who supply the value package? I hope not.

Four, in a time when environmental considerations are important and are vigorously espoused by various Government agencies, does it seem logical to kill the only industry in the food-service line that still reuses a high percentage of its containers and still gives the consumer the choice of value or convenience?

Many Government agencies such as Agriculture, Justice, and even the FTC decry the elimination of small family farms, the merger of big businesses, and the decline of competition that is the result of such bigness. It is bewildering for me to understand why the FTC desires to destroy the small local bottler, reduce the number of competitive bottlers, and put the industry in the hands of a very few giants. You know better than I what happens when control rests with a few very large companies. Prices seem to always rise and the consumer always pays more.

This is a very highly competitive business. We fight daily for space on the shelves, not only with the other franchise brands but with private labels, who are also slugging it out. We daily try to convince retailers to run our products on special and pass these

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savings on to the consumer. Secondary displays and vendor locations are all competitive battlegrounds. The FTC says there should be intrabrand competition to bring down prices. Let me say, quite frankly, that I have all the competition I can stand, and the prices we charge could not be lowered without going in the red.

Competition has kept prices of our product at some of the lowest levels of the U.S. economy at a time when all of our ingredients, supplies, equipment, and labor have increased dramatically. Remember those $850 trucks of yesteryear? They are now at least $20,000 each, which is a rather sizable 2,252-percent increase. But during this time of inflation, soft drinks that were one-half cent per ounce in 1940 are now available on special at three-quarters of a cent per ounce. This is a 54-percent increase in 40 years. How is that for competitive pressure holding down costs? I wish the rest of the economy could boast of such an accomplishment.

Our plant, which was first built in 1947 and enlarged with several additions throughout the years, has, because of increased volume and added packages, been outgrown and, due to local zoning, we are unable to make further additions. We desparately need to build a new, larger plant to remain efficient and have room for growth. The uncertainty created by the FTC has caused us to be very tentative and makes the risk of building too great. We have discussed this problem with some of our department heads and supervisory help, and they realize that their future is also in doubt if FTC destroys the soft drink franchise system.

I have tried to make a few points and to explain my deep concern over what will happen to my plant, the small retailers and the consumers. Your consideration and thoughtfulness on this subject will be deeply appreciated. I hope you will concur in my opinion that "it ain't broke, so let's not fix it."

Thank you very much.

Mr. VOLKMER. Thank you very much, Mr. Sandahl. We are going to have to recess at this time. We have two votes on. We have a quorum call now and we have a few more minutes to make that. We will now recess until 11:45 and be back at that time.

[Recess.]

Mr. VOLKMER [presiding]. The subcommittee will come to order. We will now hear from Mr. Caudill.

TESTIMONY OF RICHARD CAUDILL, CENTRAL INVESTMENT CORP.

Mr. CAUDILL. Thank you, Mr. Chairman.

Mr. Chairman, let me begin by expressing my thanks to you for the opportunity to appear today in support of legislation to preserve franchise territories in the soft drink industry.

I am Richard Caudill, vice president of Central Investment Corp. of Cincinnati, Ohio, a family controlled company engaged exclusively in the business of bottling soft drinks, holding Pepsi-Cola franchises in Ohio and Florida.

I am appearing today in support of H.R. 3573 and I shall address my testimony principally to the special environmental and other features of that bill.

I want to make it very clear, however, that I am not opposed to H.R. 3567, cosponsored by a substantial majority of the Members of the entire House.

I fully associate myself with the testimony of others which will demonstrate conclusively the disastrous effects upon our entire industry of the Federal Trade Commission's decision banning exclusive territorial franchises.

I wish to address myself principally to the impact of the FTC decision on the returnable bottle, with all the ramifications that will have for the environment, our energy and natural resource supplies, and the inflationary cost of soft drinks to the consumer, and to the inevitable creation of oligopoly in the industry by the sirup manufacturers: Coca-Cola, Pepsi-Cola, and others. I am sure that all members of the subcommittee are fully familiar with the concern of environmentalists in recent years over the adverse consequences of increased use of nonreturnable beverage containers.

It is ironic at best that at the time of this growing awareness, an agency of the Federal Government has taken a step which is certain to result in the elimination of the returnable refillable soft drink container in a matter of a very few years.

The starting point for my analysis is the superiority of the refillable container from a number of points of view. First, nonreturnable containers impose a much greater burden on our already overtaxed solid waste disposal systems. The best available estimate is that, on a national average, a refillable soft drink bottle is used 20 times before it is broken, lost, or discarded. Thus, it requires a minimum of 20 nonreturnable bottles or cans of comparable size to deliver the same number of soft drinks to the consumer as a single returnable bottle.

Second, the process of manufacturing this vastly larger number of nonreturnable containers consumes raw materials and energy and contributes significantly to industrial pollution of our air and our water supplies.

Third, the refillable container is the most economical package from the consumer's point of view. Each time a consumer buys a soft drink in a nonreturnable container, he must, in effect, buy the can or bottle along with the drink. The cost of a refillable container, by contrast, is spread over the roughly 20 trips it takes in the marketplace. Returnables are the lifeblood of the purest form of competition in our industry; local, bottler-placed, price-feature advertising.

The elimination of exclusive territories will lead immediately to a drastic reduction in the percentage of soft drinks sold in returnable bottles and, before long, to the demise of the returnable.

The total number of returnable bottles in circulation in the United States in the possession of the consumers, retailers, and bottlers is referred to in the trade as the float.

As bottles are broken or lost, bottlers must purchase new ones to keep the float at a sufficient level to maintain the refillable bottle system.

If bottlers do not reinvest in the float, the total number of bottles will decline to a point where continuation of the refillable bottle system can no longer justify the necessary capital investment and operating cost.

Because of the bottler's high investment in his float, the returnable bottle is only practicable if the bottler can be assured of collecting and reusing substantially all of his bottles in circulation. This, as the FTC, itself, recognized, requires relatively compact, exclusive territories and what is known in the trade as store-door delivery. The FTC's order will unquestionably discourage reinvestment in the returnable bottle float.

First, multiple-outlet chain supermarkets are adverse to handling returnable bottles. It is more expensive and annoying for them to engage in the collection and return of these bottles than merely to sell the drinks and be done with it. They also prefer central warehouse purchasing to store-door delivery.

There is, however, genuine consumer demand for returnable bottles, based to a large extent on the fact that soft drinks cost the consumer 50 percent to 100 percent more per ounce in throwaway containers and upon the preference of ecology-conscious buyers for returnable bottles.

Under the present system of exclusive territories, the bottlers have sufficient leverage to force the supermarket chains to honor the consumer demand for returnable bottles. The supermarket has only one source of Coca-Cola or Pepsi-Cola and, thus, if it wants to carry these popular products at all, it must accept the available package mix.

Once the territorial restrictions are lifted, the leverage will shift dramatically in favor of the supermarkets. They will then be able to purchase their requirements from distant bottlers or, more likely, the sirup manufacturers, themselves, who will have no incentive to promote returnable bottles since they will not be in a position to collect and protect their float. The supermarket chains will offer the assistant suppliers the cost advantages of volume purchases, warehouse delivery, and national advertising joint ventures in return for sales exclusively in nonreturnable containers.

The impact, then, is clear. Let me try to explore its dimensions. Forty percent of packaged soft drinks are currently sold in returnables and approximately 50 percent of all returnable sales are made in supermarkets.

Bottlers are highly unlikely to reinvest, at least in that portion of the float which, in the past, was used to service supermarket accounts. Thus, we can expect float reinvestment to drop immediately by at least 50 percent.

It is reliably estimated that the current float represents a 3- to 4-year supply of bottles. Thus, a 50 percent decline in reinvestment would lead to exhaustion of the float in, at most, 8 years, or a 5-percentage-point annual decline in returnable market share.

Actually, events are likely to move somewhat more rapidly than that. With the loss of supermarket volume in returnables, the local bottler's cost per unit for collection, washing, and refilling will rise rapidly, with the result that the returnable will quickly lose its previous economic attraction for either the bottler or the consumer.

If there is no reinvestment in the float, the returnable market share would decline at least 10 percentage points a year and the returnable bottle could not last even as long as 4 years.

The most obvious impact of a serious decline in returnable market share will be a dramatic increase in the number of throwaway bottles and cans entering our solid waste disposal systems. Depending upon the actual rate of decline in returnable use, we would in the first 4 years after implementing the FTC decision add between 32 billion and 63.8 billion additional throwaways to the system.

To quantify the energy and ecological consequences of this, my company commissioned a study by William E. Franklin Associates, the outstanding recognized experts in the field of the environmental impact of beverage containers. In terms of total postconsumer solid waste to be disposed of, Franklin found a 5-percentage-point decline would add 30 million additional cubic yards in the first 4 years, while a 10-point decline would add 87 million cubic yards; enough to fill the Orange Bowl Stadium 87 times.

Startling as these figures may be, they represent only a fraction of the environmental consequences of the implementation of the FTC's order. I have summarized some of the major impacts in my prepared statement. I only note here that the additional energy requirement in the first 4 years alone would be enough to supply electrical power to a city of 100,000 population for 34 to 69 years.

These grave environmental consequences received no consideration whatever by the FTC in its decisionmaking process, despite the idea that NEPA requires the preparation and filing of an environmental impact statement in all major Federal actions significantly affecting the quality of the human environment.

It is precisely this need for Federal agencies to take account of a broad range of congressionally mandated policies which underlies the approach of the Luken-Mica bill, which I support.

Such integrated decisionmaking must be the wave of the future or else we risk creating a situation where the implementation of one important policy frustrates the achievement of equally important national policy goals.

I have spoken about the massive environmental consequences of the elimination of the returnable bottle. Let me turn for a moment to the second major concern of the Luken-Mica bill, containment of inflation.

In the 12 months ending November 1977, soft drinks cost the consumers on the average 52.7 percent more per ounce in nonreturnable bottles and 100.1 percent more per ounce in cans as compared to the price per ounce in 16-ounce returnable bottles. Not only must the purchaser buy the throwaway container; statistics show that where returnables disappear, as they have in many northeastern cities, feature price ad activity is very low.

If we project a 50- to 100-percent increase per ounce in the price of the 40-percent soft drinks now sold in returnable bottles, the ruling will cost the American consumer billions of dollars per year, further fueling of the inflation which is the current bane of our economic existence.

A third significant element of the analysis mandated by the Luken-Mica bill involves the impact of the decision on concentration of economic power in the soft drink industry, a traditional concern of the antitrust laws.

In approaching this issue, I must step back for a moment to emphasize a fundamental point. My company and I are not part of and do not represent the Pepsi-Cola Co., even though we market its trademarked products. We franchise bottlers, who manufacture, package, and distribute the final product which constitutes a wholly separate manufacturing and distribution segment of the industry.

I am deeply concerned that members of the subcommittee, like the general public, may not adequately appreciate the strong divergence of interest between the bottlers and the sirup manufacturers in regard to the future of the soft drink industry.

The fact is that the sirup manufacturers, although they were the only defendants in the FTC proceedings, have everything to gain and nothing to lose from the implementation of the Commission's decision. The bottlers' pervasive fear is that their segment of the industry will be rapidly swallowed up by the sirup manufacturers in an unstoppable rush to vertical integration and concentration; in a word, to oligopoly.

Within a few short years after the FTC decision goes into effect, we believe there will be only a handful of corporate entities in the soft drink industry who will service the entire country from a few centralized bottling and canning plants, with precious little competition, no returnable bottles and vastly higher prices for the American consumer.

It must be remembered that while sirup manufacturers and bottlers represent very distinct segments of the industry, the sirup manufacturers actually operate at both levels. That is, they hold some of the largest and most lucrative bottling franchises in the country. By and large, where they own the franchises, returnables are down, prices are up, and feature price ad activity is low.

The only companies who will realistically be able to exploit the drastically altered post-FTC industry environment will be the sirup manufacturers. This is for three reasons: First, they have exclusive control over the basic ingredients and the heavily promoted trademarks, second, only they have the resources to produce new nationwide throwaway container distribution systems, and third, only they have the dual profit structures—at the sirup and finished product levels—which will be necessary to financial survival in the new world.

The soft drink sirup manufacturers are poised to make the 30-year growth of oligopoly in the beer industry look glacial by comparison to what they will achieve as soon as the FTC decision takes effect.

To take but one example, the strategic location of major Pepsi-Cola Co. nonreturnable bottling and canning plants and can manufacturing facilities, coupled with their existing company-owned botling franchises and their recent purchase of a nationwide trucking system in Lee-Way Motor Freight mean that they can blanket almost the entire country with an instant nonreturnable distribution system, driving the vast majority of their bottlers out of business. Coca-Cola and Philip Morris, the new owner of Seven-Up, are similarly positioned and are improving their posture all the time.

Unfortunately, I believe that the legislative efforts of the bottlers have been hampered in the past by the perception that this legislation is special interest legislation for the giant sirup manufacturers. This is emphatically not the case. It is they who stand to gain from their loss before the FTC. It is the independent bottlers and the public, and the goals of antitrust enforcement, which stand to lose.

I strongly urge you to pierce the veil of this irony and to support the legislation to preserve exclusive territorial franchises as the only means of averting the worst antitrust disaster of the last 50 years.

Thank you very much.

[The full statement of Mr. Caudill follows:]

STATEMENT OF RICHARD W. CAUDILL, VICE PRESIDENT OF CENTRAL INVESTMENT CORP. OF CINCINNATI, OHIO

Mr. Chairman, let me begin by expressing my thanks to you for the opportunity to appear here today in support of legislation to preserve franchise territories in the soft drink industry.

I am Richard Caudill, Vice President of Central Investment Corporation of Cincinnati, Ohio. Lest you be misled by the name, Central Investment is actually a family-controlled company engaged exclusively in the business of bottling soft drinks. It holds Pepsi-Cola franchises in Mansfield and Canton, Ohio, and in Ft. Lauderdale and Palm Beach, Florida. Both the Ohio and the Florida plants "piggy-back" franchises of other brands as well. I am the manager of the company's Florida operation.

I am appearing today in support of H.R. 3573, the bill introduced by Congressmen Luken and Mica, and I shall address my testimony princpally to the special environmental and other features of that bill.

I want to make it very clear, however, that I am not opposed to H.R. 3567, introduced by Mr. Hall of Texas and co-sponsored by a substantial majority of the Members of the entire House.

I fully associate myself with the testimony of others which will demonstrate conclusively the disastrous effects of the Federal Trade Commission's decision banning exclusive territorial franchises upon our entire industry.

I strongly believe that this decision will precipitate the greatest antitrust disaster in 50 years. Instead of promoting competition, as I know the Commission intended to do, it will destroy an existing system of vigorous interbrand competition, which has served the interests of consumers well for a century. This competitive system has provided the greatest barrier against inflation in our entire economy. As a result of it, the price of Coca-Cola in returnable bottles has increased less than three percent between 1939 and 1977, a period in which the Consumer Price Index increased more than 344 percent.

The competitive system in the soft drink industry has also made it relatively easy for new products developed by small, enterprising companies to enter the market, since they can "piggyback" on an existing bottling and distributing system without having to make prohibitively large investments in plants and equipment.

Implementation of the FTC decision will mean an end to all that. It will in my judgment result in duplication of the oligopolistic trends in the beer industry in the last thirty years, except that the rate of concentration will be much more rapid in the soft drink industry. The huge conglomerates which already dominate the syrup manufacturing portion of the industry can and will establish centralized distribution systems virtually overnight, which will place the entire industry firmly in the hands of four or five firms, put an end to the vigorous local price competition which has characterized this industry, destroy the returnable bottle as a viable form of packaging and result in much higher prices to the ultimate consumer of soft drinks.

These and other telling points have already been ably made by others who appeared before the Senate Subcommittee, and they will be emphasized here by others who are scheduled to appear before this Subcommittee. I wish to address myself principally to an aspect of this problem with which my company has been closely concerned, namely, the impact of the FTC decision on the returnable bottle, with all the ramifications that will have for the environment, our energy and natural resource supplies, and the inflationary cost of soft drinks to the consumer.

To place the problem in context, I am sure that all members of the Subcommittee are fully familiar with the concern of environmentalists in recent years over the adverse consequences of increased use of nonreturnable beverage containers. The Environmental Protection Agency has commissioned numerous studies of the impact of beverage containers on the environment; the Congress has created the interdepartmental Resource Conservation Committee to study this and other problems and make legislative recommendations; the Office of Technology Assessment, another arm of the Congress, has studied the problem intensively; and numerous states and localities have passed or are considering seriously some form of beverage container deposit legislation to deal with this major and growing problem.

It is ironic at best that at the time of this growing awareness of the ecological implications of nonreturnable containers, another agency of the federal government has taken a step which is certain to result in the elimination of the returnable, refillable soft drink container in a matter of a very few years. And that agency—the FTC—took this step without engaging in the very procedure mandated by the Congress in the case of all agency decisions with a significant effect on the human environment. That is, the agency consciously and deliberately refused to prepare and file an environmental impact statement, as required by the National Environmental Policy Act (NEPA).

The benefits of the returnable bottle

The starting point for my analysis is the superioity of the refillable container from a number of points of view. The most obvious point is that nonreturnable containers impose a much greater burden on our already overtaxed solid waste disposal systems. The best available estimate is that, on a nationwide average, a refillable soft drink bottle is used twenty times before it is broken, lost or discarded. In some areas—including both our franchise territories in Ohio and Florida—this "trippage rate" is significantly higher. Thus each refillable container that is removed from the stream of commerce must be replaced by a minimum of twenty nonreturnable bottles or cans of comparable size in order to deliver the same number of soft drinks to the consumer. These so-called "convenience" non-returnable containers place an enormous burden on our solid waste disposal systems, even assuming significantly improved efforts at recycling.

Second, the process of manufacturing this vastly larger number of nonreturnable containers consumes raw materials and, more important, energy. The manufacturing process also contributes significantly to industrial pollution of our air and our water supplies.

Third, the refillable container is the most economical package from the consumer's point of view. Each time a consumer buys a soft drink in a nonreturnable container, he must in effect buy the can or bottle along with the drink. The cost of a refillable container, by contrast, is spread over the roughly twenty "trips" it takes in the marketplace, thus permitting the bottler to charge a price for the soft drink which is substantially lower on a per ounce basis than the price he must charge to recover the cost of nonreturnable containers.

I shall return to these points later and document in detail the ecological and economic benefits of the refillable container from studies which have been performed by recognized experts at the request of my company. Before doing this, however, I should explain why it is that the FTC decision threatens the continued viability of the refillable container for soft drinks.

Impact of FTC decision on returnable bottles

The elimination of exclusive territories for one-way bottles and can will lead immediately to a drastic reduction in the percentage of soft drinks sold in returnable bottles, and before long to the demise of the returnable as a viable form of packaging. To understand how this will come about requires some background information.

In 1978, 40 percent of packaged soft drinks were sold in returnable bottles and 60 percent in one-way, non-returnable bottles and cans. The relative percentage is referred to as the national "package mix."

As noted above, on a national average, each refillable soft drink container is used roughly twenty times, or in trade language, the container makes about twenty trips.

It is estimated that there are approximately 4 billion refillable soft drink bottles in circulation in the United States—in the possession of consumers, retailers and bottlers. These 4 billion refillable bottles are referred to in the trade as the "float."

As bottles are broken or lost, bottlers must purchase new ones to keep the number of bottles in the float at a sufficient level to maintain the refillable bottle system. This purchase of new bottles is called "reinvestment in the float."

If bottlers do not reinvest in the float, the total number of bottles in the float will decline to a point where continuation of the refillable bottle system can no longer justify the necessary capital investment and operating cost. At that point all soft drinks will be sold in throwaway containers.

Because of the bottler's high investment in his float, the returnable bottle is only practicable if the bottler can be assured of collecting and reusing substantially all of his bottles in circulation. This, as the FTC itself recognized in its opinion, requires relatively compact, contiguous, exclusive territories and what is known in the trade as "store door" delivery. If more than one bottler is distributing the same brand in returnables in the same area, none can be confident of recapturing his float. And since each store must be visited for the purpose of collecting the bottles, returnables are prohibitively expensive in the context of far-flung territories and highly centralized distribution systems.

The FTC's orders will unquestionably discourage reinvestment in the returnable bottle float. This is true for a number of reasons.

There is unanimous agreement throughout the industry that multiple-outlet chain supermarkets are adverse to handling returnable bottles. It is more expensive and annoying for them to engage in the collection and return of these bottles than merely to sell the drinks and be done with it. The supermarket must set aside storage space for returnable bottles, assign personnel to handle and in some cases sort them, take time at crowded checkout counters to count and give credit for returned bottles, and put up with the dirt and debris which sometimes is returned along with the bottles.

There is, however, genuine consumer demand for returnable bottles. This demand, to a large extent, is based on the fact that as national statistics show, soft drinks cost the consumer an average of 50 to 100 percent more per ounce in throwaway containers than in returnables. Moreover, ecology-conscious buyers prefer the environmentally more efficient returnable bottles.

Under the present system of exclusive territories the bottlers have sufficient leverage to force the supermarket chains to honor the consumer demand for returnable bottles. The supermarket has only one source of Coca-Cola or Pesi-Cola, and thus if it wants to carry these popular products at all, it must accept the available package mix. Indeed, there have been instances in which supermarkets have sought completely to terminate their purchases of soft drinks in returnable bottles, and the bottler has been able to reverse this policy by heavy promotion of returnables to competing retailers. In order to meet the competition thus created and to take advantage of the bottler's promotional efforts, the supermarket has to make returnables available to its customers. Nationwide, over 72 percent of feature price ads are locally placed and involve the returnable bottle.

Once the territorial restrictions are lifted, the leverage will shift dramatically in favor of the supermarkets. They will then be in a position to purchase their requirements from distant bottlers, or more likely, the syrup manufacturers themselves, who will have no incentive to promote returnable bottles. To the contrary, the distant bottlers or syrup manufacturers will be uninterested in selling any returnables to the supermarket, since they will not be in a position to collect and protect their float. The perfectly foreseeable pattern will be for the supermarket chains to offer the distant bottlers or syrup manufacturers the cost advantages of volume purchases, warehouse delivery and national advertising joint ventures, in return for sales exclusively in non-returnable containers.

It is important to pause at this point to anticipate a natural question. Despite the fact that it took no evidence on question of appropriate relief, the FTC did purport to carry out an exception to the scope of its order designed to protect the returnable bottle. Recognizing the inability of the returnable to survive without exclusive territories, the Commission included a provision in the order which permits continued exclusive territories for the returnable portion of a bottler's business. Why, one might ask, will this not suffice to preserve the returnable as a viable form of packaging?

The answer really lies in the ideas I have been discussing. That is, territorial protection for the returnable portion of the business alone will not give the bottler any incentive to reinvest in his returnable float. When he loses his supermarket nonreturnable business to syrup manufacturers located far away, he will not be able to support his entire operation on returnables alone. Moreover, the FTC proviso will not take away one whit from the supermarket's new leverage over the bottlers. What good is an exclusive territory for returnables so long as the supermarkets can import non-returnables from distant suppliers and the local bottler has not power to force the supermarket to accept a package which it would prefer to discontinue?

The shift in package mix

The impact, then, is clear. It remains to explore its dimensions. This portion of my testimony is based on a study commissioned by my company and performed by Emanuel Goldman, a nationally recognized independent expert in the soft drink industry and one of the top securities analysts in this industry.

Supermarkets account for 40 percent of all soft drink sales in this country. At present, despite their preference for throwaways, supermarkets nationwide sell some 50 percent of their soft drinks in returnables, about ten percentage points above the overall national sales figure. Thus approximately 50 percent of all returnable sales are made in supermarkets.

Bottlers are highly unlikely to reinvest at least in that portion of the float which in the past was used to service supermarkets accounts. Thus we can expect float reinvestment to drop immediately by at least 50 percent.

It is reliably estimated that the current float represents a three to four year supply of bottles—or, more precisely, that it consists of three or four times the number of new returnable bottles purchased annually to replenish it. Thus a 50 percent decline in reinvestment would lead to exhaustion of the float in at most eight years—or a five percentage point annual decline in returnable market share.

Actually, events are likely to move somewhat more rapidly than that. With the loss of supermarket volume in returnables, the bottler's cost per unit for collection, washing and refilling will rise rapidly, with the result that the returnable will quickly lose its previous economic attraction for either the bottler or the consumer. Moreover, there will come a point, substantially before the entire float is exhausted, at which it will be uneconomical to collect and refill the small number of bottles in circulation, and the bottlers will simply treat them as throwaways, as is occurring in the brewing industry in Oregon today.

If there is no reinvestment in the float, the returnable market share would decline at least 10 percentage points a year, and the returnable bottle could not last even as long as four years.

Clearly relevant here is the experience in the beer industry, where the percentage sold in returnable bottles has dropped from 85 in 1947 to 12 in 1977, with most of the latter sold for on-premise consumption in restaurants and taverns. The analogy between the two industries is not perfect, but the dynamics are similar. Previously the beer industry was highly localized in this country, with 457 independent breweries in 1947, selling to local consumers. Without the protection of exclusive territorial franchises, the introduction of non-returnable bottles and cans in the late 1940's led to economies of scale in distribution which by 1977 reduced the number of brewing companies in the whole country to 47 and the returnable market share to 12 percent with obvious economic consequences for the independent brewers, significantly higher beer prices for consumers and less obvious, but highly important, ecological consequences for us all.

Environmental consequences

The most obvious impact of a serious decline in returnable market share will be a dramatic increase in the number of throwaway bottles and cans entering the already overtaxed solid waste disposal system in this country.

We noted earlier that the national average for returnable bottle trips was twenty, and thus that each returnable bottle removed from the stream of commerce must be replaced by twenty containers of the same size, to be used once and thrown away. Thus if the decline in returnable market share is only five percentage points per year, we will by 1982 have used and discarded 32 billion more one-way bottles and cans than would have been the case if the returnable market share had stayed the same. And if the rate of decline is 10 percentage points per year, the number of additional throwaway containers would reach 63.8 billion. Plainly, with the returnable bottle gone, the number of additional throwaway containers will escalate even more rapidly with each succeeding year, as the market for soft drinks expands.

Mr. Goldman's study thus establishes the inevitability of a major decline in the use of returnable containers following implementation of the FTC decision and gives us some rough parameters within which to quantify that decline and the corresponding increase in throwaway containers. We took this study to William E. Franklin of Franklin Associates in Kansas, the outstanding recognized independent experts in the field of the environmental impact of beverage containers. Franklin Associates has performed many of the most significant studies in this area for the EPA. We asked them to review Mr. Goldman's figures and to prepare a study for us of the actual environmental impact of this kind of decline in the use of returnable bottles. The next portion of my testimony is based upon the Franklin study.

In terms of total post-consumer solid waste to be disposed of, Franklin found, a five percentage point decline would add 30 million additional cubic yards by 1982, while in the event of a ten point decline the figure would be 87 million additional cubic yards.

Startling as these figures may be, they represent only a fraction of the environmental consequences of the implementation of the FTC's order. We will not only have to dispose of the additional cans and bottles; we will have to manufacture them first. This process will consume natural resources; it will require the use of energy; it will give off air and water pollutants; and it will require the use of vast additional quantities of water. A mere 5 percentage point annual decline in returnable market share would mean by 1982: (1) The consumption of an additional 5.1

billion pounds of raw materials, close to half of it bauxite, of which we import most of our supplies; (2) the generation of an additional 385 million pounds of air pollutants and 67 million pounds of water pollutants; (3) the use of an additional 102 trillion BTU's of energy (enough to provide electrical power to a city of 100,000 population for 34 years); and (4) the consumption of an additional 43 billion gallons of water (enough to supply Washington, D.C. for 2.8 years).

If the rate of decline is ten percentage points a year, the figures by 1982 would be: (1) 10.3 billion pounds of additional raw materials; (2) 773 million added pounds of air pollutants and 186 million pounds of water pollutants; (3) 206 trillion more BTU's of energy (enough to provide electricity to a city of 100,000 for 69 years); and (4) 87 billion additional gallons of water (enough to supply Washington, D.C. for 5.3 years).

Need for consideration of all statutory policies

At this point it is worth noting that these grave environmental consequences received no consideration whatever by the FTC in its decision-making process. This, despite the fact that section 102(2)(c) of NEPA unequivocally requires the preparation and filing of an environmental impact statement in all "major federal actions significantly affecting the quality of the human environment." The Commission has promulgated an internal regulation (FTC Rule 1.82(d)) unilaterally exempting itself from this congressional mandate whenever it engages in administrative adjudication—which is to say, in the vast bulk of its proceedings.

My company brought suit in the United States District Court for the Southern District of Florida seeking to compel the Commission to comply with NEPA's simple but vital requirements before proceeding to enforce its order voiding exclusive territorial franchises. The Court has stayed this action pending a decision on statutory judicial review of the Commission's decision by the United States Court of Appeals for the District of Columbia Circuit.

It is precisely this need for federal agencies to take account of a broad range of congressionally mandated policies which underlies the approach of the Luken-Mica bill which I support.

That legislation would require findings with respect to the environmental and inflationary impacts of decisions invalidating franchise territories, as well as such traditional antitrust factors as interbrand competition and concentration of economic power in the industry. It is, I submit, absolutely vital that federal agencies making decisions which will have major impacts upon the economy and the environment be required to take all relevant statutory policies into account in reaching their conclusions. Such integrated decision-making must be the wave of the future, or else we risk creating a situation where the implementation of one important policy frustrates the achievement of equally important national policy goals.

This is precisely the situation brought about by the FTC's decision in the soft drink franchise cases. Assuming for the moment that the decision fully serves the pro-competitive goals of the antitrust laws (which I do not for a moment believe it does), we still must ask whether a decision of this magnitude, involving the complete restructuring of a $15 billion dollar industry, ought to be made in willful ignorance of its impact on equally vital congressional policies to protect the environment, to preserve scarce energy resources and to contain inflation. To ask the question, I believe, is to answer it.

Inflationary impact of FTC decision

I have spoken about the massive environmental consequences of the elimination of the returnable bottle, which will flow from the implementation of the FTC decision. Let me turn for a moment to the other major concern of the Luken-Mica bill—containment of inflation.

My company subscribes to the services of Majers Corporation, which surveys advertising and pricing of a wide variety of consumer products in 106 markets nationwide. In the twelve months ending November 1977, Majers' survey showed that soft drinks cost the consumer on the average 52.7 percent more per ounce in nonreturnable bottles and 100.1 percent more per ounce in cans, as compared to the price per ounce in 16-ounce bottles. As I have noted, this is for the simple reason that the purchaser of a soft drink in a nonreturnable container must pay for the container itself as part of his purchase price, while the cost of a returnable bottle can be spread over the multi-trip useful life of the bottle.

If we project a 50 to 100 percent increase per ounce in the price of soft drinks now sold in returnable bottles, which would be sold only in throwaways after the FTC decision takes effect, it is obvious that the ruling will cost the American consumer billions of dollars per year, further fueling the inflation which is the current bane of our economic existence.

It is probably impossible to come up with an accurate projection of the cost of this decision to consumers, but the magnitude of the impact can be appreciated in light of the fact that a full 4 percent of every consumer dollar spent on food nationwide goes for the purchase of soft drinks. Moreover, 40 percent of all packaged soft drinks are now sold in returnable containers. Thus a 50 to 100 percent increase in the price per ounce of this portion of the soft drink sales will have a significant impact on the Consumer Price Index. And this impact will inevitably flow from the destruction of the franchise territories and the elimination of the returnable bottle.

Creation of oligopoly control

A third significant element of the analysis mandated by the Luken-Mica bill involves the impact of the decision on concentration of economic power in the soft drink industry, a traditional concern of the antitrust laws. I believe that examination of this question will demonstrate unequivocally that the FTC ruling is a disaster from the point of view of antitrust enforcement and promotion of competition.

In approaching this issue, I must step back for a moment to emphasize a fundamental point. My company and I are not part of and do not represent the Pepsi-Cola Company, even though we market its trademarked products. Franchise bottlers purchase trademarked syrups from syrup manufacturers. We than add further ingredients according to a fixed formula and manufacture a final product, package the product and distribute it within our territories. The bottlers thus constitute a wholly separate manufacturing and distribution segment of the industry.

I am deeply concerned that Members of the Subcommittee, like the general public, may not adequately appreciate the strong divergence of interest between the bottlers and the syrup manufacturers in regard to the future of the soft drink industry. There seems to be an impression that the industry is essentially a monolith with a single point of view. Nothing could be further from the truth.

The fact is that the syrup manufacturers, although they were the only defendants in the Federal Trade Cmmission proceedings, have everything to gain and nothing to lose from the implementation of the Commission's decision. The bottlers' pervasive fear is that their segment of the industry will be rapidly swallowed up by the syrup manufacturers in an unstoppable rush to vertical integration and concentration. Within a few short years after the FTC decision goes into effect, we believe, there will be only a handful of corporate entities in the soft drink industry, who will serve the entire country from a few centralized bottling and canning plants, with precious little competition, no returnable bottles, and vastely higher prices for the consumer. This result, of course, is undersirable from the bottlers' point of view, and we believe from the public's as well. The syrup manufacturers, however, may view it differently. They have at least been strangely silent in the current legislative battle, especially since they are the alleged "losers" before the Commission.

A number of factors lead me to believe strongly that the syrup manufacturers are in fact the only winners under the Commission's decision, and that they are fully cognizant of this fact. As I noted, they have not come forward vigorously in support of this legislation. But more important, their very handling of the case in front of the FTC suggests an indifference to the outcome at best, if not an outright desire to lose.

First, the Coke and Pepsi lawyers stipulated to a trial predicated exclusively upon the so-called "Northeast Corridor," with the result there to be binding nationwide. This geographic area is wholly untypical of the bottling industry in the rest of the country. It contains the largest concentration of urban population, the least interbrand competition as measured by feature price advertising, and the largest amount of vertical integration and economic concentration of any geographic area in the industry.

Second, a great deal of significant information concerning the actual state of vigorous competition among soft drink bottlers nationwide, the intense advertising engaged in by independent bottlers and the lack of inflation in the price of product in returnable bottles, which was in the possession of the syrup company defendants, was never brought to the attention of the Commission. For example, Coke and Pepsi both subscribe to the Majers service which I mentioned earlier. Majers' figures show that independent bottlers rank second among all categories of food marketers in feature price advertising, but that in large metropolitan areas of the Northeast Corridor, where many bottling franchises are actually owned by the syrup manufacturers themselves, feature price and activity is very low. Likewise, national figures subscribed to by Coke and Pepsi, show that where they own the franchises themselves, the returnable bottle, the most economical package for the consumer and the leading weapon of the independent bottler in price competition, has simply disappeared.

Evidence available from surveys such as Nielsen and Majers could have been marshalled to make a compelling case that the soft drink industry nationwide, with its distribution system based on independent franchised bottlers, is one of the most intensely competitive industries our entire economy. We have attempted to marshal some of this evidence in a booklet entitled "Competition in the Soft Drink Industry," copies of which I have disributed to Subcommittee Members and the staff along with my testimony.

For Coke and Pepsi to have presented this evidence, however, would not only have risked "winning" the case, it would have thoroughly indicted the competitive practices of the syrup manufacturers themselves. On the other hand, failure to present the evidence allowed the defendants to slough off the blame for the lack of vigorous competition in the Northneast Corridor unfairly upon the system of exclusive territories.

It must be remembered that, while syrup manufacturers and bottlers represent very distinct segments of the industry, the manufacturers actually operate at both levels; that is, they hold some of the largest and most lucrative bottling franchises in the country. This pattern of vertical integration is heaviest in the Northeast Corridor, where the Pepsi-Cola Co. holds franchises covering the Boston, Philadelphia and New York-Newark metropolitan areas, and the Coca-Cola Co. holds the franchise in Boston. To have told the real story of competition in the soft drink industry would have been to expose the contrasting lack of competition in those areas where the syrup manufacturing giants, freed from considerations of volume and price by double-tier profits on the syrup and the final product, hold full sway.

Yet the inevitable effect of the FTC's decision will be to remake the entire industry in the image of the Northeast Corridor, a result which I suspect is not entirely distasteful to the syrup manufacturers. The strong desire of the large food chains, which sell approximately 50 percent of the soft drinks in the country, for centralized warehouse distribution, and the apparent temporary economies of such a distribution scheme, will result immediately in the destruction of the soft drink distribution system we know today. The inevitable concomitants of this alteration in distribution patterns will be the demise of the returnable bottle (with all the attendant adverse environmental and energy consequences); a large increase in soft drink prices to the consumer; and the concentration of economic power at both levels of the industry in the hands of a few giants able to take swift advantage of the new industry situation.

The only companies who will realistically be able to exploit the drastically altered industry environment will be the syrup manufacturers. This is for three reasons: (1) They have exclusive control over the basic ingredients and the heavily promoted trademarks; (2) only they have the resources to produce new nationwide throwaway container distribution systems; and (3) only they have the dual profit structure—at the syrup and finished product levels—which will be necessary to financial survival in the new world.

Earlier in my statement I alluded to the experience in the beer industry, where the introduction of nonreturnable containers and new systems of distribution resulted in the concentration of enormous economic power in the hands of a small and ever-shrinking group of companies in roughly 30 years. The soft drink syrup manufacturers are poised to make this development look glacial by comparison to what they will achieve as soon as the FTC decision takes effect.

The strategic location of major Pepsi-Cola Co. nonreturnable bottling and canning plants and can manufacturing facilities, coupled with their existing company-owned bottling franchises and their recent purchase of a nationwide trucking system in Lee-Way Motor Freight, mean that they can literally blanket almost the entire country with an instant nonreturnable distribution system overnight, driving the vast majority of their bottlers out of business.

By the same token, Seven-Up, the third largest syrup manufacturer, was recently purchased by Philip Morris, a huge conglomerate which already owns Miller Beer. Thus it has a ready-made nationally centralized production and distribution system for throwaway containers already in place. And recently Philip Morris caused a management shakeup at Seven-Up. The new head of Seven-Up came, not accidentally, from the company's Miller Beer division.

Coca-Cola is similarly positioned, and is improving its posture all the time.

Wholesale prices to the big food chains may indeed temporarily fall slightly in the early scramble to obtain their central warehouse business for nonreturnables. But there will be little incentive for the chains to pass these temporary savings on to the consumers, and the returnable bottle will simply disappear thus raising the price to the consumer. Of course, once the major distribution contracts are in place, an instant oligopoly will have been created, which will behave precisely as other oligopolies do.

Other recent developments illustrate how tensely coiled the syrup companies are to spring to advantage in the post-FTC soft drink world. The surprising recent fundamental alteration in the pricing mechanism of the basic Coca-Cola franchise agreement (the first change in 57 years), matched by the huge increase in Pepsi concentrate prices, puts these syrup manufacturers in a perfect position to destroy the independent bottlers through the simple device of a classic price squeeze. The profit margin on syrup, already very large, will now become so huge that any independent bottler who dares to compete with his supplier (from whom he must buy the raw material at whatever price the supplier choses to set) will be destroyed.

I recognize that in economic theory competition will result in the demise of the weaker units in any market structure, hopefully to be replaced by new, more efficient units. But under the FTC decision, no bottler, however efficient, can possibly compete in distribution with the conglomerate giants which already dominate syrup manufacturing, and the resulting oligopoly will mean, not more competition, but substantially less. Moreover, the creation of a new centralized national distribution system will raise the market entry barriers (now quite low as a result of the local territorial system) to a level where no new companies will enter or threaten to enter in a way to force competition in the industry. I cannot believe that the pro-competitive goals of the antitrust laws will be served by the overnight creation of tight oligopolistic control in a $15 billion industry.

The perception of monolithic unity in the soft drink industry to which I alluded earlier is perhaps an offshoot of the industry's trade association structure. Aside from the public, it is the independent bottlers who will inevitably suffer the most drastic consequences of elimination of franchise territories. Yet there is no single organization which truly speaks exclusively for the independent bottlers.

Unfortunately, I believe that the legislative efforts of the bottlers have been hampered in the past by the perception that this legislation is special interest legislation for the giant syrup manfacturers. This is emphatically not the case. It is they who stand to gain from their "loss" before the FTC. It is the independent bottlers and the public—and the goals of antitrust enforcement—which stand to lose.

I strongly urge you to pierce the veil of this irony and to support the legislation to preserve exclusive territorial franchises as the only means of averting the worst antitrust disaster of the last 50 years.

Conclusion

In conclusion, Mr. Chairman, I recognize and deeply honor the commitment of yourself and all the Members of this Subcommittee to the preservation and enforcement of the antitrust laws and the promotion of a highly competitive economy for our nation. I like to think that as a citizen and a businessman operating in a strenuously competitive industry I too am dedicated to the same goals. I know only one way to survive in my business: I fight with all my energy to sell more products than my competitors by giving my customers quality products, excellent service and the lowest possible prices.

I genuinely believe that the legislation before the Subcommittee is designed to further the goals of the antitrust laws and to preserve a highly competitive industry from the threat of oligopoly and stagnation and the consumer from much higher soft drink prices. I believe that the Federal Trade Commission tried honestly to reach a result in accord with antitrust policy. But I suggest that the Commission's exclusive focus on intrabrand competition blinded it to the realities of the industry and the positive influence of franchise territories on interbrand competition. More important, the Commission failed to recognize the adverse impact of its order in three vital respects: (1) the creation of tight oligopolistic control at all levels of the soft drink industry; (2) the unacceptable environmental and energy consequences of the elimination of the returnable bottle; and (3) the contribution to inflation of the shift from returnable to nonreturnable containers.

Indeed, it is highly significant that Congress' own Office of Technology Assessment, in its recent study of "Resource Recovery and Recycling from Municipal Solid Waste and Beverage Container Deposit Legislation," recognized the close connection between preservation of franchise territories on the one hand, and avoidance of economic concentration and preservation of the returnable bottle on the other: "If upheld by the courts and not modified by Congress, the recent decision by the Federal Trade Commission outlawing territorial franchise restrictions for trademarked soft drinks in nonreturnable containers could lead to rapid concentration of that industry. The results would be an industry with only a few firms having a few large plants, as well as the rapid disappearance of the refillable bottle for soft drinks. By making the refillable bottle more attractive economically, BCDL could help preserve smaller, local bottlers. Legislation now under consideration to preserve the territorial franchise system could help maintain the refillable bottle's current market share."—OTA, Materials and Energy from Municipal Waste 17 (1979).

Because I believe that major economic decisions should be made with a view to balancing and promoting all the relevant statutory policies, I favor the approach of H.R. 3573. but failing that, I belive enactment of the Hall bill or similar legislation to restore the proper emphasis on interbrand competition and avoidance of concentration of economic power in the hands of a few giant corporations would serve the public interest.

Mr. VOLKMER. We will now hear from Mr. Peter Chokola.

TESTIMONY OF PETER CHOKOLA, PRESIDENT, CHOKOLA BEVERAGE CO.

Mr. CHOKOLA. Thank you. My name is Peter T. Chokola of the Chokola Beverage Co., Wilkes-Barre, Pa.

I wish to thank the chairman of the House Monopolies and Commercial Law Subcommittee for inviting me to offer testimony regarding H.R. 3567 and H.R. 3573 and any other bills to exempt certain segments of the soft drink industry from the U.S. antitrust and monopoly laws.

Our firm is a small family owned soft drink bottling company started by my father and his two brothers in 1911. We are not affiliated with any of the national trademarked brands but, in fact, compete against the Coca-Cola, Pepsi-Cola, Seven-Up, Dr. Pepper, and RC Cola companies and all the rest.

For the past 68 years, we have bottled a line of fine quality soft drinks in returnable-reusable deposit bottles under the local brand name Chokola's Beverages. These are produced and sold throughout the Wilkes-Barre market area with the farthest route distance being 40 miles from the plant.

Testimony was given by me before the committee regarding similar legislation, H.R. 6684, on July 1, 1976. The remarks made then are still relevant and, for the sake of brevity, will not be repeated here, although reference should be made to them. If the committee wishes, I could read them. I have a copy.

Mr. VOLKMER. That will not be necessary.

Mr. CHOKOLA. We are opposed to the proposed bills on the grounds they are blatant special interest legislation designed to aid and abet the monopolizers of the soft drink industry. Furthermore, these bills are not in the best interest of the soft drink consumer, the small bottler, nor will they insure continued use of returnable/reusable bottles, as its proponents contend.

The major effect of these bills will be to throw out of court a well-taken FTC monopoly action against Coca-Cola, Pepsi-Cola, Seven-Up, and Dr. Pepper, and other national trademarked brand companies, the monopolizers of the soft drink industry. The bottom line of the FTC case is price-fixing. These bills will proclaim this price-fixing scheme as legal activity in the past, as well as forever in the future. The bills also preclude payment for damages, which could run into the hundreds of millions of dollars in this case.

Conditions within the American soft drink industry sorely need vigorous antitrust and monopoly law enforcement; not exemptions or weakening of these laws.

Mr. VOLKMER. Thank you very much.

We will recognize the gentleman from Illinois for a few questions We have a very important vote on the question of decontrol of gasoline prices, so we will have to leave for that. There will be possibly another vote soon after that on the Department of Energy authorization, which is a bill we are on right now.

Mr. McClory. Mr. Chairman, what I would suggest is that, after we ask a few questions, that we have leave to submit questions that might be propounded to these gentlemen.

Mr. Volkmer. And you can make written reply.

Chairman Rodino. Perhaps we could submit the questions.

Mr. McClory. The question I have relates to the fact that the small bottlers have been going out of business. Their numbers have diminished. The existing situation certainly hasn't been a great boon to the small bottlers. I don't see how anyone can contend that. I have the figures here which indicate the total number of bottlers dropped way down in the last 10 years or so.

Mr. Sandahl. In my testimony, during the war years, the Government helped veterans by giving them sugar allocations. They couldn't stand the competition and didn't have the expertise and went out of business. There is a large group that are probably in your States that were in and out of the business before they really realized they were there.

You are getting some consolidation, but the small bottler still is in there pitching and will stay there as long as the Government lets him. This bill will help let him stay in there.

Mr. McClory. Mr. Chokola, you testified before us in 1976 and are back again. Are there nevertheless a lot of independents such as you we should be thinking about in connection with this legislation?

Mr. Chokola. Of course. The previous hearings have been a learning experience to me of what has been going on within the soft drink industry. I think looking at my previous testimony, I pointed out the fact that there is a large attrition of bottling plants.

Over 3,400 bottlers closed over a period of—about a 10-year period. But 90 percent of the ones that closed were the independents like myself. The Coke bottlers, the small Coke bottlers and Pepsi bottlers are the ones that have been bought out for very handsome prices. The large bottlers are not buying a bottling operation. They take the bottling operation and close down the machinery and throw the men out of work. All they want to buy is the exclusive territory marketing rights. The right to that territory. I think Mr. Sandahl indicated this in his testimony.

What happens, the Coke and Pepsi marketing effort in that area changes the characteristic from basically a returnable, reusable, hometown bottling operation to one that is serviced with throwaway bottles and cans. I would like to make one other comment about this.

Chairman Rodino. If you will, I wish you could just terminate here. It will be impossible to be able to make this vote and it is a very important vote.

I think we ought to suspend. I will ask the witnesses to come back in about 20 minutes. I expect to be here to ask some questions.

We will recess.

[Recess.]

Chairman Rodino. The committee will come to order.

I am directing this question to Mr. Caudill.

Mr. Caudill, is it the case that all bottlers are equally efficient regardless of the size of their territory or size of their bottling operation, or do you see any difference?

Mr. CAUDILL. Mr. Chairman, I am not an economist and I do not know that I could answer that question correctly. However, I would say this: The refillable container, Mr. Chairman, requires that bottlers have small exclusive territories and the economies of scale in the returnable container are not large, simply because the territories themselves must be small or fairly small to make the returnable package viable. There is a geographic limitation to the economic viability of the returnable container because we must pick up the empty bottles by store-door delivery, bring them back to the plant, rewash and refill those bottles. You cannot haul refillable containers over long distances economically.

Chairman RODINO. Do you think that is an answer to the question of equal efficiency of the bottlers, regardless of the size of the territory or bottling operation?

Do you think that your answer is responsive?

Mr. CAUDILL. As I stated, I am not an economist and I don't know that the efficiencies are the same for a large bottler or a small bottler.

Chairman RODINO. Then you are in no position to say that it does or does not.

Mr. CAUDILL. Yes; I don't know the answer to that question, sir.

Chairman RODINO. Would you be able to say whether or not—again, knowing you are not an economist—whether or not the consumer is served by a more efficient bottler being kept out of an area by the territorial agreements used in the soft drink industry?

Mr. CAUDILL. I will answer that this way, Mr. Chairman: I believe in the absence—I believe, first of all, we do have a tremendous amount of competitive activity in our soft drink industry today with franchised territorial boundaries and I believe in the absence of those boundaries, sir, that you would have one of the greatest oligopolies ever created in the United States. It would be similar to the brewing industry experience that we already had where the demise of the returnable bottle has become a fact and the consumer is not served by competition.

We have about five companies in the brewing industry who control 78 percent of the sales. This would happen even quicker in the soft drink industry and maybe three companies would control the entire industry.

So I don't believe that competition would be served in any event because of the fact that a bottler in this case would be more efficient in his manufacturing or distribution process.

Chairman RODINO. Mr. Caudill, I recall during the hearings that this subcommittee held some years ago on this very question that we talked about the number of bottlers that there were at that time. If my recollection is accurate, in the fifties, there were supposed to be some 7,000 bottlers, and in 1978 there are 1,900 bottlers. It is being predicted now that by 1985 there will be only 200 bottlers. If this is the case, and there is no question that the number of bottlers has been reduced, how can it be argued this legislation will benefit small bottlers since it appears they are rapidly declining in numbers? How can you account for that?

Mr. CAUDILL. You are absolutely right that there has been a decline in the number of bottlers in the United States in the soft drink industry, and I believe much of that came about by natural evolution. Mergers, acquisitions, and so on, that eliminated the number of soft drink bottlers.

Chairman RODINO. Who will benefit? The larger bottler or the smaller bottler?

Mr. CAUDILL. I think the smaller bottler who had a franchise for a particular soft drink was compensated in that he sold his business for consideration, whatever it may have been. I can't say the larger bottler who may have bought that operation benefited any more than any other purchaser of a business.

Chairman RODINO. Does not the mere reduction in size suggest that somehow or other there is less and less competition?

Mr. CAUDILL. No. I don't think particularly that the natural evolution of reduction in number of firms means there is less competition. I don't believe that in our industry you could say because a bottler may have made a purchase of a contiguous bottler that that has had a drastic negative effect on competition.

Chairman RODINO. Thank you very much, Mr. Caudill. I would like to ask Mr. Mudd, how many different exclusive soft drink franchises do you have?

Mr. MUDD. Approximately 20 throughout the entire 7-State area in which we operate.

Chairman RODINO. In the franchises that you do have, do you carry any returnable bottles for the franchises?

Mr. MUDD. Yes, sir.

Chairman RODINO. Is that the case in New York?

Mr. MUDD. No, sir.

Chairman RODINO. What is the reason?

Mr. MUDD. Consumer choice. Our action is in response to consumer request. We have tried for all the years in New York, beginning with the time of the first availability of nonreturnables, both cans and nonreturnable bottles.

Chairman RODINO. How is that choice determined?

Mr. MUDD. It usually comes to us through the retailer. A demand for a particular package or particular type of package is relayed first to the retailer, often the chainstore manager, sometimes the operator of the candy store in New York or the restaurant in New York. I think that perhaps the best representation I could give you is this: The three major markets in which we operate are New York, as you know, Chicago and Washington here. We have made exactly the same presentation over the years to the retailer and the consumer reaction in different parts of the country resulted in the condition you just mentioned, where we have no returnables any longer existing in New York in the market there, which you are familiar with.

We have in our Chicago operation about 50 percent returnables, pretty much the way Mr. Caudill and Mr. Sandahl indicated the mix is. We have about 50 percent returnables and 50 percent nonreturnables. Here in Washington, it runs 80–20, 81–19, something like that in favor of nonreturnables. This is not any doing of ours. This is the way in which the consumer in different parts of the country has weighed convenience versus an increase in cost.

Mr. VOLKMER. May I interrupt? I would like to just say from my personal experience, my family consumes a considerable amount of the beverages discussed today. As one who does a little shopping, I do buy only returnables as a matter of choice. But I will say that in the store where I buy, which is a chain store, the nonreturnables do outsell considerably the returnables in Arlington, Va.

Mr. MUDD. There is an obvious condition of the consumer that causes this. You cannot expect a lady living in a 10th-floor apartment in Manhattan to have the same attitude toward returning bottles to the store as someone living in Missouri, who can put them in his car and drive over to an outlet and dispose of them. We have that condition of tightness of space in the East, as you know. We just get a different demand from the consumer there than, for instance, in our Chicago operation. We try to respond to it.

Chairman RODINO. Mr. Mudd, I recall your appearance before this subcommittee several years ago when we held some rather exhaustive hearings and hoped to come up with a resolution of the problem at that time.

I recall that we discussed quite at length the rule of reason. If my recollection is accurate, I think your request then, was that the rule should apply to the territorial agreements.

Now you come here before us at a time when this matter is pending in the courts, when that is seemingly what the courts would have sustained, and now that the FTC applied the rule of reason and says under that rule of reason, there are questions and the matter is before the courts, you are here today suggesting we do otherwise. Now, why?

Mr. MUDD. Mr. Rodino. I don't like to use the word caprice, but I suppose I have to use some synonym. We would have thought that a properly applied rule of reason, certainly following the very, very supportive decision of Judge Dufresne, the administrative law judge in the hearing, and certainly following the *Sylvania* case, which prevented us from even coming to you in the last Congress, because we thought it was all over in our favor, would have favored us. We couldn't conceive that the rule of reason was applied in the 2-to-1 majority decision of that kind of revolving-door commission we have had to deal with over these years.

We are not content to put our business lives—again, perhaps caprice is too hard a word and forgive me for it—but we are not prepared to put our whole business lives and our whole life's investment any place as fragilely constructed in terms of decision as we think the FTC was and presently is. Perhaps maybe even more so at the present moment. We feel very strongly that there was no effort on the part of the Commission to respond in any way to our strong arguments that there was ample intrabrand competition in our industry. They seemed to have ignored it completely, and simply said because intrabrand might cause more competition, therefore, we were operating under an illegal system.

Chairman RODINO. Mr. Mudd, recognizing that is the argument on which you predicate your appearance, and recognizing that you are now suggesting that we in effect again weaken our antitrust laws and grant an exemption in this area, do you not feel that the committee would have to look at this very closely and that the presumption discussed by the Presidential Commission should apply. In other words, there should be a strong presumption that the exemption was absolutely necessary and essential to the industry.

Mr. MUDD. Mr. Chairman, knowing you and knowing this subcommittee, I think you will give it that kind of attention and that you will make your decision only after considerable deliberation.

Let me put in a disclaimer before I answer the question directly. The disclaimer is that I am certainly not unmindful of a selfish interest on my part in trying to defend my company in this action. You will understand that. But I also recognize that my company, and any other company represented in this industry or any other, lives only as a result of the indulgence of the consumer. If the consumer doesn't like the price or the quality, I don't care how good we think we are, we will go down the drain, as it were.

I would say to you that if we could just divorce ourselves for the moment from our own selfish interests and look at it from the standpoint of the consumer, it is inconceivable to me that we would want to take a 2,000-part, fragmented industry and build it into a group of maybe—who knows the number?—we can use any number we want, 5, 10, 100, it makes no difference, build it into a monopolistic condition and say that the consumer could be afforded better service or that the consumer could be afforded better availability or that the consumer would not be offended by a higher price.

I don't think our industry is properly understood. We have an industry that we think is the most competitive in the country. We think we have a system that serves the consumer better in terms of availability, service, and price than any other industry we can point to.

Although I would never take issue with your wisdom, I would certainly want you to know that we don't think of this as a request for an exemption. We think of this as a request for a clearer statement of what our position is in terms of substantial and effective competition. We admit very readily there is no intrabrand competition in our industry, except in those instances where the franchise companies sell sirup in the territory, where the bottler does not have control over the fountain sirup kind of product you know so well in a drug store, where it is coming out of a tank rather than a bottle. That is really the only intrabrand competition we know of in our industry.

But we say we have the most intense intrabrand competition that anybody could imagine in today's economy. Charley Sandahl has testified, and I don't recall whether you were present or not, but there has been testimony before you that you can buy soft drinks today almost at the same price you bought them at years ago. Charley said he has a truck that went up something like from $850 to $20,000, and here he is selling a soft drink and delivering it on that truck, but selling it at practically the same price per ounce through consumer outlets that he did 40 years ago.

We think we are extremely competitive.

Chairman RODINO. I want to thank you, Mr. Mudd. Of course, I guess each of us will do what we think is in the best interests of the consumer, and I suppose the question is whether or not, when the facts are presented, we see them in that light and reach the kind of conclusion that I suppose would achieve that end.

This is what hopefully we will be able to do, and this is why we are once again wrestling with this. We attempted to do so last time. You will recall that——

Mr. MUDD. We almost made it.

Chairman RODINO. While I didn't support it, nonetheless, I said let's wait and see. I would have hoped that would have been the case. Unfortunately, the climate changed.

Mr. Volkmer.

Mr. VOLKMER. Thank you, Mr. Chairman. I, too, have a concern that if the FTC ruling is upheld by the court of appeals, that down the line we may very well end up with a system that Mr. Caudill has alluded to in his testimony, and I believe was agreed to by Mr. Mudd and Mr. Sandahl as to what we can look forward to in the future.

Mr. Chokola, I understand you don't agree with that.

Mr. CHOKOLA. No; I don't. I feel that again the present antitrust law should be enforced and I think this is what the Federal Trade Commission is doing. I have read the initial decision by the administrative law judge. And that decision ran almost as though it was a verbatim statement issued by the president of Coca-Cola to a Senate committee on one of these antitrust exemption bills. I couldn't believe it when I saw it.

Mr. VOLKMER. Don't you envision, in the event the ruling is upheld, that there would still be franchises but no territorial marketing areas. Anybody could go in?

Mr. CHOKOLA. I think they could operate very well.

Mr. VOLKMER. You don't evision, even though they have, as I understand it, already either Coke or Pepsi or maybe both have already franchised themselves into bottling as well as producing sirup; you don't see either those or Seven-Up going into actually the bottling operations on a massive scale and distributing throughout any area? You don't see that happening?

Mr. CHOKOLA. Well, they have. In fact, I don't know the exact cities, but there are a number of cities where the sirup companies do own the bottling and packaging plants. It was reported in the industry press. There was a bill introduced in the U.S. Senate. There was a bottler up in a small town outside of Milwaukee, Wisconsin, Mr. Norm Cohen, from the Bonton Beverage Co. Again he is a small bottler that is not affiliated with any of the national companies. He is a bottler very similar to myself. According to the accounts that were in the industry press, Mr. Cohen felt he was bearing the brunt of a tremendous predatory pricing effort on behalf of the Coca-Cola bottling operation, which was owned by the Atlanta Coca-Cola Syrup Co. He attempted to get a political movement going within the industry to get some bills introduced, and I believe they were introduced, at least in the U.S. Senate, which would prohibit the sirup companies from bottling or packaging soft drinks.

Mr. VOLKMER. Prohibit what we call vertical integration?

Mr. CHOKOLA. That is right. They would just be a sirup company and have to sell the sirup to other companies. I wonder, with all the support for this type of antitrust exemption legislation, why the members of the industry that feel concerned didn't support the legislation prohibiting vertical integration. I feel it would be the solution to at least that particular part of the problem outlined by Mr. Sandahl, indicating that this is what the Pepsi-Cola organization is gearing up to do.

Mr. VOLKMER. Does anybody wish to comment on that vertical integration legislation?

Mr. Sandahl? Mr. Mudd? Mr. Caudill?

Well, you still haven't answered my question, Mr. Chokola. I want to go back to it. Do you see, let us say we don't have that legislation.

Mr. CHOKOLA. What legislation?

Mr. VOLKMER. Say that this legislation is not enacted and there is vertical integration. Coke decides to build; people in Missouri know Anheuser Busch. You have big breweries in New Jersey and Atlanta and Texas and California and Denver. Soon you have Anheuser Busch all over the United States. Pretty soon we have a huge Coca-Cola bottling plant in Miami and one in Atlanta and one in Jersey, New York, Chicago, right down the line, and they distribute anywhere because there is no exclusivity any longer in the franchises. What will that do to the rest of the small bottlers?

Mr. CHOKOLA. I feel the small bottler under the free market system has recourses. If he feels a lot of product is dumped into his territory at lower prices than he can acquire, say, canned Coca Cola, and this is a position many of the small bottlers are in, they don't have a canning line and are in effect buying from another producer and bringing it into this walled-off territory and selling it for whatever the traffic will bear without any competition, and this is what they are afraid of. I feel if Mr. Mudd's operation in New York City were to decide to go into some place down in New Jersey, and take over the small bottlers territory, at least that portion of his business consisting of the throwaway bottles and cans, I think recourse that the bottler has is to approach Mr. Mudd's company with a purchase order to buy the product at the same price they are willing to sell it free on board the plant of manufacture, and maybe leaving some of that in Mr. Mudd's own territory. This is a proper response to cutthroat competition, or when somebody comes in to try to take your market. Get back at him. Compete. And without the restricted franchised territories, as it stands now, these bottlers have their competitive response options. They have their options.

Mr. VOLKMER. Well, I would like to have one more comment. It has nothing to do with soft drinks. But, we used to have a lot more gas stations than we presently do. A lot more independent gas stations than we presently do. I will bet you right now in 5 years you will have a lot less. You will have gas stations by Exxon and Amoco and a few other people. In my opinion, if we don't do something, if the court of appeals rules along with the FTC, you will have the same thing in the soft-drink industry. I don't believe from my past experience from what I have seen with business, that business is going to give the money to the consumer unless it is necessary. When you reduce competition, the consumer gets hurt.

In the name of consumerism, what we will end up doing is hurting the consumer. That is what I am afraid of.

Mr. CHOKOLA. Could I respond to that?

There was a lot said about the returnable bottle being produced. Any bottler in the country had this option and still has this option today, or to get back into it if he wants to. This antitrust issue has grown. It started within the industry with the advent of the introduction of the can and throwaway. It is the advent of the throwaway packaging which has resulted in this present condition which we are now considering. This monopoly angle, whereby people within the industry want to move products across contractually defined territorial limitations.

Back in 1971, back in 1970–71, the early part of this decade, I was one of the few bottlers in the country who spoke out very strongly in favor of the traditional returnable, reusable bottles. I took a number of actions. One, I presented a resolution at the National Soft Drink Convention in Philadelphia. I believe the year was 1970.

The resolution basically—if you would like to hear it, I will read it, I have a copy of it—was basically that we consider the environmental impact, the impact on the consumer and the impact on the small bottler of the widespread use and conversion to single use, throwaway, packaging.

We were told back in 1969 and 1970 that within 10 years the entire industry would be converted to throwaway packaging at these much higher prices. There was very, very little outcry among the franchised bottlers to support returnable bottle legislation. They got themselves into this present situation because they made a compact with the devil. In fact, there was slight rumbling that maybe there would be a revolt in the ranks of the small franchise bottlers and they would support the legislation introduced in the Congress and just about every State legislature in the country, these so-called bottle bills.

In order to counteract a situation where the small franchise bottlers might vigorously support returnable bottle legislation, that is, bottle bills such as the Jeffords/Hatfield bill before Congress, the parent franchise companies made deals with the small franchise bottlers whereby they would become the exclusive distributors of the franchise brands packed in cans or throwaway bottles. It was this activity which led to the present situation of price fixing and consequently their antitrust, monopoly law difficulties.

Now, what they are afraid of is, now that they have converted 50 percent of their business to cans and throwaways, it is in jeopardy because the parent company no longer really needs them. There are other avenues where the stuff can be distributed at a much lower price to the consumer than it is under the present arrangement.

I think this was brought out at the previous hearing. There was a gentleman here from the Los Angeles, Calif., area. He was a food broker. In his business traveling he was able to spot the fact that in certain areas prices for national brand soft drinks were pretty high and in other areas very low. He went into Denver and found he could buy the national brand soft drinks for about half price and decided, well, here is a business opportunity. He saw that he could buy national brand soft drinks in the Denver area and ship back to Los Angeles and market it at lower prices. In doing so he lowered prices in the Los Angeles area by 25 percent.

Mr. VOLKMER. Does anyone else wish to comment?

Mr. Caudill.

Mr. CAUDILL. I would like to comment on that. I would like to say a couple of things in refutation here.

No. 1, in 1978, there were more returnable bottles sold in the United States in the soft-drink industry than in 1976.

Mr. Chokola here gave us a lot of good reasons to pass this legislation. As all warehouse brands sold in the United States are all in nonreturnable packaging, a warehouse delivery system is incompatible with the returnable bottle. Unless we have small exclusive franchised territories, there would not be any returnable bottles sold in the United States.

Thank you.

Mr. VOLKMER. Thank you.

Thank you, Mr. Chairman.

Chairman RODINO. Thank you.

Counsel.

Mr. KERN. Mr. Mudd, does the territorial franchise system, in your opinion, raise prices to the consumer?

Mr. MUDD. No, sir.

Mr. KERN. In section 2, the exemption section, or I assume you would say "the clearer statement of the applicable statute," there is a proviso that such product has to be in substantial and effective competition with other products of the same general class.

Mr. McClory handed you a little while ago a proposed further proviso which would read, "*Further provided,* That the effect of such contracts and agreements is not to increase the price of such products above a competitive level."

Would you support such an amendment since, as you state, the territorial franchise system does not raise prices to the consumer?

Mr. MUDD. I think there is a generally embracive feeling about Mr. McClory's thought. I would not respond categorically to it at the moment, because I think it would take some study. But we are certainly not antagonistic toward that suggestion. I would, with your agreement, like to ask Mr. Ruttenberg if he would add something.

Mr. KERN. Surely.

Mr. RUTTENBERG. As Mr. Mudd stated, my initial reaction would be not unfavorable. I would like to think more about what the technical implications might be. In general, it would be my view the words "substantial and effective" would in fact encompass what Mr. McClory is driving at and I would think that if and when there were a report on the bill that that report could include a reference to the point being made by Mr. McClory along with other factors, which would be in addition to substantial and effective competition.

The principle of what he is suggesting, I think, is intended to be within the framework of the legislation.

Mr. KERN. Thank you.

Another question for Mr. Mudd. A major argument is being advanced, particularly by Mr. Caudill, but I address it to you, because you are past president of the NSDA—a major argument advanced in favor of this legislation is that it will continue to make feasible the use of returnable containers. Could you tell me whether the NSDA bottlers support or oppose legislation which is now pending in the House and Senate which would require a deposit on all soft drinks in cans and in effect would force all containers to be returnables?

Mr. MUDD. NSDA would very strongly oppose such restrictions on the packaging options that are offered, I believe, to our industry. We have no animosity whatsoever toward the returnable package, because half our business is done in it, but the opposition we would bring to such a hearing would be that it would restrict our ability to serve the consumers' choice.

As I tried to indicate earlier in response to questions from the chairman, we didn't dictate that and we are somewhat at the mercy, to use that term, of the choice that the consumer expresses to us.

Now, there is just no question that we would support both returnable and nonreturnable packaging, and if you were coming to us as a Congress saying, "Hey, we would like to make it all returnable," we would resist that. If you came and said, "We would like to make it all nonreturnable," we would resist that. We want to keep those packaging options open to the consumer and be able to fill them.

Mr. KERN. You obviously realize if you would support that legislation and everything became returnable, you would fit within the parameters of the FTC order.

Mr. MUDD. I understand. That probably indicates to you even more strongly than my testimony, that we would be opposed to it. If we are not willing to trade——

Mr. KERN. Do you think the sirup manufacturers support this legislation?

Mr. MUDD. That question has been asked of me privately and in such testimony before. I have one response that I think ought to answer it very clearly. If they didn't support this, all they would have to do would be to go over to the Commission and say, "Fine, that is OK with us."

Mr. KERN. Mr. Caudill, on page 18 of your statement, you state that Coke and Pepsi sirup manufacturers have everything to gain and nothing to lose by implementation of the FTC decision.

If this is so, why did Coke incur the great expense involved in the appeal?

Mr. CAUDILL. I believe the sirup manufacturers. The sirup manufacturers with their 460 bottlers, Coke and Pepsi, they had to appear to fight the FTC on this situation. When we look at the facts and the structure of our industry and look at all the evidence that was not presented by the two defendants in their particular situation before the FTC, when we look at the fact that these people had access, both these large conglomerates had access to Majers data which indicates the competitive activity in the soft drink industry in the United States, that was never presented before the FTC.

When we look at some of the other information that was never presented before the FTC by the two defendants, we believe that they know, No. 1, that they couldn't lose in this situation.

Whichever way the FTC decision went. However, when we look at the structure of the industry, we see that they have much more to gain if they actually lost this decision, because they would have the choice at that time, whether or not they wanted to take over the soft drink industry in the United States, and how they did it, the timing, franchise by franchise, and it wouldn't be something they would have to come in and give consideration to the entrepreneurs for. They would be able to buy these businesses at a "fire" sale, if you will.

Mr. KERN. Mr. Mudd, section 3 of H.R. 3567 provides recoveries may be sought only for damages incurred after a finding that a territorial provision is unlawful.

As a practical matter, doesn't this effectively immunize the industry from the threat of private damage actions, since there is no incentive to bring such an action when the potential recovery is so circumscribed?

Mr. MUDD. We certainly hope it doesn't do that, because that is not our intent. Our intent is simply not to be punished for something that in our eyes and in the eyes of the law was not a crime up to a certain date.

Mr. KERN. If you are concerned about the transition period from the application of one standard to another, why don't you put a time limit on the hold harmless provision of section 3? It is now indefinite.

Mr. MUDD. We discussed that at great length. I will ask Mr. Ruttenburg if he would address that point. He can do it better than I.

Mr. RUTTENBERG. Our feeling has been that the equities involved are such that it would be entirely appropriate to enact section 3 of the bill.

If you look at the history of the 75 years in which these are utilized, the favorable opinion of the administrative law judge, a second Federal court ruling upholding legality of territories, a 1976 ruling also upholding it, and then you consider the alternative if the section is not enacted, if the arrangements are subsequently now found to be illegal, being subject to treble-damage suits going back to 1967, and going forward until we don't know when, whenever the litigation is concluded, that as far as the industry is concerned, it has been the feeling that the equities are such that the treble-damage provision should not in any way be retroactive.

It should only be prospective. Certainly, a time limit could be included. It would be my view, however, that in line with the Newspaper Preservation Act, where similar action was taken, that treble-damage actions should be precluded.

Mr. KERN. Why don't we simply make this apply to any illegal activity prior to the effective date of the bill, rather than prior to any final determination?

Mr. RUTTENBERG. That might be a possible solution to the problem. Perhaps we could talk about that. I would like to see the language. We would be happy to consider it.

Mr. KERN. Mr. Caudill, on pages 22 and 23 of your statement, you suggest that the sirup manufacturers are poised to "blanket almost the entire country with an instant nonreturnable distribution system overnight," and will further seek "to destroy the independent bottlers through the simple device of a classic price squeeze on sirup.

Are you impressed with the possibility that the activities you describe might be predatory practices and thus the basis for the private treble-damage actions by the affected bottlers?

Mr. CAUDILL. Yes, I am aware that that is a possibility. However, this may happen so insidiously that it would be very difficult to prove. I also look at the actions that were not taken by the Federal Trade Commission in prior acquisitions made by these companies.

For instance, since the inception of the suit by the FTC against the sirup companies, the Pepsi-Cola Co. made the largest acquisition of any Pepsi bottling franchises in the history of the United States when they bought the Rheingold Corp.—they got Los Angeles, Calif.; Orlando, Fla.; Puerto Rico, and Mexico City.

Mr. KERN. Would you support legislation prohibiting vertical expansion by the sirup manufacturers?

Mr. CAUDILL. That is not my bailiwick. I can only——

Mr. KERN. Do you perceive this as a problem?

Mr. CAUDILL. In the absence of franchised territories, it would become an oligopolistic situation overnight.

Mr. KERN. How about in the presence of franchised territories? Would you still try to erect this barrier?

Mr. CAUDILL. I think it is certainly a consideration.

Mr. KERN. May I ask one more question? This is to Mr. Chokola.

Mr. Chokola, what is your forecast for mergers No. 1 among bottlers over the next 10 years? I take it you think it will proceed very rapidly, is that right?

Mr. CHOKOLA. Will you repeat that?

Mr. KERN. Your forecast for mergers among bottlers over the next 10 years.

Mr. CHOKOLA. There seems to be a lot of merger activity within the Pepsi-Cola organization and the Coca-Cola organization and the national franchise organization. This has been going along at a pretty rapid clip. When they are buying up these franchises and just—as I indicated, what I feel they want to buy is the exclusive market territory. They closed down the bottling operation and it becomes a satellite. Just part of an enlarged territory with a wall around it.

Mr. KERN. If intrabrand competition were allowed, would you expect a different result?

Mr. CHOKOLA. Between one Coke bottler and another Coke bottler? I heard a lot said there is a lot of competition between the various companies, Coke and Pepsi and 7-Up. I think that you could say in the broadest sense there is competition but not any real hard price competition. What I found out, if Coke is selling for $5 a case, Pepsi can be $5 a case, and so does Dr. Pepper and 7-Up. The rationale given for that is, well, we could maybe come in at $4.90, but we don't want to be branded as the cheaper brand.

Mr. KERN. Getting back to the question of mergers, if there were intrabrand competition what result do you expect?

Mr. CHOKOLA. I think it would be less—I think there would be more competition if we had intrabrand competition and probably less mergers.

Mr. KERN. Thank you.

Mr. CHOKOLA. I have a number of items I would like to add in the record as corollary information regarding this subject.

Chairman RODINO. You may submit those.

Mr. Volkmer.

Mr. VOLKMER. It has been brought to my attention that where we use the words such as "effective competition with products of the same class," there may be included such things as chocolate soda, lemonade, which we see on the same shelves, and same dispensers, and does that include beer? What is included; what do you envision your including in your competition?

Let's put it that way. In general, I will ask all of you to answer that.

Mr. MUDD. Historically, our industry had the same kind of competition that we have today, varying only by degree, real competition among the basic brands that existed as we knew them as soft drinks. We have had difficulty in our national association over the last 10 years in even defining soft drink, because many people think of soft drink as a carbonated drink.

Mr. VOLKMER. I was going to grant you that as a possible alternative.

Mr. MUDD. Many think of it as a noncarbonated drink. We distribute Nestea, for example. It is in direct competition with all soft drinks. Many of the larger companies, General Foods, for example, have brought out mixes and powders, Kool-Aid, for example. We are in direct competition with Kool-Aid obviously.

There are all kinds of drinks now coming, in terms of different percentage of juice content, that can be called or cannot be called fruit drinks, because of the regulations. We consider that they are all in competition. If we are in the marketplace with that broad spectrum and are proving to you and the Commission and the court that we have effective and substantial competition, among like brands, whatever the exact wording is, that is substantially what we would like you to consider.

Again I would like to ask Mr. Ruttenberg if he would like to comment.

Mr. RUTTENBERG. My comment would be, Mr. Volkmer, that in this particular area, I think the courts are well equipped to make a determination as to what brands compete with one another. The antitrust law generally, say in the merger area or elsewhere——

Mr. VOLKMER. We are basically talking about intrabrand competition here, not interbrand.

Mr. RUTTENBERG. We are talking about interbrand under this bill, assuming the bill were enacted. You would have to show that there is substantial effective competition among products of the same general class in order to sustain the territory.

Mr. VOLKMER. Right. Let me give an example. Let us assume that within this certain territory wherever it may be, you only have one bottler. One name brand. Put it right down to that. One name brand who bottles and distributes that. Now, as to whether or not he has competition would depend on somebody else bringing soft drinks into that area.

But if no other carbonated beverage is sold in that area—I know it doesn't happen, but assume that—but other things are, Kool-Aid in the stores and lemonade and Nestea and all these things are, is that sufficient competition?

Mr. RUTTENBERG. I don't think I would want to answer that in the abstract. What I would say, though, is that you would have to take a look at the territory to see whether or not these other products were having an effect on pricing, on service, on packaging, and so forth, of the carbonated drink. If they didn't have that effect, it would not be a competitive area. You would have to look at the particular circumstances.

Mr. VOLKMER. What you are saying then is that both the FTC and we should look at—in other words, there are different factors that control different territorial situatons. The city of New York is not the same as northeast Missouri, where I am from. I recognize that. I hope other people recognize that. Different territories, territories vary within the State of Texas, too; would you agree with that?

Mr. MUDD. Absolutely. That is part of the reason we respond to the consumer. She tells us a different thing in different parts of the country.

Mr. VOLKMER. Before we finish, I would like to have the previous question; do you agree with Mr. Mudd and his attorney as to the competition factor of the general types of soft drinks we are talking about?

Mr. SANDAHL. Definitely. I think in your hypothetical case, that could never happen, of course, in the soft drink industry. There would be competition coming in from all directions. No little bottler or any bottler will sit in one area and have an exclusive. He will be banging away defending himself from all directions.

Mr. VOLKMER. In other words, you will have competition.

Mr. SANDAHL. He darn well will have it.

Mr. VOLKMER. Mr. Caudill, do you wish to comment?

Mr. CAUDILL. I agree with both these gentlemen.

Mr. VOLKMER. Mr. Chokola, do you wish to comment on the question of competition as to whether or not noncarbonated beverages are competitive with carbonated beverages?

Mr. CHOKOLA. The people that feel like going for the Kool-Aid or orange juice, I never really classed them or considered myself competing directly with them. I presume that a low-income family may opt to buy the Kool-Aid rather than carbonated beverages, because the carbonated are higher priced, but they are two separate categories. People buy carbonated beverages because they like the carbonation.

Mr. VOLKMER. Thank you.

Thank you, Mr. Chairman.

Chairman RODINO. Counsel has a question.

Mr. SIPPEL. Mr. Ruttenberg, is it correct that you stated you would judge the market under the substantial effective competiton test the same way you would judge the market under the merger laws?

Mr. RUTTENBERG. Not the same way. There is historical precedent for a determination as to what products compete with one another in order to determine whether or not there is substantial effective competition. We have the court to make a determination as to whether beer, for example, does compete with soft drinks or not.

Mr. SIPPEL. Do you think there should be a different standard for establishing a market from which to judge substantial effective competition under this bill than under the merger law?

Mr. RUTTENBERG. I think probably you have a different standard here. That is up to the courts to determine. I could not sit here and say how a court would determine whether or not powdered mixes compete in a territory with an——

Mr. SIPPEL. Would you oppose an amendment applying the market definition of the merger laws?

Mr. RUTTENBERG. I don't think I would go to that point.

Mr. SIPPEL. What if two soft drink firms merged and the courts found there was a lessening of competition under the merger laws using a market definition under those laws.

Mr. RUTTENBERG. The standards are different. We are trying to determine if the bill were enacted whether or not certain products compete with one another so as to have competitive effects. When I say competitive effects, I am not talking just price, though that is very important, as the court in *Sylvania* said. I am talking about competition in service. Competition in packages, Introduction of new products and so forth. So that it is in a different context. I would not—the merger approach is different. All I was using was the analogy that it is up to the courts to determine what the product market is. That is as far as I would want to go.

Mr. SIPPEL. So if Nestea acquired a Coca-Cola franchisee, that could possibly be anticompetitive under the merger law, but if the same bottler carried Nestea and Coke, that would be permissible under this bill?

Mr. RUTTENBERG. It may or may not.

Mr. SIPPEL. Thank you.

Chairman RODINO. Well, the Chair wants to thank the witnesses for their presentations, and the Chair wishes to state that it is not setting at this time another date for hearings, but we do contemplate there will be other hearings.

The committee has some other pressing business which it must tend to, and, therefore, will give ample notice for further hearings.

The Chair states that this session is adjourned.

[Whereupon, at 1:35 p.m., the subcommittee adjourned.]

SOFT DRINK INTERBRAND COMPETITION ACT

THURSDAY, NOVEMBER 15, 1979

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON MONOPOLIES AND COMMERCIAL LAW
OF THE COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 11:05 a.m., in room 2141, Rayburn House Office Building, Hon. Peter W. Rodino, Jr. (chairman) presiding.

Present: Representatives Rodino, Hughes, Volkmer, McClory, Railsback, and Fish.

Also present: Joseph L. Nellis, general counsel; William Sippel, counsel; Joel Ginsburg, assistant counsel; Franklin G. Polk and Charles Kern II, associate counsel.

Mr. RODINO. The committee will come to order. This morning the Subcommittee on Monopolies and Commercial Law will continue with its hearings on various bills to amend the antitrust laws to establish a different standard for judging the legality of exclusive territories in the soft-drink industry. The focus of this morning's hearings will be on the economics of the soft-drink industry, and the effect of exclusive territories on prices and competition.

This morning we will hear from two economic witnesses, and they will be Prof. Lee Preston, the Melvin H. Baker professor of American enterprise, School of Management, State University of New York at Buffalo, who will be testifying in favor of the proposed legislation.

The other witness, Prof. Louis W. Stern, A. Montgomery Ward professor and chairman of the marketing department, J. L. Kellogg Graduate School of Management, Northwestern University. Dr. Stern, along with Professor Preston, has written extensively on the soft-drink industry and has submitted with his statements a copy of his law review article on the rule of reason as it is applied to the soft-drink industry. Professor Stern will appear in opposition to the legislation.

The second panel of witnesses appearing this morning are Mr. Thomas Heckenkamp of Heckenkamp & Associates, and his counsel, Mr. Ronald Reagin. Mr. Heckenkamp has testified before the Subcommittee on Monopolies and Commercial Law in the past on the subject of exclusive territories. He is a food broker and a major purchaser of soft-drink products, and will discuss the proposed legislation from that perspective. Mr. Reagin has represented Mr. Heckenkamp in antitrust cases involving major soft-drink companies.

We are glad to welcome these witnesses. We will ask the first witnesses this morning to please appear at the witness table as a panel, and please identify yourselves as to who is who so that the members of the subcommittee will be able to identify you.

TESTIMONY OF DR. LEE PRESTON, THE MELVIN H. BAKER PROFESSOR OF AMERICAN ENTERPRISE, SCHOOL OF MANAGEMENT, STATE UNIVERSITY OF NEW YORK AT BUFFALO; AND DR. LOUIS W. STERN, A. MONTGOMERY WARD PROFESSOR AND CHAIRMAN OF THE MARKETING DEPARTMENT, J. L. KELLOGG GRADUATE SCHOOL OF MANAGEMENT, NORTHWESTERN UNIVERSITY

Dr. STERN. I am Louis Stern of Northwestern.

Dr. PRESTON. And Lee Preston from Buffalo.

Chairman RODINO. You may proceed. Your written statements will be included in their entirety for the record, and hopefully you will summarize as much as you can so that we will expedite the hearings and then go on for the questions.

[The statement follows:]

STATEMENT OF DR. LOUIS W. STERN

This occasion represents the third time I have been requested by a Subcommittee of the U.S. House of Representatives to appear and provide assistance in sorting out the complex issues attending the use of territorial restrictions in distribution. On the previous two occasions, the request to appear came from the Subcommittee on Commerce and Finance and the Subcommittee on Consumer Protection and Finance of the Committee on Interstate and Foreign Commerce during the 93rd and 94th Congresses. As was the case with regard to my previous appearances, I am pleased to be here and am honored that you have sought my advice.

I have submitted two documents which I would like to have serve as my formal prepared statement before the Subcommittee today. The first is a paper entitled "An Application of a Rule of Reason Model to Coca-Cola's Use of Territorial Restrictions in Distribution." The second is a reprint of an article of mine entitled "Territorial Restrictions in Distribution: A Case Analysis" which was published in the Journal of Marketing in April 1976 and which drew heavily upon the substance of my prior presentations before the Committee on Interstate and Foreign Commerce. The Rule of Reason model referred to in the first paper was developed by my coauthors and me in response to the U.S. Supreme Court's *Sylvania* decision. The model and the support for it will be published early in 1980 by the California Law Review.

I am the A. Montgomery Ward Professor of Marketing and Chairman of the Department of Marketing in the J. L. Kellogg Graduate School of Management at Northwestern University. My primary areas of teaching and research are distribution management and public policy issues in marketing. I have a number of publications relating to these areas which are noted on my vita which is attached to the materials I prepared for my visit with you today. One particular item of interest might be that I served as one of the principal economists on the staff of the National Commission on Food Marketing from January 1965 to June 1966 and, in that capacity, was responsible for the research on and the writing of the Commission's Technical Study No. 6 entitled "Studies of Organization and Competition in Grocery Manufacturing."

My knowledge of soft drink distribution practices comes primarily from my study of secondary source material, particularly the data presented during previous hearings in both the Senate and the House and the arguments made by the Administrative Law Judge and the Federal Trade Commission relative to Coca-Cola's use of territorial restrictions. I think, however, that I have a reasonable knowledge of distributive practices generally, based on my research in the field, and therefore, if you desire to do so, it may be possible to discuss the subject of territorial restrictions more broadly when we pause for questions and comments.

Before approaching the soft drink industry situation, I would first like to make a few general observations. I believe that the *Sylvania* decision was a landmark decision. It was remarkable in that it overturned the *Schwinn* decision, which practically every known scholar had criticized. The great contribution of the *Sylvania* decision was that it substituted a rule of reason process for the per se ruling, thus leaving it open for firms to employ territorial restrictions if those restrictions significantly enhanced interbrand competition. The problem with the *Sylvania* decision, though, was that it did not clearly specify a rule of reason model which one might follow in determining when and whether territorial restrictions could be deemed illegal. The Court, by its own admission, finds economic reasoning uncomfortable and has, to its credit, relied increasingly on the debates of economists and marketing scholars in the published literature to help it resolve some of the perplexing issues in distribution practices which it has considered. My co-authors and I hope that the model we have suggested, will be of assistance to the Court, in this respect.

What troubles me, however, is that the present bills—H.R. 3567 and H.R. 3573—are following so quickly on the heels of the *Sylvania* decision. My concern surrounds several issues. First the issue of territorial restrictions is not particularistic to one industry but is a general phenomenon, applied in a variety of lines of trade ranging from the sale of bread to the marketing of construction machinery. It is not at all clear to me why the soft drink industry should be singled out for attention by Congress, unless it is that certain interests wish to somehow prevent the Courts from deciding the present Coca-Cola case on its merits. It disturbs me, as a marketing professor and as a private citizen, that anything might be placed in the way of the Coca-Cola case, because the resolution of that case may tie together some loose ends left by the *Sylvania* decision and thereby serve to clarify important issues for a large number of marketers, not simply those in the soft drink industry.

Secondly, I seem to recall from my previous visits that one of the major concessions the soft drink industry was striving to gain from Congress was a law overturning the *Schwinn* decision so that a rule of reason could be applied to territorial restrictions rather than a *per se* rule. Isn't this outcome exactly what *Sylvania* achieved? Frankly, I don't understand why the soft drink industry is not exceedingly pleased with the *Sylvania* decision or why it is that the industry feels that it now cannot live with the outcome for which it strove.

Thirdly, I would like to re-emphasize a point implicit in the previous two points. The issue of territorial restrictions is a general one. If one were to assume that small bottlers need protection from competition, then why wouldn't small bakers or beer distributors or farm implement dealers or a legion of other wholesale distributors need exactly the same protection? What is it that makes the soft drink industry so unique or so critical to the national interest that it must be singled out for special consideration? Clearly, the assumption that competitors should be protected from competition is questionable, but, in any case, the major question regarding the need for particularistic legislation remains. If the members of this Subcommittee and of Congress truly believe that the rule of reason decision in *Sylvania* was not satisfactory as a precedent to apply to all industries, then I would much prefer to see the Congress develop a more general piece of legislation than pass particularistic exemption-type legislation. However, it seems to me that, while it could be tightened up a bit and made a bit more explicit, the *Sylvania* decision was an excellent one and provides numerous industries with the opportunity of utilizing territorial restrictions in distribution.

Turning directly to the specific issues in the soft drink industry, arguments surrounding the use of territorial restrictions appear to focus on three main factors:

1. The effect on retail prices,
2. The extent of marketing competition, and
3. The depth and quality of market coverage (i.e., the satisfaction of consumer demand through increased availability).

I will now briefly address each of these factors.

RETAIL PRICES

There appears to be general agreement that elimination of existing territorial restrictions may lead to reductions in retail prices paid for soft drinks. There is, however, disagreement as to the amount, extent, and duration of any such price reductions.

1. Estimated amount of consumer savings from price reductions range from $100 million to $1.5 billion.
2. While it could be questioned whether the price reductions at the wholesale level would be passed along to consumers, I agree with Professor William S. Comanor's comment at the Senate Hearings of 1972. He noted that it is difficult to imagine a wholesale price decline of 4 or 5 percent not being passed along to consumers either in whole or in part, by such a highly competitive industry as that which exists for the retailing of food.
3. It has also been suggested, by supporters of the Soft Drink Interbrand Competition Act, that the consumer price reductions would be short-lived. This reasoning is, in part, predicated on the assumption that the larger bottlers would, over the long-

run, be able to drive the smaller bottlers out of business via price competition. Once this market "shake-out" was accomplished, the larger bottlers would supposedly be left in monopoly positions and would then charge monopoly prices.

There is little doubt that a market "shake-out" is already occurring in the soft drink industry and would be accentuated if territorial restrictions were removed. However, it is too simplistic to argue that the "shake-out" is or would be the result of price competition alone. As I will show in a few moments, a series of market forces are at the base of the changing conditions in the soft drink industry. Indeed, a "shake-out" does not happen instantaneously, and the prime beneficiaries of the price competition that is induced during a prolonged period of market readjustment are ultimate consumers who should receive lower prices as a result of it.

Furthermore, some territories are simply not large enough to offer operating economies of scale to the bottlers attempting to serve them. It is difficult to see why such economies of scale which would naturally result from larger territories (if restrictions were eliminated) will not be able to sustain lower consumer prices which result from lower costs at the wholesale level.

And if individual markets should somehow become monopolized, then the Sherman Act already provides an avenue for attacking such conditions.

MARKET COMPETITION

Regarding market competition and the concern with increased concentration as a result of the elimination of territorial restrictions, the focus of attention here seems to be with the "protection" of small bottlers. Unfortunately, those who defend territorial restraints and argue in behalf of small bottlers do not pay concerted attention to or come to grips with the questions of who the small bottler is, what his problems are, and how his viability and efficiency can be improved.

As I have already mentioned, it is my belief that a market "shake-out" is underway in the soft drink industry due, primarily, to changing market conditions. Since the 1940's, the trend in the industry has been towards greater concentration which has occurred, in large part, as a response to natural market forces. As Mr. J. Lucian Smith, President, Coca-Cola, U.S.A., stated before the Senate Subcommittee on Antitrust and Monopoly, "improved transportation, changes in communications systems, economies of scale, shifting population concentrations, and changing tastes and income patterns have tended to reduce the number of bottling plants and increase the size of some territories."

The small antiquated bottler faces a rather untenable position under the present system. Given changes in his market, in the products available (package sizes, brands, etc.) to better serve his market, and increased labor and transportation costs, among other factors, the small bottler is faced with a major investment problem. As pointed out by Mr. Arthur D. MacDonald, President, Coca-Cola Bottling of Los Angeles, "newer and faster canning and bottling lines are required in order to reduce production costs and to offset labor rates which at a current rate of approximately $5 per hour, including fringe benefits, are among the highest in the nation. Equipment becomes obsolete more rapidly with changes in container sizes and packaging innovations. A high speed soft drink can line today costs between $750,000 and $1,000,000 depending on the size and support equipment. To justify this investment requires an annual volume of 4 to 5 million cases. It is obvious that these installations become possible only for the larger volume entities * * * a situation not envisioned in the early years of the industry when franchise boundary lines were established." Further, Mr. MacDonald stated that, after considering increases in packaging, labor, and other costs, there has been an attempt to "consolidate production and distribution facilities to achieve economies of scale." He added that "only through such consolidation could we, or (other soft drink manufacturers in our marketing area), compete effectively."

Thus, in order to serve his market area in a satisfactory manner (given the market changes mentioned by Mr. Smith), a small bottler is going to have to undertake some rather costly plant updating. These steps are going to result in increases in the rated output of his bottling operation which can only be absorbed by increasing the size of his territory. It is obvious, therefore, why there have been numerous mergers among bottlers in contiguous territories. The small bottler can either combine with another bottler (and thereby become a "large" bottling operation) or, without new investment and larger territories, he can slowly, but surely, go under, as his ability to serve his market becomes weakened and his labor and transportation costs increase. It would be preferable to give the small bottler a "fighting chance" for survival via updating his equipment and freeing him to go after business wherever he can secure it. The territorial restriction system does not give him this "fighting chance." Now, the probabilities favor his dying out or else his disappearance as a separate independent entity through merger.

In addition, information with respect to the extent of economic concentration, the degree of product differentiation, and the height of entry barriers is necessary in order to assess whether the relevant market contains a sufficient amount of interbrand competition such that the existence of intrabrand competition is relatively unimportant to the preservation of commercial rivalry in the market. Regarding concentration, the top four syrup manufacturing firms competing for the flavored carbonated soft drink market account for about 70 percent of the nationwide sales. While this figure varies by market area, the significance of it is that the industry can be characterized as oligopolistic in nature, and therefore, one would expect a high degree of mutually recognized interdependence in the setting of nonprice strategies and in pricing.

The level of concentration is also high among bottlers within relevant geographic markets. 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.

The potential consequences of this market structure are profound. First, one would expect to find territorial restrictions applied industry-wide, and, indeed, this is the case. Because concentration among bottlers is high, the industry-wide territorial restriction policy limits the extent of interbrand competition by limiting the total number of competitors in any given market area. Admittedly, competition may be intense with only a few sellers in the market, but the smaller the number of sellers, the more likely it is that the competition will be of a nonprice nature. Evidence indicates that prices in the industry are uniform among the major brands within particulr territories.

Second, the share of the market held by the major bottlers is such that intrabrand rivalry, if it existed, would likely be procompetitive. In fact, combining information about the extent of product differentiation and the height of entry barriers with the amount of concentration in the industry serves to reinforce this conclusion. Such information is provided in the paper which I have submitted to you for your consideration.

MARKET COVERAGE

Lastly, the final issue I will deal with is the issue of market coverage. While it is indeed highly likely that exclusive territorial arrangements aided the soft drink industry to achieve wide distribution and adequate market penetration during the years of its infancy and early growth, it is my belief that the industry no longer needs the protection of the legislation proposed here in order to attract investment and to grow. Territorial restrictions on competition are no longer needed to induce capital investment in the industry since real investment in economic activities is generally forthcoming whenever the prospective rate of return exceeds the cost of additional capital. This basic process of resource allocation must, especially for an established industry, be seen as the primary source of motivation for investment in soft drink bottling and distribution.

CONCLUSION

I would like to close by making some general observations, some of which are admittedly value laden.

First, competition should be promoted by legislation, not inhibited. Only in those cases where price competition is predatory in nature is there cause for concern on the part of legislators and enforcement agencies, and there are already a number of existing laws that can deal with predatory conduct. If territorial restrictions were eliminated in this industry, desirable price competition should be enhanced.

Second, natural market forces are basically at the root of what is transpiring in the soft drink industry. They should be permitted to run their course.

Finally, let me re-emphasize that existing laws are available to curb concentration of markets, should increased concentration occur as the result of eliminating territorial restrictions. (In this regard, one might look closely at the merger activity in the industry—both horizontal and conglomerate.) To assume, though, that the legislation proposed here will make for a more competitive system in the long-run in the soft drink industry is erroneous. We cannot make progress by standing in the way of natural market forces in order to protect individual competitors from competition.

Dr. STERN. I have been selected as the first speaker. I am honored that you sought my advice. I am going to summarize from my oral statement, and if you happen to have that in front of you, I will simply refer to certain pages as I thumb through it and then be as brief as possible.

Basically, the first couple of pages simply give you some idea about my background, and I think we can basically skip over that and get to the more substantive issues starting on page 2.

My knowledge of soft-drink distribution practices comes primarily from my study of secondary source material, particularly the data presented during previous hearings in both the Senate and the House and the arguments made by the administrative law judge and the Federal Trade Commission relative to Coca-Cola's use of territorial restrictions. I think, however, that I have a reasonable knowledge of distributive practices generally, and we can talk about other issues with respect to distribution and territorial restrictions if you like, when we pause for questions.

Before approaching the soft-drink industry situation, I would first like to make a few general observations. I believe that the *Sylvania* decision was a landmark decision. It was remarkable in that it overturned the *Schwinn* decision, which practically every known scholar had criticized. The great contribution of the *Sylvania* decision was that it substituted a rule of reason process for a per se ruling, thus leaving it open for firms to employ territorial restrictions if those restrictions significantly enhanced interbrand competition.

The problem with the *Sylvania* decision, though, was that it did not clearly specify a rule of reason model which one might follow in determining when and whether territorial restrictions could be deemed illegal. The court, by its own admission, finds economic reasoning uncomfortable and has, to its credit, relied increasingly on the debates of economists and marketing scholars in the published literature to help it resolve some of the perplexing issues in distribution practices which it has considered. My coauthors and I hope that the model we have suggested, the rule of reason model, will be of assistance to the court in this respect, and that model is before you in one of the statements that I have prepared.

What troubles me, however, is that the present bills—H.R. 3567 and H.R. 3573—are following so quickly on the heels of the *Sylvania* decision. My concern surrounds several issues. First, the issue of territorial restrictions is not particularistic to one industry but is a general phenomenon, applied in a variety of lines of trade ranging from the sale of bread to the marketing of construction machinery. It is not at all clear to me why the soft-drink industry should be singled out for attention by Congress, unless it is that certain interests wish to somehow prevent the courts from deciding the present *Coca-Cola* case on its merits. It disturbs me, as a marketing professor and as a private citizen, that anything might be placed in the way of the *Coca-Coca* case, because the resolution of that case may tie together some loose ends left by the *Sylvania* decision and thereby serve to clarify important issues for a large number of marketers, not simply those in the soft-drink industry.

Second, I seem to recall from my previous visits to Congress and to the House of Representatives that one of the major concessions the soft-drink industry was striving to gain from Congress was a law overturning the *Schwinn* decision so that a rule of reason could be applied to territorial restrictions rather than a per se rule. Isn't this outcome exactly what *Sylvania* achieved? Frankly, I don't understand why the soft-drink industry is not exceedingly pleased with the *Sylvania* decision or why it is that the industry feels that it now cannot live with the outcome for which it strove.

Third, I would like to reemphasize a point implicit in the previous two points. The issue of territorial restrictions is a general one. If one were to assume that small bottlers need protection from competition, then why wouldn't small bakers, or beer distributors, or farm implement dealers, or a legion of other wholesale distributors need exactly the same protection? What is it that makes the soft-drink industry so unique or so critical to the national interest that it must be singled out for special consideration?

Clearly, the assumption that competitors should be protected from competition is questionable, but, in any case, the major question regarding the need for particularistic legislation remains.

If the members of this subcommittee and of Congress truly believe that the rule of reason decision in *Sylvania* was not satisfactory as a precedent to apply to all industries, then I would much prefer to see the Congress develop a more general piece of legislation than pass particularistic exemption-type legislation. However, it seems to me that, while it could be tightened up a bit and made a bit more explicit, the *Sylvania* decision was an excellent one and provides numerous industries with the opportunity of utilizing territorial restrictions in distribution.

Now I would like to turn very briefly to some of the specific issues in the soft-drink industry, and issues that surround the whole territorial restriction notion. I think that there are three basic factors, as I state on page 5 of my statement, that there has been quite a bit of concern about. First, the effect on retail prices of territorial restrictions; second, the extent of marketing competition in the industry; and third, the depth and quality of marketing coverage, that is, the satisfaction of consumer demand through increased availability.

In everything that I have read thus far, it seems to me that almost everybody agrees that there will be lower prices if in fact the restrictions are removed. The big question is whether those lower prices will be passed along by food retailers, and what will happen over the long term if in fact the market becomes more concentrated.

Frankly, I cannot imagine a wholesale price decline of let's say 4 or 5 percent not being passed along to consumers either in whole or in part, by such a highly competitive industry as that which exists for the retailing of food. Let's not forget that some soft drinks are leader items, traffic-building items, and the retailing operations would love to have lower prices to pass on as something that will bring more customers into the store.

It has also been suggested that these prices will elevate, once the market becomes concentrated. I believe that the concentration problem is too complex to simply be tied into lower prices as a result of removal of territorial restrictions. I think that there are a lot of forces that are going on in this industry that are going to bring about concentration or that may induce additional concentration, and I think we ought to talk about those a bit and think about those more globally than just consider the elimination of restrictions alone as a causal factor.

I believe that some territories are simply not large enough to offer operating economies of scale to the bottlers attempting to serve them. It is difficult to see why such economies of scale which would naturally result from larger territories, if the territorial restrictions were eliminated, will not be able to sustain lower consumer prices which result from lower costs at the wholesale level. At any rate, I do feel that a shakeout is happening and would like to explain that a bit. And if individual markets should somehow become monopolized, then the Sherman Act already provides an avenue for attacking such conditions.

Let's turn to the shake-out notion and to market competition. Regarding market competition and the concern with increased concentration as a result of the elimination of territorial restrictions, the focus of attention here seems to be with the protection of small bottlers. Unfortunately, those who defend territorial restraints and argue in behalf of small bottlers do not pay concerted attention to or come to grips with the questions of who the small bottler is, what his problems are, and how his viability and efficiency can be improved.

Mr. J. Lucian Smith, president, Coca-Cola, U.S.A., has pointed out a whole host of changes in the environment of bottling which would bring about a great change in what the structure of the industry would be. I have tried to point those out on page 7 of my statement. I have also pointed to a quotation from Mr. Arthur D. MacDonald, who is president of the Coca-Cola Bottling Co. of Los Angeles, in which he simply indicates that in order to be able to achieve economies of scale of operation, you are going to need a reasonably large plant, or you are going to have to make a reasonably sizable investment, and therefore you are going to have to have a reasonably large market outreach in order to take that volume off your hands. Some small bottlers cannot exist unless they update their equipment, and we can talk about that in more detail if you would like. Unless they update their equipment and are capable of being able to do battle with those firms that have been able to achieve those economies, they will not survive. And if you keep them in a small territory, where they cannot possibly sell what they produce, once they have updated that equipment, then it seems to me to be counterproductive, and almost anticompetitive.

In order to serve his market area in a satisfactory manner—given the market changes mentioned by Mr. Smith—a small bottler is going to have to undertake some rather costly plant updating. These steps are going to result in increases in the rated output of his bottling operation which can only be absorbed by increasing the size of his territory. It is obvious, therefore, why there have been numerous mergers among bottlers in contiguous territories. The small bottler can either combine with another bottler—and thereby become a large bottling operation—or, without new investment and larger territories, he can slowly, but surely, go under, as his ability to serve his market becomes weakened and his labor and transportation costs increase.

It would be preferable to give the small bottler a fighting chance for survival via updating his equipment and freeing him to go after business wherever he can secure it. The territorial restriction system does not give him this fighting chance. Now, the probabilities favor his dying out or else his disappearance as a separate independent entity through merger.

In addition, information with respect to the extent of economic concentration, the degree of product differentiation, and the height of entry barriers, is needed to assess the extent of interbrand competition In other words, when we look at the structure in the soft drink industry we find concentration both nationally among the syrup makers and locally within metropolitan areas among the bottlers. Even though there are numerous brands in any given market, and there are a host of brands, that does not mitigate or lessen the concentration, because the reason why there are numerous brands is because of piggybacking. That is, bottlers take on a number of different brands, and manufacture those. They use the syrup and manufacture those particular soft drinks. There aren't a host of bottlers in any given territory. There are relatively few, especially if there is a great deal of this piggybacking that happens. It doesn't mean that the existence of a large number of brands will breed an enormous amount of competition in the marketplace.

The potential consequences of this market structure are profound. First, one would expect to find territorial restrictions applied industrywide, and, indeed, this is the case. Because concentration among bottlers is high, the industrywide territorial restriction policy limits the extent of interbrand competition by limiting the total number of competitors in any given market area. Admittedly, competition may be intense with only a few sellers in the market, but the smaller the number of sellers, the more likely it is that the competition will be of a nonprice nature. Evidence indicates that prices in the industry are uniform among the major brands within particular territories.

Second, the share of the market held by the major bottlers is such that intrabrand rivalry, if it existed, would likely be procompetitive. In fact, combining information about the extent of product differentiation and the height of entry barriers with the amount of concentration in the industry serves to reinforce this conclusion. Such information is provided in the paper which I have submitted to you for your consideration.

Last, I do not believe that territorial restrictions are needed in this particular industry in order to induce capital investment in the industry, because real investment in economic terms is generally forthcoming whenever the prospective rate of return exceeds the cost of additional capital. We have an established industry. If in fact a company is a new entrant or a failing firm, or even if a number of other special considerations exist which I spell out in my paper, I would gladly grant the need for this particular kind of restriction. But given the established nature of the industry and its structure, the rule of reason model developed by my coauthors and me would indicate that this industry, and particularly the very, very large firms in the industry, have no need for these restrictions any more, especially to gain market coverage.

I would like to close by making some general observations, some of which are admittedly value laden.

First, price competition should be promoted by legislation, not inhibited. Only in those cases where price competition is predatory in nature is there cause for concern on the part of legislators and enforcement agencies, and there are already a number of existing laws that can deal with predatory conduct. If territorial restrictions were eliminated in this country, desirable price competition should be enhanced.

Second, natural market forces are basically at the root of what is transpiring in the soft drink industry. They should be permitted to run their course.

Finally, let me re-emphasize that existing laws are available to curb concentration of markets, should increased concentration occur as the result of eliminating territorial restrictions.

In this regard, one might look closely at the merger activity in the industry—both horizontal and conglomerate.

To assume, though, that the legislation proposed here will make for a more competitive system in the long run in the soft drink industry is erroneous. We cannot make progress by standing in the way of natural market forces in order to protect individual competitors from competition.

[Article submitted by Professor Stern follows:]

AN APPLICATION OF A RULE OF REASON MODEL TO COCA-COLA'S USE OF TERRITORIAL RESTRICTIONS IN DISTRIBUTION

Louis W. Stern*
Eugene F. Zelek, Jr.**
Thomas W. Dunfee***

*A Montgomery Ward Professor and Chairman of the Marketing Department, J.L. Kellogg Graduate School of Management, Northwestern University; A.B., Harvard College, 1957; M.B.A., University of Pennsylvania, 1959; Ph.D., Northwestern University, 1962.

**B.S., University of Illinois, 1974; M.M., J.D., Northwestern University, 1978; Member, Illinois Bar.

***Professor and Chairman of the Department of Legal Studies and the Public Management Unit, The Wharton School, University of Pennsylvania; A.B., Marshall University, 1963; J.D., LL.M., New York University, 1966, 1969; Member, West Virginia Bar.

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PREFACE

Early in 1980, the California Law Review will publish a paper entitled "A Rule of Reason Model After Sylvania" which was written by the authors of this paper. Here, we show how the rule of reason model, summarized in Exhibit 1 and detailed in the forthcoming article, can be applied to Coca-Cola's use of exclusive territorial restrictions. At one time, the application was part of a larger manuscript, which explains why the footnote numbers begin with 179 and why some of the footnotes make reference to footnotes which are not reproduced here. In order to make certain that this paper was available for the Subcommittee hearings, it was necessary to leave it in its present form with only minor editing. The basic content of the paper will, however, not change even after a more thorough editing process.

Exhibit 1

Rule of Reason Decision Model After Sylvania

Steps

I. Identification

a. Identify the parties involved and their relationships to each other
b. Identify the restraints used and how they have operated
c. Trace the evolution of the restrictions
d. Identify the relevant market (product and geographic)

II. Per Se Tests for Horizontal Conspiracies and Vertical Price Fixing

III. Negative Impact on Intrabrand Competition

a. Negative impact: when any restriction significantly impedes or inhibits a distributor carrying a particular brand from attempting to win away customers seeking that brand from another distributor carrying it.

b. If no negative impact can be shown, the case is closed.

c. If a significant negative impact can be shown, proceed to Step IV.

IV. Importance of Intrabrand Competition

a. Is substantial intrabrand rivalry necessary? In other words, does the relevant market contain a sufficient amount of interbrand competition?

1. Structural analysis
   (a) level of concentration
   (b) extent of product differentiation
   (c) height of entry barriers
   (d) market power of the defendant
      (1) market share
      (2) product differentiation

2. If intrabrand competition has been significantly impaired and if it is essential to the preservation of competition generally, then examine the following special considerations. If none hold, the restriction is illegal.
   (a) new entrant
   (b) failing company
   (c) product safety and quality
   (d) broad societal issues

3. If there is a substantial amount of interbrand competition and/or the supplier has limited market power, go on to Step V.

V. Assessing the Effects on Interbrand Competition

a. Determine what the impact of the restraints has been and is likely to be on interbrand competition in the relevant market.

1. Examine the state of interbrand competition (see Step IV)
2. Examine restraint universality
3. Examine purpose of the restraint
   (a) Market coverage
   (b) Stimulating supportive activity

b. Determine whether the restraint is presently having or is likely to have a substantial positive effect on interbrand competition. If answer is "no," restraint is illegal, unless there are special considerations or off-setting factors (see Step IV).

If answer is "yes," restraint is legal.

APPLICATION OF THE RULE OF REASON DECISION MODEL

An appropriate test of the proposed model is provided by the Federal Trade Commission's complaint and subsequent decisions regarding the territorial restrictions currently imposed on independently owned, licensed bottlers of soft drinks sold under Coca-Cola and PepsiCo trademarks.[179] On April 28, 1978, the FTC ruled that such restrictions are unreasonable and anticompetitive.[180] Since the case is on appeal, and because of the obvious need for additional clarification of matters pertaining to distribution channels and vertical restraints, the likelihood is high that it will eventually come before the Supreme Court. The following discussion presents a topical example of how the proposed general model could be applied by the Court in specific commercial situations where customer and/or territorial restrictions are being challenged.

In the discussion below, reference is made only to The Coca-Cola Company's distribution system, as differences in the distribution systems of Coca-Cola and PepsiCo are not significant enough to warrant separate examination of each here. This narrow focus is supported by PepsiCo's agreement that the decision in its case before the FTC could be based upon the completed trial record of the Coca-Cola matter.[181]

Step 1: Identification

Coca-Cola is a diversified corporation with sales in excess of $1 billion.[182] In its Coca-Cola USA Division, the corporation manufactures and sells the soft drink syrups and concentrates used in the processing of finished flavored carbonated soft drinks sold under a number of trade names[183] licensed by Coca-Cola to approximately 700 bottlers operating slightly more than 800 bottling plants. Its syrup sales to these bottlers exceed $250 million. Not only does the corporation sell syrup to independent bottlers, but it also operates 27 bottling plants itself. All bottlers, whether independent or wholly owned by Coca-Cola, have been assigned exclusive territories.[184]

Historical Context of Territorial Restrictions[185]

The bottling of flavored soft drinks began in the United States in the latter half of the nineteenth century. Prior to that time, syrup had been used almost exclusively as a base for soft drinks served for immediate consumption at soda fountains. During this period, a growing number of extract or syrup manufacturers, including The Coca-Cola Company, entered the industry and began to develop and introduce many new proprietary flavors. Numerous companies franchised the right to bottle their common law trademarked products.

In 1899, The Coca-Cola Company granted an exclusive trademark license to J.B. Whitehead and B.F. Thomas to produce and sell bottled Coca-Cola in most states. Ancillary to the trademark licensing agreement, Coca-Cola specified an exclusive geographic territory in which only Whitehead and Thomas could vend bottled soft drinks under the Coca-Cola trademark. Because of the size of the territory, the company created by Whitehead and Thomas in turn franchised hundreds of independent local bottlers to produce and sell bottled Coca-Cola in exclusive geographic territories within that part of the country covered by the Whitehead and Thomas license. Other proprietary syrup companies soon followed Coca-Cola in franchising independent bottlers to produce and sell their trademarked soft drinks in exclusive geographic territories.

At this time, syrup companies were, for the most part, owned by entrepreneurs with limited capital and therefore, were largely small operations.[186] Establishing territorial restrictions which prohibited intrabrand competition encouraged greater initial development of marketing and distribution efforts during this early phase of the industry's life, because exclusive licensees knew that their licensors and other licensees could not obtain a free ride on their efforts. In addition, the restrictions facilitated the licensor's maintenance of quality control, permitted better production planning by enabling greater accuracy in forecasting syrup demand within a territory, reduced the selling cost of the product by avoiding duplication of territorial sales effort, and encouraged the bottler to develop the potential of its territory to the fullest. During these early years, most business-people "probably considered soft drink bottling little more than a newfangled invention with a questionable future".[187] Therefore, viewed in its historical context, the territorial exclusivity awarded to Whitehead and Thomas, and subsequently awarded to others, was no doubt important in attracting the manufacturing and distribution capital necessary to develop a new business and to expand the sale of a new product--finished Coca-Cola in bottles--into new markets.

Since its inception, the system of exclusive territorial licenses has been consistently employed in the manufacture and distribution of bottled soft drinks.[188] There are currently more than 50 syrup companies, and 36 of them operate nationwide. These firms market more than 150 different soft drink brands through 7,500 written agreements with 2,300 bottlers.[189] In sum, Coca-Cola, along with other syrup manufacturers, has contractually imposed and enforced territorial restrictions for nearly eight decades. The interactions between The Coca-Cola Company and its bottlers relative to these restrictions are well-documented and not disputed.[190]

Relevant Market

Coca-Cola and its allied products compete with local,- regional,- and national-brand carbonated beverages; private label soft drinks; and, to some extent, powdered mixes and noncarbonated drinks.[191] This broad market can be considered the global market for Coca-Cola based on subjective and objective estimates of the cross-elasticities of demand between Coca-Cola's products and the other products listed.[192] However, it is also likely that, within this global market, there exists a relevant submarket comprised only of carbonated flavored beverages. The marketing managers of the various soft drink companies (*e.g.*, Coca-Cola, PepsiCo, Royal Crown, 7-Up) direct the bulk of their energies and attentions to serving this submarket.[193] Thus, the suppliers to this submarket are the primary actors in the competitive arena relative to marketing decisions.[194]

The geographic markets for these products are circumscribed artificially. Local markets,[195] not national markets, are the loci of competition in soft drink bottling because territorial restrictions confine bottlers to competing in local markets.[196] It is not known exactly how widely shipments might be made if territorial restrictions were lifted.[197] When initally set, the territorial boundaries reflected the likely potential market out-reach of bottlers, given existing production, marketing, and transportation technologies.[198] However, with present day technologies, it is not impossible to consider almost all bottlers of soft drinks as potential competition, irrespective of location, especially if nonreturnable containers are being shipped.

Within the relevant product submarket as defined above, a major question is whether to include post-mix syrup sold by independent wholesalers for use primarily at soda fountains and in cup vending machines.[199] It could be argued that the entire bottling industry exists because of its ability to service the demand for soft-drinks in take-home packages. If one accepts this argument, the likely conclusion is that, in the sale of soft drinks in bottles or cans for home consumption which the bottler alone is uniquely equipped to serve, intrabrand competition from post-mix wholesalers is virtually non-existant. Furthermore, bottlers seldom make attempts to sell fountain syrup to the on-premise consumption market[200] because of the extent of price competition in that market.

While it is probably correct to view the pre-mix and post-mix markets as separate competitive arenas given the present situation, the separation is an artificial one. Because post-mix wholesalers do not have protected territories, they are subjected to both interbrand and intrabrand competition. Bottlers, on the other hand, have complete protection from intrabrand competition. It is, therefore, not surprising that they have chosen to devote little attention to the post-mix market. If territorial restrictions were removed, it is likely that, in the ensuing scramble for business brought about by the intrusion of competitors into previously protected territories, bottlers would find the post-mix market segment increasingly attractive.

Given this argument, the appropriate relevant market is the sale of carbonated flavored beverages, including post-mix sales by wholesalers, because there is presently some competitive overlap between firms involved in marketing post-mix and pre-mix soft drink items and because considerably more overlap would likely result from the removal of territorial restrictions. Within this market, a relevant submarket is the sale of Coca-Cola products by licensed bottlers in cans, bottles, and other pre-mix containers. This submarket can be segregated on the basis of its size and the commonality of distribution methods employed within it. Although the FTC chose to focus solely on this submarket, this is probably too narrow a view. However, it has also been adopted here, because data regarding the competitive significance of post-mix wholesalers are not in the public record or otherwise readily available. Such data could, of course, be obtained by an investigator buttressed with subpoena power.

<u>Step 2: Per Se Tests for Horizontal Conspiracies and Vertical Price Fixing</u>

<u>Existence of a Horizontal Combination or Conspiracy</u>

Coca-Cola's ownership of 27 bottling plants 201
indicates that the company is engaged in dual distribution--it is vertically integrated, on the one hand, and employs independent bottlers, on the other. While dual distribution is not a commerical curiosity or in any way unique, the issue raised in this case is whether Coca-Cola, in its role as a bottler, has somehow combined with other bottlers to divide markets through the use of territorial restrictions and exclusive distributorships which prohibit intrabrand competition.

In its opinion, the FTC explicitly recognized the seriousness of this issue. It distinguished the Coca-Cola situation from Topco's with the following reasoning:

> The Coca-Cola Company's forward integration by acquisition into the bottling industry did not alter in a substantive way either the nature of the restraints or the implementation [of] policies employed by The Coca-Cola Company with respect to established bottling territorial relationships. These restraints were in place nationwide for several years prior to Coca-Cola's entry into bottling. When it acquired a bottler, The Coca-Cola Company itself became subject to the same territorial limitations it had previously

> imposed upon the acquired bottler. . . . While it is true that respondents may at times resolve border disputes involving bottlers, unlike Topco, it has not been established on this record that the independent bottlers exercise control over any respondent or the way in which a respondent implements the territorial aspects of its trademark licensing programs. 202

It would, however, be somewhat naive to believe that the intrusion of a major corporation with franchisor status onto the plane of distribution occupied by less powerful concerns with franchisee status would not have some psychological, if not actual operating, effect on the latter. The fact that Coca-Cola was joining an already existing system rather than creating one upon entry makes it no less a participant in the market division.

The question of the existence of a horizontal combination is, therefore, debatable rather than, as the Federal Trade Commission has indicated, excusable. If there is sufficient evidence of a horizontal combination, the conflict with the FTC's position may force the Court to consider, for the first time in recent history, the possible "reasonableness" of such a combination. Thus, rather than adopt a per se standard, the Court might ask whether the combination is truly "pernicious" and "without redeeming virtue" if the purpose of the combination is to establish exclusive territories with the aim of promoting more effective interbrand competition. 203 Such an inquiry may also prompt the Court to investigate whether there is any difference in ultimate market effects between vertically and horizontally imposed and policed territorial restraints. The results of a horizontal division of markets may be indistinguishable from those gained under a vertically imposed division.

The Presence of Price Fixing

There is no evidence that resale price maintenance has been practiced by Coca-Cola in its dealings with its bottling network.[204] Apparently, the company has not used its power as a franchisor to set prices at the wholesale level, i.e., between the bottlers and their customers (grocery stores, restaurants, etc.). There is no justification, therefore, under the proposed decision model, for a per se ruling on this issue. From a managerial perspective, however, it should be noted that the need for any form of price maintenance is usually found when protection against intrabrand price competition is desired by either the dealers or by the manufacturer seeking to maintain an "orderly" distribution system at the wholesale or retail level. Because intrabrand competition is eliminated via territorial restrictions, resale price maintenance would be a superfluous policy.[205]

Step 3: Negative Impact on Intrabrand Competition

Because there exists no intrabrand competition within the territories assigned to its bottlers by The

Coca-Cola Company, the impact of the restriction on intrabrand competition is clearly above the threshold required for proceeding with application of the model.

Step 4: The Importance of Intrabrand Competition

The structural dimensions of particular importance in antitrust situations involving vertical restraints are basically those which would be important in any antitrust action in which restraint of trade is alleged. As indicated above, information with respect to the extent of economic concentration, the degree of product differentiation, and the height of entry barriers is necessary in order to assess whether the relevant market contains a sufficient amount of inter-brand competition such that the existence of intrabrand competition is relatively unimportant to the preservation of commercial rivalry in the market.

Industry Concentration

Within the relevant product submarket, the level of concentration is quite high. The top four syrup manufacturing firms competing for the flavored carbonated soft drink market account for about 70 percent of the nationwide sales.[206] While this figure varies by market area, the significance of it is that the industry can be characterized as oligopolistic in nature, and therefore, one would expect a high degree of mutually recognized interdependence in the setting of nonprice strategies and in pricing.[207]

The level of concentration is also high among bottlers within relevant geographic markets. 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.[208] Although the number of brands available to the consumer in local markets is generally large,[209] 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--[210] 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.

The potential consequences of this market structure are profound. First, one would expect to find territorial restrictions applied industry-wide, given the oligopolistic nature of the industry, and indeed, this is the case.[211] This means that, in any given territory occupied by a Coca-Cola bottler, it is unlikely that there will be more than two Pepsi Cola bottlers striving for business, depending of course on how the territories are drawn, and if there are two, they will not be competing against one another but will be competing in different areas within the Coca-Cola bottler's territory. Because concentration among bottlers is high, the industry-wide territorial restriction policy limits the extent of interbrand competition by limiting the total number of competitors in any given market area. Admittedly, competition may be intense with only a few sellers in the market, but the smaller the number of sellers, the more likely that the competition will be of a nonprice nature. Evidence indicates that prices in the industry are uniform among the major brands within particular territories.[212]

Second, the share of market held by Coca-Cola bottlers, as indicated by their frequent number one position in their territories and by the concentration ratios reported above, is such that intrabrand rivalry, if it existed, would likely be procompetitive. Given its strong position in the market, what happens to Coca-Cola affects the entire sphere of competition in the flavored carbonated soft drink market.

Product Differentiation

The major syrup companies have devoted a large amount of money and energy in differentiating their brands from those marketed by smaller syrup companies and their affiliated bottlers.[213] While prices within the oligopolistic core of the industry tend to be similar or identical due to the extent of mutually recognized interdependence which exists among the brands promoted by the major syrup producers, they are higher than those of the lesser-known brands because of the extent of differentiation which has been achieved. Moreover, the prices set for Coca-Cola and its closest competitors are higher than they would be in the absence of territorial restrictions. Key management personnel of The Coca-Cola Company and representatives of various bottling companies have predicted reductions in wholesale prices if the restrictions are lifted.[214] Lower prices for Coca-Cola would, in turn, exert enormous downward pressure on the price of other flavored carbonated beverages.

On the basis of these predictions, it is possible to conclude that the product differentiation achieved by Coca-Cola and the other major syrup companies for the end products made with their ingredients, combined with the existing territorial restrictions, have resulted in a pricing situation indicative of a significant amount of market power on the part of these companies and their franchised bottlers. As noted above, the greater the degree of product differentiation, the greater the importance of intrabrand competition in preserving vigorous commercial rivalry in an industry.

Entry Barriers

The existing territorial restrictions are, in themselves, barriers to the entry of new bottlers of current brands. For syrup manufacturers, entry is also blockaded but not as severely. To enter a market, a new entrant must either convince an existing bottler to "piggyback" its brand, or the entrant must establish a bottling network of its own to produce and distribute its product.[215] In the former case, potential competition is limited by existing management policies. For example, bottlers often produce and distribute only one brand of any given flavor. If a bottler is already marketing an orange-flavored soft drink, for instance, it will not accept directly competitive brands into its line. In the latter case, the absolute costs associated with purchasing high-speed bottling equipment alone are often prohibitive,[216] not to mention all of the other costs required to establish a bottling network. Therefore, significant efforts must be put forth to attract entrepreneurs and/or venture capital, and these efforts are likely to be time-consuming, expensive, and risky.[217]

Even in the presence of these barriers, it has been shown that achieving distribution through existing bottlers is not uncommon.[218] However, the extent of advertising and other marketing efforts required to establish a brand in a territory is likely to be high, given the present mode of competition in the industry.[219] Clearly, Coca-Cola's success has established a model for potential new entrants which is difficult to emulate without a vast outpouring of promotional expenditures.[220] Even without the territorial restrictions, it would be difficult to enter the carbonated soft drink industry, quite apart from the difficulty involved in securing production and then adequate distribution in retail stores, restaurants, and vending machines. Thus, extensive product differentiation not only affects the wholesale or retail price level, but also the height of the entry barriers in the industry.

Market Power

It would be difficult for anyone familiar with the soft drink industry or soft drinks generally to argue that The Coca-Cola Company and its individual bottlers do not have substantial market power. Simply on the basis of brand recognition alone, the success of Coca-Cola is nearly unparalleled. Nationally, Coca-Cola has achieved over a 20 percent share of total domestic food store sales of flavored carbonated soft drinks.[221] While market shares vary from region to region, it is clear that, despite some softness in its market share in recent history due to aggressive promotional efforts by Pepsi Coca, Coca-Cola is the leading member in an industry which, on the basis of the structural analysis outlined above, can be typified as a tight-knit oligopoly.

Even though numerous fringe firms exist within the industry, it is possible to conclude from the preceding discussion that *intra*brand competition would be beneficial, from a social welfare perspective, to the preservation and fostering of commercial rivalry among the major brands of soft drinks, given the restricted nature of interbrand competition. Aside from the questions raised about a horizontal combination, the restrictions on intrabrand competition which The Coca-Cola Company has imposed are clearly not producing countervailing benefits for interbrand competition.

The structure of the market is such that bottlers should be free to sell wherever they please in order to promote more vigorous price competition on the wholesale level among the major brands and thereby enhance an efficient and equitable allocation of resources throughout the industry and on the retail level.[222] Thus, in the absence of applicable special considerations, the current territorial restrictions employed by Coca-Cola are per se illegal.

Special Considerations

The Coca-Cola Company is neither a new entrant nor a failing company. While one of its independent bottlers may fail from time to time, The Coca-Cola Company has not hesitated to acquire it in the past[223] and could be expected to play a like role in the future without resorting to territorial restrictions as a means for propping up a financially distressed bottler in its network. Therefore, only the remaining two special considerations will be addressed here-- product safety and quality and broad societal issues.

Product Safety and Quality.-- While there are no apparent questions concerning product safety, there are issues of product quality in the Coca-Cola situation. However, the major concern here is whether territorial restrictions are reasonably necessary to assure quality. Presumably, the restrictions induce bottlers to manufacture a high-quality product and ensure that it is subsequently stored and merchandised in a way which prevents the buildup of stale inventory at retail outlets. While it may indeed be the case that the restrictions provide an incentive to bottlers to perform these necessary functions in soft drink production and distribution, there is little doubt that quality can be assured through much less anticompetitive means. The FTC opinion provides an excellent set of arguments in this respect, so they have been paraphrased below, with a few elaborations where needed.[224]

First, The Coca-Cola Company has instituted an elaborate and excellent inspection and sampling program relative to bottlers' manufacturing operations. The presence of intrabrand competition within a territory would have little, if any, effect on this program. Second, stock rotation at the retail level is also important for quality control purposes. Both of these functions assure that consumers will be receiving uniformly high-quality products consistent with the image of the Coca-Cola trademark. A store-door delivery system by bottlers permits the maintenance of appropriate stock rotation policies, because the driver-salespeople go into the stores periodically to check on the stock.

Under a system where territorial restrictions were eliminated, there would undoubtedly be more shipments of Coca-Cola made directly to grocery chain warehouses by bottlers located outside existing territories. The chains would then take the responsibility for delivering the product to individual stores. Driver-salespeople would play a limited role, and therefore, stock rotation might be less consistent relative to past behavior, given the number of items in the average supermarket which must be attended to by retailer-employed clerks.

There is no question that maintenance of quality control at the retail level is critical and that territorial restrictions aid in achieving it. However, quality control can be accomplished through a less restrictive alternative. The Coca-Cola Company could increase its sampling program in retail outlets, and each bottler could place an identification mark on its product 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.[225] Finally, there is nothing to prevent The Coca-Cola Company from insisting that, as part of its franchise arrangement, 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.

It is likely that the increased inspection and coding required will raise costs and that these costs will be reflected in the price of Coca-Cola and its allied products. However, the increase in competition when territorial restrictions are eliminated will serve to keep prices in line. The net effect to consumers and to the industry in general will be beneficial.

Broad Societal Issues.-- In the Coca-Cola situation, three broad macro issues are of some importance, aside from the micro issues referred to above. The potential effect of eliminating territorial restrictions should be examined with respect to (1) retail prices, (2) small bottlers, and (3) the ecosystem.[226]

(1) Potential Effect on Retail Prices. There appears to be general agreement among supporters and opponents of territorial restrictions that the abolition of such restraints would lead to reductions in retail prices paid for soft drinks. There is, however, disagreement as to the amount, extent, and duration of such price reductions.

The staff of the FTC has estimated that if territorial restrictions were eliminated, the average price of soft drinks would fall by as much as 5 percent, saving consumers $250 million per year.[227] Comanor, an opponent of the restrictions, has quoted two separate amounts -- $100 million and $1.5 billion -- as potential consumer savings that might result from their elimination.[228] The lower figure was suggested by Preston,[229] a proponent of the restraints, while the latter was developed by government officials opposing the restraints.

Although supporters of restrictions appear to concede potential price reductions, their admission is not without reservations. In fact, Preston questions whether the potential price reductions at the wholesale level would automatically be passed along to consumers.[230] At the same time, the president of the National Soft Drink Association contends that any price reductions to the consumer would be short-lived.[231] Indeed, he has suggested that if exclusive territorial arrangements were to fall pressures would be generated that would tend to increase the costs of soft drinks to the consumer at an accelerated rate.[232]

By and large, the issue of potential effect on prices presents a notably vulnerable point in the defense of territorial restraints. It is also a key issue over which there is some measure of agreement in the opinions of both supporters and opponents of territorial restrictions, in spite of the qualifying reservations of the former. The arguments that wholesale price reductions might not be passed along to consumers and that price reductions would be short-lived are, while plausible, not strongly convincing. In an industry as highly competitive as food retailing, it is difficult to imagine a wholesale price decline of 4 percent or 5 percent not being passed along to consumers, either in whole or in part.

The notion that consumer price reductions would be short-lived is partly predicated on the assumption that the larger bottlers would drive the smaller bottlers out of business in the long run through price competition.

Once this market "shakeout" occurred, the larger bottlers would supposedly be left in monopoly positions, allowing them to charge monopoly prices. However, a market shakeout is already occurring in the soft drink industry via mergers, consolidations, and the like, and it will simply be accentuated if territorial restrictions are removed. It is too simplistic to argue that the shakeout is and will be the result of price competition alone. Instead a series of market forces are at the base of the changing conditions in the soft drink industry, including the growth of chain grocers, the increased use of nonreturnable containers and private labels, the restructuring of consumer markets, and the growth in industry sales.[233] During a prolonged period of market readjustment, the prime beneficiaries of the price competition that is induced will be ultimate consumers, who should receive lower prices as a result.

Two major sources of downward pressure on retail prices are noteworthy. First, intrabrand and interbrand price differentials of up to 30 percent have been found to exist between contiguous territories.[234] These differentials reflect, in part, the fact that some territories are simply not large enough to offer operating economies of scale to bottlers attempting to serve them. Such scale economies will be achievable as territories are expanded once territorial restrictions are lifted. They will be a potent force in lowering costs at the wholesale level and thereby lowering consumer prices. Second, because the elimination of restrictions will enable retail grocery chains to deal with distant, price-competitive bottlers shipping one-way containers on a large-lot, warehouse-delivery basis, the lowered distribution cost should lead to reduced consumer prices.

(2) Potential Effect on Small Bottlers. It has been suggested that if territorial restraints were removed, some of the largest bottlers would grow at the expense of small bottlers, which would lead to an increase in concentration in bottling on both a nationwide and a regional basis. It has further been suggested that the number of different bottlers in any specific local market area would probably decline, decreasing the number of brands available in those areas and lessening interbrand competition.[235]

On the other hand, it has already been observed that there is currently a high level of market concentration in the soft drink industry at both local and national levels. At the bottling level, this is, in part, attributable to piggybacking. Elimination of territorial restrictions would probably bring about a reduction in the number of bottling firms but would also, in the period of market adjustment, generate more competition among the surviving firms than now exists. In the absence of restrictions, chain grocers and other retailers would be free to make their soft drink purchases from whichever bottlers offered the lowest prices and most attractive services. This factor would almost certainly lead to the elimination of price differentials among continguous territories and to lower consumer prices.

In addition, the small bottler faces a rather untenable position in the present system.[236] Given the changes in its market, in the products available (package sizes, brands, etc.) to better serve it and in increased labor and transportation costs, among other factors, the small bottler is faced with a major investment problem. As pointed out by the president of Coca-Cola Bottling of Los Angeles during Senate hearings on exclusive territorial allocation legislation:

> [N]ewer and faster canning and bottling lines are required in order to reduce production costs and to offset labor rates which. . . are among the highest in the nation. Equipment becomes obsolete more rapidly with changes in container sizes and packaging innovations. A high speed soft drink can line today costs between $750,000 and $1,000,000 depending on the size and support equipment. To justify this investment requires an annual volume of 4 to 5 million cases. It is obvious that these installations become possible only for the large volume entities. . . a situation not envisioned in the early years of the industry when franchise boundary lines were established.[237]

Thus, if the small bottler is to serve its market area in a satisfactory manner, it will have to undertake some costly plant modernization. This process will result in increases in the rated output of its bottling operation that can only be absorbed by increasing the size of its territory. It is obvious, therefore, why there have been numerous mergers among bottlers in continguous territories. The small bottler can either merge with another bottler and thereby become a "large" bottling operation, join a cooperative, or, without new investment and larger territories, it can slowly, but surely, fade from the market as its ability to serve its market becomes weakened and its labor and transportation costs increase. While it would be preferable to give the small bottler which can update its equipment and pursue competitive markets a fighting chance, the territorial restrictions do not provide it. Under this system, the small bottler must allocate resources inefficiently, and, as a result, it is faced with redundancy, eventual bankruptcy, or disappearance as a separate independent entity through merger.

There is no doubt that abolishing the existing system of restrictions will serve to accelerate the rate of decline in the number of bottlers, especially small bottlers. However, those bottlers that are eliminated will be those that natural market forces have determined to be allocating scarce resources inefficiently. The existing system does not appear to support or encourage the very conditions or qualities that make for an efficient and growing operation. Thus, it does not really protect or aid the small, inefficient bottler, even if that were socially desirable. Instead, it limits the competitiveness and opportunities for growth of the efficient bottler, irrespective of size.

(3) Potential Effect on the Ecosystem. One of the major consequences attending the removal of territorial restrictions will be the shipment of soft drinks in non-returnable containers across previously defined territorial boundaries to the warehouses of grocery wholesalers and retail chains. While soft drinks packaged in nonreturnable or nonrefillable containers already account for 45 percent of the sales of Coca-Cola in bottles and cans on a volume basis,[238] this percentage would be expected to grow as bottlers begin to compete for one another's customers. In other words, once territorial restrictions were eliminated, market outreach would be expanded. As outreach expands, it would become increasingly difficult for bottlers to serve distant customers on a store-delivery basis, which is the common form of distribution when "returnables" or "refillables" are used.

Aside from the retail price considerations addressed earlier, there are important ecological considerations which should be confronted. For example, a nonrefillable bottle is not designed to withstand the punishment of reuse. In its opinion, the FTC noted:

> Made of thinner glass than the refillables, products liability considerations dictate that it be used only as a one-way, one-fill container....While some jurisdictions have enacted litter laws which require the consumer

> to pay a deposit, which is refundable upon the return of the nonrefillable bottles and cans, the containers reclaimed are not returned to the bottler for reuse. Instead, the non-refillable bottles recovered from post-consumer waste streams are processed or recycled into crushed glass or cullet for glassmaking processes. 239

Thus, there are two environmental concerns noted here. One is the problem of litter, especially in those cases where jurisdictions have not passed so-called "bottle bills" which require deposits on nonrefillable soft drink and other beverage containers. The other is the problem of material waste associated with the inability to reuse the containers, except through an expensive recycling process.

At the same time, consideration must be given to energy and other resources (*e.g.*, water) consumed in the returnable and nonreturnable systems. For example, returnable containers are heavier and are transported in small trucks within limited geographic regions for the purpose of servicing individual outlets directly. The lighter weight nonreturnables are transported for longer distances in larger vehicles. Therefore, the petroleum consumption associated with the former system will undoubtedly be higher than with the latter, even when accounting for deliveries from the wholesale or chain warehouses to local food stores once the soft drinks are shipped to the warehouses by the bottlers. The trade-offs are significant, and only a full-scale impact analysis could foretell the net ecological damage or benefits accruing from the elimination of territorial restrictions, under the assumption that elimination of the restrictions will encourage greater usage of nonreturnable containers. Such an analysis is beyond the scope of this article. However, it will be assumed that this special factor is unavailable.

Given the history of intrabrand restraints in the soft drink industry, it is clear that they played an important role in fostering interbrand competition when the industry was in its infancy. But since it is also clear that the extent of interbrand competition--as measured by the traditionally applied market structure variables--is limited, it would be a rather futile exercise to attempt to show the procompetitive effect of the intrabrand restraints. After examining and rejecting the special considerations, analysis should end, and the court should declare the restrictions illegal. Nevertheless, in the interest of illustrating the proposed model fully, the next part will be applied.

Step 5: Assessing the Effects on Interbrand Competition

The extent to which restraints foster interbrand competition is only relevant when intrabrand competition is unnecessary to the preservation of effective commercial rivalry in the marketplace or when intrabrand competition is essential but a special consideration saves restrictions. Besides the structural measures investigated in the previous step, it is appropriate at this point to consider the universality of the restraint within the industry as well as the issue of whether market coverage and the provision of supportive activities might be enhanced by the existence of the territorial restrictions.

Restraint Universality

Within the soft drink industry, every major producer of soft drink syrup which employs a bottler network for the manufacture and distribution of its brand(s) has adopted the policy of establishing exclusive territories. The universality of this policy is predictable, due to the structure and, in particular, the economic concentration of the industry. As shown earlier, the widespread use of such restraints has a depressing effect on interbrand competition because they generally serve to limit the number of bottlers competing for customers in any one territory.

Market Coverage

Relative to inducing a market presence, it has been argued that because the soft drink industry is capital intensive, territorial restrictions preventing intra-brand competition create a climate conducive to capital investment.[240] Indeed, it is possible that territorial restrictions have been an effective instrument in encouraging the development of the deepest distribution and the highest level of product availability possible, because they have assured potential investors monopolies with respect to the marketing of individual brands. In this way, exclusive territories were an incentive used to lure and motivate franchisees. The consequence of taking away the right to provide this stimulus could result in a diminishing of the attractiveness of bottling with a concomitant disinvestment and/or merger period, leading to a lower level of market penetration.

While this argument is relevant to some extent for an emerging industry or distribution system, it has little support in the case of an established, ongoing situation, such as Coca-Cola's, where profits are positive. Territorial restrictions on competition are not needed to induce capital investment in the Coca-Cola bottling system, because real investment in such activities will continue whenever the prospective rate of return exceeds the cost of additional capital.[242] So long as the return from bottling operations is sufficiently high, entrepreneurs recognize that profits can be earned by the investment of funds obtained either from internal sources or from the capital markets.

Moreover, as demand expands in some markets, and contracts in others, the return on investment varies accordingly. When increased consumer demand calls for further investment in bottling facilities, the normal functioning of the market creates temporarily higher markups and increased bottler profits. These increased profits, rather than restrictions on intrabrand competition, serve as a signal for new investment. Eliminating Coca-Cola's territorial restrictions is not likely to affect significantly the level of investment in Coca-Cola bottling operations.

Alternatively, one could effectively argue that territorial restrictions might be needed if they were the <u>only</u> means by which a new syrup manufacturer could secure entry into the industry. After all, it is likely that the territorial protection given to bottlers in the early years impelled market presence and penetration. However, as the FTC eloquently observed in its opinion:

> While capital investment considerations. . . may justify a territorial restriction imposed by a new entrant or a failing or faltering firm, we do not, in applying Section 5 ordinarily distinguish between capital-intensive and less capital-intensive businesses by applying different antitrust standards to them, granting the former license to restrain trade because it promotes capital investment while mandating, in the case of the latter, that competition should be preserved. [243]

Relative to market coverage, territorial restrictions historically have provided incentives for bottlers to secure every conceivable location for soft drink sales. According to this argument, if an in-market bottler were not protected from intrabrand competition, its major accounts would be in jeopardy due to aggressive marketing practices of bottlers located outside its territory.[244] Without the major accounts, an in-market bottler would not be able to serve some of its smaller and unprofitable or marginally profitable accounts. Instead, the bottler would have to seek major account business elsewhere or else give away its profits to retain existing, but threatened, large accounts. Even now, it is maintained that bottlers serve many vending machine accounts, small outlets, and "special events" which they claim are unprofitable.[245] Presumably, they do this in order to obtain "paid sampling" of their products. The increase in product awareness through sampling supposedly makes the larger accounts profitable.[246]

Indeed, it is a rather curious argument that the interests of bottlers are furthered if all possible outlets, regardless of their profitability, are somehow permitted to receive deliveries of Coca-Cola. Perhaps the syrup manufacturers might desire such coverage because of the increased sales of syrup this policy might generate, but it would seem to be an unwise approach for bottlers to pursue over the long run. If the bottlers choose to serve such accounts because of the promotional advantages obtained,[247] then perhaps they can write off the losses sustained as an expense. The justification for using territorial restrictions for either market presence or market coverage has very little support in the Coca-Cola situation, or for that matter in many other situations, unless a new entrant or a failing company were involved.

Stimulating Supportive Activity

By prohibiting intrabrand competition, Coca-Cola hopes that all of its bottlers will provide the promotional and delivery services necessary to stimulate consumer demand, on the one hand, and adequately control the distribution process to and through retail outlets, on the other. The territorial restrictions are incentives or rewards; they are employed to induce the appropriate behavior from bottlers.

Their uniform application is designed to avoid the free-rider problem. If all distributors were not properly motivated to provide the necessary promotion and delivery services, then some of the distributors would want to take a free ride on the efforts of those which do by selling at lower prices in the territories cultivated and stimulated by the service-minded bottlers. In other words, some of the bottlers would let others provide the supportive activities desired by Coca-Cola and supposedly needed by the market. Like parasites, they would simply erode the market once the market has been made by the others.

The free-rider problem is undoubtedly significant for all manufacturers seeking to construct an effective and efficient distribution system. However, there are several critical considerations which must be addressed in assessing this justification for using territorial restrictions. First, if the services provided are important to some retail customers and household consumers but not to others, then certain bottlers will want to provide them to certain market segments while other bottlers will want to serve segments which do not desire them. The latter will charge lower prices commensurate with the fact that they are offering reduced services.

In fact, this may eventually be the case with regard to warehouse delivery of soft drinks and store-door delivery, if territorial restrictions are disallowed. That is, certain Coca-Cola bottlers will offer to ship large lots over long distances to retailers' warehouses at reduced prices. The retailers will then be responsible for store delivery and maintenance of shelf space.[248] Other bottlers will continue to offer in-store services and direct-to-the-store delivery to those retailers who do not wish to assume the distribution functions associated with marketing soft drinks effectively.

This segmentation outcome is already feasible. Bottlers can provide both warehouse delivery of Coca-Cola in certain types of packages, such as cans, and store-door delivery of bottles. As pointed out by the FTC opinion:

> [T]here appears to be a significant market among high-volume retailers for various delivery options. As a consequence, the competitive opportunities for small bottlers in open markets include not only the business which might evolve from central warehousing, but also the store-door trade to chain store outlets both within and outside their present territorial borders.
>
> [Furthermore,] many small bottlers would, absent territorial restrictions, have access to huge metropolitan markets in which thousands of soft drink retailers not serviced by central warehouses for other food items presently obtain Coca-Cola and allied products on a store-door delivered basis. . . . [S]tore-door delivery of nonrefillable containers in these metropolitan areas still holds substantial opportunities for growth and market expansion by small bottlers.[249]

The problem with advertising, as opposed to delivery systems, is that advertising is a public good. That is, once a product is advertised to consumers, demand is likely to be stimulated globally for the product; it will not, in the case of Coca-Cola, be particularized to a specific bottler. Therefore, any bottler permitted to do so could capitalize on the expenditure of another.

Given this free-rider potential, it is to be expected that if territorial restrictions were eliminated, many bottlers would become less and less interested in providing promotional services and that The Coca-Cola Company would have to absorb more of the promotional function in local market areas. This may even have ramifications for sign programs, point-of-purchase displays, local contests, and the like. There is little doubt that competition among bottlers would evolve rapidly into a more price-oriented rivalry than previously. Given the already high awareness level for Coca-Cola products, it is possible that this result will be more beneficial than detrimental. Whether increased promotional efforts on the part of bottlers are really as essential as they once were is questionable.

Additional Factors

If it were shown in Step 4 of this model that intrabrand competition is unnecessary because interbrand competition is reasonably vigorous or because the market power of the defendant is slight, then the broad societal issues outlined in that part would now be considered. However, as has been observed, there is no need to undertake Step 5 or to examine additional factors as part of it in the situation currently under scrutiny because intrabrand competition was found to be critical, and none of the special considerations are relevant.

Overall, it is difficult to find a great deal of justification for the continued use of territorial restrictions by The Coca-Cola Company. Even if the restrictions were not viewed as being illegal based on the first four steps, and were judged solely on the basis of the information generated in Step 5, it is apparent that the prevention of intrabrand competition in the marketing of Coca-Cola and its allied products is unwarranted.

FOOTNOTES

179. Coca-Cola Co., 91 F.T.C. 517 (1978), _appeal docketed_, No. 78-1364 (D.C. Cir. ______ 1978) [hereinafter cited as _Coca-Cola_]; PepsiCo, Inc., 91 F.T.C. 680 (1978), _appeal docketed_, No. 78-1544, 78-1545 (D.C. Cir. ______ 1978). [hereinafter cited as _PepsiCo_].

180. _Coca-Cola_, 91 F.T.C. at 674; _PepsiCo_, 91 F.T.C. at 696-97.

181. _PepsiCo_, 91 F.T.C. at 692.

182. _Coca-Cola_, 91 F.T.C. at 527, 607.

183. Such names are: Coca-Cola or Coke, TAB, Sprite, Fresca, Fanta, Simba, Santiba, and Mr. PiBB. _Coca-Cola_, 91 F.T.C. at 527.

184. _See_ note 24 _supra_.

185. This history is found in _Exclusive Territorial Allocation Legislation: Hearings on S. 3040, S. 3166, S. 3133, S. 3145 and S. 3587 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary_, 92nd Cong., 2d Sess. 1, 605 (1972) (Part 2; Appendix) [hereinafter cited as _1972 Hearings_].

186. _Coca-Cola_, 91 F.T.C. at 532; _1972 Hearings_, _supra_, note 185, at 606.

187. _Coca-Cola_, 91 F.T.C. at 612 n.12.

188. _Id_. at 532.

189. *Coca-Cola,* 91 F.T.C. at 532; *1972 Hearings, supra* note 185, at 588, 606.

190. *Coca-Cola,* 91 F.T.C. at 540-43, 607-09.

191. *Id.* at 619 n.21, 634-35, 643.

192. *Id.* at 619 n.21.

193. *Id.*

194. This submarket determination is essentially the same as that adopted in Borden, Inc., 89 F.T.C. 207 (1977) (interlocutory order) (ReaLemon case) and Kellogg Co., 91 F.T.C. 704 (1978) (interlocutory order) (Cereal case). It is, however, not quite as restrictive as in these cases. If it were, the relevant submarkets might be sugar-free and regular carbonated beverages.

195. Local markets are generally considered to be major metropolitan areas or, at most, entire states.

196. *1972 Hearings, supra* note 185, at 223.

197. This point is illustrated by the fact that Shasta, a company which sells only on a warehouse delivery basis, ships its products several hundred miles. *Shasta's Difficult Sales Goal,* Bus. Week, Dec. 5, 1977, at 125. *See* 1972 Hearings, *supra* note 185, at 589.

198. *Coca-Cola,* 91 F.T.C. at 623.

199. The administrative law judge found that "Coca-Cola sold by licensed bottlers in bottles, cans and pre-mix containers is subject to vigorous intrabrand competition from post-mix Coca-Cola sold by independent wholesalers," id. at 563, but the Commission rejected his conclusion. Id. at 620. It noted that Coca-Cola and its bottlers view the wholesaling of post-mix syrup as distinct from the soft drink bottling business and said that such distinction is a valid one. Id. Although the Commission recognized that some soft drink retailers may choose "either finished packaged soft drinks. . .or post-mix syrup which they can mix with carbonated water," id., it found that "the intrabrand competition which may exist between syrup jobbers and bottlers is confined to a limited, rather well-defined class of customers who cater to the cold drink market." Id. at 621.

In discussing the competition between the syrup jobbers and the bottlers, neither the administrative law judge nor the Commission confronted directly the question of whether post-mix syrup belonged in the relevant product market. Post-mix syrup was included in the Complaint's definition of soft drink products, id. at 518, and the Commission noted that "the trial below explored the implications of these restraints in an exceedingly broad framework which encompassed interbrand competition within the total context of the soft drink industry." Id. at 619 n.21.

200. Included in this market are restaurants, fast-food retailers, cafeterias, sports stadiums, and other types of outlets which serve soft drinks in cups, bottles, or cans for immediate consumption.

201. Coca-Cola, 91 F.T.C. at 527, 607.

202. Id. at 612-13.

203. This issue should have been dealt with more explicitly in Topco, and after Sylvania the Court may be forced to reexamine its holding in that case. See notes 91-96 and accompanying text supra.

204. Coca-Cola, 91 F.T.C. at 582, 615-16.

205. If the purpose of price maintenance is to "assure" that dealers earn a reasonable profit so that they can provide reasonable services in the face of severe interbrand competition, then price maintenance may be desired by manufacturers, even in the absence of intra-brand competition.

206. 1972 Hearings, supra note 185, at 223-24.

207. See Stern & Morgenroth, Concentration, Mutually Recognized Interdependence, and the Allocation of Marketing Resources 41 J. Bus. U. Chi. 56 (1968) (nonprice aspects); Washburn, Price Leadership, 63 Va. L. Rev. 691 (1978) (pricing).

208. _1972 Hearings_, _supra_ note 185, at 223-24.

209. _Coca-Cola_, 91 F.T.C. at 548-49, 628.

210. _Id._ at 636 n.38.

211. _Id._ at 640.

212. _Id._ at 640-41. However, monopoly profits do not appear to exist, as prices are relatively low. Also, there are numerous price promotions in the industry.

213. _Id._ at 643-44. _See_ Abrams & Koten, _Soda Showdown, Soft Drink Companies Prime Their Weapons in Market-Share Battle_, Wall St. J., April 26, 1979, at 1, col 6.

214. _Coca-Cola_, 91 F.T.C. at 642-43.

215. _Id._ at 636-39.

216. _1972 Hearings_, _supra_ note 185, at 198.

217. In this respect, it will be instructive to follow the success (or lack of it) of a new soft drink brand as it seeks bottlers. Abrams, _Pepsi, Coke, Veterans Launch King-Cola, Plan Soda Pop War_, Wall. St. J., Sept. 14, 1978, at 16, col. 2.

218. For examples of piggybacking with limited capital investment, see _Coca-Cola_, 91 F.T.C. at 569. However, this analysis ignores the promotion costs

necessary to establish the various brands mentioned in each market.

219. See Larner, *The Economics of Territorial Restrictions in the Soft Drink Industry*, 22 Antitrust Bull. 145, 147-48 (1977).

220. It is surprising that neither the administrative law judge nor the Commission addressed this critical issue directly. Therefore, there is no evidence presented as to the exact amount of expenditures required to introduce a new brand into a metropolitan area.

221. *Coca-Cola*, 91 F.T.C. at 571.

222. For concurrence, see Larner, *supra* note 219, at 145-46.

223. *Coca-Cola*, 91 F.T.C. at 528.

224. *Id.* at 631-34.

225. *Id.* at 632 n.35.

226. The discussion of the potential effect on retail prices and small bottlers of the removal of territorial restrictions has been drawn from Stern, Agodo & Firat, *supra* note 14, at 72-74.

227. *1972 Hearings*, *supra* note 185, at 224.

228. *Id.* at 453.

229. *Id.* at 396, 453.

230. *Id.* at 396.

231. *Id.* at 18.

232. *Id.* at 19.

233. *See* Stern, Agodo & Firat, *supra* note 14, at 71.

234. *1972 Hearings*, *supra* note 185, at 224.

235. *Id.* at 395.

236. *See* Larner, supra note 219, at 153-54.

237. *1972 Hearings*, *supra* note 185, at 198.

238. *Coca-Cola*, 91 F.T.C. at 645 n.48.

239. *Id.* at 647 n.51.

240. *Id.* at 626-27; *1972 Hearings*, *supra* note 185, at 36-37.

241. *1972 Hearings*, *supra* note 185, at 36-39.

242. *Id.* at 446. *See also* Stern, Agodo & Firat, *supra* note 14, at 74.

243. *Coca-Cola*, 91 F.T.C. at 626.

244. *See* Preston, *supra* note 12, at 512-19.

245. Coca-Cola, 91 F.T.C. at 627-28. See Posner, supra note 10, at 6.

246. Coca-Cola, 91 F.T.C. at 628.

247. Typically, a petroleum company will establish many more retail outlets than are necessary to adequately service a given market. Besides providing extra stations for consumer convenience, outlet proliferation carries with it the promotional advantage of keeping the company's name before the public. The cost of this approach is written off as promotional expense even when franchises are involved, as the company supports its dealers with sign programs and the like. The same type of promotional strategy is used by the bakers of white bread as route salespeople generally put many more loaves on the supermarket shelves than will be purchased before they return. The objective is to maintain as many facings as possible, even though a large number of loaves may have to be taken back and disposed of at a loss.

248. King-Kola is planning to adopt a warehouse delivery system. See Abrams, supra note 217, at 16, col. 2. Shasta already delivers on this basis only. See note 197 supra.

249. Coca-Cola, 91 F.T.C. at 660-61.

Chairman RODINO. Thank you.
Professor Preston.

TESTIMONY OF DR. LEE E. PRESTON

Dr. PRESTON. Thank you, Mr. Chairman. It is a pleasure for me to be here this morning to share the table with Mr. Stern who is a gentleman and scholar even in those areas where we disagree. I have been working in this area of concern to the soft-drink industry and other industries with the type of problems you are considering here for about a decade. I have visited a large number of soft-drink firms, and talked with a great many people in the industry. I have also been connected with the *Sylvania* case throughout its long history, having been an original witness in the district court, and favorably cited by the Supreme Court in its opinion, so I don't feel unfamiliar with the issues before you.

I would like to call your attention to some of the comments that have been made by some of the other economists that have served as witnesses in the course of these proceedings, because they present some different points from those that Professor Stern has raised. One is Prof. Oliver Williamson of the University of Pennsylvania who addressed this whole area of contractual marketing arrangements under what he called an efficiency presumption, that is, the presumption that these contractual arrangements are not unnatural, a term that Professor Stern has suggested in his testimony, but rather that they represent natural responses of firms to types of problems that they encounter in pursuing their affairs, and are adopted in the search for efficiency.

Professor Stern has asked why we wouldn't have this kind of problem in every industry. The answer is that most industries have not adopted this particular form of manufacturing and distribution because they have not found it in their interests to do so. When we find such arrangements I think we have to look at them carefully to see if they are not in fact efficiency-increasing arrangements, such that the economy would lose something if we in fact departed from them. That view of course was given explicit endorsement in the *Sylvania* case in a quotation that I included in my paper.

A second economist who has testified in this area is Prof. Victor Goldberg of California at Davis. Professor Goldberg has looked much more carefully at the soft drink industry itself, and has looked particularly at the price effects and cost effects likely to follow the elimination of territorial restrictions.

Professor Stern has said that there is no disagreement about the notion of falling costs and prices. That is not quite true. There is disagreement.

Professor Goldberg pointed out that even though there could be types of customers for whom costs may fall, such as the large retail chains, and those customers may or may not also pass along those cost decreases to their retail customers, the final consumers with which we are concerned, his general observation was that the FTC decision in this respect was, as he said, "almost certainly wrong." Instead, he called attention to two facts: First, the shift to chain-store distribution and warehouse distribution certainly involves a shift more in the direction of one-way containers, which are more expensive. Second, it involves cost and price effects on the rest of the market, that is the market that is other than the chainstore market. This now has to be served perhaps at an increasing cost as a result of the change in the marketing structure that might occur with elimination of the territories. So the net effect of increasing costs and prices in one part of the market, and possibly decreasing costs and prices in another part of the market, can simply not be ascertained in advance. And to assume that this is an efficiency increase is certainly naive.

Williamson and Goldberg both have the view that we cannot really even anticipate the cost and price results in the short run, much less the cost, price, and market structure results in the long run, that would ensue from an abandonment of the territorial system in this industry.

Switching over to page 9 of my statement, I would like to call your attention to another economist, Dr. Comanor, who testified against this legislation in the Senate as he has on previous occasions. Dr. Comanor expressed some concern over the state of concentration at the brand franchising level of the industry, that is the syrup industry rather than the bottling industry, and Dr. Stern has mentioned that also this morning. Dr. Comanor's remarks on this problem, this topic, are absolutely baffling to me. He says there seems to be substantial market power, but that the facts presented do not indicate that this has any connection with the bottling level of the industry or the territorial system.

Nevertheless, he thinks that, for reasons completely unexplained, it, that is the territorial franchise system, may be used to achieve anticompetitive results. That is a perplexing statement, and doubly perplexing in that the other economist who has looked into this issue, and who is no friend of the franchise system, as a matter of fact, Dr. Robert Larner, has explicitly found in a published paper quoted on page 9 of my statement, that "Territorial restrictions do not appear to be an important device for enhancing the market power of the syrup manufacturers."

So we have two economists that have looked at this matter, one I think more carefully than the other, and that is Dr. Larner, and they have come to quite opposite conclusions and I of course agree with Dr. Larner in that regard.

Beyond that, I believe that the bottling level of the industry, its structure and its behavior, actually serves to diffuse some of the potential effects of concentration at the syrup-producing level, and I have prepared a collection of data on page 11 to which I would invite your attention, to illustrate what I mean by that. I have some additional data in preparation but the notice prepared for this meeting did not allow me the time to get the brand-level data into appropriate shape to give you. I hope to be able to submit that later for the record, Mr. Chairman, if I may.

Chairman RODINO. Without objection, it is so ordered.

[The information follows:]

STATEMENT OF

DR. LEE E. PRESTON
MELVIN H. BAKER PROFESSOR OF AMERICAN ENTERPRISE
SCHOOL OF MANAGEMENT
STATE UNIVERSITY OF NEW YORK AT BUFFALO

ON H.R. 3567

BEFORE THE

SUBCOMMITTEE ON MONOPOLIES AND COMMERCIAL LAW

OF THE

HOUSE COMMITTEE ON THE JUDICIARY

November 15, 1979

Biographical Note

Lee E. Preston is Melvin H. Baker Professor of American Enterprise in the School of Management, State University of New York at Buffalo. He was educated at Vanderbilt University (B.A. 1951) and Harvard University (M.A. 1953; Ph.D. 1958), and was a member of the faculty of the School of Business Administration, University of California, Berkeley (1958-69). He was a Staff Economist with the Council of Economic Advisors, Executive Office of the President (Kennedy) during 1961-62, and a member of the White House Task Force on Antitrust Policy, 1967-68. He has testified frequently before Congressional committees, served as a member of the American Ecomomic Association Advisory Committee to the U.S. Bureau of the Census, and served as a consultant to a number of public agencies and private firms. He is the author of some seventy-five books, monographs, and articles dealing with a wide range of subjects in economics, marketing, management and public policy.

This is my second appearance before this Committee, and my fifth before various committees of the Congress, to discuss the legal and economic status and consequences of the territorial franchise system with particular reference to the soft drink industry.[1] Over the years, a number of different legislative proposals have been discussed, and a variety of problems and implications have been investigated. We are, however, once again today focusing on a piece of legislation, the purpose of which is "to make clear that the traditional territorial franchise system under which certain trademark soft drinks have been manufactured, distributed and sold is lawful under the antitrust laws, so long as there is substantial and effective competition among different products and vendors."[2] In other words, if the tests of competitive acceptability normally applied in antitrust matters are satisfied, the territorial franchise system should not be considered in itself an unacceptable arrangement for the manufacturing and marketing of soft drink products.

Prior Testimony

At the outset I would like to draw the Committee's attention to some of the salient points raised by other economists who appeared during the more extensive hearings conducted by the Subcommittee on Antitrust, Monopoly and Business Rights of the Senate Committee on the Judiciary last June.

Professor Oliver E. Williamson, of the University of Pennsylvania, emphasized in his testimony that contractual marketing arrangements, i.e., arrangements other than the two textbook extremes of (a) wholly uncoordinated market exchange between participants at successive stages of production and distribution and (b) complete vertical integration, may be presumed to arise from the search for greater efficiency.

He noted that: "The principal reason for maintaining an efficiency presumption is that this presumption better accords with reality. Not only are transaction costs real, but efforts to economize on them explain a good deal of economic activity within the enterprise system." (Prepared statement, pg.6).[3]

This general view was previously given explicit endorsement by the Supreme Court in the Sylvania case:

> "Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products."[4]

Recognizing this fact, the Court overturned the Schwinn decision, and reaffirmed the validity of a rule of reason approach to these issues. The FTC action against the soft drink industry was, of course, initiated in the shadow of the *Schwinn* decision. Nevertheless, it has continued to wind its way through the legal process, in spite of both the Supreme Court's subsequent reversal of that decision and an initial finding by the FTC Administrative Law Judge that the territorial franchise system did not, on balance, constitute an unacceptable contractual arrangement in the soft drink industry.

Also in the June hearings, Professor Victor P. Goldberg, of the University of California at Davis, applied the general principles enunciated by Professor Williamson to some of the specific features of the soft drink industry. He referred particularly to the FTC decision in the *Coca-Cola* case, and to the efficiency (cost) and price effects likely to follow from an elimination of territorial restrictions. Goldberg noted that it is generally agreed that an initial effect of eliminating the territories would be price competition focused on the larger chain store accounts, and an accompanying shift to warehouse, rather than store-door, delivery of soft drinks to major chain retailers. The Commission decision argued that such a shift would be "efficient," resulting in lower costs and prices. Goldberg, however, sharply disagreed:

> "This ~~decision~~ conclusion is almost certainly wrong. . . [Such a shift] would mean that in many regions route delivery systems will lose a significant piece of their volume. The remaining volume will have to spread over fewer sales. Cost per unit will, therefore, rise. Thus, the relative wholesale price of soft drinks sold through non-chain store outlets will rise relative to that in chain stores. . ." (Prepared statement, p. 6)

The initial impact on consumer prices thus depends upon two factors. First, as I have strongly emphasized in previous testimony, whether and to what extend wholesale price reductions are actually passed along to consumers -- any my own previous research revealed that they frequently were not.[5] Second, the relative importance of price-reduced and price-increased purchases in total consumption. (Food stores accounted for almost 60% of packaged soft drink distribution in 1978; some substantial portion of this figure would, however, be accounted for by stores other than large chain outlets.) Moreover, as Goldberg notes, it is reasonable to expect changes in other costs, including promotional activity, and in the importance of various package forms as well. Warehouse distribution over greater distances necessarily involves both greater transport costs and greater use of one-way containers, both of which add to, rather than reduce, both costs and consumer prices. Thus, to describe this entire process of market reorganization as unquestionably a shift in the direction of "efficiency" is, as Goldberg stated, "almost certainly wrong."

Competitive Conditions and Trends

My own view with respect to this entire situation can be simply stated. I believe that the present structure and behavior of firms in the soft drink industry presents ample evidence of and opportunity for effective competition in the marketplace. Furthermore, I believe that the likely effects of the elimination of the territorial franchise system would reduce, rather than increase, the strength of competitive forces in the industry.

Critics of the territorial franchise system in the soft drink industry have expressed concern that, on one hand, the system may permit the continued operation of small and inefficient, and hence high-cost, bottlers; and, simultaneously, that it may also result in increasing domination of soft drink bottling and distribution by giant multi-plant enterprises, and possibly by the franchise companies themselves. Even on the surface, these two possibilities seem somewhat contradictory, since the preservation of inefficient small firms would almost certainly imply limitations on the growth of very large firms, and vice versa. However, it is more important to note that neither of concerns is supported by the facts. On the contrary, the soft drink industry has adjusted to changing economic and technological conditions by the gradual combination and absorption of smaller bottlers into larger and more efficient enterprises. At the same time, the share of the largest firms, and of the franchise companies themselves, in overall bottling activity has not increased substantially in recent years. The principal trend seems to have been growth in the number and market share of moderately-sized, independent firms, which is precisely the type of adjustment that would be expected to promote efficient economic operations as well as maximum competitive flexibility.

In my previous appearance before this Committee, Chairman Rodino suggested in a question that there might be some way in which the franchise system itself had contributed to the decline in the number of smaller bottlers over the long run. I am happy to have an opportunity to make a more thoughtful response than time permitted on that occasion.

It seems entirely clear that the decline in the number of independent soft drink bottling companies over the long term has been caused by changing economic conditions -- primarily economics of scale in bottling and canning and increased efficiency in physical distribution. Changes in industry structure to achieve greater efficiency and respond to new market opportunities are, of course, highly desirable. The fact that such changes have occurred _within_ the franchise system demonstrates conclusively that this system does not constitute an insurmountable barrier to appropriate long-term economic change. However, there is no evidence or argument, to my knowledge, that the franchise system itself contributed in any way to the long-term decline in the number of bottling companies. On the contrary, I believe that traditional franchise arrangements undoubtedly made that decline more gradual and permitted the orderly transfer of economic interests in response to changing cost and demand conditions.

The traditional franchise system does, without any question, preserve the legal status of established business enterprises. It prevents the sudden collapse of many smaller independent firms that would inevitably occur if the best customers of these firms unexpectedly shifted their business elsewhere -- to the largest existing bottling companies, the franchise companies themselves, or to their own wholly-owned bottling units. Again, the franchise system will not prevent changes in the organization of the soft drink industry from taking place in the future, just as they have in the past. It will, however, affect the form, and therefore the speed of such changes, and in a manner that I believe to be desirable from the viewpoint of public policy.

Franchising and Brand Competition

A very different question about the competitive impact of the franchise system has recently been raised by Dr. William Comanor in testimony before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary (prepared statement, 26 September 1979). He points to the high levels of national concentration among soft drink branded franchise companies (not bottlers) and the relatively high rates of profit experienced by the leading firms, and concludes that "there appears to be substantial monopoly power in this industry." He adds immediately that "the facts presented do not indicate that this monopoly power necessarily rests on the vertical restraints which limit intrabrand competition in soft drinks," but nevertheless proceeds to condemn the franchise system because it "may indeed be used to achieve anti-competitive results" (prepared statement, p. 7).

I confess to being entirely baffled by Dr. Comanor's remarks, since they contain no shred of empirical evidence or analytical argument, and the sequence of statements appears on the surface to be inconsistent. Dr. Robert Larner, although also a critic of the soft drink franchise system, explicitly disagrees with Dr. Comanor on this point; he writes: "Territorial restrictions do not appear to be an important device for enhancing the market power of syrup manufacturers . . ."[6] Moreover, it appears to me that ~~his~~ basic premise -- that the major franchise companies enjoy a measure of market power -- has precisely opposite policy implications from those he so surprisingly suggests. If, indeed, nationwide concentration among the leading soft drink franchising firms is rather high, it is therefore all the more significant that the market positions of different types of drinks in different geographic areas are quite different, as the data in Table 1 reveals. (More detailed data by brand and major metropolitan markets are in preparation.)

The fact that specific geographic market positions are not the same in all areas and are not the same as national market positions strongly suggests that the franchise system has the effect of unsettling the market positions of the leading brands, both individually and as a group, and thus of reducing the potential impact of nationwide concentration (whatever it may be) on actual markets and customers. If one is at all concerned about monopoly power among the soft drink franchise companies, one might wish to preserve, rather than eliminate, the bottling manufacturing-distribution structure that may well serve to offset or diffuse it.

More important, it is necessary to consider the likely effect of the elimination of the franchise system on the role of the major franchise companies in local bottling and distribution activities. My own strong belief is that the major brand companies will lose as little time as possible in taking over the largest retail customer accounts for direct service. Such a development need not arise from any inappropriate "attempt to monopolize" but simply in order to prevent those accounts from being lost to the largest existing bottling organizations and/or to backward integration by the major retail customers themselves (i.e., the

Table 1. Soft Drink Flavor Mix, 1978, by Region.

Mix	North-East	South	East Central	West Central	South-West	West	U.S.
Cola	67.2	64.1	63.7	57.1	51.5	52.2	61.0
Lemon-Lime	9.4	7.8	11.1	15.3	10.2	18.1	10.7
Ginger Ale	2.3	2.3	2.7	*	*	*	2.0
Root Beer	*	3.3	3.0	3.6	*	*	2.7
Orange	3.4	3.0	*	2.9	1.6	2.7	2.6
Grape	*	2.3	*	*	1.2	2.5	1.8
"Pepper"-Type	3.5	7.7	4.7	5.6	25.3	11.2	8.9
Non-Carbonated	*	*	*	*	1.2	5.9	1.8
Other	14.2	9.5	14.8	15.5	9.0	7.4	8.5
TOTAL REGULAR	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Regular	85.7	90.6	87.3	88.7	90.5	86.8	88.3
Diet	14.3	9.4	12.7	11.3	9.5	13.2	11.7

* Included in "Other."

Source: NSDA 1978 Sales Survey of the Soft Drink Industry.

chain food stores) -- both of which developments would greatly alter the franchise companies' ability to determine their own branding, packaging and wholesale pricing policies. (The likelihood of these developments was recognized in some of the early FTC remedy proposals, but to the best of my knowledge all of these have been discarded as unworkable -- which, indeed they are.) The point, therefore, is that elimination of the franchise system cannot fail to extend the existing concentration at the brand-franchising level of the industry forward into bottling and distribution. If Dr. Comanor is at all concerned about the level of concentration and profits among the franchise companies, why he would wish their position expanded and strengthened in this fashion is entirely beyond my comprehension.

(or anyone else)

Consequences of Change

The major disagreement among the economic analysts who have studied this matter appears to involve the likely consequences of the elimination of the traditional territorial franchise system. My own conclusion is that elimination of the territorial franchise system in the soft drink industry would lead to five significant, and closely interrelated, developments:

1. Extensive vertical integration by the major brand franchisors.
2. Backward integration by major chain stores.
3. Geographic market expansion by the largest and strongest established bottlers.
4. Disappearance of minor brands from the market.
5. Disappearance or substantial contraction of a large number of smaller, but currently viable and profitable, bottling firms throughout the country.

Let us consider each of these briefly in turn.

Vertical integration by the major brand franchisors would seem almost inevitable, since they clearly have the resources to supply the product needs of the largest and most profitable customers served by any of their current franchisees. Whether the franchisors would choose to eliminate the franchisees entirely or simply permit them to survive, if possible, by serving the smaller and less profitable segment of the market is a secondary consideration. Undoubtedly, some bottlers would adapt and survive in an altered form, while some would simply disappear. In any event, the role of the franchisors in the bottling-canning and distribution phase of the industry would be substantially expanded, with a corresponding increase in the concentration of activity among very large economic units throughout the entire soft drink production and distribution system.

The position of chain stores in the production and distribution system for soft drinks would be substantially altered; and this alteration could take a number of different specific forms. Most obvious would be a backward integration into the bottling of franchised brands by the acquisition of bottling rights directly from the franchisors or the purchase of a small bottling franchise somewhere on the fringe of the chain store's market area. An alternative to franchise acquisition would, of course, be obtaining an extremely favorable sales contract from a weak bottler, to the advantage of the chain in terms of wider profit margins, but not necessarily to its customers in terms of lower prices. Finally, of course, if backward integration were prevented, the chains might respond to increased market power of the major brand franchisors and surviving large franchisees by placing greater emphasis on their own brand products, and even eliminating national brand items from their shelves altogether, as has been the pattern in fresh milk.

A third invevitable result of the elimination of territorial franchises would be horizontal geographic expansion of the largest bottlers, particularly their pursuit of the largest and most profitable customers in market areas accessible from their existing locations. Again, the effect of this type of expansion would be either to greatly curtail the operations of surviving smaller bottlers or to eliminate them altogether. In either case, there is an additional tendency toward increasing concentration and greater market control by a smaller number of large units within the production and marketing system.

Finally, as a consequence of all of the above developments, one can anticipate with certainty the disappearance of minor brands and smaller firms. Indeed, it would appear that the only way for a small bottler to survive after the loss of major large accounts to his franchise supplier or neighboring large bottlers, or as a result of backward integration by major retailer-customers, would be for the firm to cimbine all conceivable major brand franchises into a single operation for production and distribution to small accounts, for which segment of the market he would be effectively a monopolist, with high costs and, of course, high prices.

It is evident that each of these trends individually, and all of them taken together, point in the direction of increased concentration and declining product and price variety for soft drinks. As suggested earlier, these developments may also carry with them some implications for increasing costs, since larger territories inevitably increase transportation costs and also involve an extension of one-way packages, which are the most expensive forms of soft drink packaging. When these potential sources of cost increases are added to the possibilities of price increases due to increased concentration and bargaining power, there seems little reason to expect that competitive market forces would be strengthened, and certainly no reason to think that significantly lower final consumer prices would result.

I cannot understand how anyone would view such a pattern of increased concentration and reduced variety, with no clear guarantee of overall lower prices, as a favorable development from the viewpoint of consumer welfare. Indeed, it seems bizarre that attempted enforcement of the antitrust laws would push an industry in this particular direction. Hence, it seems to me that the economic implications and legal validity of the specific types of franchise arrangements long utilized in the soft drink industry should be examined, if at all, on a case-by-case basis to determine the strength of competition in specific market areas, the net effects of existing franchise arrangements, and the likely impact of any feasible alternatives. This principle is precisely embodied in the piece of legislation before your Committee, and I am pleased to have this opportunity to endorse it as strongly as possible.

As a final remark, I should like to emphasize that if it should appear -- either as a result of court decisions or simply as a result of delay -- that the territorial franchise system in the soft drink industry is legally invalid, then widespread changes in industry structure can be expected to occur which would almost certainly be nonreversible. Thus, if large bottling and canning operations can expand quickly to capture the most desirable customers in neighboring territories now served by smaller firms, subsequent Congressional action confirming the validity of the territorial system would be of little effect. Indeed, the more likely it appears that Congress will eventually take such corrective action, the greater incentive large firms would have to invade neighboring territories -- and franchisors to begin serving final retailer customers -- even on a break-even or below-cost basis, in order to obtain the permanent advantage of market control. For these reasons, I believe we are dealing with a situation that, once substantially altered, cannot be restored to its present state. If, in fact, it is the intent of the Congress that the historic pattern of manufacturing and marketing arrangements in the soft drink industry shall be permitted to continue, and particularly that the economic values of the smaller firms involved shall be protected, then definitive Congressional action simply cannot come too soon. It will do no good for the Congress to act later to protect those interests; they will simply be gone.

Footnotes

1 Hearings before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, U.S. Senate, 92nd Congress, pp. 52 - 81; June 4, 1979, in press; Hearings before the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, U.S. House of Representatives, 93rd Congress, 2nd Session, June 27, 28, July 1 and 2, 1974, pp. 367-390; Hearings before the Subcommittee on Monopolies and Commercial Law of the Committee on the Judiciary, U.S. House of Representatives, 94th Congress, 2nd Session, June 24 and July 1, 1976, pp. 392-412; Hearings before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, U.S. Senate, 92nd Congress, 2nd Session, August 8, 9, 10 and September 12 and 14, 1972, pp. 392-399.

2 Report of the Committee on the Judiciary, U.S. Senate, 93rd Congress, 1st Session, June 4, 1973, p. 3.

3 See also O. E. Williamson, "Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach," University of Pennsylvania Law Review, Vol. 127, No. 4 (April 1979), pp. 953-993.

4 Continental T.V., Inc., et al. v. GTE Sylvania, Inc., 433 U.S. 36 (1977), at 54.

5 Paul E. Nelson and Lee E. Preston, Price Merchandising in Food Retailing: A Case Study, Institute of Business and Economic Research, University of California, Berkeley, 1966.

6 Like some other commentators on these issues, Dr. Larner appears to be of two minds as to whether the franchise system causes the total number of bottlers to be less or greater than it would otherwise be. The thought that the number may be less is suggested by his remark that it "reduces the number of potential price-cutters" (p. 151); however, his impression that "a large majority of soft drink bottler are below minimum efficient size" suggests that the franchise system maintains a larger number of bottlers than would otherwise exist. Whatever the past situation, Larner eventually concludes that "The small bottler will disappear whether territorial restrictions end or remain. The important issue . . . is whether the wealth of small bottlers will be maintained or decreased . . . If territorial restrictions are declared unlawful, the value of many small bottlers' assets will fall to virtually zero." (Emphasis added) R. Larner, "The Economics of Territorial Restrictions in the Soft Drink Industry," Antitrust Bulletin, Vol. XXII, No. 1, Spring 1977, pp. 145-156.

Dr. PRESTON. Thank you. The data we have on page 11 is helpful enough. What I want to draw your attention to is the differences in the relative importance of different types of drinks—this is, as you will note, by flavor, not by brand—in the different parts of the country. This shows us that because of the operation of the bottlers, as well as of course because of regional differences in taste, weather, and everything else, there are very substantial regional differences in the relative market shares and market positions of different types of drinks.

This says to me that the structure of the manufacturing and distribution phase of the industry in bottling serves to offset some of the tendencies that you would think would arise from the level of concentration at the syrup level. I feel that the independent bottling industry is a procompetitive factor in this market and industry, and that the idea of reducing its economic position and vastly altering its mode of behavior would be very harmful to the way that the industry is in fact serving the public.

Now, my main conclusions as to the effects that would flow from the elimination of territorial franchise system are summarized on page 13 of my statement. They are, just to read them quickly, vertical integration by major brand franchisors. I think that is by far the most important effect and will have a very significant increase on concentration throughout the entire industry.

Second, backward integration by the chain stores.

Third, market expansion by the largest and strongest established bottlers.

Fourth, the disappearance of the minor brands.

Fifth, disappearance or substantial contraction of a large number of smaller bottling firms.

As far as I can see, all of us, all of the economists that have looked into this matter, including Professor Stern and myself, agree about these matters. Where we disagree is about the significance of their impact. My view is that their impact is and cannot be other than a very substantial increase in concentration, a very great increase in the rigidity of the industry, and a departure from competitive patterns of behavior and development over time.

Professor Stern says this can all be dealt with by existing law. My answer is we don't have any problem if we don't create additional concentration, and so then we don't have to go into the law again to correct a situation which will not requre correction if it does not occur.

I have just come from a 6-month jury trial. It focused on predatory marketing practices and predatory pricing. I can assure Professor Stern, as I know this committee knows well, that adjudicating issues of increased concentration and possibly predatory behavior in an unsettled market situation is very, very difficult.

We have about 15 years of experience behind us in the *Schwinn-Sylvania* saga, and it is not over yet. Professor Stern asks: "Why single out the soft drink industry for this legislation?" The answer is very simple: The soft drink industry was singled out by the Federal Trade Commission in its attempt to apply the *Schwinn* rule, a rule which had been overturned by the Supreme Court. And yet this judicial event—the litigation that has arisen out of the attempt to apply the *Schwinn* rule to the soft drink industry—still proceeds while the rule is gone, having been eliminated in the *Sylvania* case.

The bill before you, it appears to me, is an attempt to permit the Congress to do precisely what Professor Stern thinks is needed, that is, to provide some direction to the courts following the *Sylvania* case, as to what the appropriate standards shall be. And the standard it seems to me is directly stated in this piece of legislation, that the product be in substantial and effective competition with other products of the same general class.

Thank you.

Chairman RODINO. The gentleman from Missouri has a unanimous consent question.

Mr. VOLKMER. I ask unanimous consent that the subcommittee permit the hearing this morning to be covered in whole or in part by live television broadcast, radio broadcast, and/or still photography, pursuant to rule V of our committee rules.

Chairman RODINO. Without objection, it is so ordered.

Professor Stern, in the article you wote in 1976, you cited statistics showing that plants with volume over 2 million in sales accounted for 69 percent of sales in the soft drink industry, and that was up 59 percent in 1968. Would you have an estimate as to those percentages for today?

Dr. STERN. No; I really don't know, Mr. Chairman, what those percentages would be, but my guess would be that they would have increased, that in fact the larger plants are becoming more and more important as a total in the industry, but I don't know specifics of the increase.

Chairman RODINO. Let me ask you, since you have presented these papers and made such a study of this question, is there anything that is so unique about this industry that this kind of exemption is necessary in order that the industry continue to exist or to protect the interests of the consumer?

While we have to recognize that it has got to be profitable—and be assured that in this competitive world it would be able to sustain a profit—but taking that into account, is there anything so unique in this industry, suspicions, that would require this committee to take this kind of unusual action?

Dr. STERN. I wish I could think of something, Mr. Chairman. I have scratched my head over that many, many times and tried to understand why it is that the industry is really being singled out. I realize that there are lots and lots of bottlers and that, in fact, they would like some protection from competition, but I also think that there are lots of bakers, there are lots of beer distributors, there are lots of farm implement dealers, there are lots of automotive dealers, each of which is part of a franchise system, each of which has a territorial restriction or at least a location clause which the *Sylvania* decision addressed itself to.

I find it very, very difficult to justify in my own mind why it is that the soft drink industry has been singled out. And if, in fact, there is a problem in this area, if we all agree that there is a problem, which I am not sure there is, I think *Sylvania* decision has handled that. But if there is a broad problem, then we need general legislation, not just a piece of legislation focusing on one particular industry.

If a case was brought under the *Schwinn* decision, as Professor Preston has mentioned, by the Federal Trade Commission, surely one would have thought then that once the *Schwinn* decision sort of folded away, because of the *Sylvania* decision, that maybe the case would have gone away. But in fact it didn't, and it didn't because, when trying to apply the rule of reason that came out of the *Sylvania* decision, the Federal Trade Commission said there are some critical issues here, and that is exactly what they wanted to look at in the Coca-Cola situation and did look at when the case went to the circuit court of appeals.

In answer to your question, I just don't understand why it is that this legislation is really before us, but that is my own confusion.

Chairman RODINO. May I ask a further question. I suppose that you might make a comment or not if you wish. In view of the fact that the courts are considering this matter, do you think that Congress should at this time, given the circumstances and given the questions that rise, should the Congress at this time interfere and write this kind of legislation?

Dr. STERN. I really would be antagonistic toward that. The reason for that is that the case has come a good deal along. I mean, it is not as if it is going to be years and years and years in the deciding. There have been tremendous arguments on either side, and it is now in the circuit court of appeals, and the decision should issue forth, shortly after the first of the year.

It will possibly go on to the Supreme Court, because some of the issues are really significant issues. I would love to see for all of marketing—I am talking about the whole of the marketing field—what the court decides on that case, given the strong arguments on either side, and I would like to see Congress wait, and if in fact the decision that comes out of the Supreme Court is one that is onerous to the Congress, then the Congress can, on the basis of that increased knowledge and increased information, frame a much more insightful law.

Chairman RODINO. May I ask another question. The proponents of these territorial agreements say that only the present system allows for returnable bottles. Do you believe that restricted territories encourage the use of returnable bottles?

Dr. STERN. I think that they probably would.

Chairman RODINO. That would be an argument in favor.

Dr. STERN. Right. That would be an argument in favor of restricted territories.

Chairman RODINO. Would such an argument in favor, would that have great weight, and should that then justify the writing of such legislation?

Dr. STERN. I am a great believer in what is called market segmentation. That is the ability to serve various market segments with various kinds of services. What would happen if restricted territorial situations fell by the wayside is that certain bottlers would serve certain kinds of accounts on a store-door delivery basis with returnable bottles. Other bottlers would serve other kinds of accounts with nonreturnables. It would be a natural market selection process.

I agree totally with Professor Preston. There will be some losers. There will be some winners. But this is exactly what this whole situation is about. The returnable bottle issue is a question that has to do with litter. It also has to do with energy conservation. There are a whole host of other issues in that.

In my rule of reason model, I say that that is one of the kinds of issues that can become a special consideration, that should be looked at, but it is not a dominant issue. What I try to establish is that there are certain presumptions, and then one would go to that special consideration.

I cannot say whether the returnable bottle issue should be so tied into this issue that it should overrule every other thought that we have about competition.

Chairman RODINO. What do you say, Professor Stern, to those who have appeared in support of the legislation, and who say in their testimony to the subcommittee that bottlers are reluctant to invest in additional plant capacity, because of the uncertainty of the FTC decision, and the Congress should act immediately, even though the courts cannot decide just now?

Dr. STERN. I would probably say that if I were in the soft drink industry, and I were a bottler, I would probably hesitate too. It would be an imposition to wait and see what is happening in the *Coke* case, but it isn't up to the antitrust laws to prohibit or to promote additional investment in an industry. It is up to market forces to do that, and I think that the Federal Trade Commission in its opinion on the Coca-Cola case made an excellent point on that, that it is not up to the antitrust laws to either influence investment or to stimulate investment. It is a question now of judicious business decision and business practice, so I am not concerned over the fact that people are waiting. I would tell them to wait, too.

Chairman RODINO. Let me ask one question of Dr. Preston. Dr. Preston, in 1976 you testified before the subcommittee on the need to enact legislation to have the legality of exclusive territories judged under the rule of reason. Why is this new standard for judging legality of exclusive territory in the soft-drink industry necessary at this time, and it wasn't considered necessary then?

Dr. PRESTON. The same essential point is being made now that was being made then, Mr. Chairman. I have a little different interpretation of what happened at the FTC from that given by Dr. Stern. We are neither attorneys and so we are probably encroaching in areas that we perhaps had better not tread. But in reading the FTC decision and in much of the preliminary material that went on before, I think we do have to remember that the FTC proceedings started out as a per se illegal proceeding. At the administrative law judge level I feel that the administrative law judge definitely moved it from that to a rule of reason proceeding, and as such found that the territorial arrangements were acceptable.

I am sure you have looked at the decision, when it got to the Commission, and you can make your own analysis of it. But the truth is, Mr. Chairman, that the Commission, as far as I can see, did not find an absence of competition in the soft drink industry. It did not find the prices too high. It did not find an objectionable situation that needed correcting, except some kind of lingering effect of this initial presumption that the territorial franchise system was illegal.

Chairman RODINO. That may be the case. Let me ask you this, though. Asking you to testify, and I recall your testimony, and your testimony was to the effect that at that time the rule of reason would have been all right with you. Why do you seem to find that a different standard is necessary today? What has changed?

Dr. PRESTON. Sir, I do not feel that the Commission genuinely applied a rule of reason.

Chairman RODINO. That is not the question. The question is you understand the rule of reason is just. Why do you now feel that the rule of reason is not justly applied in such situations, and you are changing your standards now, or am I misunderstanding what you are presenting?

Dr. PRESTON. I hope there is no misunderstanding, Mr. Chairman. I feel that the statement of substantial and effective competition presents guidance to the meaning of a rule of reason. That would be my understanding of what a rule of reason is.

Chairman RODINO. Let's put it this way. Would you support the same bills that you supported in 1976 today and feel that they would be adequate? You considered them the case then, made a pretty strong case, as I remember.

Dr. PRESTON. Yes.

Chairman RODINO. A pretty strong argument, I may say.

Dr. PRESTON. I have not changed my own position at all, Mr. Chairman. I have not changed my own position at all. I view these bills as all aimed at the same purpose, as having this situation examined on its competitive merits, which I do not think has in fact occurred yet, in the final decision.

Chairman RODINO. Frankly, it is my opinion, that the kinds of standards that you were seeking then are different from the standards you are seeking today. This is what bothers me.

Dr. PRESTON. Well, sir, I do not intend or see such a difference, except that the present legislation before you is an attempt to explain, to clarify, to refine the meaning of a rule of reason approach.

Chairman RODINO. Thank you.

Mr. McClory? Mr. Fish?

Mr. FISH. Thank you, Mr. Chairman. I thank the gentleman from Illinois as well.

Dr. Preston, the chairman asked Dr. Stern a question as to whether or not he believed there is anything so unique about the soft drink industry that we should apply special standards for determining legality of exclusive territorial restraints under the antitrust laws, and I would like to have your response to that question on the record as well.

Dr. PRESTON. Mr. Fish, I think that the simple fact is that this form of manufacturing and distribution under contractual arrangement has evolved in this industry over about 100 years, has become the framework for competition, for the expansion of markets, for the development of products, for the development of firms in this industry. Every industry has its own unique features. This happens to be a feature of this industry.

I see no reason to believe that this feature has within it something so undesirable that it should be abruptly eliminated, and I think that the clarification of that fact is a perfectly legitimate act.

Mr. FISH. I think you mentioned earlier in your testimony that it was the government that has focused the attention on the soft drink industry.

Dr. PRESTON. That's correct, Mr. Fish. This whole matter came up because of the FTC's attempt to apply a rule which has now been reversed by the Supreme Court.

Mr. FISH. I would like to have you elaborate on the conflict in the testimony before us. On the one hand, we are told that if not bounded by territorial restrictions small bottlers can, with the aid of food brokers or distributors, capture a large part of urban markets while you have implied that the end of the territorial franchise system will lead to the sudden collapse of many smaller independent firms. We are faced with two conflicting opinions, therefore, and I wonder if you could explain the discrepancy.

Dr. PRESTON. Well, I was surprised that that statement appeared in Dr. Stern's document, because we are not at all disagreed about the collapse of a large number of small firms. Dr. Stern said that before and said it again in his statement today. I certainly think so, and all of the analysts that have looked into the matter think that that is the case.

It seems to me quite preposterous to think that small bottlers would be enabled to make the investment, make the production, get the contracts, to get large sales volumes established on the periphery of their existing territories, when there are already large bottlers and canners and of course the franchise companies themselves, that is the syrup companies themselves, ready to ship into those territories at a moment's notice. There is no reality in that possibility.

Dr. STERN. May I add something, Mr. Fish?

Mr. FISH. Certainly.

Dr. STERN. Somewhere in the process of all this it seems to me that the assumption is being made that a small businessman, or anybody with a plant threatened by major competition, is going to roll over and play dead, and I can't believe that. Now, I do believe that there will be market attrition. I do believe that there will be a shakeout in this industry. The shakeout is occurring right now. It is going on right now, with restrictions and will go on without restrictions, but why shouldn't small bottlers resist and fight like the devil for their territories?

Mr. FISH. I believe that is why we are here today—for that very reason.

Dr. STERN. That is right. But I think what they are doing is they are fighting for a piece of legislation to protect them from competition as opposed to saying let's take off the gloves and let's get down to bare knuckles, because I can now invest and obtain a plant with a capacity that allows me to achieve economies of scale. I am going to go after Jewel in Chicago as a customer, if I am Coca-Cola of Wisconsin, and not just give it up.

Mr. FISH. If time permits, I do want to get back to you because you inferred something along those lines in your testimony. But continuing with Professor Preston for a moment here: Professor, Dr. Stern in his testimony on page 5 says, "There appears to be general agreement that elimination of existing territorial restrictions may lead to reductions in retail prices paid for soft drinks." Do you agree with that statement?

Dr. PRESTON. No; I don't, and neither does Professor Goldberg.

Mr. FISH. I thought it was a bit broad. Further, in his conclusions, "If territorial restrictions were eliminated in this industry, desirable price competition should be enhanced."

Dr. PRESTON. I don't think we can jump to that conclusion at all. There is, however, one conclusion that we can jump to or proceed to, and it follows directly from the point you just raised a moment ago, Mr. Fish, about the decline of the number of small bottlers. This was also the conclusion of Dr. Larner when he looked into this matter. If I could call your attention to the very last sentence in the last footnote on my paper on page 18 from Dr. Larner, saying, "If territorial restrictions are declared unlawful, the value of many small bottlers' assets will fall virtually to zero." Under circumstances like that, and I think that is a very correct statement of the circumstances, I question the ability of these firms to fight back.

Mr. FISH. Thank you very much.

Dr. Stern, on page 8 of your testimony you made the statement, "It would be preferable to give the small bottler a 'fighting chance' by updating his equipment and freeing him to go after business wherever he can secure it."

Would you like to elaborate on the steps you had in mind to provide this fighting chance?

Dr. STERN. Yes. I think that freeing him up from his present territory, allowing him to seek investment, seek moneys, to expand his plant, or at least update it, to be able to produce with the level of efficiency that surely other competitors may have. The territories are not drawn one for one, so if you're a Pepsi-Cola bottler or a 7-Up bottler, and you are in a small territory, you could be facing somebody, let's say a Coke bottler, who has a larger territory, which includes yours. He is much more efficient than you are. Therefore, he is selling at a lower price in your particular territory.

I would like to see the small bottler given the opportunity to expand his market outreach, and we learn from Mr. MacDonald that there are certain economies of scale in production, and given those economies of scale, you have to have a specific rated output for your machinery. That rated output may not be able to be absorbed by the territory that a small bottler now has, so what I am saying is let's give him a chance to fight and get that market share, get that volume, get that revenue by going outside of his existing territory, and seeking business wherever he can get it. Otherwise somebody else is going to knock him off.

Mr. FISH. If I understand the thrust of your testimony, particularly with respect to page 7, it was that, in your judgment, greater concentration in larger, more efficient bottlers is inevitable. Are you proposing tax credits or accelerated depreciation for the smaller bottlers to give them a fighting chance?

Dr. STERN. No, no, I don't think that that is necessary. I think that they can do the job. It is good old American enterprise.

Mr. FISH. Doesn't that go against everything to which you testified?

Dr. STERN. Oh, no.

Mr. FISH. The fact that the plants get obsolete and they can't compete and that concentration is inevitable?

Dr. STERN. And would give them tax credits?

Mr. FISH. How do you reconcile the good old American free enterprise, slug-it-out philosophy, with the fact that concentration is inevitable?

Dr. STERN. I am only saying that concentration in terms of the size of the plants that they are going to have to establish is inevitable. It isn't necessarily that concentration will get higher. Concentration means economic concentration of an industry. It means that the top four firms will get larger, or the top eight firms will get larger and the smaller firms will melt away.

I have agreed with Professor Preston that increased concentration is a possibility, that there is a possibility of that happening, because of technology, because of competition, because of the existence and availability of being able to fight with one another. But in no way would I ever walk in and say: Well, because a small competitor is being displaced by changing market forces, that he should be protected. Just take a look at that same page, if you will, on page 7 at the top, the statement by Lucian Smith, president of Coca-Cola, U.S.A. He said:

> Improved transportation, changes in communication systems, economies of scale, shifting population concentrations, and changing tastes and income patterns have tended to reduce the number of bottling plants and increased the size of some territories.

That is the kind of thing that I am referring to, so if in fact the small bottler goes by the way of all flesh, then that is market competition, Mr. Fish, and that is his lot. But he, I think, should have a chance to fight against this, rather than being restricted to a small territory where he can't update his equipment.

Chairman RODINO. The time of the gentleman has expired.

Mr. FISH. Thank you, Mr. Chairman.

Chairman RODINO. The gentleman from New Jersey.

Mr. HUGHES. Thank you, Mr. Chairman.

I want to thank the panel for what I sincerely believe has been a very helpful dialog this morning. I wasn't sure I understood, Dr. Preston, your response to the chairman relative to your testimony in 1976 and your testimony today. As I understand your testimony in 1976, it was that you believe that the rule of reason should apply and that there should not be arbitrary rules to determine whether there is a lack of competition in the marketplace. That should be a matter of fact based upon each individual situation.

Is your testimony today that you still believe that that in fact should be the rule, the rule of reason should be applied, and that we should decide on the basis of the facts in the marketplace as to whether there is ample competition?

Dr. PRESTON. Yes, sir, the way you phrased the question is excellent, because you said a rule of reason based on the existence of competition in the marketplace. What this bill does is clarify that very point, that the decision should be based on the competition in the marketplace.

Mr. HUGHES. I appreciate that. Is there anything in the bill that you are presently here testifying in support of, is there anything in the bill that was not in the legislation that you supported in 1976?

Dr. PRESTON. There are different words, obviously, sir. There is nothing to my way of thinking different in substance, except that this is a further clarification, that this makes clearer what it would mean to apply a rule of reason to the circumstances, to find whether or not there is substantial and effective competition.

Mr. HUGHES. So you believe this is an improvement over the legislation you supported in 1976?

Dr. PRESTON. Yes, sir, an improvement.

Chairman RODINO. Would the gentleman yield?

Mr. HUGHES. I would be happy to yield, on the chairman's time.

Chairman RODINO. Expanding on that point, what factors would be left out at this time that were not left out then, or to put it more clearly, more specifically, weren't you saying then that the rule of reason ought to be applied on a case-by-case basis, and that is it?

Dr. PRESTON. Yes.

Chairman RODINO. Are you saying that now, when you say that this legislation before us is exactly the same as the rule of reason? We are now limiting that, and we are now setting standards, which you say are the basis which would justify these territorial agreements, which seems to me abandons the rule of reason.

Dr. PRESTON. Mr. Chairman, my understanding as a nonlawyer, and certainly not a Member of Congress, is that the "Provided" clause, the statement about substantial and effective competition, is an attempt in this piece of legislation to make clear what the standard of reasonableness is.

Chairman RODINO. Professor, let me read you what you said in 1976 in your prepared statement. You said:

> However, a series of recent court decisions and administrative agency actions have opened up the possibility that exclusive territorial franchises of all types, and without regard to particular industry circumstances and effects, might be held to be per se illegal. The legislation before you is a vehicle for the expression of congressional intent in this matter.

That is the legislation back in 1976, which is not before us now. Referring again to the legislation before us then:

> The legislation clarifies the issue by stating that exclusive territorial franchises of certain types do not fall within a per se rule legal or illegal, but rather require a case-by-case investigation on a "rule of reason basis." I appear here today in support of this legislation.

Now, very frankly, you know what you are saying today is not what you said in 1976 when you said a case-by-case basis and the rule of reason should apply. You know I am not trying to in any way confound or embarrass you. I am just trying in my own mind to determine whether or not the rule of reason was right then and wrong now, and whether there are any other circumstances which you would add to the rule of reason.

Dr. PRESTON. Sir, there has been no change in my position at all. I view the bill before you as an attempt to clarify the meaning of the rule of reason in this context.

Chairman RODINO. I will not pursue that. I am sorry.

Mr. HUGHES. That is all right, Mr. Chairman.

In essence, what you have said then is that you would support a simple bill that would, in essence, say that in the soft drink industry the rule of reason shall be applied?

Dr. PRESTON. I am not drafting the legislation, sir. Just in commenting on the legislation that is before you, this seems to meet a problem that the Commission and the courts have found in interpreting what the meaning of the rule of reason is.

Mr. HUGHES. I understand what you are saying.

Dr. Stern, responses to testimony that you gave to questions by my colleague from New York, Mr. Fish, indicate that the small bottlers should be upgrading their plant equipment and reaching out, and yet if I understood your previous testimony you indicated it would be kind of foolish for the small bottler to do it at this present time, given the state of the uncertainty.

Dr. STERN. Yes; that is right.

Mr. HUGHES. Do you find anything inconsistent in these statements?

Dr. STERN. No, I don't. I think I would like to see him update that equipment, but he is going to have to wait until this issue resolves itself, and just like any court case that has come along in the history of our country provides some uncertainty with respect to what the market occupants might have to do with regard to it, I suspect that this court case falls in that category, that there is some uncertainty with respect to it.

Now I can't tell him which way to go. I think he should update his equipment, but he will just have to wait, unless he wants to do it now and take the risk. Either way I hope that he is going to be a winner. Either way, if he does make the decision now to update, I hope that he is going to be a winner in the sense that he won't have any territorial restrictions to face, and he will be able to go after business wherever he can get it. If he is going to invest in equipment where he can't possibly sell all of the output that he has because he is restricted to a small territory, he is going to have to merge then eventually with somebody in a contiguous territory. That is the way I perceive it, Mr. Hughes.

Mr. HUGHES. Let me just ask you a little broader question. In the law we apply presumptions for various public policy reasons. Can you tell us in your opinion why we should use the per se rule or any other presumptive rule in the soft drink industry? As a matter of public policy, why should we be using an arbitrary standard, such as a per se rule?

Dr. STERN. I don't agree with a per se rule as applied to territorial restrictions. In an earlier version of the paper that you have in front of you that I wrote, and part of which will be published in the California Law Review, we used the term "per se" to describe a certain part of our discussion, and we have since amended that, and what we are talking about, though, is a presumption.

Mr. HUGHES. What is there about the franchising arrangements in the soft drink industry which has evolved in the fashion that we now find it that would require protection of a presumption? Why should not a court be permitted to find as a matter of fact, applying usual standards of law, to determine whether there is in fact ample competition in the marketplace?

Dr. STERN. I think that that is an excellent question. I know that my California Law Review article is not the issue of the day. I am delighted that it has a focus of attention. I am frankly very pleased about that, but I would be glad to answer that question.

Mr. HUGHES. I hope that I have time left.

Dr. STERN. I believe that our article addresses not the soft-drink industry per se, but any industry in which a restraint of this kind would be evident. I believe that an intrabrand restraint, that is a territorial restriction, is indeed a restraint of trade, that is, it is impeding competition of some kind. Therefore, what we have to find out is whether or not that intrabrand restraint significantly improves the amount of interbrand competition. That is a critical question.

If it has no effect whatsoever, then I don't believe we should allow a restraint of trade, but if we are interested in interbrand competition, and if we are interested in the effect that the intrabrand restraint has on that kind of competition, then we first have to ask the question, Is there significant interbrand competition in the marketplace? That is the subject of my presumption.

Mr. HUGHES. Let me ask a question. Does the existence of exclusive territories in any way adversely affect competition between brands of soft drinks?

Dr. STERN. Yes; it does.

Mr. HUGHES. Can you tell us how you arrive at that determination? because I think that that is a pivotal question——

Dr. STERN. Yes.

Mr. HUGHES [continuing]. Relative to your assumption that there should be a presumption because you reason that there is, by virtue of franchising system, some restraint of trade.

Dr. STERN. I hope we can understand the character of the presumption. It asks whether or not there is enough interbrand competition in the market, and then one moves on and says if there is plenty of interbrand competition in the market, and there has been this interbrand restraint, what is the effect of this restraint on interbrand competition. Now the key question is, Do territory restrictions, as they now exist, impede interbrand competition?

The restraints happen to be universal across the entire industry, that is, most of the major soft drink producers use them. There are a few that serve markets on a warehouse distribution basis only, Shasta being one. There are others that do this, but the basic rule of thumb across the industry is this territorial restriction. If one were to figure it out on a probabilistic basis, one could see that the likelihood of there being any more than a few competitors facing one another—I am talking about firms facing one another—in any one given geographical area, say the Chicago area, would be very low. There are only a few soft-drink bottling firms likely to be selling in the Metropolitan Chicago area, competing against one another, and why? It is because of the existence of the territorial restrictions.

For example, supposing Coca-Cola of Chicago was competing against Pepsi-Cola, which it obviously is. The likelihood of there being any more than two Pepsi-Cola bottlers that Coca-Cola of Chicago would face in that particular market are very slim.

The second thing is that the two Pepsi bottlers that might be facing Coca-Cola wouldn't compete against themselves, so Coca-Cola would be facing one Pepsi bottler in one part of Chicago, and another Pepsi bottler in another part of Chicago.

Mr. HUGHES. Let the record reflect that Dr. Preston is shaking his head no.

Mr. VOLKMER. The time of the gentleman is up. I will now recogize the gentleman from Illinois, Mr. McClory.

Mr. HUGHES. Would the gentleman from Illinois yield to me for just a second?

Mr. MCCLORY. Certainly, I am delighted to.

Mr. HUGHES. I would hope the gentleman would permit Dr. Preston to respond, because I think that the issue that we are framing is an important one. It gets to the very heart of the legislation. I thank the gentleman for yielding.

Dr. PRESTON. Thank you, Mr. Hughes.

The reason I am shaking my head is that there are only going to be a few firms in any one local market in any event, for the very reasons that Dr. Stern outlined in his paper; that is, the economics of the business is such that there are only going to be a very few firms.

It is not the territories that determine the fact of the very few firms; it is the economics of the situation. The specific location, the specific firms, will of course be affected by the particular marketing arrangements, contracts, franchises, and so forth, that are involved, but there are no circumstances in which there is going to be a large number of competitive bottlers. By large number I mean 25 or something bottlers within a metropolitan area, for the very reasons he outlined in his statement, so that the elimination of the territory does not change that.

Mr. HUGHES. I thank the gentleman for that. I thank my colleague from Illinois for permitting Dr. Preston to respond.

Mr. MCCLORY. Both of you have testified previously on this or a related issue. The situation has changed a little bit, Professor Preston, since you appeared in 1976.

Professor Stern, your previous appearances were before another committee of the Congress. It is possible there would be variations between statements that you would have made then and those you make now, because circumstances and situations have changed. I might say that there is a very good reason why this legislation may be taking a slightly different form and why it is coming up again now. This is because the Federal Trade Commission has acted rather positively with respect to the Coca-Cola Co. in the intervening period.

First of all, I know that you are here at the invitation of the committee. However, I would like to know what soft drink interests, if any, you have, financially or otherwise, both now and at the time of your previous appearance, if you don't mind relating that to me.

Are you under any retainer now or were you then? Do you represent any bottlers' interest, or Congress Watch, or any special interest groups? That would help us in weighing the testimony that you are giving, if you would not mind relating that to us.

Dr. STERN. I will be glad to answer it for you. I am here because of me. I was asked on all occasions by the subcommittee to come and testify. The first time that my name was suggested I think it was suggested to the subcommittee by somebody in the Federal Trade Commission, who thought that I might have a perspective that the subcommittee might want to hear, but I have no ax to grind and I have not been compensated by anybody. I wish I had been, but I have not been compensated by anybody.

Mr. MCCLORY. In bespeaking the territorial problems in the Chicago area, you belie your Bostonian background.

Professor Preston.

Dr. PRESTON. Yes, Mr. McClory. I don't have any financial interest in any kind of soft-drink operation, but I have been a consultant to the National Soft Drink Association for most of this decade, and have therefore had extensive exposure to the evolution of these issues and to the industry in that role, and I am still in that role.

Mr. MCCLORY. The problem that the soft drink industry is experiencing, in addition to the threat from the aggressive position of the Federal Trade Commission, is that these bottlers are being absorbed by the parent companies. I am worrying, myself, that perhaps we are more threatened as far as competition is concerned by this vertical integration—mergers that are taking place—than we are by the territorial exclusivity. I wonder if you, Professor Stern, would want to suggest some action by this committee which would bar vertical integration of companies? Do you think that type of action would be in the interest of promoting competition in the market place?

Dr. STERN. Again, I am not really sure, Mr. McClory. I think that the kind of integration that has been taking place has been with respect to the conglomerate merger, the buying up by Philip Morris, let's say, of 7-Up interests, or Westinghouse with bottling plants, and so on, and I don't know what that bodes for the long-term future of the industry as far as——

Mr. MCCLORY. Do you think it might be appropriate to provide legislation for divestiture in order to promote the autonomy of these bottlers?

Dr. STERN. Mr. McClory, that is a fascinating question. The reason why I am fascinated by it is because I think the problem is much more universal than it is to the soft-drink industry. I don't really believe that Congress has given enough attention to the impact of conglomerate mergers on our society generally and on competition, and that the soft-drink industry is only a microcosm of what may be going on out there.

I have no point of view one way or the other on this issue. I simply think that if in fact you are going to begin to think about impeding vertical integration or impeding conglomerate mergers, that that is a really very broad topic that pertains to a much broader arena, and that the soft-drink industry should not be singled out as the industry by which we pass, let's say, test legislation, if you will.

Mr. MCCLORY. You say that, Professor Stern, but the problem is that the soft drink industry is experiencing a unique problem with regard to the conduct of its business, especially the smaller organizations of the industry, the bottlers that have the exclusive territorial contracts. Those who have commented on this overall subject feel that the current method of doing business is most beneficial to the consumer, and that if we interfere with it, the consumer is going to suffer. Others contend that if we would just not pass this legislation, that somehow greater competition would occur, thereby lowering prices.

I am in doubt myself as to whether the consumer is going to benefit if we pass the legislation or if we don't pass the legislation. Do you have any comments on the subject of the consumer interest as opposed to the interests of those that are involved in this competitive operation? Of course I would like to invite the comments of Professor Preston as well.

Dr. STERN. I believe that the consumer interests are going to be served. I think that the end result will be lower prices. I think that what will happen is that in those cases where there are going to be higher prices, those higher prices would have evolved because of what service output levels are required to serve particular kinds of accounts.

The bundling and unbundling of services for those accounts will cause an increase and an elevation in prices for those accounts, but I think generally if you even calculated a weighted average, and you figured who are going to be the prime recipients of the lower prices, it is going to be the consumer who shops in the major chain supermarkets, and I think that it has been shown that the major chain supermarkets—and I am not talking just about Kroger and Safeway; I am talking about all of the chains, whether they are corporate chains or cooperative chains or whatever—that the likelihood is that prices will be lower in those organizations, because they will be able to receive shipments on a warehouse delivery basis, and therefore I believe the consumer will be better off if territorial restrictions were eliminated.

Mr. MCCLORY. The independently owned supermarket is rapidly putting the chain supermarkets in debt. Professor Preston, would you care to comment on the vertical integration divestiture issue?

Dr. PRESTON. If I could, Mr. McClory, I would like to draw Mr. Stern's attention to my footnote 5, research done some years ago by Dr. Paul Nelson of the U.S. Department of Agriculture about the specific issue and connection between wholesale and retail prices in supermarkets. And there we found a tremendous tendency for the prices not to move together, that is independent retail pricing action and also wholesale price changes that were not reflected in retail prices. So to think wholesale prices are going to be automatically reflected in the retail prices in the supermarket industry simply is not so.

On the vertical integration issue, Mr. McClory, certainly I share your concern and your interest in that dimension of the industry, and that indeed is the principal thrust of my statement, that I do believe that if the territories are eliminated, their legal status is eliminated, that we will see a very, very rapid increase in vertical integration, and that this could be on a scale to change the whole character of the industry, and have a vast increase in concentration in the industry, and would be very undesirable.

As to present levels of vertical integration, my general feeling is there is enough variety in the system as it exists now that these may not be sources of any great concern, but to have certain amount of vertical integration in an industry that is not primarily vertically integrated and is in fact occupied by firms of many different sizes and interests that is going to be offset by a lot of other competitive effects.

If you switch, however, to an industry in which all of the major firms are completely vertically integrated so that the local market structure is exactly the same as the national market structure, then you are going to have another story entirely, and I think discouraging that development is desirable, whereas the way the FTC decision is going is to encourage that very development which seems to me a very undesirable development.

Mr. McCLORY. Your footnote to which you made reference is to a 1966 article. Have you updated that?

Dr. PRESTON. No, sir.

Mr. McCLORY. Thank you. Thank you, Mr. Chairman.

Mr. VOLKMER. I would like to comment before I ask questions that the Office of Technology Assessment also agrees with Dr. Preston on the result of the FTC decision. If I may quote from them:

> If upheld by the courts and not modified by the Congress, the recent decision by the FTC outlawing franchise restrictions for trademark soft drinks in nonreturnable containers would lead to rapid concentration of that industry. The results would be an industry with only a few firms having a few large plants as well as the rapid disappearance of refillable bottles for soft drinks.

Now if we assume that that is correct, and Professor Stern, you haven't said that that won't happen. You said, as I understand it, that may very well happen. You do not say it will, as Dr. Preston says in his opinion it will. Now if we assume that is true, that it does, that that is the end result, what is going to happen, and you just a little bit ago said, in answer to a question of the gentleman from New Jersey, that at the present time with the territorial restrictions you really do not have anticompetition between different brands, you are not going to have it either under the FTC decision if we assume that this is true?

Dr. STERN. If we assume increased concentration, if we assume that that is the way it is going to be, and that the small bottlers can't fight out of their box, they are not going to have it; no.

Mr. VOLKMER. And I would like to draw on one thing just to bring that home. Recently, one of the large syrup manufacturers raised their prices. Did the other large syrup manufacturer keep its down, in order to compete? No. Guess what it did? It raised its prices.

Now, let's look at another industry. Not just soft drinks, but it concerns me in a lot of fields. What I am seeing and I don't like, in the name of consumers, in the name of people, in the name of government even.

Let's take oil. Do you think today, if we remove all controls completely, that prices are going to go down, Dr. Stern?

Dr. STERN. No; I don't think they are going to go down.

Mr. VOLKMER. Why, you have competition. Why won't they?

Dr. STERN. I am not familiar enough with what is going on in the petroleum industry.

Mr. VOLKMER. Do you believe, as I, that the price would rise the same as it will eventually in the soft drink industry. If today's testimony is correct then the price will rise to a point where people only buy a certain amount, and then the manufacturers, and I don't care whether it is oil or anything else, are going to hold or reduce prices because they have to sell a product at a sufficient volume?

Dr. STERN. I believe you are comparing apples and oranges.

Mr. VOLKMER. To a certain degree, I am.

Dr. STERN. Because in one situation, in the petroleum situation, it isn't a question of taking off some kind of wraps in order to allow them to go and fight in one another's territories. It is just taking the wraps off and allowing them to continue whatever it is that they are going to continue.

In the soft drink situation, what we are saying is that Thrifty Marts, or Ralph's Supermarkets or Jewel Tea, or whoever else it is, will be free to go out and get the very best deal he can from any Coca-Cola bottler in the country, and if he wants to ship it in from the east coast, that is his prerogative if he can get that deal.

Now I think that those buyers are going to be bloody sharp, and I think that they are going to go after those deals, and I think that price levels will come down.

Mr. VOLKMER. Let's look at that a minute. Let's say I am in the Los Angeles area and I want to buy Pepsi-Cola, do you know who I buy from when I buy Pepsi-Cola?

Dr. STERN. No; I don't know.

Mr. VOLKMER. I buy from Pepsi-Cola. Do you know if I go to New York who I buy from? Pepsi-Cola—I buy from Pepsi-Cola. It is not only in those places. It is all over. That is what is going on. The major markets are being taken over by the syrup manufacturers, even under the present system.

Dr. STERN. Or Northwest Industries or some other major conglomerate. There are a number of forces that are going on.

Mr. VOLKMER. You don't believe that more of that will occur if the FTC amendment is not overturned in any way?

Dr. STERN. I don't think that the answer to the question is territorial restrictions in distribution. I think what you are raising is a basic question that hasn't been addressed by the Congress or by anybody else in a satisfactory manner, and that is the whole question of the conglomerate merger movement, and if you want to throw in vertical integration, vertical movements, that is fine too, but you are asking that kind of question.

I am saying in this particular industry there isn't enough to stand on the side of territorial restrictions, and permit them to be utilized from my point of view.

Now, my argument, and I want to make this very clear, has to do with the facts as I saw them in the Coca-Cola situation, and I argued those facts in the Coca-Cola situation. Whether it would pertain to a small soft drink franchiser and his bottlers would be a very questionable thing, such as King Cola, for instance, or Coca-Cola, or any new kind of beverage that comes along.

They might be able to utilize these territorial restrictions, but the major forces in the industry do not need this at this time. They do not need a law that allows them or permits them to continue to use them. Let the rule of reason have its time in court. That is what we have been all looking for over these years.

Mr. VOLKMER. Some of us are concerned that upon the court ruling, if it upholds the FTC immediately, and I am not talking about a year from then or 2 years from then, but immediately, actions will be taken by the syrup manufacturers to start taking over every market that they can get into.

Dr. STERN. Sir, if that is a concern, I would urge the committee to hold a set of hearings where you actually subpena the syrup manufacturers' information. Believe me, they know right now what they are going to do if those territorial restrictions are lifted.

Mr. VOLKMER. They have already done one thing, at least one of them has. One of the syrup manufacturers signed a new franchise agreement providing that that agreement is of no force and effect if the FTC ruling is upheld. I may be wrong and perhaps if there is a representative of the syrup manufacturers here they can correct me.

Dr. STERN. That is one evidence.

Mr. VOLKMER. If that isn't evidence of what they intend to do I would like to know what it is for.

Dr. STERN. I think it is a very reasonable question to begin to ask what their plans are for the future, and I am convinced that they will have those plans already mapped out. They are very bright, very capable people, and they can see handwriting on a wall.

Mr. VOLKMER. The other thing that concerns me is when you reduce the numbers down to two, or three, or four within a country this large and production this large, that as long as there is a sufficient demand for the product, that the price goes up, not down, no matter what the cost of production.

Dr. STERN. That is a curious concern that I don't think is going to happen in this particular situation.

Mr. VOLKMER. You don't believe that that is a factor of economy. The old rule of supply and demand isn't there anymore, Professor?

Dr. STERN. I understand exactly what you are saying, and I find it a very, very curious thing myself, but in this particular situation, in the scramble for markets, there is one very big difference that we have to recognize. The bottlers and the soft-drink franchisers are facing concentrated buying power. That is the difference then when we go out as consumers and face the petroleum companies. We are one person with one automobile. We fill it up one time at the gas station per week. We don't have the clout to be able to manipulate.

Mr. VOLKMER. Thank you.

Mr. MCCLORY. Would the chairman yield?

Mr. VOLKMER. I will yield.

Mr. MCCLORY. Thank you.

If the court of appeals overruled the Federal Trade Commission, then, of course, the rule of reason would apply, and there would be no occasion for this legislation. Of course, it has been suggested to us that we should wait until the court decides the issue.

On the other hand, if the court were to sustain the Federal Trade Commission, I think it would be virtually impossible at that time to legislate on the issue to provide any protection or to provide against the apprehension that the chairman expressed with regard to the absorption of the bottlers by the syrup manufacturers.

I am wondering what your comments would be as to the propriety of our considering and acting on this legislation at this time?

Dr. STERN. Mr. McClory, I understand the dilemma. I mean it is a dilemma, and it isn't something that we put aside and we just sort of rub over it. But this is competition in this country. This is the way it is made. It is done without shackles, and it is done so that people can go after markets wherever those markets are.

Mr. MCCLORY. I think what we are contending with here is not the question of competition. We are contending with a governmental regulatory body that arguably is undertaking to regulate existing businesses out of business; at least regulating them in areas of competition or areas of activity that are inconsistent with the contracts that the parties have, and inconsistent with the particular competitive practices that have built up over a long period of time.

Dr. STERN. Let me just respond. I know Professor Preston would like to say something, and I don't want to filibuster, but I am disturbed by how the term "regulation" is being now used in our society. On the one hand, there is the regulators who actually regulate competition out of an industry.

On the other hand, there are the regulators who are trying to increase and enhance competition.

I believe that we ought to get a lot of the regulators in the first category out of the business of regulation. Take the wraps off of a lot of these industries, where they have had the wraps on them for a long time.

I think what the Federal Trade Commission is attempting to do in this, and granted it has been overzealous in a lot of its activities, and I understand the problems again, but I think what it is trying to do in this industry is asking the question, "Is interbrand competition as effective and as efficient as it ought to be, and if these interbrand restraints, which are a restraint of trade, are not productive of enhanced competition, not positively helping that industry toward increased competition, then why permit the restraint of trade?"

Dr. PRESTON. May I comment, Mr. McClory. I now have two comments. My first comment is about the last thing Professor Stern said. It would be a totally different standard than we have ever had for our public policy if anything other than arm's length transactions or vertical integration had to be tested as a competition promoting force, rather than tested as it has been in the past as a question of whether or not it represented a substantial decrease in competition.

The chairman was speaking earlier about the possibility of a new antitrust standard. That would really be a new antitrust standard, and I don't know that you are prepared to consider that this morning.

My earlier attempt to make a comment was following up on Dr. Stern's previous comment about concentrated big power among the chainstores. It is true now that vis-a-vis individual bottlers the chainstores are large customers, they are very significant customers.

I think they do have significant buying power, and that this does work to promote a competitive vertical force in the market holding the prices down. However, if you go to the market structure which I anticipate—and which Mr. Volkmer quoted from another publication, the Office of Technological Assessment, anticipates—would flow from the elimination of territories, so that you have a nationwide vertically integrated system, the concentration in the syrup companies in the major brands is much, much, much greater than the concentrated power of the retail stores, and the balance of power will be entirely on the side of the soft drink syrup companies.

Mr. McCLORY. Thank you.

Mr. VOLKMER. I now recognize staff.

Mr. NELLIS. Thank you, Mr. Chairman. I am interested in some of the actual facts and I would like your answer to this question, Dr. Preston, first.

In your testimony in the Senate you presented statistics showing that soft drinks in Buffalo were selling for 45 cents less per 72 ounces than in New York. This is under present circumstances as I understand it.

How is the consumer going to be served by keeping the distributor in Buffalo who can afford to sell at a much lower price from offering his product in New York?

Dr. PRESTON. Sir, I don't think there is any possibility that the distributor from Buffalo could offer his product at a lower price in New York.

Mr. NELLIS. Why not?

Dr. PRESTON. Well, he is in Buffalo, and he would have to take the product down to New York.

Mr. NELLIS. That would depend upon whether or not this 45 cents difference represents more than just the cost of the extra delivery.

Dr. PRESTON. Oh, and the cost of operating a store-door delivery operation in New York City, which is, of course, many times the cost of operating that same kind of activity in Buffalo.

Mr. NELLIS. I am not sure that the statistics would bear you out, but I am sure that if I were a distributor in Buffalo, and felt that I could compete in New York at 45 cents less per 72 ounces, I would want to take a crack at it. Wouldn't you?

Dr. PRESTON. Making your assumptions, perhaps, but I don't believe that corresponds with reality at all.

Mr. NELLIS. The bill we have before us would prohibit that, because the bill says that no matter what the circumstances are, you are entitled to maintain exclusive territories regardless of circumstances, if there is substantial competition.

Dr. PRESTON. But that is not regardless of circumstances, sir. If there is effective competition in New York, then I would expect the prices to be competitive in New York, and I would be astonished if someone could go down there from Buffalo at a lower price.

Dr. STERN. Could I respond to that? Right now in Chicago, if you read the labels on the cans of Coca-Cola you will find Coca-Cola of Chicago and, again, this is an assumption on my part after reading the cans, Coca-Cola of Chicago has some kind of arrangement with Coca-Cola of Wisconsin to utilize the canning plant that is in Wisconsin, and that they ship from Wisconsin into the Chicago area under a contractual arrangement with Coca-Cola of Chicago.

If they can do that, I don't understand, Lee, why they couldn't go to another market area and penetrate that. Why wouldn't it be possible to ship from Buffalo or from a place like Rochester on a warehouse delivery basis into New York City?

Mr. VOLKMER. Will the gentleman yield?

Perhaps because Coca-Cola of Chicago and Coca-Cola of Milwaukee are the same people.

Dr. STERN. Are they both——

Mr. VOLKMER. They are both vertically integrated.

Dr. STERN. But they both have separate territories, don't they?

Mr. VOLKMER. It doesn't make any difference if you are the same owner?

Dr. STERN. No; the point is that they have vertical territorial restrictions, and that is another question. Whether or not there is some sort of horizontal conspiracy going on between Coca-Cola bottlers on the same level as other bottlers who are independently owned, I will leave that question. I raised that in my article.

Mr. VOLKMER. I just wanted to point out what is going on, what you questioned is actually going on, and will go on further because of FTC.

Dr. STERN. But the fact is that there are all sorts of contractual agreements, among independents, among nonindependents, because of that need for that high-speed technologically sophisticated bottling or canning operation, so it doesn't matter whether it is owned by Coca-Cola of Atlanta or whether it is owned by some other company.

Mr. NELLIS. Dr. Stern, would you address yourself to this little conundrum. Dr. Preston says that it is not possible for the Buffalo distributor to sell in New York because of cost. If it is not possible, why do you need a bill to make it impossible?

Dr. STERN. I cannot answer that. I think it ought to be possible for anybody to sell wherever he so desires, and I think that the bill should not prohibit competition from occurring.

Mr. NELLIS. Dr. Preston, one other question that occurs to me because of some investigation we did. I talked to a major syrup producer of a noncompetitive product, noncompetitive to Coca-Cola, and I was informed that it is impossible for him to introduce a cola brand, although he is a national manufacturer in the markets because about 60 percent of his bottlers are Coca-Cola distributors, and they would not accept the competing brand at a lower price.

What do you have to say about that? I am talking about a well-heeled, large corporation would like to go into the cola business, and cannot go into the cola business because the bottlers they deal with on their other product will not accept a new cola.

Dr. PRESTON. I don't see why he couldn't deal with other bottlers that don't have a cola base.

Mr. NELLIS. That is 60 percent of the market.

Dr. PRESTON. I am sorry?

Mr. NELLIS. In my hypothesis I stated that the bottlers who would not deal with it represent 60 percent of the market.

Dr. PRESTON. But the other 40 percent is still there.

Mr. NELLIS. In other words, you think it would be fair for him to proceed to try to sell his product in Freeport, Ill., but not in New York City?

Dr. PRESTON. I don't know what company you are talking about.

Mr. NELLIS. I don't want to mention the company.

Dr. PRESTON. Or the details of those firms at all, but I don't see any reason that he could not merchandise his cola product to other bottlers that do not have cola drinks. Goodness, right here in Washington, D.C., I believe there are two dozen different cola drinks that we sampled in a previous study here.

Mr. NELLIS. Dr. Preston, I think you have misconstrued my hypothesis. Sixty percent of his present bottlers deal with Coca-Cola. They will not accept a new brand even though the manufacturer I am talking about is a national distributor of a noncola drink. Now, in view of that fact, you are saying he should tackle the other 40 percent, but the other 40 percent are in rural nonmetropolitan areas, so you are asking him to struggle competitively with that 40 percent when he can't enter the 60 percent market; is that correct?

Dr. PRESTON. Part of it, sir, but my first point was that any other bottlers that are not bottling cola drinks at all should be potential customers for him.

Mr. NELLIS. That is 40 percent.

Dr. PRESTON. And, of course, since there is no compulsion that he do business in this way at all, he can set up a Shasta-type operation, to bottle his cola drink and sell it anyway he pleases. He has complete freedom. He is not in any way restricted in the mode of doing business.

Mr. NELLIS. Based on your own chart though, Mr. Preston, I observe that the cola drinks are the major drinks being consumed, up to two-thirds of all the drinks being consumed; is that correct?

Dr. PRESTON. Well, the statistics that I had in my paper, it is not quite up to two-thirds. They are certainly the major drinks. There is no doubt about that, and there are, of course, two major brands, and the share of those two major brands differs considerably among markets, which you do not have evidence of here, but you know to be true. In addition, there are this very large number of other cola drinks at a very wide range of prices.

Now, I cannot see why the consumer does not have a very wide range of choice among cola drinks. It seems to me obviously he does.

Mr. NELLIS. What troubles me is if these other cola drinks are sufficiently competitive, why you need a statute that makes competition impossible.

Dr. PRESTON. The competition is in no way impossible, sir. It seems to me that you have an enormous field of competition in this industry, and I do not see why the existing pattern of doing business in the industry has to be disrupted for what seems to me an arbitrary reason.

Mr. NELLIS. I would like to be able to buy Coke at 45 cents a bottle less. Dr. Stern, do you have a response to this?

Dr. STERN. I certainly don't agree with Dr. Preston that it is an arbitrary reason, that we are asking the question should we have a law that protects these restraints. I think the reason is very clear. That this is a major restraint of trade. There is no question in anybody's mind that this restrains trade, and the key question that we want to ask ourselves is should this restraint of trade be permitted to continue, and we now have a fantastic mechanism for doing that, which is called the rule of reason approach, and I don't want anything to subvert that as the *Sylvania* court has handed that down to us.

There is a need for a rule of reason model, and I happen to propose one. I am sure that there have been at least seven others proposed somewhere along the way. The court will interpret that as it will.

Mr. VOLKMER. I wish to thank both of the witnesses. I am sorry to have taken so much of your time. We will now proceed to Mr. Heckenkamp and Mr. Reagin.

Mr. McCLORY. I am sure that the chairman would want you to have leave to file your full statements for the record. You can summarize your statements for the purposes of the record.

[The prepared statements follow:]

STATEMENT OF THOMAS J. HECKENKAMP, PRESIDENT OF HECKENKAMP & ASSOCIATES BROKERAGE COMPANY, GLENDALE, CALIFORNIA

I am Thomas J. Heckenkamp of Glendale, California. I am President of Heckenkamp & Associates Brokerage Company. We operate as Food Brokers in the Los Angeles Area and as such, we represent manufacturers and distributors of food products and other items sold in food stores.

We supply sales and marketing services to suppliers who want access to the Los Angeles grocery store market but who lack either adequate personnel or knowledge of that market.

Much of our business involves regular and close contact with buyers for the grocery chains and for the grocery-buying cooperatives in which small stores pool their buying power to take advantage of quantity discounts.

We also deal with buyers for the regular wholesale grocery supply houses. Our service is based on our knowledge of the Los Angeles market and our understanding of what the grocery buyers want, and need to do their jobs successfully.

The large gorcery chains operate their own central warehouses. They supply their regular stores by assembling each store's requirements at the warehouses, and making regular deliveries to the store. Instead of a lot of supplier's trucks backed up behind each store trying to unload at the same time, there is one truck from the warehouse carrying exactly what the store needs.

The merchandise is handled by store employees who know how much of each item is needed on the shelves and where it is needed, rather than by truck drivers or route salesmen whose aim it is to get as much shelf space as possible for their product.

The grocery-buying cooperatives and the independent wholesalers supply the smaller non-chain stores in the same way the chains supply their stores. Cooperative members and independent small stores can take advantage of most of the same economies of mass purchasing and distribution as the chainstores by using central warehouse facilities for their supplies rather than attempting to buy directly from distributors.

In the Los Angeles area, potato chips, cookies, crackers and some brands of soft drinks, all formerly purchased off trucks are now warehouse items. A good example of warehousing former off truck items, is Sunshine Biscuit Company. Sunshine and Nabisco are very competitive, yet Sunshine is distributed through major chain and co-op warehouses whereas Nabisco maintains an off truck policy with no warehousing.

In the Los Angeles area, there are only three products delivered in any quantity directly to the stores rather than through the warehouses, except private label; milk, bread, and soft drinks. Milk and bread have a very short shelf life and require special handling. Milk must be continually refrigerated. Bread must be protected from crushing.

There is no justification for direct delivery of solf drinks. The stores do not want the soft drink truckdriver backing up behind the store and requiring special handling of his product outside the more efficient distribution and handling system they use for most other products.

In most instances, the retailers have no choice but to take soft drink delivery at each store, because the bottlers refuse to delivery it to the warehouse and there is only one source of each brand.

Because each bottler has an exclusive territory for his brands, there is no competition to provide the more economical warehouse delivery and distribution the stores prefer. If the store does not like the bottlers' terms, their only choice is to drop his brand entirely. They cannot go to a competitor for either a better price or better service.

It should not surprise anyone that where a bottler has a monopoly on a heavily promoted brand in a defined territory, his price is going to be higher than if he had competition. That is exactly what happens at this point.

Soft drinks are wholesaled at artifically high prices that reflect the absence of competition among bottlers of the same brand.

When I started in the brokerage business, a little over nine years ago, many of the buyers I talked to asked if I could develop a competitive source of brand name soft drinks to be delivered to the warehouse.

I could see that there was penty of "fat" in the prevailing bottlers' wholesale prices, and that the "fat" would let me ship soft drinks long distances and still undersell the off truck price in Los Angeles. Certified Grocers and the major chains had an existing program shipping to Las Vegas from a central warehouse in Los Angeles.

It was not long before I found a distributor in Las Vegas who could buy Royal Crown, Diet Rite and Dr. Pepper from a bottler there and ship it to all my customers in Los Angeles.

At that time, R. C. Cola was selling "off the truck" and delivered by the bottler to each individual store in Los Angeles at $3.20 per case; the warehouse price on those items was $2.95.

My distributor was able to buy the same product in Las Vegas, ship it to Los Angeles and charge $2.55 delivered to a warehouse.

Now, the warehouses add a charge for their handling which usually runs about five percent. So the product was delivered to the stores at a cost to them of $2.68 per case. The stores like to work with a twenty percent markup on beverages, and they pass eighty percent of the savings on to the customer in the form of a lower retail price.

Warehouse delivery affects consumer prices in another way, as well. Under the exclusive territory system, a chain with stores in several different bottlers' territories may be paying different prices for the same product at various stores.

Bottlers of the same brand rarely, if ever, coordinate their promotional deals. So the chain has a difficult time creating retail promotions because it can't advertise the same price for all of its stores.

If the product was sold to the warehouse for distribution, the stores serviced by the warehouse would have a strandardized price on which they could base their advertising. Consumers would benefit from more frequent promotional low prices on soft drinks.

The Royal Crown bottler in Las Vegas was unable to keep on supplying our distributor because the parent company restricted the small bottlers syrup but left the large bottler in Los Angeles unrestricted. This practice put the distributor out of business on Royal Crown, Diet Rite and Dr. Pepper.

Since our soft drink sources near Los Angeles had been shut off by the syrup companies, we began to look further from home.

We found that we could obtain brand name soft drinks from St. Louis, Mo., from Illinois, South Dakota, Montana, and Nebraska, and delivery it under the prevailing price in Los Angeles.

Even then, with the cost of transporting a low-value, liquid product two-thirds of the way across the country, we would have made a good profit. However, the syrup companies pressured our sources and prevented them from dealing with us.

We started in April of 1976, shipping Canada Dry products packed in glass from a franchise in Las Vegas to Los Angeles. Since we started this competitive program the price of Canada Dry dropped 95¢ a case on 10 oz. Mixers, and $1.00 per case on 28 oz. Mixers.

In May of this same year we started shipping Royal Crown and Diet Rite Cola cans from this same source. At that time the "off truck" price on Royal Crown was $4.15 per case. We came in with a warehouse price of $3.75. Then Royal Crown in Los Angeles came in with a price of $3.65 off truck; a reduction of 50¢ per case. We then dropped the price to $3.50. Shortly after this move our supplier had his cans cut off from Tuscon, Los Angeles and finally from Salt Lake. Arrangements had been made for contract packaging of the cans, and syrup had been shipped to can 58,000 cases. One hour before the cans were to be manufactured, Crown Cork and Seal Co. received a call from Royal Crown Company in Columbus, Ga. stating that under no circumstances were those cans to be sent to the contract packer for filling. The owner of the franchise had to be called back from Europe to meet with the President of Royal Crown. At that meeting he was told no more shipping out of his territory or he would not receive any more syrup. This would cause him to go out of the Royal Crown business.

Two things happened this year that reveals to us that a warehouse program on major brand beverages will lower retail prices.

1. We represent a company who had access to Pepsi Regular and Diet Cans, Royal Crown, Diet Rite Cans and Dr. Pepper Cans. We obtained purchase orders from a major chain and a large Co-op wholesaler in Los Angeles and shipped over 500,000 cases of the products. The pricing difference on Pepsi was $6.05 "off truck" local franchise, versus $4.50 f.o.b. San Francisco for warehouse price. With the freight from San Francisco being 15¢, their warehouse cost was $4.65 versus $6.05 The Pepsi product was packed in Seattle and shipped to San Francisco. $1.40 saving per case or 35¢ per 6-pack savings.

During the shipping period, January through June, Pepsi promoted heavily. After this product was shipped, Pepsi took a price increase to $6.34 "off truck". The new retail price is $1.99 per 6-pack.

Royal Crown was priced at $4.00 per case versus $5.70 "off truck" price. With the same 15¢ freight from San Francisco, the warehouse price was $4.15 or a savings of $1.55.

Dr. Pepper had the same cost and selling price as Pepsi with the same savings. To our knowledge this is the first time all of these brands were offered from one source.

2. Also, this year was the introduction of C&C Cola and King Cola into the Los Angeles market. These products have been introduced as warehouse items in both 12 oz. cans and 2 liter plastic bottles. The pricing to the warehouse is as follows:

C & C COLA	12 oz. Cans	-	$3.40
KING COLA	12 oz. Cans	-	$3.93

With these lower prices and television and radio exposure, these two companies, C & C Cola which is owned by IT & T, and King Cola, a local franchise, have proved a competitive force for the major brand soft drinks. Both of these companies use Food Brokers to market their products in the Southern California area.

When we are able to introduce competition into the soft drink business, we will bring better service to the retailers and lower prices to the consumers, and we will prosper as a small business ourselves.

Finally, we will help many soft drink bottlers who are now frozen out of the markets where the action is. These little bottlers are confined to their exclusive territories where they will eventually find their volume is too small to permit them to survive.

They cannot afford to remain in a business that requires expensive equipment or efficient and high-quality production, unless they can develop the volume to pay for it.

With the aid of brokers like us, they can capture a part of the large urban markets and find the volume they need to stay in business. Without it, they will disappear and leave the field to the already large bottlers, who will take over without any competition from other bottlers of the same brand.

There is another aspect of this bill that works against the small bottler. Most of the large grocery warehouses are located in the exclusive territories of large bottlers. These warehouses serve stores in the exclusive territories of other small bottlers.

Whenever soft drinks do find their way into the warehouses they are going to be distributed to the small bottlers' customers. And it is the big bottler who will be supplying the warehouse because it is in his territory.

It is easy to keep the little bottler from selling to a warehouse. A limit on his syrup supply is an effective way. But it is almost impossible to enforce a restriction on the large bottlers.

This bill would discriminate against the little man simply because it is easier to enforce restrictions aginst him. He will be unable to fight back because his syrup supply is a short and tight string by which he can be controlled.

I think we have shown what a little free enterprise and competition can do for the soft drink business. A legislation that permits exclusive territories to continue will guarantee that the present conditions of poor service and inflated prices will continue.

This bill will not help the little man. It will guarantee his exclusion from the soft drink marketplace.

STATEMENT OF RONALD W. REAGIN

OF LOS ANGELES, CALIFORNIA

I am Ronald W. Reagin of Los Angeles, California, I am an attorney with the law firm of Reagin & King. I have represented plaintiffs in three private action anti-trust law suits which were brought after soft drink concentrate companies cut off the supply of concentrate or syrup to bottlers who had agreed to sell finished soft drink products to distributors for resale outside of the defined territory of the bottler.

While I am in complete agreement with other witnesses who have testified that such exclusive territories are anti-competitive and undesirable in our economic society, there are two provisions in H.R. 3567 which particularly disturb me as an attorney. These are the provisions in Section 2 that nothing contained in any anti-trust law shall render unlawful the enforcement of the exclusive territorial provisions found in the bottlers contracts of virtually all national brands of soft drinks, and the provision in Section 3 that the existence or enforcement of territorial provisions in such contracts shall not be the basis for recovery in a private anti-trust action under Section 4 of the Clayton Act until after a final determination that such provisions are unlawful.

The proposal in Section 2 will legalize any economic strongarm methods the soft drink companies choose to use to bring recalcitrant bottlers or their customers into line to enforce the exclusive territorial provisions. The methods used could include price fixing, horizontal conspiracies and group boycotts, all of which are long established to be _per se_ violations of Section 2 of the Sherman Act.

For example, such provisions could be enforced by the requirement that sales of soft drinks outside of a bottlers exclusive territory could be made only at prices acceptable to the bottler in whose exclusive territory the soft drinks are ultimately to be sold for consumption. Such blatant price-fixing would unquestionably be illegal under the long-established principles of anti-trust law to which even the soft drink companies pay lip service, but this would be sanctioned under H.R. 3567 as merely the enforcement of a trademark licensing contract.

A perhaps more likely manner of enforcement of the clauses would be by horizontal agreement of all of the bottlers, under which the bottlers would get together and form their own policing committees to seek out those among them who desire to sell their product to whatever customers wish to buy it, in the normal manner of our economic system. At the present time, such horizontal conspiracies are clearly _per se_ illegal, and in all of the actions brought to date, the defendant concentrate and syrup companies have vigorously contended that the provisions are merely vertical provisions between the concentrate company and the individual bottler, and are not horizontal agreements or conspiracies between bottlers at the same level of competition. Be that as it may, the pretext could be dropped if the proposed provision becomes the law, and the exclusive territories could be easily enforced by a naked horizontal combination with the full blessing of Section 2 of H.R. 3567.

Another effective means of enforcing such provisions would be a group boycott which would be blatantly illegal at the present time, but which would be allowed under the Bill as proposed. As you are aware from the earlier testimony in favor of H.R. 3567, virtually all of the major soft drink brands favor these provisions, while as Mr. Heckenkamp testified earlier this morning, one of the prime movers in seeking to obtain soft drinks outside of exclusive territorial boundaries has been the supermarket chains. An extremely effective tool in enforcing the exclusive territorial provisions for the soft drink companies would be the refusal of all brands, Coke, Pepsi, Royal Crown, Seven Up, and the smaller brands, to sell to any supermarket chain who obtains supplies of any brand from a bottler outside of the territory in which the supermarket is located. This would effectively completely stop such practices, since soft drink sales do represent a significant portion of the sales of a supermarket. This type of inter-brand agreement is so blatant as to be shocking to even consider, but it is one which would be expressly legalized by H.R. 3567.

Next, Section 3's provision that no damages can be collected in a private anti-trust action under Section 4 of the Sherman Act except for enforcement acts which occur after a final determination that the provisions are unlawful will completely eliminate any private actions in this area. It is recognized by all authorities, including the Supreme Court, that the private anti-trust action is an important tool in the enforcement of the anti-trust laws, since it allows the person directly harmed by the illegal acts to bring an action for damages he has suffered. This places the economic incentive squarely on the person who was most affected. However, Section 3 of H.R. 3567 expressly provides that the existence or enforcement of the territorial provisions, prior to any final determination that such provisions are unlawful, shall not be the basis of recovery in such a lawsuit.

As is well known, private anti-trust actions are usually difficult, complex and costly to bring. If a person cannot even recover his actual damages which have been inflicted upon him unless the acts continue after a final determination that they are illegal acts, not only will the person have no incentive to bring such a lawsuit when he is so damaged, he is actually penalized for doing so, since he will have to pay the extensive costs for bringing such a lawsuit just to eliminate the practice so that in the future it will no longer continue. This is clearly the function of the Justice Department or of the Federal Trade Commission, not of the private litigant, and the adoption of such a provision will undoubtedly bring a complete halt to any private actions in this area.

The provision in Section 3 may seem to be quite academic. Because Section 2 so obviously legalizes the exclusive territories, regardless of their effect on competition, whether reasonable or unreasonable, it is unlikely that any private actions would ever be brought anyhow, since there is no likely chance of success of such an action. However, this Section, like the enforcement provisions of Section 2, illustrate the arrogance of the promoters of this type of Bill in attempting to get themselves totally exempt from the anti-trust laws. No such provisions like these presently exist anywhere in the anti-trust laws, or in any other field of law of which I am aware. If these provisions are adopted, they will serve as a precedent for other special interest groups to seek similar exemptions and shields from the anti-trust law. It will open a Pandonra's Box of loopholes and attempted special interest legislation in the anti-trust area which at best will make anti-trust law a patchwork of special interest litigation, and at worst will completely destroy the effectiveness of our anti-trust laws.

Mr. McClory. Please state your name first.

TESTIMONY OF THOMAS J. HECKENKAMP, HECKENKAMP & ASSOCIATES, FOOD BROKERS, GLENDALE, CALIF., AND RONALD REAGIN, COUNSEL TO HECKENKAMP & ASSOCIATES

Mr. Heckenkamp. I am Thomas J. Heckenkamp, a food broker from the Los Angeles market, and I would like to explain what a food broker's function is. It is part of the statement, but I would like to review that. We supply sales and marketing services to suppliers who want access to the Los Angeles market, to the grocery market, but who either lack adequate personnel or knowledge of that market.

Much of our business involves regular and close contact with buyers for the grocery chains and for the grocery-buying cooperatives in which small stores pool their buying power to take advantage of quantity discounts.

We also deal with buyers for the regular wholesale grocery supply houses. Our service is based on our knowledge of the Los Angeles market and our understanding of what the grocery buyers want, and need to do their jobs successfully.

The large grocery chains operate their own central warehouses. They supply their regular stores by assembling each store's requirements at the warehouses, and making regular deliveries to the store. Instead of a lot of suppliers' trucks backed up behind each store trying to unload at the same time, there is one truck from the warehouse carrying exactly what the store needs.

The merchandise is handled by store employees who know how much of each item is needed on the shelves and where it is needed, rather than by truck drivers or route salesmen whose aim it is to get as much shelf space as possible for their product.

The grocery-buying cooperatives and the independent wholesales supply the smaller nonchain stores in the same way the chains supply their stores. Cooperative members and independent small stores can take advantage of most of the same economies of mass purchasing and distribution as the chainstores by using central warehouse facilities for their supplies rather than attempting to buy directly from distributors.

In the Los Angeles area, potato chips, cookies, crackers, and some brands of soft drinks, all formerly purchased off trucks are now warehouse items. A good example of warehousing former off-truck items, is Sunshine Biscuit Co. Sunshine and Nabisco are very competitive, yet Sunshine is distributed through major chain and co-op warehouses whereas Nabisco maintains an off-truck policy with no warehousing.

In the Los Angeles area, there are only three products delivered in any quantity directly to the stores rather than through the warehouses, except private label; milk, bread, and soft drinks. Milk and bread have a very short shelf life and require special handling. Milk must be continually refrigerated. Bread must be protected from crushing. Those are the reasons for store-door delivery.

There is no justification for direct delivery of soft drinks. The stores do not want the soft-drink truckdriver backing up behind the store and requiring special handling of his product outside the more efficient distribution and handling system they use for most other products.

In most instances, the retailers have no choice but to take soft drink delivery at each store, because the bottlers refuse to deliver it to the warehouse and there is only one source of each brand.

Because each bottler has an exclusive territory for his brands, there is no competition to provide the more economical warehouse delivery and distribution the store prefers. If the store does not like the bottler's terms, their only choice is to drop his brand entirely. They cannot go to a competitor for either a better price or better service.

It should not surprise anyone that where a bottler has a monopoly on a heavily promoted brand in a defined territory, his price is going to be higher than if he had competition. That is exactly what happens at this point.

Soft drinks are wholesaled at artificially high prices that reflect the absence of competition among bottlers of the same brand.

When I started in the brokerage business, a little over 9 years ago, many of the buyers I talked to asked if we could develop a competitive source of brand name soft drinks to be delivered to the warehouse.

As I did my research, I found out there was enough fat in the prices to come in with a competitive situation on major brands. I located a distributor in Las Vegas that could supply Royal Crown, Diet Rite, and Dr. Pepper into the Los Angeles market. The pricing differential at that time, Royal Crown was selling off the truck and delivered by the bottler to each individual store in Los Angeles at $3.20 per case; the warehouse price on those items was $2.95.

My distributor was able to buy the same product in Las Vegas, ship it to Los Angeles and charge $2.55 delivered to a warehouse.

Now, the warehouses add a charge for their handling which usually runs about 5 percent. So the product was delivered to the stores at a cost to them of $2.68 per case. The stores like to work with a 20 percent markup on beverages, and they pass 80 percent of the savings on to the customer in the form of a lower retail price.

Warehouse delivery affects consumer prices in another way, as well. Under the exclusive territory system, a chain with stores in several different bottlers' territories may be paying different prices for the same product at various stores.

Bottlers of the same brand rarely, if ever, coordinate their promotional deals. So the chain has a difficult time creating retail promotions because it cannot advertise the same price for all of its stores.

If the product was sold to the warehouse for distribution, the stores serviced by the warehouse would have a standardized price on which they could base their advertising. Consumers would benefit from more frequent promotional low prices on soft drinks.

The Royal Crown bottler in Las Vegas was unable to keep on supplying our distributor because the parent company restricted the small bottlers sirup but left the large bottler in Los Angeles unrestricted. This practice put the distributor out of business on Royal Crown, Diet Rite, and Dr. Pepper.

Since then we have worked to obtain soft drinks from other areas and tried to get them into the Los Angeles market, some of them as far away as St. Louis, from Illinois, South Dakota, Montana, Nebraska. Even with the cost of transporting a low value, liquid product two-thirds of the way across the country, we would have made a good profit. However, the syrup companies pressured our sources and prevented them from dealing with us.

We did a similar project with Canada Dry that we did with Royal Crown, and at the time of the Canada Dry deliveries, the case cost dropped 95 cents per case on 10-ounce mixers and $1 per case on 28-ounce mixers.

In going through these numbers, in that same year we started a Royal Crown promotion from the distributor in Las Vegas, and we came in with a price; in other words, the price off-truck at that point was $4.15 per case. We came in with a warehouse price of $3.75. Then the local dealer dropped the price to $3.65, which was a big reduction for him, 50 cents per case. We then dropped to $3.50 a case. When that happened, this man was told no more warehouse deliveries.

Bringing up to date on a couple of things that have happened this year. No. 1, we represent a company that had access to Pepsi regular and diet cans, Royal Crown, Diet Rite cans, and Dr. Pepper cans. We obtained purchase orders from a major chain and a large co-op wholesaler in Los Angeles and shipped over 500,000 cases of the products. The pricing difference on Pepsi was $6.05 off-truck, which is the only way that the stores could obtain it until our program, versus $4.50 f.o.b. San Francisco for warehouse price. With the freight from San Francisco being 15 cents, their warehouse cost was $4.65 versus $6.05. The Pepsi product was packed in Seattle and shipped to San Francisco; $1.40 saving per case or 35 cents per six-pack savings.

During the shipping period, January through June, Pepsi promoted heavily because of this entrance of our product into the market. After this product was shipped, Pepsi took a price increase to $6.34 off-truck. The new retail price is $1.99 per six-pack.

Royal Crown was priced at $4 per case versus $5.70 off-truck price. With the same 15 cents freight from San Francisco, the warehouse price was $5 or a savings of $1.55.

Dr. Pepper had the same cost and selling price as Pepsi with the same savings. To our knowledge this is the first time all of these brands were offered from one source.

Also, this year was the introduction of C. & C. Cola and King Cola into the Los Angeles market. These products have been intro-

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duced as warehouse items in both 12-ounce cans and 2-liter plastic bottles. The pricing to the warehouse on cans was C. & C. Cola, $3.40 a case versus the higher $6.34 on the major brands, King Cola, 12-ounce cans, $3.93.

With these lower prices, and television and radio exposure, these two companies, C. & C. Cola, which is owned by I.T. & T., and King Cola, a local franchise, have proved a competitive force for the major brand soft drinks. Both of these companies use food brokers to market their products in the southern California area.

When we are able to introduce competition into the soft-drink business, we will bring better service to the retailers and lower prices to the consumers, and we will prosper as a small business ourselves.

Finally, we will help many soft-drink bottlers who are now frozen out of the markets where the action is. These little bottlers are confined to their exclusive territories where they will eventually find their volume is too small to permit them to survive.

They cannot afford to remain in a business that requires expensive equipment or efficient and high-quality production unless they can develop the volume to pay for it.

With the aid of brokers like us, they can capture a part of the large urban markets and find the volume they need to stay in business. Without it, they will disappear and leave the field to the already large bottlers, who will take over without any competition from other bottlers of the same brand.

There is another aspect of this bill that works against the small bottler. Most of the large grocery warehouses are located in the exclusive territories of large bottlers. These warehouses serve stores in the exclusive territories of other small bottlers.

Whenever soft drinks do find their way into the warehouses they are going to be distributed to the small bottlers' customers. And it is the big bottler who will be supplying the warehouse because it is in his territory.

It is easy to keep the little bottler from selling to a warehouse. A limit on his sirup supply is an effective way. But it is almost impossible to enforce a restriction on the large bottlers.

This bill would discriminate against the little man simply because it is easier to enforce restrictions against him. He will be unable to fight back because his sirup supply is a short and tight string by which he can be controlled.

I think we have shown what a little free enterprise and competition can do for the soft drink business. A legislation that pemits exclusive territories to continue will guarantee that the present conditions of poor service and inflated prices will continue.

This bill will not help the little man. It will guarantee his exclusion from the soft-drink marketplace.

Mr. VOLKMER. Thank you, Mr. Heckenkamp.

Mr. Reagin, do you have a statement?

TESTIMONY OF RONALD REAGIN

Mr. REAGIN. Yes, sir. My name is Ronald Reagin. I am an attorney of the law firm of Reagin & King in Los Angeles. I have represented the various plaintiffs in three private action antitrust suits which were brought after the soft-drink-concentrate companies cut off the supply of sirup to various bottlers who had agreed to sell products through Mr. Heckenkamp into the Los Angeles area.

What I particularly wanted to discuss this morning were two provisions of H.R. 3567 which particularly disturbed me as an attorney. These are the provisions in section 2 that nothing contained in any antitrust law shall render unlawful the enforcement of the exclusive territorial provisions found in virtually all bottlers' contracts of the national brands, and the provisions in section 3 that the existence or enforcement of territorial provisions in such contracts shall not be the basis of a recovery in a private action under section 4 of the Clayton Act until after a final determination that such provisions are unlawful.

The proposal in section 2 will legalize any economic strong-arm methods the so-called parent companies choose to use to bring recalcitrant bottlers or their customers into line to enforce the exclusive territorial provisions.

The methods used could include price fixing, horizontal conspiracies, and group boycotts, all of which are long established to be per se violations of section 2 of the Sherman Act.

For example, such provisions could be enforced by the requirement that sales of soft drinks outside of a bottler's exclusive territory could be made only at prices acceptable to the bottler in whose exclusive territory the soft drinks are ultimately to be sold for consumption.

Such blatant price-fixing would unquestionably be illegal under the long-established principles of antitrust law to which even the soft drink companies pay lip service, but this would be sanctioned under H.R. 3567 as merely the enforcement of a trademark licensing contract.

A perhaps more likely manner of enforcement of the clauses would be by horizontal agreement of all of the bottlers, under which the bottlers would get together and form their own policing committees to seek out those people who are selling to people like Mr. Heckenkamp for shipment to his customers wherever they happen to be.

At the present time, such horizontal conspiracies are clearly per se illegal, and in all of the actions brought to date, the defendant concentrate and sirup companies have vigorously contended that the provisions are merely vertical provisions between the concentrate company and the individual bottler, and are not horizontal agreements or conspiracies between bottlers at the same level of competition.

Be that as it may, the pretext could be dropped if the proposed provision becomes the law, and the exclusive territories could be easily enforced by a naked horizontal combination with the full blessing of section 2 of H.R. 3567.

Another effective means of enforcing such provisions would be a group boycott, which would be blatantly illegal at the present time but which would be allowed under the bill as proposed.

As you are aware from the earlier testimony in favor of H.R. 3567, and the preceding bills in all of the sessions, virtually all of the major soft-drink brands favor these provisions that legalize their exclusive territorial provisions while, as Mr. Heckenkamp and I believe, other witnesses have testified one of the prime movers in seeking to obtain soft drinks outside of exclusive territorial boundaries has been the supermarket chains.

An extremely effective tool in enforcing the exclusive territorial provisions for the soft drink companies would be the refusal of all brands, Coke, Pepsi, Royal Crown, Seven-Up, such as House of Betta, Thrifty Mart, or certified companies that have been leaders in buying in the Los Angeles area, if any of these obtained supplies of any brand to sell to any supermarket chain who obtains supplies of any brand from a bottler outside of the territory in which the supermarket is located. This would effectively completely stop such practices, since soft drink sales do represent a significant portion of the sales of a supermarket.

This type of interbrand agreement is so blatant as to be shocking to even consider, but it is one which would be expressly legalized by H.R. 3567.

As has been commented here earlier this morning, soft drinks are a leading item in the major chains. They are used as promotion items to get the customers in, and the threat of a boycott of all the national brands is something that would undoubtedly bring every supermarket chain into line, even those who are fighting the system now.

Next, the provision in section 3 that no damages can be collected in a private antitrust action under section 4 of the Clayton Act, except for acts which occur after a final determination that the provisions are unlawful, will undoubtedly completely eliminate any private actions in this area.

It is recognized by all authorities from the Supreme Court downward that private antitrust action is an important tool in the enforcement of the antitrust laws, since it allows the person directly harmed by the illegal acts to bring an action for the damages he has suffered.

This places the economic incentive squarely on the person who is most affected.

However, section 3 of H.R. 3567 expressly provides that the existence or enforcement of the territorial provisions, prior to any final determination that such provisions are unlawful, shall not be the basis of recovery in such a lawsuit.

As is well known, private antitrust actions, such as a long running New York IBM disaster case, are among the most difficult, complex, and costly to bring. If a person cannot even recover his actual damages which have been inflicted upon him unless the acts continue after a final determination that they are illegal acts, not only will the person have no incentive to bring such a lawsuit when he is so damaged, he is actually penalized for doing so, since he will have to pay the extensive costs for bringing such a lawsuit just to eliminate the practice so that in the future it will no longer continue.

This is clearly the function of the Justice Department or of the Federal Trade Commission, not of the private litigant, and the adoption of such a provision will undoubtedly bring a complete halt to any private actions in this area.

It would probably be that the provision in section 3 denying such a recovery until after judgment would be completely academic, because section 2 so obviously legalizes the exclusive territories, regardless of their effect on competition, so it is unlikely that any private action would be brought anyhow, because there is no chance of its success.

But this section, like the enforcement provisions of section 2, illustrating the arrogance and the extent to which the promoters and the backers of this bill in lobbying Congress have gone to get themselves totally exempt from the antitrust laws. No provisions like this presently exist anywhere in the antitrust laws, or in any other field of law of which I am aware.

If these provisions are adopted, they will serve as a precedent for other special interest groups, to seek similar exemptions and shields before this committee. It will open a Pandora's box of loopholes and attempted special interest legislation in the antitrust area, which at best will make the antitrust law a patchwork of special interest litigation and at worse will completely destroy the effectiveness of our antitrust laws.

Mr. VOLKMER. Thank you very much.

We will now proceed and recognize the gentleman from Illinois for 5 minutes.

Mr. MCCLORY. Thank you.

Mr. Heckenkamp, you appeared before this committee 3 years ago. I remember your testimony, and I think you indicated that if we would not act on the bottlers bill at that time, and freeze in the prerogatives that the local territorial franchised bottling works were enjoying, that the independents such as you were going to capture a large part of the market.

Have you, as well as other independent bottlers, greatly expanded your business during the intervening years?

Mr. HECKENKAMP. Well, we have been able to get some supplies as we intimated here, with major brands being shipped all in one truck. That has never been done before. It is obvious you can only do that in certain areas, because the parent companies do not want it to happen this way, so for us to expand, we have the limitations of people who will take the chance to ship, and most of the franchisees are afraid if they do this they will get cut off and be put out of business.

Mr. MCCLORY. You have both concentrated on the subject of chain stores. I understand the chain stores provide about 60 percent, I believe, of the soft drinks that are sold, Coke and Pepsi; the remaining 40 percent are through, I believe, other outlets, including vending machines.

What I am concerned about, if we were to adopt your practice of supplying the warehouses instead of having the door delivery, is who is going to look after the vending machines? It seems to me that what you are suggesting is that you would like to be free to handle the lion's share of the market, and that the individual customer of the vending machines and the smaller outlets, should be handled by someone else.

Mr. HECKENKAMP. Well, now, that is not really true, because they are being handled by someone right now. There are separate distributors that handle the vending machine people. There are cash-and-carry stores that handle the small mom-and-pop stores, so the distribution system is set that those people are still taken care of.

Their pricing may be different because of certain expenses that are built in, and more handling, but they are served. At one point some of the major producers of product in the Los Angeles market termed their store deliveries to chain stores as a necessity, because it made it economically feasible then to service the little 7-Elevens and the rest of the stores.

Mr. McClory. You want to compete in the supermarkets essentially. You don't want to compete with the vending machine operation, do you?

Mr. Heckenkamp. We would sell to them. We have.

Mr. McClory. You would sell to businesses that serviced vending machines?

Mr. Heckenkamp. Sure. If they can take the quantities that are required to get the best price.

Mr. McClory. You are not going to provide individual delivery to the vending machines?

Mr. Heckenkamp. No.

Mr. McClory. To smaller or the mom-and-pop stores?

Mr. Heckenkamp. No. That would be handled through distributors that we would sell on a secondary basis.

Mr. McClory. I thank you for your testimony. I thank the chairman.

Mr. Volkmer. I now recognize the chairman, the gentleman from New Jersey.

Chairman Rodino. Thank you very much.

Mr. Heckenkamp, you are a food broker?

Mr. Heckenkamp. Yes, sir.

Chairman Rodino. Could you provide the subcommittee with some estimate of the cost of delivering soft drinks to warehouses as opposed to store-door delivery, and would you be able to tell me why do soft-drink bottlers choose store door delivery over warehouse delivery?

Mr. Heckenkamp. Well, two things. No. 1, if they go into a warehouse delivery, the warehouses deliver other franchises that are used over that little imaginary line that exists in various counties or what have you, and, therefore, they are infringing on another franchisee's territory, so they are reluctant to put it into a major warehouse.

In the case of, let's say, Alpha Beta in Los Angeles, they have 240 stores that encompass San Diego and along the border of Mexico, all the way into northern California, San Francisco, so in that instance they are probably crossing five, six or seven major brand territorial franchises, so that is the hesitancy on the part of the local franchise.

Now we have no major franchise bottlers in the Los Angeles area delivering warehouses. They were up until December 1978, and they mysteriously all pulled out.

In other words, Royal Crown, Coca-Cola, and Canada Dry all stopped, mysteriously disbanded their warehouse program. They now only have off-truck available.

Chairman Rodino. How about the cost?

Mr. HECKENKAMP. The cost differential based on what our research shows and what we have been able to obtain from pretty far away areas, it varies anywhere from $1.40 to $1.55 per case difference.

Chairman RODINO. Where?

Mr. HECKENKAMP. In Los Angeles. We can bring it into Los Angeles.

Chairman RODINO. Does that vary in other parts of the country?

Mr. HECKENKAMP. Yes; it would vary. One question came up before about being able to ship from Baltimore into New York, how that could happen. One way, one thing that we have been very active in, and that is in backhauls. The chain stores have their own trucks that go to other areas, and then they backhaul the product on their own trucks; and that is a very economical way to get the product back into, let's say, the Los Angeles market.

Chairman RODINO. Mr. Heckenkamp, studies of the soft drink industry showed that a volume of 1 million cases a year would be the amount required for the industry to be efficient. Do you feel that territorial restrictions would help the small bottler achieve the most efficient level?

Mr. HECKENKAMP. Do I think the restriction would help him?

Chairman RODINO. Yes.

Mr. HECKENKAMP. No, sir. I think he is helped without the restrictions, because he is then free to enter that larger market that is available to him, either on a backhaul basis, because those trucks are going to his territory——

Chairman RODINO. In other words, they won't be able to achieve an efficient level of sales.

Mr. HECKENKAMP. There would be no way. They could not ship out of that particular area, and when you restrict that particular man at that point, he has only his small area to serve. He has no growth potential.

Chairman RODINO. Do you think that small bottlers would be able to compete with large bottlers for supermarket accounts?

Mr. HECKENKAMP. Very much so. We have done it. We have done it because most of the people that are willing to ship product have evaluated their product at the end of the production line, without the overhead of the small trucks going out, and therefore the pricing differential. You have less handling. You can load a truck, a 2,000-case truck or trailer, you can load in 35 minutes if it is all palletized.

Chairman RODINO. With the territorial agreements?

Mr. HECKENKAMP. You would have no way.

Chairman RODINO. Mr. Reagin, you make a very interesting observation as to some of the leeway that you suggest would be given to bottlers if this legislation were enacted, and that would be complete immunization from some of the antitrust laws.

If some bottlers conspired to divide markets or allocate customers, and have their supplier, in this case the sirup manufacturer, enforce the agreement, will this bill immunize this type of conspiracy?

Mr. REAGIN. There is nothing in this bill that restricts it at all to a vertical territorial agreement. It would cover horizontal just as well.

Chairman RODINO. Do you believe then that no such action would lie under the antitrust laws?

Mr. REAGIN. I can certainly hear the arguments that the syrup company defendants would make in court, if the action were brought. It is in plain English here. "Nothing contained in any antitrust law shall render unlawful the inclusion and enforcement in any trademark licensing contract."

Chairman RODINO. You think this would be an open door then to violate the antitrust laws, notwithstanding the fact that it is intended to protect bottlers' territorial agreements——

Mr. REAGIN. No, sir; I am disagreeing with your words, not your meaning. It would change it. It would no longer be a violation of the antitrust laws. It would allow them to do things far beyond.

Chairman RODINO. In other words, you are saying that the bill would just wipe out the antitrust laws or just legalize what now would be considered illegal?

Mr. REAGIN. Certainly, if you can hang it on the hook of being the enforcement of an exclusive territory, yes.

Chairman RODINO. Under the bill would the sirup manufacturers and also the bottling plants have an antitrust immunity for dividing territories with their customers who are also their competitors in the bottling industry?

Mr. REAGIN. That is what they are doing right now. When we did the *Coca-Cola* case, for instance, the *Taft* v. *Coca-Cola Bottlers* in the 1973–74 time period, the discovery at that time indicated the company-owned plants supplied about 28 to 29 percent of Coca-Cola in the country.

I am sure the numbers are higher now, just from reading the acquisitions that occur, and since that time 7-Up and Pepsi and others seem to have taken over more of their own plants, but when you have a Coca-Cola plant in San Francisco which is company owned by a subsidiary, and have a contract with itself, Coca-Cola, U.S.A., saying I will not sell out of a particular defined area, and I am not positive what theirs is, but it isn't the entire Bay area.

There is an independent Coca-Cola plant in Burlingame, I believe it is, that is not company owned, and it has a contract with Coca-Cola, U.S.A., saying we will only sell in the San Mateo County area, or whatever their territory is. They sit down and for any real purpose, or even a fictional purpose, they have agreed with the San Francisco Coca-Cola bottler you and I aren't going to compete with each other because the San Francisco Coca-Cola bottler is in fact the other party to the contract that the Burlingame body signed.

Chairman RODINO. You have represented Mr. Heckenkamp——

Mr. REAGIN. Yes, sir.

Chairman RODINO [continuing]. In antitrust suits. As an attorney and one conversant with the antitrust laws, do you think that this bill would be protective of Mr. Heckenkamp, a commercial purchaser of soft drinks?

Mr. REAGIN. Well, no, this bill would not protect Mr. Heckenkamp at all. I would not flatly sit here and say it will run Mr. Heckenkamp out of the soft-drink business. In 8 years I have been impressed at his creativity at getting the stuff to distribute it around, but it will certainly make it a great deal more difficult for him to get any.

Chairman RODINO. I thank you very much, Mr. Chairman.

Mr. VOLKMER. I am intrigued by your remarks concerning the effect of section 2 and section 3 of the bill, and I appreciate your comments in bringing it to my attention.

I would like to ask Mr. Heckenkamp, in the transportation costs, you said backhauling by the chains is one way of effecting lower costs in order to do it.

Mr. HECKENKAMP. Yes, sir.

Mr. VOLKMER. And in the past in your enterprise have you not also used other than common carriers to do the same thing?

Mr. HECKENKAMP. Yes; we have.

Mr. VOLKMER. And do you do that extensively?

Mr. HECKENKAMP. It depends on what the situation is. If there is a trucking arrangement going into an area empty, and hauling merchandise back, as in the case of some produce companies, they come into the Los Angeles market to pick up produce because it is a very large produce area, they will come in empty, and, therefore you have what we call a forward haul. They would haul the merchandise in and drop it at the warehouses.

Mr. VOLKMER. So these are people who are not really common carriers in trailing rates that someone may have to use?

Mr. HECKENKAMP. Yes; that is right, but those things are always available, and it is our understanding the way the Government is now viewing this——

Mr. VOLKMER. Soft drinks is an exempt commodity.

Mr. HECKENKAMP. Well, it is an exempt commodity, and also the fact that these trucks are available for other commodities that can help reduce the costs of transportation.

Mr. VOLKMER. Now let's turn it around. Let's assume that the FTC ruling is upheld by the courts, and there are no territorial restrictions, no franchise. Let's assume again that the people in Los Angeles, whoever is bottling there, decides that that market is better out there, so we will move up into San Francisco and up into Seattle. Do you think the little ones will survive?

Mr. HECKENKAMP. I think they will not only survive. I think they can thrive, because they have economies in some areas, depending on what their contract is.

Mr. VOLKMER. What contract?

Mr. HECKENKAMP. The contract they have with the parent company.

Mr. VOLKMER. The contract with the parent company is limited by the amount of syrup that they get?

Mr. HECKENKAMP. No, I am talking about the fact that the parent company is providing them with cans or various packs that they are under contract to do. In other words, some of the smaller areas, let's say Coca-Cola, are provided out of San Francisco, with a truck laid-in price that is very, very acceptable, and they can make profit by transshipment or shipping into another area, and that would still exist.

I would imagine that they would not change those contracts completely.

Mr. VOLKMER. You don't believe that the larger bottling firms, and those that are owned by the syrup firms, could take over those territories?

Mr. HECKENKAMP. Oh, I think they could if they wanted to pay the price, and I think that is what the problem is right now. If they let them go by the wayside in the next 3, 4, or 5 years, they don't have to buy them back. Those territories just close up.

Mr. VOLKMER. That is right, and then who is going to take them over?

Mr. HECKENKAMP. Then the parent company would at that point.

Mr. VOLKMER. Yes.

Mr. HECKENKAMP. But that would not be a cause of what is happening here. That would be because it wouldn't happen, it couldn't happen. If we are not able to ship into other areas, and this restriction is enforced, to me that is going to make sure that those little guys out there will be taken over.

Mr. VOLKMER. The smaller ones, the real small ones, would be gone then?

Mr. HECKENKAMP. Right.

Mr. VOLKMER. Because it is an uneconomic situation?

Mr. HECKENKAMP. You would see the same situation happen that happened in the oil industry as you brought up before, in canned oil which is marketed through the grocery chains. In years gone by each area was defined. Each territory, a man had so many square blocks in, let's say, Los Angeles. Well, there was one enterprising man who decided on Pennzoil. He would truck it out of Pennsylvania, and he did, and he ended up breaking up that whole distributorship situation where he could sell anyone he wanted. He did it because he was enterprising. He would bring full truckloads from Pennsylvania all the way into Los Angeles.

As a result, that canned oil now in the stores is priced at a price that is very reasonable as compared to what you pay in the station.

Mr. VOLKMER. Maybe I don't see it, but I still feel that the large bottling plants, if there is no territorial restriction at all, can eventually take over the more lucrative markets, and will.

Mr. REAGIN. May I respond to that, sir?

Mr. VOLKMER. Yes.

Mr. REAGIN. During the last 15- to 20-year period in southern California, which is obviously a major market.

Mr. VOLKMER. Yes.

Mr. REAGIN. The Coca-Cola small bottlers have been disappearing one by one until the last one disappeared in August or September of this year when the Taft plant, under some sort of secretive arrangements—to which I am not privy and I do not know was disposed of—to someone, and I do not know who, and I will not speculate who, but the Ventura bottler has disappeared, the Bakersfield bottler has disappeared.

Now the Taft bottler has disappeared, the Santa Maria, the Fresno bottler, the Las Vegas bottlers have disappeared. They all had exclusive territories, and they didn't save a one of them, and they didn't save any jobs in those areas either, because every one of their bottling plants was closed down. They are served out of Los Angeles now. You buy a can of Coca-Cola in the high Sierras hunderds of miles from anywhere it says bottled by Coca-Cola under the authority of the Coca-Cola Bottling Co. of Los Angeles.

Those people, when they sold those franchises to Mr. MacDonald, a very enterprising businessman for whom I have very great respect, he wasn't buying a plant or outmoded trucks. He was buying nothing in the world but territory, but you don't pour Coca-Cola on territory. You don't water the cotton fields of the Central Valley. He was buying people pure and simple, and he wasn't retaining jobs when he took it over.

Mr. VOLKMER. My time is up. I would like to recognize the gentleman from Illinois.

Mr. RAILSBACK. Thank you, Mr. Chairman.

Mr. Heckenkamp, 3 years ago, I believe, you indicated that if not frozen by territorial restrictions, smaller bottlers, with the aid of food brokers and distributors such as yourself, could capture a large part of the urban market.

I am personally troubled by the prospect that if we do not enact legislation, and if the FTC ruling is upheld, that there may be activity by the manufacturers to vertically integrate by acquisition or by expansion, and that many of the small bottlers would simply not be able to compete. As a matter of fact, it is my understanding that the overwhelming number of small bottlers would disagree with your view and are quite concerned about what would happen if we don't legislate.

Could you comment on the vertical integration aspect?

Let me just say that it is my understanding also that Pepsi Cola has already acquired in the vicinity of 24 percent of the Pepsi bottling subsidiaries, and Coca-Cola now owns 14 percent of their bottling subsidiaries.

Mr. HECKENKAMP. What you are saying is what was mentioned before. They should be concerned if this passes, and I think if it doesn't pass, that is where they can survive. The fact that Mr. Reagin just mentioned before, that Coca-Cola, Los Angeles, has bought up all these franchises, there is a reason they bought those up. They bought them up because at that point in time they were delivering product into their territories through the "S.F." system, which Mr. MacDonald acknowledges is the most economical system available for soft drinks; so to eliminate the fact that those people want to ship back into his territories, they went out, expanded, and bought all those territories, so the territories in essence became more valuable.

Now, if I had a little bottling plant, let's say in Bakersfield, which is 100 miles from Los Angeles, and I had this little plant, and this bill did not exist, and the FTC prevailed, I have all the economies in the world to be able to get that product into the Los Angeles market. Those people in Los Angeles don't want that.

Mr. RAILSBACK. Why, then, are the overwhelming number of small bottlers in disagreement with you?

Mr. HECKENKAMP. Because they have been told many, many times from the parent company—and the parent company is just what it says. It is like their parents. They tell them what to do, when to do it, and they have been instructed that this is their survival.

Mr. RAILSBACK. I think perhaps you are assuming that the small bottler businessman may not be a good businessman. I happen to be very well acquainted with several small bottler businessmen who are leaders in their community, very capable, and successful, and they disagree very much with your view as to what is likely to happen.

I happened to see a map that indicated that, I believe it was Pepsi-Cola, had really expanded by acquisition not on the west coast but on the east coast.

What happens if the sirup manufacturers really start to use their leverage in taking over the whole market?

Mr. HECKENKAMP. Don't you then have a situation that is like Lever Bros. or Procter & Gamble? They are putting out their own product. That is the end result. How can you prevent that from happening? You can't legislate that. That is our free enterprise system.

Mr. RAILSBACK. I agree with you, except they have seen fit, initially anyway, to enter into franchise agreements giving existing small bottlers the opportunity to make some money. The small bottlers express concern. These small bottlers believe, I think most of them do, that they are doing pretty well and that their products are competitive.

I think they would argue that the cost of soft drinks, when compared to other items in the economy, have not risen disproportionately. Let me put it this way. My major concern about the FTC determination may be that it is not taking into account vertical integration, which could work to the great detriment of the small bottler. I would ask your lawyer to comment on this as well. This may occur in direct contradiction of terms that were entered into voluntarily by the franchisee and the franchisor, which doesn't seem right at all to me.

Mr. HECKENKAMP. Let me explain something that maybe people forget. The reason that the cola companies, Seven-Up, or whatever, the reason they started franchising years back was that was their only method, much similar to Kentucky Fried Chicken. You look at those franchises, how many were bought back after they were succesful, but they went out and bought them back. But if things don't go right here, and some of those small people fold up, maybe because of this bill, those people don't have to be bought back. Those territories just get closed up.

Mr. RAILSBACK. Let me ask either one of you this. What kind of time frame now do the franchise agreements have? What is the duration of the typical, if there is a typical, franchise?

Mr. REAGIN. They differ from brand to brand, I believe, sir. I have seen Coca-Cola franchises in perpetuity.

Mr. RAILSBACK. Is it renewable or is it in perpetuity?

Mr. REAGIN. It is in perpetuity. The contract that the Taft Bottling operation had was a perpetuity contract.

Mr. RAILSBACK. What about Pepsi-Cola?

Mr. REAGIN. I have never litigated a Pepsi-Cola case. Tom hasn't been good enough in getting us enough of that product, I guess. The Royal Crown franchise, I guess, at Las Vegas, I believe, was a 10-year contract, is my recollection. I haven't read it for a few years but it did have a term of not an unreasonable number of years.

Mr. RAILSBACK. So if I am correct, the only way then that Coca-Cola, for instance, can acquire a franchise is to negotiate and buy that franchise; is that right?

Mr. REAGIN. Or sit there and let it go broke.

Mr. RAILSBACK. Or what?

Mr. REAGIN. Or sit there and let it go broke, which is precisely what Pope Foster was doing before Tom Heckenkamp came along.

Mr. RAILSBACK. How does that happen? Is it not in violation of an agreement?

Mr. REAGIN. There weren't enough people there to support the product. Pope Foster had a one-spout bottling machine. He was bottling soda pop one bottle at a time. The man in Bakersfield at least had a considerbly better machine than that, but neither of them had anything compared to what Mr. MacDonald had in Los Angeles.

When you are bottling one bottle of soda pop at a time in a plant with maybe three employees and his son working a forklift loading the trucks, you are not going to put out very much soda pop, and you are not going to support your family, and you are going to sell out pretty soon or close up. You have no option.

Mr. HECKENKAMP. At a small price.

Mr. REAGIN. Yes. He was offered, I believe, $25,000 or $30,000 by Bakersfield to buy him out, and that was the final straw that broke his back, and he agreed to sell to Pope, and talk around the trade on what they finally sold out to, to get them the threat of selling into Los Angeles off of their back, Thrifty Mart announced for their 51 percent that they acquired they got $1.6 million.

Mr. RAILSBACK. Let me ask you this: If you were sitting on the FTC or if you were a lawmaker, and you agreed with the general thrust to do away with the existing system, ideally, would it be better to have some kind of a phased-in time period, rather than just in effect——

Mr. REAGIN. It has been going on for 20 years. The number of franchised bottlers in the country has diminished from 6,000 to less than 2,000. If I could directly approach the question you asked earlier and invited me to answer, and one that the chairman was asking of the earlier academic witnesses, is this bill going to stop vertical integration, why use a back door, side door or trap door approach to it. If that is a problem, introduce a bill to stop this vertical integration and hold hearings directly on the issue, but if you do, I think you will find a very different set of opposition to the bills than you are finding here today.

I think you would find the suppliers would be the ones who would be here.

Mr. RAILSBACK. I agree with you. If we don't legislate positively to do something about what I perceive as a real threat, then I think we have to do something in the other direction, to recognize what I think is a very real threat caused by vertical integration.

I agree with you that it would be a different set of opponents.

Mr. REAGIN. But if that is an evil, and it may well be, it is not one I have studied particularly, if that is an evil, it should be attacked by the Congress directly, instead of people saying that this is somehow going to stop vertical integration. Territories are in fact not stopping vertical integration. It is occurring when territories are in all contracts, and probably to a high 98–99 percent nationwide correlation they are being on order, and vertical integration is still going on.

Mr. VOLKMER. Thank you. Perhaps some of us feel that the vertical integration will be slowed down with this type of bill. We slow the process more by having the territories than if we don't have the territories.

Mr. REAGIN. You are giving them the choice, slow poison or the gun?

Mr. VOLKMER. Well, it is something anyway. I agree with you that vertical integration is going on right now. Nobody disagrees with that.

Mr. REAGIN. I would rather do away with both slow poison and the gun, if we are going to do away with murder.

Mr. VOLKMER. The trouble is I don't think that is possible right now. The legislation is not before us to do that. Mr. Nellis.

Mr. NELLIS. Thank you, Mr. Chairman.

Are either of you familiar with how prevalent the practice of refusing to deal is in your industry? I notice that in the case of your Las Vegas distributor, he was finally cut off. The Los Angeles distributor was cutoff from dealing with you. How prevalent is that practice in the soft drink industry? Are you able to say?

Mr. HECKENKAMP. In the case of the Canada Dry-Royal Crown situation, which I described here, the people in Los Angeles, the people in Ventura, the people in Las Vegas all got together and sat down and said, OK, we will have no more, and I think when you do that, I don't know what the legal term is for it but they sat down and said we won't have this anymore, and, therefore, it faded away.

Mr. NELLIS. It sounds like a group boycott.

Mr. HECKENKAMP. Something of that sort. Immediately the prices shot up, because now the man who had control of the Los Angeles market went out, priced it and they had no choice.

Mr. NELLIS. That is my next question. The prices, you say, shot up. Can you give us some specifics? What was the price before this event to the consumer, and what was the price after this event?

Mr. HECKENKAMP. In the case of Canada Dry, the 28-ounce mixer, which is the big, the best seller for Canada Dry, at the time that we were bringing the product in from Las Vegas, that product could be bought on the shelf, any shelf in Los Angeles, at around 46 to 49 cents. When this source was dried up, and there was no more shipping from Las Vegas into Los Angeles, it is now 69, 79.

Mr. NELLIS. Some people might say that increase is due to inflation. Is it?

Mr. HECKENKAMP. Well, you don't have inflation on water, and that is all that is in Canada Dry is water and a little salts.

Mr. NELLIS. And over what period of time are you talking about, Mr. Heckenkamp?

Mr. HECKENKAMP. Sixty days.

Mr. NELLIS. Within 60 days?

Mr. HECKENKAMP. Within 60 days.

Mr. NELLIS. The price went up?

Mr. HECKENKAMP. Right. Once the warehouses moved out the product that they had in the warehouses, it took about a 60-day period. You check the market today, and it is sky high.

Mr. NELLIS. Mr. Reagin.

Mr. REAGIN. I would note on that same issue Canada Dry in Los Angeles is part of the Coca-Cola of Los Angeles empire. Mr. MacDonald, to my knowledge, is the only bottler in Los Angeles who ever chose to fight back with lower prices. When the other brands came in they screamed to the parent company to cut off the source and it happened every time. They didn't choose to price compete.

Mr. NELLIS. Did they cut Mr. MacDonald off?

Mr. REAGIN. No.

Mr. NELLIS. You mean he is still there?

Mr. REAGIN. Yes; I believe it may have been Mr. MacDonald's comment, or was it Mr. Susong of Atlanta that he spills more sirup than Taft was using in a year. How can you cut him off?

Mr. NELLIS. Mr. Reagin, I am trying to get at something.

Mr. REAGIN. Yes.

Mr. NELLIS. Is it a function of being cut off that you are a small operator like Mr. Heckenkamp, whereas, if you are a big operator, some accommodation might be made under present law?

Mr. REAGIN. Yes.

Mr. NELLIS. Thank you. Thank you, Mr. Chairman.

Mr. VOLKMER. Are there additional questions? I wish to thank the witnesses for testifying.

We will adjourn the meeting. Thank you.

[Whereupon, at 1:50 p.m., the committee was adjourned.]

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SOFT DRINK INTERBRAND COMPETITION ACT

WEDNESDAY, MARCH 19, 1980

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON MONOPOLIES AND COMMERCIAL LAW
OF THE COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met at 11:15 a.m., in room 2141, Rayburn House Office Building, Hon. Mike Synar presiding.

Present: Representatives Synar, Volkmer, Harris, Railsback, and Butler.

Staff present: Warren S. Grimes, chief counsel; Joel Ginsburg, counsel; Franklin G. Polk and Charles E. Kern II, associate counsel.

Mr. SYNAR [presiding]. The Subcommittee on Monopolies and Commercial Law will come to order.

I'm Congressman Synar from Oklahoma, sitting in for Chairman Rodino, who has been detained, and he has requested that I read his opening statement.

This morning the Subcommittee on Monopolies and Commercial Law meets to continue consideration of the bills which would create a special antitrust standard for the soft drink bottling industry. The subcommittee will look to the guidelines for special exemptions set by the Presidential Commission to Review Antitrust Laws and Procedures.

The guidelines require the proponent of the exemption to show that a convincing public interest rationale exists for abandoning competition. They also recommend that the exemption be framed in the narrowest possible terms in order to minimize any adverse effects on competition.

With the most recent inflation figures showing an 18-percent annual rate, we must be sure that the codification of any restrictions on the interbrand competition of the soft drink industry not retard efficiency and productivity.

We have a primary obligation to the consumer to insure that no unnecessary or anticompetitive costs are engendered by our legislative action.

We are also conscious that the Federal Trade Commission has concluded that the soft drink industry is characterized by a system of territorial restraints developed when the industry was in its infancy, and transportation and technology alternatives for manufacturing and marketing were much more limited.

Our consideration of these bills is also influenced by the knowledge that a decision by the U.S. Court of Appeals in the Federal Trade Commission's proceeding involving the Coca-Cola and Pepsi Cola companies appears to be imminent. Finally, we are also aware

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that the Ninth Circuit Court of Appeals in the recent *Royal Crown Cola* case appears to uphold the existence of the company's territorial restraints as consistent with existing antitrust law.

We are hopeful that the witnesses appearing before the subcommittee this morning will provide us with helpful information on these and other issues relevant to the proposed bills.

Again, that was the opening statement by Chairman Rodino. Joining us this morning, and before we start with our first witness, I'd like to call on my good friend, the Congressman from Texas, Mr. Sam Hall, who has a few remarks.

Mr. VOLKMER. Mr. Chairman, before Mr. Hall starts, I'd like unanimous consent, if the subcommittee will permit me this morning, to be covered in whole or in part by television broadcast, radio broadcast, and/or still photography, pursuant to rule 5, committee rule.

Mr. SYNAR. Without objection.

TESTIMONY OF HON. SAM B. HALL., JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. HALL. Mr. Chairman, at a critical time in the Nation's economic development, everyone seems to have a scapegoat for high interest rates, 20 percent inflation, and declining production.

It is only natural that some economic experts and public interests groups would single out lack of competition as a major reason for the Nation's economic woes.

Maybe the soft drink industry got caught up in this kind of thinking when the Federal Trade Commission issued its decision in 1971 to restructure their entire means of production, but I submit that few industries in this country can match the competitiveness of the soft drink industry.

A lot of people will tell you there is probably too much competition. Soft drink vending machines are becoming more complicated in terms of selection than cigarette machines. There is a soft drink for every occasion today.

The soft drink industry doesn't operate like the airlines when it comes to the competition issue, and therefore cannot be the subject of some deregulation scheme bent upon fostering more competition.

In the first place, soft drinks have been around longer than airplanes; and second, everyone can afford and has access to a bottle of soda pop, which is certainly not the case with air travel.

If the Federal Trade Commission ruling is allowed to stand, it will only result in the big getting bigger, and the little guy being forced out of business. Do away with the family-owned soft drink franchise operation we have had for the past 80 years or so, and you invite cutthroat competition that invariably leads to mergers, which truly stifles competition and gives rise to price increases.

This will not hurt the affluent, who will buy 7-Up, Pepsi, or Yoo-Hoo Cola, regardless of price, but it will be another blow to those in the low-income sector of our economy.

Mr. Chairman, we have 312 cosponsors of this bill. I didn't go buttonholing Members on this thing. In fact, only two letters went out inviting cosponsors. In truth, Members of Congress know their local bottlers, and they understand the small business nature of this industry, and the fact that competition is keen.

The approach to this bill is simple. It goes to the heart of the philosophy that "if it ain't broke, don't fix it."

Talk about inflation and the economy on the verge of ruin. One of the principal reasons is ridiculous decisions on the part of Government regulatory agencies like the Federal Trade Commission, based not upon economic realities and proven performance, but rather on some theoretical whim concocted by people who have had little or no experience in the real business world. As I like to say, people who have never had to meet a weekly payroll.

It sort of reminds me of Charles Finley, who after winning three world championships at Oakland, Calif., let his entire team get away from him.

In other words, in this day of uncertainty, if one endeavor is working pretty well, why in heaven's name try to restructure it.

I have read a lot of arguments for and against this bill, but the bottom line to me is clear: Does Congress have the constitutional authority to legislate or not? To those who say Congress should not interfere in the judicial process, I can only say that *Marberry* v. *Madison* was not intended to prevent the Congress from challenging the courts or taking action in lieu of the courts.

I say it is the province of Congress to determine if the antitrust laws should be used to restructure an industry.

Further, if we do not act and the resolution continues to be delayed in the courts, the entire industry system could begin to fall apart beyond any ability to save it.

In that event, Congress might be precluded from any effective action. Besides, Mr. Chairman, this case has been in litigation for 9 years. That's a pretty long gestation period.

Tragically, as a result, this inordinate delay is beginning to cripple the soft drink industry. I think the arguments are in, Mr. Chairman. We just cannot thwart what is clearly the mandate of the House of Representatives any longer.

I honestly hope that we can now proceed to mark up H.R. 3567 and get it to the floor within the next 4 to 6 weeks.

I would like to reiterate again, there are 312 sponsors to this legislation. I don't believe that any committee in this Congress, whether it be a subcommittee or a full committee, has the prerogative or has the right to sit on a bill with that many cosponsors.

I appreciate the generous time that the committee has given to me, and I yield back the balance of my time.

Thank you, Mr. Chairman.

Mr. SYNAR. Thank you, Sam. I think everyone in this room knows the leadership that you have shown on this particular legislation. As a cosponsor with you on this legislation, I think we can point to your leadership and your determination to get this issue resolved and, as a force which has caused this hearing today.

I, like you, am very hopeful that we can resolve this 9-year delay on a very important issue which will affect every person in this country. We are all aware of the fact that the bottling industry operates in every congressional district throughout the country.

You are to be commended and it is a great opportunity to join with you in this effort.

Mr. HALL. Thank you, sir.

Mr. SYNAR. Our first witnesses today will appear in a panel. I think only one of them is here. Congressman Tom Luken introduced H.R. 3573 and has requested the opportunity to testify before the subcommittee.

Mr. Luken feels that the territorial agreements in the soft drink industry are procompetitive and facilitate the use of returnable containers. So at this time I'd like to call on my good friend from Ohio, and the author of H.R. 3573, Congressman Tom Luken.

TESTIMONY OF HON. THOMAS A. LUKEN, A REPRESNTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. LUKEN. Thank you, Mr. Chairman Synar and Congressman Volkmer.

I think it is appropriate that Chairman Rodino's letter was read at the outset of this hearing, because I think his letter did frame the issues which are the basis of this legislation, and the answer to the questions raised in his letter are simply that the FTC decision is blatantly inflationary, and that's the reason that 312 cosponsors of this bill have gone on the bill and remained on the bill.

These are not 312 cosponsors who have capriciously cosponsored the bill yesterday. The bill has been around for quite some time, for many months. The Members have had plenty of time to consider it. The Members of this Congress are very sensitive about inflation. It's the most sensitive thing, as the chairman and I were discussing before this meeting, and the meetings we had down at the White House yesterday, and the meetings that are going on on this Hill all the time. It's at the present time about the most crucial issue facing this country, and that is inflation. I think any cold analysis of the issues on this matter and the FTC decision would lead to at least the adoption of the bill introduced by Mr. Hall, which would simply say that these agreements in the soft drink industry are not unlawful, where there is substantial and effective competition.

Now it doesn't eliminate competition at all. It only provides that in a situation like this, which is almost unique in the sense that the refillable bottles which are in danger as a result of the FTC decision, that these refillable bottles—in my territory, in my district—are now selling incredibly—at approximately the same price per ounce as they did in 1939. The same as in 1939, because of this system which the FTC is attacking.

And I might say that the previous witness stole the language, and it was not original with either one of us, but this is not an area of the economy which is particularly ailing. It's an area where I, as a small business representative—I am a member of the Small Business Committee and chairman of the Energy Research and Development Committee—have a particular interest, a special, almost unique interest in the issues here, because they do involve energy. They do involve the saving of energy.

The congressional support of this legislation is extraordinary, and in addition to the legislation which has been discussed, which I just described, Congressman Mica and I have introduced another piece of legislation. Both bills have the same objective, to validate these exclusive territorial franchise systems which have well served consumers of soft drinks since the beginning of the century.

They differ to this extent: That my bill places greater emphasis on the need for this legislation to protect the environment, to avoid unnecessary energy consumption, and to make possible the continued availability of soft drink products in the lowest cost package, the returnable bottle.

Now another record before this subcommittee describes the structure of the soft drink industry, its unique distribution system and the relationship existing among the sirup manufacturers, the bottle franchisers operating within an exclusive territory, and finally the retailers, particularly the large supermarkets. The large supermarkets become very important in consideration of this legislation, because it is the large supermarkets which would be very quickly taken over by Coca-Cola and Pepsi Cola with the cans, because of their ease of handling, and the prices would shoot up, as compared to the present prices in most parts of this country.

The soft drink industry distribution system has permitted the development of vigorous competition among many popular brands. Why else is the price so reasonable? Where there are returnable bottles, there is intensive price advertising, price competition among brands seeking to increase their market shares.

The effectiveness of competition within the industry is proven by the fact that prices remained low compared to the price index of other items, and notwithstanding this convincing evidence of vigorous interbrand competition in the soft drink market, the FTC attacked the industry's time-tested system of territorial franchises, and the administrative law judge who heard the evidence dismissed the complaint.

He found that according to the rule of reason, there was competition. So it isn't just the 312 cosponsors of this bill who recognize that there is competition and that the FTC decision is anticonsumer. It is also the administrative law judge who heard all the facts in the case.

And what has been happening as a result of the FTC decision? Pepsico, which manufactures the Pepsi syrup and concentrate, has over the years reacquired Pepsi franchisers covering 25 percent of the population—there is a threat to competition, which is not addressed by the FTC act.

These markets include many of the largest cities in this Nation. The inevitable concentration in the soft drink industy which will rapidly occur under the FTC decision will have a ruinous effect on hundreds of small businesses, jeopardizing substantially their entire network, and I submit that that is another reason we have 312 cosponsors, because the Members of this House are very sensitive to the small business interests, and when they have the opportunity, they evidence that interest in legislation such as this.

These bottles, the refillables, will be replaced by cans or other nonresusable package forms with disastrous adverse effects on the ecology. I point out a recent study done by Franklin Associates, consultants in resource and environmental policy and planning, who were used time and time again by the Department of Energy and other agencies of this Government, and this study projects truly alarming consequences from the disappearance of the returnable bottle in the soft drink beverage industry. The returnable bottles are used on the average of 20 times each, just to give us an idea of the saving of energy, and the savings of labor.

Other substantial adverse environmental consequences are found in the increased air and water pollution, but recently Franklin has attacked the subject again. They have made a comparative analysis of the cost of the manufacture and delivery of soft drinks in 16-ounce refillable bottles, and these conclusions I don't think the committee has had before, come from a very reputable survey, a very reputable consultant, and they have found that overall the can system costs 72.4 to 103 percent more per fluid ounce than the refillable bottle system, and it is to the can system that we are headed if the FTC decision is allowed to stand.

So, finally, at issue is the question whether Congress approves the distribution system which has served us very well since the beginning of the century, or run the risk by failing to act, that this system of territorial franchises will end. I don't want to take too much of the committee's time, but I have here the proposed amendment to the bottlers contract of Coca-Cola.

Coca-Cola has recently gone around to its bottlers and proposed an amendment to their franchise agreements which has the effect of raising the cost of the syrup. And as an incentive, so that the bottlers will accept it, Coca-Cola lists several things, and one of them is what Coca-Cola Co. is giving to the bottlers is as follows:

If any provision of the contract is held to be void and unenforceable by a court or governmental authority in competent jurisdiction—that's this case, the FTC case—the bottle contract will be construed so as not to be inconsistent with such order, and will otherwise remain in full force and effect.

Coca-Cola is saying that the FTC decision which says that the refillable bottles will be left, that part of it will be left immune from the decision. Coca-Cola is not going to pay any attention to that. Coca-Cola says right here if one part of the contract goes, the whole contract goes, and the bottler will have no rights whatsoever. That's what it says in this amendment. But they are offering as an incentive to the Coca-Cola bottlers, individual bottlers, that if they agree to a revision which will have the effect of jacking up the price.

In that case, they will allow this particular provision which leaves that part of it, the refillable part, the returnable part, in the contract, and will not be held void upon the decision of the FTC becoming effective.

I thank the members of the committee, and just reiterate what Mr. Hall, Congressman Hall, effectively stated, that the will of the Congress seems to be fairly clear. I think it's been demonstrated over a period of time, and I hope the members of this committee will agree and will report the bill out at the earliest opportunity.

Thank you, Mr. Chairman.

Mr. SYNAR. Thank you, Tom. As is the normal case, I will ask for unanimous consent that you may revise and extend your remarks.

[The complete statement follows:]

PREPARED STATEMENT OF HON. THOMAS A. LUKEN

Mr. Chairman and members of the subcommittee, I am grateful for the opportunity to appear before you in support of H.R. 3567 and H.R. 3573, legislative proposals that have the purpose of overturning a decision of the Federal Trade Commission involving the soft drink industry which, if allowed to stand, will have serious adverse effects on our environment, our national energy goals, our efforts to combat inflation and hundreds of small business concerns.

The Congressional support for this legislation is extraordinary. More than 300 members of the House have cosponsored H.R. 3667 and over 80 members of the Senate the campanion bill, S 598. The latter bill, incidentially, has been ordered reported by the Senate Judiciary Committee, and I am informed passage by the Senate is anticipated soon.

In addition to H.R. 3567 your Subcommittee has before you H.R. 3573, a bill cosponsored by Congressman Mica and me, which has been jointly referred to Committees on the Judiciary and Interstate and Foreign Commerce. Both bills have the same objective—to validate the exclusive territorial franchise system which has well served the consumer of soft drinks since the beginning of the century. They differ primarily to the extent that H.R. 3573 places greater emphasis on the need for the legislation to protect the environment, to avoid unnecessary energy consumption and to make possible the continued availability of soft drink products in the lowest cost package form—the returnable bottle. H.R. 3573 also represents an unambiguous legislation declaration that nothing in the Federal Trade Commission Act or other anti-trust laws shall render invalid the exclusive territorial agreements in the soft drink industry, unless it is found that within a territory there is an absence of generally available competing products, and futher found that the elimination of the territorial rights will not adversely affect the quality of the environment, increase energy consumption, inflate the cost of soft drink products, or lead to concentration of economic power in the industry.

I know the record already before the Subcommittee describes the structure of the soft drink industry, its unique distribution system, and the relationship existing among the syrup manufacturers, the bottler franchisees operating within exclusive territories (many of which are now owned by the syrup manufacturers), and finally the retailers, particularly the large supermarkets.

The soft drink industry distribution system has permitted the development of vigorous competition among the many popular brands, to the benefit of all consumers. There is intensive price advertising competition among brands seeking to increase their market shares. The effectiveness of competition within the industry is proven by the fact the price per ounce of Coke in the 16-ounce returnable bottle has increased less than three percent over the 1939 cost of the product, despite a rise in the consumer price index during those years of 344 percent.

Notwithstanding the convincing evidence of vigorous interbrand competition in the soft drink market, the FTC attacked the industry's time tested system of territorial franchises. The Administrative Law Judge who heard the evidence dismissed the complaint, but unfortunately and unwisely a 2–1 majority of the Commission reversed, and thus it is we are here today.

Virtually everyone with knowledge of the soft drink industry agrees that, if the FTC order is allowed to become effective, there will be a rapid movement to concentration within the industry, resulting in the major markets falling under control of the syrup manufacturers and perhaps a few of the largest bottler firms. Pepsi Co, Inc., which manufactures the Pepsi syrup and concentrate, has over the years reacquired Pepsi franchises covering 25 percent of the population. These markets include Boston, New York, Philadelphia, Detroit, Pittsburgh, Dallas, Houston and Los Angeles. The Coca-Cola Company has reacquired franchises covering 14 percent of the population. These include Boston, Chicago, San Francisco, etc. The FTC decision now permits, and indeed seems to require, the syrup manufacturers to compete with their independent bottler franchises anywhere in the country.

The inevitable concentration in the soft drink industry that will rapidly occur under the FTC decision not only will have a ruinous effect on hundreds of small business firms, jeopardizing substantially their entire net worth, but also will lead to the near total disappearance of the returnable, refillable glass bottle in which more than 40 percent of soft drink products are now sold.[1] These bottles will be replaced by cans or other non-reuseable package forms with disastrous adverse effects on the ecology, in the form of increased solid litter waste; on our energy conservation goals since the alternative package forms are far more energy consumptive in their production than the refillable glass bottle; and on our battle with inflation due to higher cost of the alternative package forms, particularly cans made from aluminum and steel.

A recent study done by Franklin Associates, Ltd., research consultants in resource and environmental policy and planning, projects truly alarming consequences from the disappearance of the returnable bottle in the soft drink beverage industry.

[1] Approximately 50 percent of all returnable sales are made in supermarkets.

Remember that returnable bottles are used an average of 20 times so that each one that disappears and is not replaced in kind must be replaced by 20 cans or other non-returnable package forms. The Franklin Associates' study projects the effects of the complete disappearance of the returnable bottle, now accounting for 40 percent of the beverage product sold, an assumed condition other industry experts agree is probable. The resulting increase in energy consumption is expressed in the following equivalencies for each year:

(1) The total energy impact equals the supply of electricity for a city of 100,000 persons for 69 years; (2) An increase in natural gas consumption equal to the amount necessary to heat 100,000 midwestern homes for 4.9 years; (3) An increase in petroleum consumption equal to the amount of fuel requirements for 100,000 passenger cars (based on 14 miles per gallon and 12,000 miles per year, per car); (4) An increase in coal consumption equal to the amount of coal that could be carried by a train 686 miles long.

The equivalent expressions of the impact of the FTC decision on solid waste generation is equally alarming. The study finds that the increase is solid litter waste, resulting from the replacement of the returnable bottle by cans and other nonreturnable package forms, would fill the Orange Bowl in Miami, Florida 87 times each year.

These equivalencies for increased energy consumption and solid waste generation cover only a four-year period. Other substantial adverse environmental consequences are found in the increased air and water pollution emissions inherent in the manufacturing process of cans and other non-returnable package forms.

Another study recently concluded by Franklin Associates[2] consisted of a comparative analysis of the cost for the manufacture and delivery of soft drinks in 16-ounce refillable bottles and 12-ounce cans. Franklin Associates found: "Overall, the can system costs 72.4 to 103 percent more per fluid ounce than the refillable bottle system. This significant difference is mainly due to the cost of the packaging for the can system which is 2.3 to 9.0 times higher than the refillable system packaging per ounce of beverage." This explains why for the year 1977 the consumer paid an average of 97 percent more per ounce for soft drink products in a 12-ounce can than in the 16-ounce returnable bottle. It has been estimated that the disappearance of the returnable bottle will add a minimum additional cost of $1.45 billion annually to the price consumers now pay for carbonated soft drinks. The legislation before you provides the Congress with an opportunity to do something meaningful and substantial to assist the consumer in coping with the heavy burden of inflation.

It has been suggested by some that the Congress should defer action on these legislative proposals until the U.S. Court of Appeals for the District of Columbia rules on the appeal from the Federal Trade Commission decision. I disagree and, we may assume, so do the other 300 House members who have cosponsored the legislation. At issue is the question whether the Congress approves the distribution system which has existed in the soft drink industry since the beginning of the century, or run the risk, by failing to act, that the system of territorial franchises will be radically changed to the serious detriment of our environment, our energy conservation goals and to the consumer in the form of higher prices for soft drinks. The validity of the territorial franchise system has been subject to challenge for ten years and the Court of Appeals has failed to render a decision 18 months after oral argument. It is time for the Congress to act.

Mr. SYNAR. Joining you to your right is Congressman Paul McCloskey. Mr. McCloskey is also in favor of the proposed legislation, and has requested the opportunity to present his views before the subcommittee, so at this time, Congressman.

TESTIMONY OF HON. PAUL N. McCLOSKEY, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. McCLOSKEY. Thank you, Mr. Chairman.

I don't have much to add to the testimony that has gone before. I would just like to reiterate that in 1973, after this litigation had

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[2] Both studies by Franklin Associates to which reference is made were prepared at the request of Central Investment Corporation which owns Pepsi Cola franchises in Canton and Mansfield, Ohio and Ft. Lauderdale and Palm Beach, Florida. Submitted for the record of these hearings is the more recent study, dated March 14, 1980, entitled: "A Comparative Analysis Of The Cost For The Manufacture And Delivery Of Soft Drink In 16-Ounce Refillable Bottles And 12-Ounce Cans".

commenced, the Senate passed a bill to allow these franchises. In 1976, the House bill was reported by both the Judiciary Committee and the Interstate and Foreign Commerce Committee.

I would hate to see this Congress let this bill fail once again. Four years ago I wrote a "Dear Colleagues" letter agreeing with the FTC administrative law judge, who ruled that the bottlers were not in violation of the antitrust law; that they were competitive. The Commission chose to overrule the administrative law judge. You have seen the reaction of the Congress to the FTC's expansion.

I have read the testimony of the Justice Department opposing this bill. I would point out that their testimony is based on theory and on speculation as to what may happen.

I would probably concede that having small bottling companies in rural areas of the country may not give the consumer the price benefit that having bottling companies in major cities might.

But, this intrusion by Justice and the Federal Trade Commission into something that has been in existence for 80 years, in my judgment, is just not reasonable. I would set aside theory unless there is some showing of abuse, which, in my judgment, there has not been. I would go along with the administrative law judge and restore or preserve the status quo.

I don't think any industry ought to be subjected to 9 years of uncertainty because of a position taken by the Federal Trade Commission, as they did 9 years ago. It would seem to me that to restore the public's faith in the system of enacting laws as well as in Congress, we ought to speedily act to clarify this law which has been uncertainty since the administrative determination 9 years ago.

Mr. SYNAR. Thank you, Paul.

At this time I will call on Congressman Volkmer from Missouri for opening statements and any questions you might have.

Mr. VOLKMER. At this time I'd just like to make a brief statement. I wish to commend the gentleman from Texas and the gentleman from Ohio and others who have taken the lead in this legislation, and I quite agree with them, it's time for the Congress to act.

The idea that we wait for the court would have been reasonable if it had been within a time frame in which the court had no opportunity to act, but the court has had that opportunity, and it delayed. Recently the subcommittee heard from the Assistant Attorney General in charge of the Antitrust Division of Department of Justice, and he was asked if he had any idea as to when the court would act on this, and his reply was, "Who knows?"

Rather than wait another year or two for the court to act, I think it's time for this committee and the Congress to have the opportunity to act. Whatever the Congress and this committee feels should be done, at least we should have that opportunity.

Thank you, Mr. Chairman.

Mr. SYNAR. The Chair recognizes the Congressman from Virginia for any opening remarks or questions.

Mr. BUTLER. I thank the Chairman. I have no questions. I appreciate the interest that these witnesses have taken in this legislation. I think the support that it has in this body is significant, judging by the number of cosponsors, and the interest these three gentlemen have particularly taken in this legislation indicates that the time has come for our subcommittee to act.

It's a little bit embarrassing to find—I checked down the list—the number of our Members and of this committee who are sponsors of this legislation. Somehow I am hard put to explain to you gentlemen why it is necessary for you to have to work so hard to get it out of our subcommittee. But we will do what we can. I'm sorry our chairman couldn't be here to respond to that comment, but maybe that will give you some insight into the problem. [Laughter.]

Mr. SYNAR. I thank the gentleman. At this time I will call on the minority counsel for any questions they might have.

Mr. POLK. Thank you, Mr. Chairman.

Mr. Luken, is there anything inconsistent between the environmental and the economic concerns that you voiced in the transshipment of soft drinks in cans?

Mr. LUKEN. I don't think there is anything inconsistent. I think that the environmental benefits are simply incidental to the basic maintenance of this system of local bottlers who have built up the tradition and the practice of providing local bottlers with the sirup or buying the formula from the parent bottler, and because of the local bottling system and refillable system we thereby get the environmental benefits, because we do have a refillable bottle.

We have no particular transportation problems because of the relative closeness of the bottlers. These are the considerations which are simply byproducts. I don't think there are any tradeoffs involved.

Now what will happen, predictably, according to the studies that have been done, and apparently according to anybody who is familiar with the industry, is if these agreements, these franchises, are set aside, that Coca-Cola and Pepsi-Cola and the big companies will move in with regional kinds of bottling plants and distribution systems, just as the brewers have done, and if we compare the two industries, the brewing industry has changed in recent years dramatically to where in most places it's difficult to get a returnable bottle.

In my neighborhood, which is not atypical, it's fairly typical of many parts of the country, it is difficult to get a returnable beer bottle. I can tell you from personal experience. But it is the common thing to get a returnable Pepsi-Cola, Coca-Cola, 7-Up, and the price reflection.

Mr. POLK. Suppose the territorial arrangements were not set aside with respect to a returnable container, but were set aside with respect to others.

Mr. LUKEN. Well, that's what the FTC decision attempts to do.

Mr. POLK. Yes; and I'm wondering what fault you find with that agreement. You seem to offer the suggestion that a territorial arrangement should be kept because of the savings of returnables, but you indicate that it is impossible to divide it as the FTC did.

Mr. LUKEN. Well, what's going to happen according to those in the industry, and I think it would be fairly evident to any observer, is that Pepsi-Cola and Coca-Cola are going to come in with their cans, their 12-ounce can, and market them through the supermarkets. They are going to turn the whole marketing system topsy-turvy and tend to monopolize it. That's what will happen.

So that the bottlers who are left with just this portion of the market, must face the competition. Price competition would be fine. But the competition—and this is the thing—competition with the giants, the behemoths who will come in and take it over.

Mr. POLK. So you think the price of the canned soft drinks will be lower, then?

Mr. LUKEN. The price of the cans, as experience has demonstrated, will be much greater. The price of the cans, as I understand it, is on the average of about a six-pack for $2; whereas in many areas, I know in Cincinnati, you can get six 16-ounce bottles of Coca-Cola, Pepsi-Cola, or the 7-Up for $1.28 almost any day of the week.

Mr. POLK. So it would not seem likely that the can products are making any inroads into the returnable product, would it?

Mr. LUKEN. Exept for the power of the advertising and the power of the big companies in taking over the supermarkets. If what you were saying was true, it wouldn't have happened in the brewing industry, but it does. You can't go into a supermarket in Cincinnati and get a returnable beer bottle, but it's cheaper if you can get it.

You can go into a little mom and pop store, in what we call a pony keg in our area, and you can get beer in returnable bottles cheaper than you can get in a supermarket, but the people who are going to the supermarket are restricted. They can only buy what's on sale in the supermarket, and that's the nonreturnable beer cans.

That is the experience.

Mr. POLK. Thank you, Mr. Chairman.

Mr. MCCLOSKEY. I think from an environmental standpoint, I'd like to see the aluminum can banned. I don't see any social value to the aluminum can, and I don't know if there is any other product on the environmental landscape that consumes as much energy as the aluminum can.

Mr. POLK. Thank you.

Mr. SYNAR. Does majority counsel have any questions?

Well, I'd like to thank both Congressman McCloskey and Congressman Luken for their very informative remarks this morning, and we appreciate them taking time out of their very busy schedules. Thank you all.

At this time we will continue with our next witness.

Mr. LUKEN. Thank you, Mr. Chairman.

Mr. SYNAR. Our next witness is Mr. J. Lucian Smith. Mr. Smith is the past president of Coca-Cola, Inc., the sirup manufacturer. Mr. Smith has testified before this subcommittee in 1976 in favor of legislation which would have applied the rule of reason standard to this industry, and Mr. Smith will testify in favor of H.R. 3567, which will preserve a system which Coca-Cola believes enhances competition and facilitates the introduction of new products.

TESTIMONY OF J. LUCIAN SMITH, MEMBER, BOARD OF DIRECTORS, AND PAST PRESIDENT, COCA-COLA CO., ACCOMPANIED BY ROBERT KELLER, GENERAL COUNSEL

Mr. SMITH. Thank you very much, Mr. Chairman and members. It is a distinct pleasure for me to testify before this distinguished committee.

As the chairman has commented, on June 24, 1976, I had the privilege of testifying before this committee as president of the Coca-Cola Co. Today I testify as a member of its board of directors and as a consultant to the company.

With me is Mr. Robert A. Keller, genral counsel of the Coca-Cola Co.

While my position with the company has changed, my purpose in appearing before this subcommittee is the same; to preserve the soft drink territorial system which had fostered the intense interbrand competition in the soft drink industry that has resulted in the most phenomenal consumer story in America today.

The 6½ ounce returnable bottle of Coca-Cola sold for 5 cents, 80 years ago, just under 1 cent per ounce. Today, 80 years later, the 32-ounce returnable bottle sells for just under 1 cent per ounce. The average for all returnable packages of Coca-Cola is 1.2 cents per ounce—and the returnable package still represents 60 percent of Coca-Cola purchased for home consumption. There could hardly be a better evidence of the competitive nature of the present system.

The interbrand competition fostered by the system of exclusive territories has also made soft drinks available in more than 1 million places in virtually every one of the 25,000 cities and counties in the 50 States. That interbrand competition has made market entry easy for new products which are free to piggyback on the existing distribution systems of major soft drink bottlers like Coca-Cola bottlers. That interbrand competition has kept hundreds of small businessmen viable as independent bottlers of Coca-Cola and other soft drink products throughout America.

But today that interbrand competition and the benefits that flow from it are threatened by the Federal Trade Commission. The Commission found a violation of the antitrust laws in the arrangement under which a bottler is given the authority to manufacture and distribute soft drinks, like Coca-Cola, exclusively in a defined geographic area.

This decision by the Commission reversed the decision by the administrative law judge who ruled that the present system is in fact competitive and serves the public's interest. The legislation I testify in support of today—H.R. 3567—would permit such arrangements to continue.

Let me describe briefly the role of the Coca-Cola Co. in the soft drink business in the United States. The Coca-Cola Co. produces syrups and concentrates for approximately 550 of the 2,000 soft drink bottlers operating throughout the country. The bottler commits to develop and service consumer demand. To fulfill this commitment, the bottler must make significant investments in manufacturing plant and equipment, containers and delivery systems. To give the bottler the opportunity to make a return on his investment, he is granted the exclusive right to manufacture and sell Coca-Cola in a defined geographic area.

In addition to Coca-Cola, we also sell syrups and concentrates for other products, such as Fresca, Tab, Sprite, Mr. Pibb, Mello Yello, and the Fanta soft drinks under the same bottler system. There is no tie-in among these products. A bottler of Coca-Cola does not have to distribute any of our other products, and is free to manufacture and deliver soft drinks that compete with them.

The company also sells fountain syrups to approximately 4,000 wholesalers across the United States, who compete with our bottlers and with each other in selling Coca-Cola. These wholesalers resell the syrup for use at retail outlets where the product is mixed into the consumer beverage at the point of sale.

These wholesalers are simply that: They do not perform any manufacturing or demand-developing activities for fountain Coca-Cola syrup, and in many instances they do not even deliver that syrup. These fountain wholesalers only sell to retailers the same syrup they purchase from the Coca-Cola Co. Because these wholesalers do not have to make the substantial investments and commitment required of bottlers, there is no need for the incentive of an exclusive territory.

In contrast, the bottlers purchase syrup from the Coca-Cola Co. which is used to manufacture a finished product. The bottlers package the product in their own containers; they sell the packaged product at wholesale prices that they themselves set in competition with other bottlers selling numerous other brands of soft drinks.

Retailers, in turn, set the final price of the product to the consumer.

The bottler system began 80 years ago at the turn of the century when few Americans had heard of Coca-Cola. It was essential to give bottlers the exclusive right to manufacture and sell the trademarked product within the defined geographic area in order to persuade them to make the substantial investments to develop and service consumer demand for the product.

Most other soft drink trademarked licensors were later able to enter the soft drink business only because they could provide the same incentive to their bottlers. As a result, there are today more than 2,000 indpendent bottlers in the United States—1,500 of which are competing vigorously with the 550 Coca-Cola bottlers.

Exclusive territorial arrangements were necessary 80 years go to encourage individual bottlers to make substantial investments in plant and equipment. Today, with the impact of inflation and high-interest rates, such arrangements are even more necessary.

The 550 Coca-Cola bottlers are local businesses which employ more than 60,000 people. They have invested an estimated $2 billion in their manufacturing and distribution systems. Their investment has benefited not only their own communities, their employees and themselves, but most importantly, the American consumer.

At the beginning of my testimony, I cited the most persuasive evidence of the success of the special kind of interbrand competition fostered by the system of exclusive territories: The fact that today the American consumer can purchase Coca-Cola in returnable containers at about the same price it was available 80 years ago.

Returnable containers are economically sound. And exclusive territorial arrangements for all types of containers are essential to preserving bottler interest in using returnable containers. The deposit the bottler receives on a returnable container is less than the cost of that container. Unless the bottler can recover the container for repeated use, it cannot remain as the economy package.

Indeed, a bottler would certainly not invest in expensive assets, which returnable bottles are, without some assurance that the value of the asset will be realized.

Coca-Cola sold in food stores in nonreturnable packages priced on the average 57 percent higher than Coca-Cola sold in returnable bottles. The difference lies essentially in the cost of packaging. The cost of returnable bottles is spread over many uses, the cost of nonreturnable packages must be absorbed in a single use.

The American consumer recognizes the significant savings from returnable bottles, as evidence by the fact that approximately 60 percent of Coca-Cola purchased for home consumption in food stores is purchased in returnable bottles.

The remarkable distribution system, made possible by the exclusive territorial arrangements that encourage bottler investments in manufacturing plants and delivery capability, has enhanced the ability of competitors to market their products.

Many brands have achieved nationwide distribution in a very short time by using the existing goodwill and production and distribution systems of established local bottlers of other brands.

For example, Nestea, which is a canned ice tea, was able to be distributed in areas serving 90 percent of the people in the country in just 3 years, by entering exclusive territorial licensing agreements with 135 established national brand bottlers. The introduction of new products to wide segments of the market would not be possible without the existing distribution system.

At Coca-Cola, we have chosen to distribute soft drinks through a local decentralized bottler system with exclusive territories, rather than to manufacture and market products in the way others, like Proctor & Gamble, do, retaining all of the system profits by selling directly to retailers.

We believe the evidence confirms that soft drinks can be more economically produced and distributed through the independent bottler system.

In view of the facts developed over 80 years of the current distribution system, it is no wonder that, which the sole exception of the Federal Trade Commission, every tribunal which has considered the reasonableness of the soft drink territorial arrangements has found the system to be lawful.

In 1920, a Federal district court examined the bottler system for Coca-Cola and found, and I quote, "Nothing having an effect or intended to have an effect to defeat or lessen competition * * * nor * * * anything therein that may be said to be an unreasonable restraint of trade."

The Federal Trade Commission administrative law judge ruled in October 1975, and I quote, "There is substantial and effective interbrand competition in each Coca-Cola bottler's territory. The territorial exclusivity provisions * * * are no more restrictive than is necessary to persuade bottlers to make and to continue to make the sizeable capital investments necessary to operate successfully * * * and to contribute to the economies of the communities in which they are located."

I have quoted that in part.

The judge concluded that the:

elimination of the territorial exclusivity provisions would have an adverse effect on competition and be contrary to the objectives of the antitrust and environmental impact laws.

Further recognition of the reasonableness of territorial exclusivity is found in the decision of the *Tomac* case. There a Federal district judge declared that the territorial provision, and I quote:

is reasonable because it is necessary to promote a legitimate business purpose; it provides a necessary incentive to the bottler to make a substantial investment needed to equip himself to compete successfully, and it enhances, rather than has a detrimental effect, on competition.

The Ninth Circuit Court of Appeals in the *Royal Crown* case in January of this year affirmed a jury verdict sustaining the reasonableness and legality of the soft drink territorial system under the antitrust laws.

Congressional action of the kind proposed in H.R. 3567 is fully consistent with these decisions, and there is ample precedent for the Congress to act in a situation like this. Though these issues are being considered by the courts, Federal judges have repeatedly recognized the limits of their ability to balance the economic, social, and human values at stake in restructuring an entire industry.

The Supreme Court in the *Topco* case explicitly recognized the Congress as an appropriate forum for discussing and resolving these issues.

Across the spectrum of economic and social activity, the Congress has legislated while matters were pending in the courts. In major issues in the tax area—like the critical distinction between an employees and an independent contractor—the Congress has legislated in the face of judicial action. When the courts enjoined the construction of the trans-Alaskan oil pipeline and set the matter down for future consideration, the Congress legislated to permit its construction.

Perhaps the best example, Mr. Chairman, of congressional action while litigation was ongoing can be found in the civil rights area. With cases pending in several Federal courts, the Congress enacted legislation prohibiting discrimination in public accommodations and legislation assuring voting rights.

The present case has been in litigation for almost a decade. The economic, social, and human considerations are far beyond the ability of the courts, and the delay itself is not serving the cause of competition.

Four years ago, I testified that if territorial exclusivity were eliminated, the result would be the forced concentration of the bottling industry into the hands of a few bottlers. In the intervening period of uncertainty, that process has already commenced.

Mr. Chairman, Coca-Cola is sold by bottlers of every size in every corner of America. Operations vary in scope of territory, and in the mix of products bottlers manufacture and distribute. But the overwhelming majority of these independent bottlers have one common and persistent theme in their conversations with the Coca-Cola Co.: The system of exclusive territories is essential if they are to continue to provide the American people, over the long run, a quality product at low cost, and permit the economic forces of this Nation to operate competitively and fairly.

We believe that the independent bottler system represents the best of the American system. It encourages businessmen, close to their communities, to own and operate their own businesses. It has encouraged and enhanced interbrand competition. It has permitted easy market entry and national distribution for new products.

Unlike any other system of which we are aware, it permits the American consumer to buy Coca-Cola today at the same price our grandparents bought it 80 years ago.

Thank you, Mr. Chairman. I'll be glad to try to answer any questions.

Mr. SYNAR. Thank you, Mr. Smith. At this time I'll ask for unanimous consent that you can revise and extend your remarks.

I will first call upon Congressman Volkmer for any questions you might have.

Mr. VOLKMER. Yes. Thank you, Mr. Chairman.

Mr. Smith, would you tell me, since the FTC decision by the ALJ, whether or not there has been any uncertainty in the soft drink industry about the value of the bottling franchises?

Mr. SMITH. Congressman, there has indeed been a great deal of concern about it. I know very few times when we have interchanges with bottlers where that isn't a subject they want to discuss.

Mr. VOLKMER. Prior to that time, had Coca-Cola purchased exclusive franchised territories?

Mr. SMITH. Yes, sir. We owned a few bottling plants for a long number of years.

Mr. VOLKMER. Have you since that time acquired others?

Mr. SMITH. Yes, sir.

Mr. VOLKMER. Can you tell me why? Was it for purposes of investment, a pure business matter, or because of other reasons? What were the reasons that you acquired additional bottling plants?

Mr. SMITH. Maybe it would be helpful if I quantify it for you and you'll see it's de minimis. When we testified here before, we had eight bottling companies. We now have nine. When I testified here before, the territories we owned served about 14 percent of the U.S. population. They now serve about 15 percent of the U.S. population. There has not been a policy change at all. We purchased the Atlanta Coca-Cola Bottling Co., which is our hometown, because it was put on the market by the owners, not because we sought it, and we felt it had many advantages that we should own a plant in our hometown.

Policywise, we have not changed our policy.

Mr. VOLKMER. Is it your policy not to own or to own?

Mr. SMITH. Our policy is not to own.

Mr. VOLKMER. Let's assume that the FTC ruling would be revised, either by Congress with this act, or by the court of appeals. Would you seek to divest yourself of those franchised territories?

Mr. SMITH. Congressman, we stipulated before the Federal Trade Commission that if all of our competitors were required to and did divest themselves, we would also.

Mr. VOLKMER. If the other companies were required to do so, you would be willing to do it also?

Mr. SMITH. Yes, sir.

Mr. VOLKMER. All right.

Do you know the term "piggybacking" Mr. Smith?

Mr. SMITH. Yes, sir.

Mr. VOLKMER. All right. Has piggybacking had an impact upon the retail market for soft drinks?

Mr. SMITH. Oh, yes, sir. It's created the availability of many, many more products.

Mr. VOLKMER. Many more brands of different soft drinks.

Mr. SMITH. Yes, sir.

Mr. VOLKMER. Do you require your bottlers to handle the other soft drink products that the Coca-Cola Co. produces?

Mr. SMITH. No, sir.

Mr. VOLKMER. Is that purely an option with them?

Mr. SMITH. Yes, sir.

Mr. VOLKMER. If they do not, does it become available to any other bottler within the franchised territory?

Mr. SMITH. Under our present and long-time policy, we have not offered the product to others if our bottler chooses not to take it.

Mr. VOLKMER. all right. We have heard testimony in regard to your fountain sales. Fountain syrups are currently handled through wholesalers, are they not?

Mr. SMITH. Yes, sir.

Mr. VOLKMER. And those fountain wholesalers are in basic competition with your bottlers?

Mr. SMITH. They are indeed, and with each other.

Mr. VOLKMER. In other words, does the fountain sale compete with the bottle sale within the retail market?

Mr. SMITH. Yes, sir.

Mr. VOLKMER. At the present time you basically have two different type of franchise agreements, do you not?

Mr. SMITH. Yes, sir.

Mr. VOLKMER. One has to do with using, I think, a derivative of corn for a sweetener rather than sugar. You are using that now, are you not?

Mr. SMITH. Yes, sir, but that's not part of contract.

Mr. VOLKMER. That is not?

Mr. SMITH. No, sir.

Mr. VOLKMER. All right. I will skip that for a minute and go to another issue. My time is going to run out, and I wish to discuss another issue that's more important to me.

In the event that the FTC ruling is upheld by the Court of Appeals, and that Congress does not act, what would be the position and policy of your company in regard to the franchises?

As I understand it, from a statement that was made at shareholders' meeting, you don't consider those franchises legal. Right?

Mr. SMITH. If I follow your question, the new contract specifically, the amended contract which has been signed by more than 70 percent of the business, specifies that if any provision of that contract is declared to be unenforceable, the remainder of it will stay in full force and effect.

Mr. VOLKMER. All right.

Mr. SMITH. Is that responsive?

Mr. VOLKMER. But on the other hand, would or would you not then be unable to go into the franchised territories?

Mr. SMITH. Oh, no, sir.

Mr. VOLKMER. Even with the FTC ruling?

Mr. SMITH. Well, the other bottlers would be, yes, indeed. The Coca-Cola Co. would be.

Mr. VOLKMER. You would not still franchise anybody else in the area?

Mr. SMITH. If I'm following you correctly, the answer is no, but the neighboring——

Mr. VOLKMER. Neighboring bottlers can go in and sell?

Mr. SMITH. One-way containers. No question but they would.

Mr. VOLKMER. I'm asking for 1 minute, because I want to go to one more basic question, and that is would you as Coca-Cola come in and buy up bottlers?

Mr. SMITH. Oh, no, sir.

Mr. VOLKMER. You wouldn't do that?

Mr. SMITH. Well, I mean if you calculate it, I've already said that the bottlers have $2 billion invested. I can't imagine that we'd undertake to do that. We don't believe in it, in the first place.

Mr. VOLKMER. I just wanted to know. Thank you very much.

Mr. SYNAR. The gentleman from Virginia.

The gentleman from Illinois.

Mr. RAILSBACK. Thank you, Mr. Chairman. Unfortunately, I'm going to have to leave shortly, so I will be brief. What percentage of the bottlers that sell your product are owned by Coca-Cola itself, your firm?

Mr. SMITH. I don't have the number in front of me in percentage, but it's very small. We have 9 bottling companies out of 550.

Mr. RAILSBACK. I see.

Mr. SMITH. And they serve 15 percent of the population of the United States.

Mr. RAILSBACK. If the FTC decision were upheld, would it not make it very feasible for the Coca-Cola Co., if it so chose, to get even deeper into the business of vertically integrating by acquiring other independent firms' bottling facilities?

Mr. SMITH. Congressman, I am advised by our lawyers that the issue we are dealing with here through the Federal Trade Commission and you really doesn't relate to that subject, that the antitrust—there are other laws that would be governed, if we undertook to buy other bottlers. It is not a policy. I don't think you would find bottlers concerned about us, nearly so much as they are concerned about their neighboring Coca-Cola bottlers.

Mr. RAILSBACK. The reason I'm asking the question is I find your testimony even more persuasive inasmuch as it would seem to me that in the event the FTC decision were to prevail, it might give you more leverage and more opportunity to profit if you were able to acquire some of the Coca-Cola independent bottlers.

So what I am saying to you is that—despite the fact that Pepsi Cola, for instance, has apparently acquired a substantial number of Pepsi Cola bottlers—both Pepsi Cola and Coca-Cola are willing to come forward and testify in favor of preserving the existing arrangement, which, as I understand it, you claim to be competitive. You believe that it has not been inflationary, and so you are testifying in favor of a bill that is very strongly supported by at least three out of four of the apparently independent bottlers. Is that correct?

Mr. SMITH. It certainly is, and I don't know how it could be better stated.

Mr. RAILSBACK. Let me ask you this: At one point it was my understanding that bottlers were in favor of legislation that would require the use of the rule of reason. Now the FTC indicates that it has, as I understand it, employed the rule of reason in reaching its decision, which is now on appeal and pending.

Do you still think, now that the FTC apparently has seen the light and is allegedly using the rule of reason, that there is a need for this legislation?

Mr. SMITH. Yes, sir. We believe that the rule of reason needs to be more clearly defined as it applies to this issue.

Mr. RAILSBACK. All right. How would you do that? Do you have specific recommendations along those lines, or do you think that the legislation pending would effectively deal with that?

Mr. SMITH. Yes, sir.

Mr. RAILSBACK. All right. Now what is the status? There are some who seem to suggest that maybe the Judiciary Committee is not acting inasmuch as there is a lawsuit pending on appeal, and I understand you are a party in that lawsuit.

Mr. SMITH. Yes, sir.

Mr. RAILSBACK. All right. Now what's the status of that? When is the court likely to render a decision, and are you still in favor of going ahead with legislation, inasmuch as there may be a decision rendered fairly soon?

Mr. SMITH. It may be that I should ask Mr. Keller, who is our general counsel, to answer that, because I'm sure he's more familiar than I am, Mr. Chairman.

Mr. KELLER. The current status of the litigation is that we have filed briefs and had an oral argument before the Court of Appeals here in Washington, D.C., appealing the FTC's decision.

We have not had a decision out of the court. One of the three judges who is on that court has died, and we don't know what the status of it is, because of that death. It's very difficult to predict when the court is going to decide it, or whether or not we are going to have to go back for reargument.

Of course, as you know, when we get that decision, there is always the Supreme Court that will be ahead of us. I know of no way of predicting that.

The second part of your question—Luke, it may be that I would need some help from you on this—the second part of that question is whether or not we shouldn't wait until that decision is completed before this committee or the Congress acts.

Really, there are two parts. One, it's been 9 years already, and everything that's happened to the business in the meantime.

Two, after the decision comes down, and the need to respond, if it's against us, the need to respond to that from a business standpoint to avoid treble damages.

Mr. RAILSBACK. Let me just ask one very quick question. Thank you.

Is it also your belief that the pending, unresolved litigation, until it is finally resolved, has resulted and will continue to result in disruptions of decisionmaking by businesses that may be directly affected?

Mr. SMITH. Yes, indeed, it is, Congressman. Since I testified here before, we have lost approximately 50 bottlers. It is our judgment that more than half of that resulted from doubt as to what the outcome of the litigation would be. The other was because of economic necessity.

Mr. RAILSBACK. Well, I thank the gentleman.

Mr. SYNAR. The gentleman's time has expired.

The Chair now recognizes the distinguished chairman of this subcommitee.

Chairman RODINO. Thank you very much, Mr. Chairman.

Mr. Smith, thank you for appearing again before this committee, along with your counsel.

Mr. Smith, I was interested in finding out something about the trend that seems to be taking place in the elimination of the number of bottlers. I believe that that is something that is of paramount concern, because we talk about having this need to assure that competition existing does at the same time not only provide for fairness in the market and protection to the consumer, but allows people who are able to, to continue in this very industry.

I find that when we get at the numbers, and these are numbers according to the National Soft Drink Association, is that back in 1950, there were 6,000 bottling plants. In 1960, 4,500 bottling plants. In 1970, 3,000. And less than 2,000 by 1979.

First of all, I'd like to ask whether your company has been harmed by the elimination of so many bottlers, and then ask you why this trend.

Mr. SMITH. Mr. Chairman, I really have to confess that I'm not qualified to speak to those particular numbers. I am qualified to talk to you about the Coca-Cola side of that coin, and would be glad to.

Chairman RODINO. That would be helpful.

Mr. SMITH. There has been a decline prior to the FTC's action in 1971 in numbers of bottlers. That decline was because of economic forces. Many small bottlers simply couldn't continue to function profitably, and so they sold to neighboring bottlers, usually.

In any event, they sold and received their equities for what they had done during the years, and that process has continued, and is continuing now.

The thing that has happened new since 1971 is that to economic pressure has been added the doubt of the continuing value of the bottlers' assets, if there is an adverse decision out of the Federal Trade Commission, and the legal process that follows.

As I think I testified last time, the bottler's concern, who acts out of that fear, is not only the loss of his physical assets, which are substantial, but his most important asset is the good will he has created by running his business for these many years, and so the fear of losing those two things has prompted many bottlers to sell neighboring larger bottlers, even though they were physically big enough to continue to stay in business.

I testified, I believe, when you were not here, but at any rate, I will repeat it, since I was here in 1976, 52 bottlers no longer exist. It is our judgment that based on conversations with them, not guesses, that about half of those, perhaps a little more than half, but to be conservative, I will say a half of those, merged into a neighboring bottler because of economic reasons. But the other half who were large, viable businesses merged into other companies because of their concern about a continuing value of their business, if territorial exclusivity were lost.

Chairman RODINO. Has this decrease of numbers of bottlers had any harmful effect on your company?

Mr. SMITH. No, sir, not as of this moment. It would be very hard to measure, but I would like to give you our judgment about it.

Chairman RODINO. Please do.

Mr. SMITH. Our experience is, and this can be documented, that the more bottlers we have, consistent with their economic viability, the more intensively is the business developed in that territory.

So, to the extent that we lose small bottlers, we lose a competitiveness that a larger bottler doesn't bring to bear.

Now I don't know that I could tell you that we now feel that, but our judgment is if this trend continues, and the business ends up in the hands of three or four or five or six bottlers, there will be a definite disadvantage to the consumer and to us.

I hope I was responsive.

Chairman RODINO. Well, I thank you. I appreciate the fact that it's a judgment on your part and you are trying to be as responsive as you can under the circumstances.

What I would like to know from you, Mr. Smith, and I guess you will refer this to your counsel, is in view of the action taken by the ninth circuit in the *Royal Crown Cola* case, does your company feel that this decision is such that there is no future concern on your part about the action that might be taken by the other circuit, the D.C. circuit in the case presently pending before it?

Mr. SMITH. I would like Mr. Keller to add anything he wants to from what I'm about to say. Nine years of doubt of whether or not you should reinvest in the ongoing nature of your business is a long time, and nobody can give us—I mean we have asked every lawyer we can find, and nobody can give us any reason to believe we are not confronted with a long period of time again in the future.

Bob, would you like to add anything to that?

Mr. KELLER. Mr. Chairman, I think as I read the *Royal Crown* decision, it was essentially one at the ninth circuit level which said that the jury's determination of reasonableness was accepted, and the facts and circumstances, as I understand the thrust of this legislation, is to find a reasonableness standard with which we can all live, and not run the risk of on any given day having another jury make another different kind of decision.

So that the *Royal Crown* case, all that tends to confirm that under those facts and circumstances, it is a reasonable system, wouldn't give us the kind of assurance that the bottler system needs for the future that this legislation would.

Chairman RODINO. Let us assume that the D.C. circuit would hand down a decision which would be in keeping with *Royal Crown Cola* case, which would affirm the rule of reason in that sense, would you still insist on legislation?

Mr. SMITH. I don't know if you heard Mr. Keller's comment or not. This is the bottlers' legislation, and we are simply testifying in support of that.

Chairman RODINO. You are supporting that point of view?

Mr. SMITH. Yes, sir.

Chairman RODINO. Incidentally, why do you urge that point of view? Is it going to be beneficial to your company? And just how? I mean is this going to be more beneficial to you, or is there just the sense of fairness on your part that suggests that you come here and in the interest of bottlers support this legislation?

Mr. SMITH. I appreciate the chance to speak to that. There is a sense of fairness, and I would not like that to go unnoticed. These bottlers have invested huge amounts of money and time and effort in building the equities they have in these businesses. If the Federal Trade Commission's present order is allowed to stand, many, many, many bottlers will lose all of that equity.

As I testified last time, I believe, we don't know who will survive and who will demise, but many will lose their equities without any chance of recovery, as we view it.

As to the other part, the main thrust of your question, we have been at it for a long time in the United States, and then as the years unfolded, in country after country around the world, until it's now 135, at last count. And our experience is that the best and most effective way to run this kind of business is through the franchised bottler system.

We believe it is best for us because it produces the most volume through the efforts of local entrepreneurs. We think the fact that here 80 years after the franchise system started, the consumer can still buy Coca-Cola at the same price per ounce reflects the amount of volume we get from the competitiveness of the business at the bottler level.

Chairman RODINO. Thank you. Is my time up? May I ask one additional question, Mr. Chairman?

Recently, the Presidential Commission for the review of the antitrust laws and several members of this committee served on that commission took the view that many of the various exemptions that now exist, are outdated and that, frankly, they just make a sieve of our antitrust laws. So that there is really no protection to the consumer.

I would like to ask this. Would you think the same of what you are asking and what the bottlers are asking, if the large brewers, such as Coors, Anheuser-Busch, Miller, were to urge similar exemptions? Would you think that would be in order, too, and would that serve the public interest?

Mr. SMITH. Mr. Chairman, I don't presume to practice law, although our lawyers accuse me of it. We do not believe we are asking you to take action which would exempt us from antitrust laws. We believe that the evidence states that the present system is definitely procompetitive and encourages interbrand competition, and so I would have to start off with that point of view as representative of the Coca-Cola Co.'s view and its bottlers, so far as I am informed.

The brewing business is a different kind of an enterprise. The brewing is done, the whole process of preparing the product for ultimate consumer consumption, is done by the brewer. He has a distributor, much as our own fountain post-mixed business is, and at least in our business we find no need for the incentive of territorial exclusivity for distributors, and I am not asking for that.

I hope I was responsive.

Mr. SYNAR. Thank you.

The Chair recognizes the gentleman from Virginia.

Mr. BUTLER. Thank you, Mr. Chairman. I appreciate the witness taking the time to be with us today. I want to identify myself with the portion of your remarks which suggest that it's not appropriate for the legislative body to wait for the judiciary to resolve all their differences. I've been here now for 7 or 8 years. We have created all sorts of judgeships, and I can't remember a single one calling up and asking me if it's all right for them to go ahead and make a decision, and yet we are supposed to be coequal branches, and what they are doing is not infrequently legislative in nature.

I have no problem at all with identifying myself with those who believe that it's appropriate for the Congress of the United States to go forward and act at any time it feels that an issue is before us, without waiting to see what the other legislative body does, the courts of the United States might do.

I would like to inquire for a moment. A moment ago in response to Mr. Rodino's question, your emphasis was on the value of interbrand competition and, of course, on page 5 of your statement, you go to great lengths to develop this point.

What I have difficulty with is this: If interbrand competition is so good, how can additional competition, intrabrand competition, be harmful?

Mr. SMITH. I'm not—you say if one Coca-Cola bottler begins competing with another Coca-Cola bottler, if I understand your question?

Mr. BUTLER. That's what I would call intrabrand competition.

Mr. SMITH. Well, then I've used the word wrongly. That's what we believe would be very damaging to the business.

Mr. BUTLER. Yes. I'm having difficulty understanding exactly why that form of competition would be harmful.

Mr. SMITH. That is one Coca-Cola bottler competing with another Coca-Cola bottler.

Mr. BUTLER. Yes.

Mr. SMITH. If that happens, under the ruling as it now stands, under the ruling of the Federal Trade Commission, one-way packages will quickly go to warehouse distribution, as is the case with beer, for instance, meaning the bottler or canner who produces at the lowest price will invade every other bottler's territory where it is feasible for him to do so, with his one-way containers of Coca-Cola. And the bottler whose territory he invades will lose, in our case, all of that volume which is in the one-way container.

He will only have left that portion of his business which is in returnable packages, and the inevitable result of that is that the volume he had on that before which included returnable and one-way packages of Coca-Cola will now be confined only to Coca-Cola in returnable packages.

He will then have, in our case, only 60 percent of the business he had before on those trucks. Inevitably the price of that product must go up, because it has to absorb all the expenses that heretofore had been spread over the total spectrum of the packages. That's why we believe that it is in the disinterest of the consumer and the disinterest in the equity of the bottler to let that thing happen.

Have I been responsive?

Mr. BUTLER. You have been responsive, but I'm going to ask, if I may, Mr. Chairman, to read that answer when it's written up and reserve the right to followup with some other questions after I've had a chance to do so.

Chairman RODINO [presiding]. The gentleman has that right.

Mr. SMITH. I will appreciate the opportunity.

Mr. BUTLER. Thank you. Because I did want this on the record. Coming now to a related problem, I think in effect what you are saying is that the territorial franchise system protects the low price. Is it fair to say the territorial franchise system does not raise the prices that the consumer must ultimately pay? Is that true?

Mr. SMITH. Indeed so. I don't know of any other kind of distribution system that for 80 years has still been able to offer to the consumer its product at essentially the same price if the consumer chooses to buy it in the most economical package which is available to him.

Mr. BUTLER. Well, to follow up a little on that, would it be appropriate to amend this legislation—and I'm asking your counsel to respond to this, too—to provide that a particular franchise would be given an exemption from the antitrust laws, as long as the arrangement does not artificially increase prices over what they would otherwise be?

Mr. SMITH. Well, I will let my counsel have the opportunity to second-guess me. It seems to me that, first, we are not asking for an exemption from antitrust laws.

Second, that if any one bottler has the opportunity to invade another bottler's territory, the domino effect of that kind of action would be fairly dramatic, and so that you would have opened up the way of destroying the system.

Mr. Keller, would you——

Mr. KELLER. I don't know that I could add much useful to that, Mr. Congressman. It seems to me that the wording of the current bill has been carefully examined by an awful lot of people, and the wording that you have proposed may raise some other issues that I would not see would necessarily solve the problem that we would see.

Chairman RODINO. The time of the gentleman has expired. The gentleman from Missouri.

Mr. VOLKMER. I would like to briefly ask Mr. Smith—I'd like to go further with what the gentleman from Virginia proposed on intrabrand, and see if this scenario or proposal also could possibly occur.

Suppose we had a franchised bottler in Richmond, Va., and the FTC ruling stands—the bottler contacts A&P and other national retailers and works out an agreement with them whereby he bottles exclusively for them and delivers to their warehouse and they distribute to their stores. That could occur, could it not?

Mr. SMITH. We believe that is in fact what will occur, if it is allowed to stand.

Mr. VOLKMER. They might ship down to stores in Roanoke and all the other small towns in southern Virginia. The bottler in Roanoke, Va., loses those customers, doesn't he?

Mr. SMITH. He loses that business.

Mr. VOLKMER. That's what you're basically saying, and then he's got only what remains, and if the mom-and-pop stores or the other small stores, other places, are to be served, the bottler will have to service both.

Mr. SMITH. Yes, sir.

Mr. VOLKMER. The soda machines in gas stations, and other locations, whose going to service those customers? That man up in Richmond is not going to do that, is he?

Mr. SMITH. No, sir, he surely isn't, and he's not going to do anything else but produce and deliver, and he will have, in our judgment, much less concern with the quality of the product than the bottler who has got his whole life invested in the future of his own territory.

Mr. VOLKMER. And returnables are gone, because that man in Richmond isn't going to fool with returnables.

Mr. SMITH. It's our judgment, and there's a lot of evidence already in existence that says the supermarket will simply quit handling returnable packages altogether.

Mr. VOLKMER. Right.

Mr. SMITH. And inevitably the price the bottler would have to get if he stayed in business with returnables would have to rise to cover his costs, and as that happened and it got closer to the price of the one-way container, then it would simply disappear from the market.

Mr. VOLKMER. He's out of business, then, too, probably.

Mr. SMITH. Yes, sir.

Mr. VOLKMER. Thank you.

Chairman RODINO. Thank you. I'm going to state, Mr. Smith, and the other witness who will follow, that the committee would hope that further questions that may be submitted in writing and will be answered and responded to in writing. It is unfortunate that time will not permit us to present those to you now, and we will give you more of an opportunity to respond to them in writing.

Chairman RODINO. But before you leave, I have just one question.

Mr. SMITH. Yes, sir.

Chairman RODINO. You talked a while ago about competition and higher prices, and it seems to me we will have to agree that under this legislation, the retailer would not be able to purchase soft drinks outside the territory, which is part of the territorial agreement, as he would wish to do when they are cheaper.

Why shouldn't retailer be allowed to purchase at the lowest prices possible?

Mr. SMITH. Mr. Chairman, I'm going to be repetitive, for which I apologize. If the Federal Trade Commission ruling is allowed to stand, meaning there is not territorial protection for nonreturnable, one-way containers, there is only protection for returnable containers, the chain stores of the world, of the United States, are going to start shopping for the place they can buy the product in one-way containers only at the lowest price they can get it.

They will be able to haul it back in an empty truck, usually because the truck has left their warehouse, gone out and emptied itself in various stores, and is on the way back home. They will tend to put all of their emphasis on the one-way container at very low prices.

At the same time they will be depriving the bottler, who has retained the exclusive right for returnable bottles, of the volume which they have taken away from him in one-way containers. That means that as he loses volume in one container, the one-way one, he has to cover his costs with a much reduced volume in returnable containers, and as he does that, raising the price of the returnable container, it will disappear from the market.

There is ample evidence already in existence to support that as more than theory. Now if that happens, you will end up, according to all of our studies, with a relatively few people producing cans and one-way bottles at very low costs, with nobody having an incentive to promote and build the business, consumer franchise.

Chairman RODINO. But isn't the consumer then making that decision? Isn't he making that choice?

Mr. SMITH. He won't have a choice, sir. He now has a choice under the present system to buying Coca-Cola in returnable packages.

Chairman RODINO. When he buys it at the lower price, isn't he making the choice then, knowing that the other situation isn't going to be available to him?

Mr. SMITH. I guess I don't follow that question, sir. In the case of Coca-Cola, he now buys—for home use 60 percent of all that he buys is in a returnable package. He opts to—sitting side by side with the returnable package at a low price, and a one-way package at a higher price, in the case of Coca-Cola, 60 percent of that which he takes home is in a returnable package because it's cheaper.

Under the system the FTC proposes, I have tried to explain why, we have testified that the returnable package will go up in price so high that is will disappear from the market for practical purposes, leaving the consumer with no choice except the high-priced, one-way container.

Chairman RODINO. The gentleman from Virginia wants me to yield.

Mr. BUTLER. Thank you. Along those lines, can you tell us what factors in the rule of reason you consider to be unreasonable? Perhaps counsel would rather do that.

Mr. KELLER. Well, I'm not sure I understand the question. It seems to me that the way the rule of reason—the FTC has purported to apply to the rule of reason in that decision.

Mr. BUTLER. I'm addressing myself to that.

Mr. KELLER. By my understanding of the evidence, that they should have looked at, they have failed to properly do so, and the legislation is designed to make them look at the proper evidence, as I understand it, in deciding the rule of reason. I don't believe they have done that. They said they did it, but I don't believe they have done it, in fact. So it's not that there is anything unreasonable about the rule of reason. It is just that the FTC decision said they were applying the rule of reason, and in fact did not look at all of the relevant evidence.

The legislation would require them to do so.

Mr. BUTLER. Thank you very much.

Chairman RODINO. Thank you very much, Mr. Smith. we appreciate your coming here, and our next witness is Mr. Cartha DeLoach, vice president, corporate affairs, Pepsico, Inc. Mr. DeLoach.

Mr. DeLoach, I understand you have a prepared statement, and I hope that in the interest of time, if you will, you will attempt to summarize it. I understand you can do it within 10 minutes. And then the committee intends to adjourn this hearing at 1:30. Hopefully we will get those questions out of the way.

TESTIMONY OF CARTHA DE LOACH, VICE PRESIDENT FOR CORPORATE AFFAIRS, PEPSICO, INC., ACCOMPANIED BY GERARD CASEY, DIVISION COUNSEL FOR U.S. SOFT DRINK OPERATIONS

Mr. DELOACH. Thank you, Mr. Chairman.

Chairman RODINO. Please proceed.

Mr. DELOACH. Thank you, Mr. Chairman and members of the subcommittee.

I am Cartha D. DeLoach, vice president, corporate affairs, PepsiCo, Inc. And seated with me is Gerard Casey, our division counsel for U.S. Soft Drink Operations.

We are pleased to have this opportunity to inform the subcommittee and the American public why PepsiCo totally supports the effort to enact H.R. 3567 into law.

The reasons are simple, Mr. Chairman: Exclusive territories have been a part of the soft drink industry for 80 years. They have made the soft drink industry one of the most intensely competitive in America. They have allowed our licensed bottlers to grow and prosper, also enabling them over the years to invest in a heavily capital-intensive business and to fully serve and develop their territories.

They have permitted the American consumer to enjoy the lowest prices possible along with widespread availability of products and packages. They have fostered store-door delivery, the most effective selling tool, which in turn permits the use of returnable bottles, the most economical and ecologically beneficial packaging.

In brief, Mr. Chairman and members of the subcommittee, we are committed to the preservation of exclusive territories simply because they work and because they benefit everyone.

PepsiCo's support for and commitment to exclusive territories has had a long history predating the actions filed by the FTC almost a decade ago. Our belief in exclusive territories started way back at the turn of the century when they enabled a regional cola formulated by a North Carolina pharmacist name Caleb Bradham to grow into a nationally marketed brand and strong and vigorous competitor.

This belief and commitment was forged and strengthened during the Great Depression which, as with the rest of industry, proved a very difficult time for our company. Back in those days, when capital was tough to raise, it was our "exclusive" bottlers who went out and raised it for their businesses and our total enterprise.

Now the reason for this risk taking was the exclusive territory. Territories also encouraged small local banks to lend to our bottlers to give them the capital needed to invest in their business. Otherwise, they wouldn't have done it.

Sales improved, and again, because Pepsi-Cola bottlers were able to develop their territories free from intrabrand competition, Pepsi-Cola became an even stronger interbrand competitor.

We had a major setback in July 1971, when the FTC approved the issuance of complaints against Coca-Cola and PepsiCo and six other soft drink companies seeking to prove that exclusive territories constituted a per se violation of the antitrust laws. The FTC changed its mind in mid-1973 when the commission attorneys abandoned their attempt to prove a per se case, electing rather to follow a rule of reason approach.

In October 1975, the FTC's own administrative law judge, Judge Joseph Dufresne, issued a detailed opinion. I could go on and on, Mr. Chairman. But you said I should summarize, and I think this history has been covered before by the previous witness, Mr. Smith.

But one of the points I'm trying to get across, Mr. Chairman, is how bottlers feel, faced with what they feel is a totally unwarranted reward for eight decades of vigorous competition. The soft drink industry has appealed to Congress to put an end to this decade of uncertainty for its bottlers.

Mr. Chairman and members of this subcommittee, PepsiCo totally supports this request.

The arguments in favor of exclusive territories are compelling and overwhelming by almost any standard. First of all, they permit a bottler to focus all of his marketing activity on the brand covered by his trademark license in one particular area.

In that way he functions the same as any other manufacturer. Campbell's Soup, for example, does not have to worry about competition from another Campbell's Soup manufacturer. In no way, however, is the bottler insulated from other bottlers, for every day he must heavily engage in interbrand competition.

Nevertheless, in return for this narrow intrabrand protection, the bottler is encouraged to invest in favor of the brand he is licensed for. And furthermore, he can concentrate on every aspect of his territory, thereby securing full distribution of the brand in every available outlet.

The bottler is also encouraged to participate in area advertising plans and willingly does so because his adjacent bottler will not be getting a "free ride" on his advertising activity.

Exclusive territories, Mr. Chairman, have permitted the soft drink industry to offer its products to the American public in a very widespread choice of packaging, including returnable packaging. This widespread package availability further improves competition in the soft drink industry and permits soft drink bottlers to offer their products to the American public on a very low cost per ounce basis.

As the previous witnesses testified, exclusive territories also cause more personal attention and insurance that product quality remains at a high level. Each bottler must by law place his name on the product, and due to the exclusive territory, PepsiCo is able to monitor the product quality more effectively in the field.

Responsibility is fixed and clear, since there is a single source of the brand in any given territory. No bottler will risk marring his image by producing an inferior product. But in the unlikely event that a product recall were necessary, it could be more easily handled because of the existence of territories.

Product quality is also improved through the ability of thousands of driver-salesmen to rotate stock on shelves of supermarkets every day to assure the American public that they are receiving the freshest product available.

Mr. Chairman and members of the subcommittee, it would be impossible to talk about the history of territories and their procompetitive benefits without discussing what would occur in their absence.

Plainly stated, the Federal Trade Commission would substitute in these very unsettled economic times utter chaos and doubtful economic benefits for a system which has proven so good for the economy and the consumer.

If exclusive territories are eliminated, dozens and dozens of Pepsi-Cola bottlers will be driven out of business by their larger neighbors. This will be accomplished quickly through the ability of larger bottlers by virtue of their location in major areas and their bottling capacity to take the cream of the business, that is warehouse accounts, leaving smaller bottlers with less profitable accounts to service.

Now when the large bottlers focus on the large warehouses, and the small bottlers lose their volume chain store accounts, upping their distribution costs, who will be left to service the mom-and-pop stores on an economic basis?

Prices may go down short term, but we can't be sure they will; but the point is, there is no guarantee that savings will be passed on to consumers.

Long term, not only will there be fewer outlets handling soft drinks, but after the bottler ranks are decimated, the survivors, I am certain, will be able to raise soft drink prices higher than ever.

Indeed, the FTC itself, in appearances before the Congress, has retreated on this issue. In December 1969, the FTC staff advised the Congress that elimination of territories would bring a potential gain to the consumer of "perhaps $1 billion or more * * *," they stated. But this was revised downward to $250 million by Alan Ward, then director of the FTC's Bureau of Competition.

And 2 years later, Mr. Ward's successor, James Halverson, reduced this to $50 million. And now complaint counsel, on appeal, now speak generally of "substantial if not mathematically certain savings."

Besides not receiving any economic benefit from the elimination of the exclusive territory, thousands of people would lose their jobs, not only as direct employees of the soft drink industry, but also among their suppliers as packaging forms change and former customers no longer exist.

Please keep in mind that the small bottler will be driven out of business. Returnable packaging will not be saved or encouraged if the FTC decision is upheld. It will, I assure you, be eliminated. Warehouse delivery and returnable packaging are incompatible. They cannot coexist.

Small bottlers will not be able to raise capital to compete effectively against their larger neighbors without the exclusive territory, simply because the worth of their businesses will have been drastically reduced.

Because of its ruling, the FTC will achieve market concentration rather than eliminate it if the decision is allowed to stand and Congress takes no action to save the exclusive territory.

Concentration will further be increased because the ease of entry and total distribution for new brands that formerly existed in the soft drink industry will have been eliminated.

No longer will these new market entrants have the same benefits that existed before, because warehouses will certainly concentrate on high-volume drinks, not untried new ones. Product quality will surely suffer and advertising will be reduced sharply as bottlers will be reluctant to give their neighbors a free ride on their marketing efforts.

Mr. Chairman and Members of this subcommittee, I want to assure you there is no trick or plot here, insofar as my company or, any other company that I know of, is concerned in backing this legislation.

H.R. 3567 merely seeks to insure that this high level of competition in the soft drink industry continues. It is not an unlimited guarantee, either. It only renders exclusive territories legal if there is substantial and effective competition with other products of the same general class.

We are not, therefore, seeking immunity. The bill only clarifies the standard by which territories are to be judged. In arriving at the language used in this proposed legislation, the industry deliberately avoided seeking a total unqualified exemption because we knew that Congress would have reservations about enacting such legislation on public policy grounds.

We think that H.R. 3567 accomplishes the valid needs of soft drink bottlers while working within the framework of existing antitrust laws. The tremendous support that H.R. 3567 and its counterpart, S. 598, enjoy in the Congress would indicate that both objectives have been met.

In closing, Mr. Chairman and Members of the subcommittee, let me add one final note to why my company, PepsiCo, is committed to exclusive territories. There are two names which appear on our exclusive bottling appointment, PepsiCo's and our bottler's. There are 426 of these documents in existence in America today, not only with corporations, but with families such as the Goodings in

Denver, the Campodonicos in San Francisco, the Muhls in Iowa, the Sandahls in Texas, the Minges in North Carolina, the Brolls in Delaware. I could go on and on. The list is long, but I assure you gentlemen that the faces are familiar and personal to me and to our management. These families stood by us and invested in our total enterprise in the period of our corporate history when we needed them. They participated to a very great extent in one of the greatest free enterprise success stories of all time.

None of this would have happened if we had not organized this business on territorial lines. We are proud of our way of doing business and the current competitive spirit of our bottlers in these very unsettled, troubled economic times.

We totally support our bottlers in their efforts to preserve the exclusive territories we granted them, because we are deeply grateful for their past and continuing commitment to their parent company, and because we need such fiercely competitive partners in our future.

Thank you, Mr. Chairman, and members.

[The complete statement follows:]

PREPARED STATEMENT OF CARTHA D. DELOACH, VICE PRESIDENT, CORPORATE AFFAIRS, PEPSICO, INC.

Good Morning, Mr. Chairman and members of the subcommittee, I am Cartha D. DeLoach, Vice President, Corporate Affairs, PepsiCo, Inc. Seated with me is Gerard Casey, our Division Counsel for U.S. Soft Drink Operations. We are pleased to have this opportunity to inform the Subcommittee and the American public why PepsiCo totally supports the effort to enact H.R. 3567 into law.

The reasons are simple. Exclusive Territories have been a part of the soft drink industry for eighty years. They have made the soft drink industry one of the most intensely competitive in America. They have allowed our licensed bottlers to grow and prosper, also enabling them over the years to invest in a heavily capital intensive business and to fully serve and develop their territories. They have permitted the American consumer to enjoy the lowest prices possible along with widespread availability of products and packages. They have fostered store-door delivery—the most effective selling tool—which in turn permits the use of returnable bottles, the most economical and ecologically beneficial packaging. In brief, we are committeed to the preservation of Exclusive Territories simply because they work and benefit everyone.

PepsiCo's support for and commitment to Exclusive Territories has had a long history predating the actions filed by the FTC almost a decade ago. Our belief in Exclusive Territories started way back at the turn of the centry when they enabled a regional cola formulated by a North Carolina pharmacist named Caleb Bradham to grow into a nationally marketed brand and a strong and vigorous competitor. This belief and commitment was forged and strengthened during the Great Depression which, as with the rest of industry, proved a very difficult time for our Company. Back in those days, when capital was tough to raise, it was our "exclusive" bottlers who went out and raised it for their businesses and our total enterprise. Now the reason for this risk-taking was the Exclusive Territory. Territories also encouraged small local banks to lend to our bottlers.[1] Sales improved, and again, because Pepsi-Cola bottlers were able to develop their territories free from intrabrand competition, Pepsi-Cola became an even stronger interbrand competitor.

A major setback to our Pepsi-Cola enterprise occurred in July, 1971 when the Federal Trade Commission approved the issuance of complaints against Coca-Cola and PepsiCo and six other soft drink companies seeking to prove that Exclusive Territories constituted a per se violation of the antitrust laws. This view changed in mid 1973 when the Commission attorneys abandoned their attempt to prove a per se case, electing rather to follow a rule of reason approach. In October of 1975, the FTC's own Administrative Law Judge, Judge Joseph Dufresne, issued a detailed opinion which completely upheld Exclusive Territories under a rule of reason analysis and dismissed the complaints against Coca-Cola and PepsiCo. After two oral

[1] Hearings on S. 3040, et al. Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 92nd Cong., 2d Sess., pt. II, at 618 (1972).

arguments, the Federal Trade Commission in a 2-1 opinion elected to overturn Judge Dufresne's decision as it related to non-returnable packages only. This decision showed a total lack of understanding of our store-door system in that the returnable package totally relies on Exclusive Territories, and the elimination of territories and store-door delivery will eliminate, rather than encourage, returnable packaging. The cases are now on appeal before the D.C. Circuit Court of Appeals.

Faced with what it feels is a totally unwarranted regard for eight decades of vigorous competition, the soft drink industry has requested the Congress to put an end to this decade of uncertainty for its bottlers. PepsiCo totally supports this request.

The arguments in favor of Exclusive Territories are compelling and overwhelming by any standard. First of all, they permit a bottler to focus all of his marketing activity on the brand covered by his trademark license in one particular area. In that way he funcions the same as any other manufacturer—Campbells Soup does not have to worry about competition from another Campbells Soup manufacturer. In no way, however, is a bottler insulated from other bottlers, for every day he must heavily engage in interbrand competiton. Nevertheless, in return for this narrow intrabrand protection, the bottler is encouraged to invest in favor of the brand he is licensed for. Furthermore, he can concentrate on every aspect of his territory, thereby securing full distribution of the brand in every available outlet. The bottler is also encouraged to participate in area advertising plans and willingly does so because his adjacent bottler will not be getting a "free ride" on his advertising activity. Because of the intensity of interbrand competition, the bottlers must devote considerable time to merchandising and price promotion activity which further heighten the level of competition in his territory. Exclusive Territories also permit PepsiCo to work with its bottlers more effectively in developing promotional programs and activities to improve and sharpen their competitive skills.

Exclusive Territories also have permitted the soft drink industry to offer its products to the American public in a widespread choice of packages including returnable packaging. This widespread package availability further improves competition in the soft drink industry and permits soft drink bottlers to offer their products to the American public on a very low cost per ounce basis.

Exclusive Territories also cause more personal attention and insurance that product quality remains at a high level. Each bottler must by law place his name on the product. Due to the Exclusive Territory, PepsiCo is able to monitor product quality more effectively in the field. Responsibility is fixed and clear since there is a single source of the brand in any given territory. No bottler will risk marring his image by producing inferior product. But in the unlikely event that a product recall were necessary, it could be more easily handled because of the existence of territories. Product quality is also improved through the ability of thousands of driver salesmen to rotate stock on shelves of supermarkets every day to assure the American public that they are receiving the freshest product available.

It is impossible to talk about the history of territories and their pro-competitive benefits without discussing what would occur in their absence.

Plainly stated, the FTC would substitute in these very unsettled economic times utter chaos and doubtful economic benefits for a system which has proven so good for the economy and the consumer.

If Exclusive Territories are eliminated, dozens and dozens of Pepsi-Cola bottlers will be driven out of business by their larger neighbors. This will be accomplished quickly through the ability of larger bottlers by virtue of their location in major areas and their bottling capacity to take the cream of the business, that is warehouse accounts, leaving smaller bottlers with less profitable accounts to service. When the large bottlers focus on the large warehouses, and the small bottlers lose their volume chain store accounts upping their distribution costs, who will be left to service the mom and pop operators on an economic basis? Prices may go down short term, we can't be sure they will, but there is no guarantee that savings will be passed on to consumers. Long term, not only will there be fewer outlets handling soft drinks, but after the bottler ranks are deciminated, the survivors, I am certain, will be able to raise soft drink prices higher than ever. Indeed the Commission itself in appearances before the Congress has retreated on this issue. In December, 1969 the FTC staff advised the Congress that elimination of territories would bring a potential gain to the consumer of "perhaps one billion dollars or more. . . ." [1] This was revised downward to 250 million by Alan Ward, then director of the FTC's Bureau of Competition.[2] Two years later Mr. Ward's successor, James Halverson,

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[1] Hearings on S. 3040, et al. Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 92d Cong., 2d Sess., pt. II, at 618 (1972).

[2] *Id.* at 581.

reduced this to 50 million.[3] Complaint Counsel on appeal now speak generally of "substantial if not mathematically certain savings".[4]

Besides not receiving any economic benefit from the elimination of the Exclusive Territory, thousands of people would lose their jobs, not only as direct employees of the soft drink industry but also among their suppliers as packaging forms change and former customers no longer exist. Keep in mind that the small bottler will be driven out of business. Returnable packaging will not be saved or encouraged if the FTC's decision is upheld. It will, I assure you, be eliminated. Warehouse delivery and returnable packaging are incompatible. They cannot co-exist.

Smaller bottlers will not be able to raise capital to compete effectively against their larger neighbors without the Exclusive Territory simply because the worth of their businesses will have been drastically reduced.

Because of its ruling, the FTC will achieve market concentration rather than eliminate it if the decision is allowed to stand and Congress takes no action to save the Exclusive Territory. Concentration will further be increased because the ease of entry and total distribution for new brands that formerly existed in the soft drink industry will have been eliminated. No longer will these new market entrants have the same benefits that existed before because warehouses will surely concentrate on high volume drinks, not untried ones. Product quality will surely suffer and advertising will be reduced sharply as bottlers will be reluctant to give their neighbors a "free ride" on their marketing efforts.

H.R. 3567 merely seeks to insure that this high level of competition in the soft drink industry continues. It is not an unlimited guarantee either. It only renders Exclusive Territories legal if there is substantial and effective competition with other products of the same general class. We are not, therefore, seeking immunity. The bill only clarifies the standard by which territories are to be judged. In arriving at the language used in this proposed legislation, industry deliberately avoided seeking a total unqualified exemption because we knew that Congress would have reservations about enacting such legislation on public policy grounds. We think that H.R. 3567 accomplishes the valid needs of soft drink bottlers while working within the framework of existing antitrust laws. The tremendous support H.R. 3567 and its counterpart S. 598 enjoy in the Congress would indicate that both objectives have been met.

In closing, Mr. Chairman, and members of the Subcommittee, let me add a final note on why PepsiCo is committed to Exclusive Territories. There are two names which appear on our Exclusive Bottling Appointment. PepsiCo's and our bottler's. There are 426 of these documents in existence in America today not only with corporations but with families such as the Goodings in Denver, the Campodonicos in San Francisco, the Muhls in Iowa, the Sandahls in Texas, the Minges in North Carolina, the Brolls in Delaware—the list is long but the faces are familiar and personal to our management. These families stood by us and invested in our total enterprise in the period of our corporate history when we needed them. They participated to a very great extent in one of the greatest free enterprise success stories of all time. None of this would have happened if we had not organized this business on territorial lines. We are proud of our way of doing business and the current competitive spirit of our bottlers in these unsettled times. We totally support our bottlers in their efforts to preserve the Exclusive Territories we granted them because we are deeply grateful for their past and continuing commitment to their parent company and because we need such fiercely competitive partners in our future.

Chairman RODINO. Thank you very much, Mr. DeLoach.

As I announced previously, we would hope that the questions which will be submitted in writing will be responded to as quickly as possible so that the committee will, after the next two hearings—there are going to be two further hearings, and then we will close the hearings on this particular legislation and these proposals before us, in an effort to try to get the committee to consider what it will do with the legislation and markup sessions.

Mr. DELOACH. Mr. Chairman, we will feel it a privilege to answer any questions the committee may desire to send us.

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[3] Hearings on H.R. 122, et al. Before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, 93d Cong., 2d Sess., 27, 36 (1974). *See also* Hearings on H.R. 4978, et al. Before the Subcommittee on Consumer Protection of the House Committee on Interstate and Foreign Commerce, 94th Cong., 1st Sess., 30 (1975).

[4] Complaint Counsel's Appeal Brief Before the Federal Trade Commission at 36.

Chairman RODINO. Thank you very much. And as I said, I would urge that we get those responses back as quickly as possible, so that we can move forward with the work we need to do in studying the responses and proceeding from there on.

I have just a few questions, Mr. DeLoach. I did ask Mr. Smith about the effect of the elimination of so many small bottlers on the Coca-Cola Co., and I would ask you the same question. Has there been any harmful effect as a result of the elimination of these bottlers, the figures having been those that I cited? As many as 6,000 in 1950 down to less than 2,000 in 1979.

Mr. DELOACH. Mr. Chairman, it is true that some bottlers have gone out of business. However, in most instances, they have gone out of business for several different reasons:

No. 1, some of them have gone out of business, and I am sure this is true of Pepsi-Cola, because I know from first-hand experience, because of the FTC decision. The uncertainty, the chaos, the confusion that has resulted as a result of the FTC and what they have brought about by this 9 years of not making up its mind about this overall matter.

Some of the bottlers also, Mr. Chairman, were troubled from a financial standpoint and consequently went out of business.

In all instances, to the best of my knowledge, Mr. Chairman and Members of the subcommittee, these bottlers were fairly compensated when they sold their properties.

Now, my company represents about 5 percent of the franchises as compared with the total Pepsi-Cola franchises.

Let me point out also that the Pepsi-Cola Co. is not standing on the sidelines just waiting for the gavel to be brought down on the FTC's decision to prevail as some great giant that's going to jump in and gobble up territories.

I would say, Mr. Chairman, in fact, I know from my own personal experience that 80 percent of our customers are independent bottlers. If their volume goes down, Pepsi-Cola's volume goes down. It would be like a man biting off his nose to spite his face.

Now, admittedly, we have acquired territories, I don't deny that 1 minute, but we have acquired territories when they were available, made available by the bottler. When the bottler is in financial trouble, or other various reasons.

So, Mr. Chairman, I would have to say in concluding that the answer to your question that if the FTC decision does prevail, there will be one heck of a lot more bottlers going out of existence than there would be if the Congress, in its wisdom, your subcommittee and the full committee passed H.R. 3567.

Chairman RODINO. Mr. DeLoach, you mentioned 5 percent of the franchises, and would you be able to tell me what that represents by way of sales?

Mr. DELOACH. Approximately 20 percent, Mr. Chairman.

Chairman RODINO. Mr. DeLoach, how does the Pepsi market in soft drinks outside the United States operate? Does it have a system of small exclusive distributors in foreign countries?

Mr. DELOACH. That's correct, sir.

Chairman RODINO. It does?

Mr. DELOACH. It does, yes, sir.

Chairman RODINO. In every foreign country?

Mr. DELOACH. Not every foreign country, no, sir. We are in approximately 144 foreign countries at the present time.

Chairman RODINO. You understand it's the same kind of a system we are talking about, exclusive distribution? Is that the system you are using?

Mr. DELOACH. Yes, we do, Mr. Chairman.

Chairman RODINO. In view of the fact that the decision was handed down by the ninth circuit in the *Royal Crown Cola* case, do you anticipate that the D.C. Court of Appeals is going to render a decision which will be at variance?

Mr. DELOACH. Mr. Chairman, I am a layman, I am not an attorney. I can only point out to the best of my knowledge, we are encouraged by the *Royal Crown* decision in its consideration of interbrand competition, because we believe in interbrand competition. That is the point of our entire text this morning.

However, we can't say that that's a fait accompli, because the second circuit court here in Washington, D.C., may have a different decision. If so, it may go to the Supreme Court.

The entire point, Mr. Chairman, is that we have waited 9 years, with this chaos and uncertainty, and we should not be made to wait much longer because the whole business is going to be thrown into disruption if we do.

Chairman RODINO. Well, hypothetically assume that the D.C. Court of Appeals would hand down a decision which would be within keeping with the decision handed down in the *Royal Crown Cola* case. Would you still want to proceed with this legislation?

Mr. DELOACH. I respectfully point out, Mr. Chairman, the point I made previously still stands, that it still could go to the Supreme Court. We don't know how long that would take. We have already waited for 9 years.

Chairman RODINO. Mr. Volkmer?

Mr. VOLKMER. Thank you, Mr. Chairman.

Mr. DeLoach, you mentioned that you have 5 percent of the franchise business, 20 percent of the volume. Do you know how many of those franchises were acquired since the FTC ruling?

Mr. DELOACH. Mr. Volkmer, the Pepsi-Cola Co. has acquired 12 franchise companies in the last 10 years. We have divested ourselves of two.

Mr. VOLKMER. In the event that Congress would pass this legislation, would PepsiCo, or does PepsiCo have any position as to divestiture of those bottling franchised areas?

Mr. DELOACH. Mr. Chairman, frankly—I intend to fully answer your question, but we are talking about apples and oranges. If Congress passed the National Soft Drink Association bill, 3567, or S. 598 in the Senate, there would be no reason for divestiture, since small bottlers would be protected by exclusive territories.

In other words, they would be protected the same way they are at the present time.

If the FTC decision prevails, they would not be protected. They would be eaten up. Bottlers are not threatened by company-owned plants at the present time. They would not be threatened if the Congress, in its wisdom, passed 3567 or S. 598. Nor would they be threatened in the future if these territories are preserved.

Furthermore, I think the point should be made, Mr. Volkmer, that during the 10-year proceedings before the Commission, it has never been shown that there is anything wrong with this particular system, nothing whatsoever. There has nothing been shown that divestiture will increase interbrand competition.

The key question throughout these proceedings is competition. That is the entire key question. Volume is the name of the game, not company-owned versus independent bottlers. It's not a matter of big versus small. It's a matter of competition, interbrand competition. We say there is and has been all the time.

Mr. VOLKMER. Well, I agree that there is interbrand. We passed that question up because we do have a time limitation.

As I asked Mr. Smith, do you agree that there has been a positive impact on competition with piggybacking, or negative impact?

Mr. DELOACH. There are a great number of advantages to piggybacking, Mr. Volkmer. In the first place, piggybacking is brought about—well, let's take the bottler in Albany, N.Y. This is a man who's been in the business for years. He has invested considerable time and money into the business. He has many people depending upon him as employees. He makes a gross of, let's say, $8 to 10 million a year. He must invest 10 percent of that back into the business on an annual basis.

Now by doing that, and by keeping up his business in a very efficient way, he is creating demand, he is creating volume, even though he has to service many marginal accounts, mom-and-pop stores that may not give him any net, so to speak. Beauty shops, filling station operators, right on down the line. But he has built that up. He has built up the image and demand and as a result has created through his own risk-taking, and capital investment, brought about a situation where he can piggyback and has ease of entry into the marketplace.

Mr. VOLKMER. Do you require your bottlers to accept other syrup from you?

Mr. DELOACH. No, sir, we do not.

Mr. VOLKMER. You have other syrups, of course, other than the cola syrup?

Mr. DELOACH. Yes, sir, we do. As a matter of fact, I can read you a long list, or just give you a long list off the top of my head of many other products.

Mr. VOLKMER. Right. But many of them carry the various other products, right?

Mr. DELOACH. Yes, sir.

Mr. VOLKMER. OK. Now could you tell me approximately what the total amount of volume of Pepsi products are sold through chainstore food outlets?

Mr. DELOACH. Approximately under 50 percent, I believe, Mr. Volkmer.

Mr. VOLKMER. Around 50 or under 50?

Mr. DELOACH. Under 50, I believe just slightly under.

Mr. VOLKMER. Just slightly under 50?

Mr. DELOACH. Yes, sir.

Mr. VOLKMER. And you heard one of the last statements to Mr. Smith in regard to if the FTC prevails and what happens in the chainstores. In other words, some of these bottlers could possibly lose 50 percent of their outlet, right?

Mr. DeLoach. It's much greater than that, Mr. Volkmer. As previously indicated here, and I'd like to, if I may, sir, just take one second and mention that again. Not only would they suffer a great loss, not only would they possibly go out of business, but additionally, sir, returnable packaging will be totally decimated. But many other important things, loss of jobs, thousands of losses of jobs, the bottler being driven out of business, returnable packaging being totally decimated. This is what the FTC called for, and yet they didn't go far enough to consider interbrand competition, to know that the returnable packaging they were calling for would be driven out, totally.

There is more to it than that. Fresh supplies, rotation of product, personal attention to accounts, which store-door delivery, which is the best delivery in the world, would provide. All of this would be lost through warehouse delivery.

Mr. Volkmer. Mr. Chairman, one last question, very fast. Do you also agree that comparing the soft drink industry with the beer industry is like comparing apples and oranges?

Mr. DeLoach. That is correct, sir.

Mr. Volkmer. Thank you.

Chairman Rodino. Mr. Harris.

Mr. Harris. Thank you, Mr. Chairman.

Is Pepsi-Cola any better than Coca-Cola?

Mr. DeLoach. I beg your pardon, sir? [Laughter.]

Would you repeat the question?

Mr. Harris. I said is Pepsi-Cola any better than Coca-Cola?

Mr. DeLoach. In my opinion, it is, sir. [Laughter].

I'll be glad to debate the point any time. [Laughter.]

Mr. Harris. Could you in one sentence or less tell me why? I'm trying to consider this interbrand competition here, and I just wondered, is Pepsi the same product or not?

Mr. DeLoach. It is not the same product, Mr. Harris, and I think that the public represents the best judge of that, and the volume of food chain sales represents the best judge to answer your question.

Mr. Harris. It's not the same product?

Mr. DeLoach. It is not the same product.

Mr. Harris. So if you preferred Coca-Cola, you wouldn't get the same thing if you bought Pepsi-Cola?

Mr. DeLoach. That's correct, sir. It depends entirely upon your own taste.

Mr. Harris. So how can you say that there is competition if we get a whole lot of folks that wanted to sell Coca-Cola if it's different from Pepsi-Cola? How can you say it's competition, if there's Pepsi-Cola and Coca-Cola?

Mr. DeLoach. Mr. Harris, when that housewife walks into that grocery store, any morning of the world, and looks upon that shelf, she is attracted by many different things: No. 1, her own taste and that of her family. No. 2, packaging. No. 3, the way the packaging is done up, returnable, nonreturnable, right on down the line. There is vigorous, intense competition, I assure you, with Coca-Cola.

Mr. HARRIS. I know there is competition, but it's difficult for me to understand if you've got a family that prefers—you've told me Coca-Cola and Pepsi-Cola are two different products. If you've got a family that prefers Coca-Cola and if you've got an exclusive franchised area for Coca-Cola, that means they can only get what they want from one store.

Mr. DELOACH. Let me go a step further, sir. There is no concentration under interbrand competition, as long as it keeps up with the way it is going at the present time. Why? Simply because of the fact you have as many as 135 colas out there that the consumer can pick up, according to taste or according to pricing.

Mr. HARRIS. Could you help my education on this? I think I have noticed an increase in competition with regard to colas. When I go into the big retail outlets, I start seeing a lot of in-house brands. Who makes that?

Mr. DELOACH. I believe, sir, that you are referring to private label brands.

Mr. HARRIS. What I am referring to is in-house brands like Giant in the Giant stores. Who makes these, sir?

Mr. DELOACH. Private packers, sir. And I will agree, you see a lot of them.

Mr. HARRIS. Does Coca-Cola or Pepsi-Cola make those syrups, or is that just private packers out there making syrup? Are they basically different?

Mr. DELOACH. At times we have, sir, but for the most part our syrups are sold exclusively to our bottlers.

Mr. HARRIS. How do you feel your company would benefit from this legislation?

Mr. DELOACH. As I have indicated previously, Mr. Harris, 80 percent of our customers are independent bottlers. If their volume goes down, our volume goes down, because of the sale of concentrate to these independent bottlers, and consequently we have no intention of biting off our nose to spite our face.

But how would we benefit? We would benefit through a continuation of store-door delivery. We would benefit through a continuation of personal service. We would continue to benefit through identification of a good product; right on down the line. We would continue to benefit from the standpoint of option, the freedom of choice. In other words, Madam Housewife choosing the returnable packaging or the nonreturnable packaging. All down the line we would benefit as a parent company. There is no doubt about it. And I am frankly very glad to be here and finally say that.

Mr. HARRIS. Do you feel there would be more or less competition with the passage of this bill?

Mr. DELOACH. There would be more competition, Mr. Harris.

Mr. HARRIS. What would be the effect of the passage of this bill? Would it be more or less competition?

Mr. DELOACH. The passage of the bill would cause more competition, interbrand, vigorous competition as exemplified by volume over the years.

Mr. HARRIS. Thank you, Mr. Chairman.

Chairman RODINO. Mr. DeLoach, just one last question. Would the failure of the Congress to enact this legislation result in the purchase of less soft drinks on the part of the consuming public?

Mr. DeLoach. In my opinion, yes, sir, eventually. Simply because——

Chairman Rodino. Why?

Mr. DeLoach. Availability is the principal thing, Mr. Chairman. The FTC may cause the returnable bottles to go out of existence. There are many people who prefer the returnable bottle, but the failure by Congress to pass this legislation would possibly be the death knell of this bottle. Madam Housewife may not want that, she may want convenience packaging. So, consequently, she may or may not buy, but availability is the main point, Mr. Chairman.

Mr. Volkmer. Mr. Chairman?

Chairman Rodino. Mr. Volkmer.

Mr. Volkmer. I'd like to make an observation. Maybe Mr. Harris would agree or disagree.

Mr. DeLoach. Yes, sir.

Mr. Volkmer. The house brands I have noticed in the chain stores are all either in cans or nonreturnable bottles. I have yet to find one in returnable bottles, and I think that just points exactly to what everybody that has talked in favor of this legislation is trying to point out, that if we don't have this legislation, and if the FTC ruling is upheld by the court of appeals, this is just what we are going to see all soft drinks sold.

Mr. DeLoach. Mr. Volkmer, this proves the point.

Mr. Volkmer. That's what I'm saying.

Mr. DeLoach. Precisely.

Mr. Volkmer. Thank you.

Chairman Rodino. Counsel has a question to ask.

Mr. Polk. Thank you, Mr. Chairman.

I believe at one of our earlier hearings, we had testimony to the effect, or elicited the fact, that not all of the bottlers provide returnables to their customers. The argument was made that in some areas it is not profitable to do so.

In view of that, since the argument is made time and again that returnables seem to be the heart of the rationale behind the legislation, would it be acceptable to you to condition the passage of the bill on the provision of a certain percentage of the soft drinks, say 50 percent, in the form of returnables?

Mr. DeLoach. It would not, Mr. Counsel. Again, I don't know where you studied economics, but I don't think we went to the same school. We have to depend upon the housewife. She is the judge and the jury. If we don't depend upon her from the standpoint of freedom of choice, we will go out of business.

So, consequently, we'd be foolish to make any such stipulation. That's the name of the game, the competition, the volume and the business.

Mr. Polk. But why, then, on the other hand should the bottlers who do not provide the returnable bottles that are the rationale of the legislation get the free ride?

Mr. DeLoach. Why would the bottler not do that, Mr. Counsel, and tend to lose considerably in the marketplace?

Mr. Polk. Well, the testimony is that this is already the case. I don't know why.

Mr. DeLoach. It is my testimony that we have to obey the demands of the general public insofar as the sale of our products are concerned, and that's true not only with respect to packaging, quality, taste, right on down the line. If we don't do that, we are out of business.

Mr. POLK. As I understand it, if you are a consumer in New York City, you have to go sometimes pretty far to find a returnable bottle.

Mr. Chairman, If I may be permitted to ask this——

Mr. DELOACH. It depends entirely again, Mr. Counsel, upon the needs of the marketplace.

Mr. POLK. With respect to the legislation, the term "soft drink" is used, and I am wondering whether you intend this legislation to apply only to carbonated soft drinks.

In other words, is this to include Nestea or iced tea and things like that?

Mr. DELOACH. I want to answer your question as best I know how. I frankly think that such a question should be left up to the court to decide in its widom, not for us to decide.

Mr. POLK. Well, the question is really what Congress would be intending in setting the special rule and to whom it would apply. I think that's a policy judgment. I was wondering what your advice was on that.

Mr. DELOACH. If the chairman permits, I would like for Mr. Casey, our counsel, to answer that.

Chairman RODINO. The counsel may proceed.

Mr. CASEY. Mr. Rodino and counsel, I just wanted to add to that that we have seen just in these past few years in major metropolitan areas a whole new class of products grow up, namely bottled waters, and grow in considerable demand. Were we to now try to come up with an omnibus definition that included everything under the sun as it now exists, I submit that the Congress may be doing a disservice to future marketers under trademark licensing schemes that might come on the scene, where they manage to avail themselves of the benefits of selling products under technical exclusive territories.

I think if you try to define it narrowly now, who knows what other products may be out there that might come under the definition of soft drinks.

Mr. POLK. That, of course, is the question and the problem. Perhaps you could respond to that in writing, after you have more time to think about it.

Mr. CASEY. Be happy to.

Mr. POLK. Let me ask another question, Mr. Casey. With regard to the word "enforcement" as it appears on page 3, line 2, it indicates that the antitrust laws shall not apply to the means of enforcing these contracts or agreements. What means that would normally be a violation of the antitrust laws, but for this legislation, would your company envision using to enforce these contracts or agreements?

In other words, why is that protection necessary?

Mr. CASEY. I don't think that we would use any means other than what would be available to us under our contract.

Mr. POLK. So it would not, I take it, be a violation of antitrust laws?

Mr. CASEY. I don't believe so, but I wouldn't want to be second-guessed on that, either, Mr. Counsel.

Mr. POLK. For example, would you be inducing boycotts of——

Mr. CASEY. No, that's not the intent, sir. No. This bill, as I believe Mr. Rutenberg indicated in his comments to the chairman, is not intended to sanction any type of antitrust violation along the lines of what you are getting at; namely, price fixing, concerted refusals to deal, and so forth. It merely is intended to protect those exclusive territories which the bottling of the sirup companies granted to their bottlers many years ago. It is merely aimed at the distribution of product and no other antitrust violations, to my way of thinking, are contemplated.

Mr. POLK. Do you believe that a sirup cut off to a licensee that had violated the contract should be a violation of the antitrust law?

Mr. CASEY. I don't believe it would be. I think that would be up for a court to decide at a later date.

Mr. POLK. So you don't see any real reason why the enforcement mechanism need be protected from the antitrust law?

Mr. CASEY. Again, Mr. Counsel, I would not want to be second-guessed on that point at a later date. I would rather have it in legislation covering that point.

Mr. POLK. Now with regard to the sublicensees, I am wondering why the benefits of the legislation should flow to a licensee that has made no investment in a bottling plant, but who only sells the right to operate in an exclusive territory?

Mr. CASEY. I respectfully submit that all of our bottlers have bottled over the years. I really don't feel competent from a business standpoint to address the particular need of that legislation, or part of the legislation. However, I could get that information for you or provide it for you through the National Soft Drink Association.

Mr. POLK. But as far as you presently know, you are not aware of any licensee who is not a bottler who needs protection under this legislation?

Mr. CASEY. I'm sorry, I don't exactly understand what——

Mr. POLK. Well, the bill does protect the licensees who are not bottlers, and I am wondering what the reason for that is.

Mr. CASEY. I think it may be to cover those limited situations where a bottler may be temporarily out of production, for whatever reason.

Mr. POLK. You wouldn't object to the subcommittee clearing that up, would you?

Mr. CASEY. Not at all.

Mr. POLK. Thank you.

Chairman RODINO. Well, I thank those who testified today for their appearance before the committee. We do have other witnesses, and the Chair will announce that. During the third or fourth week during April, we will be again meeting and conducting two other hearings which will include testimony from two additional colleagues of the House who have asked to testify, Prof. Jonathan Rose of Arizona State University, Prof. Ernest Gellhorn of the University of Virginia, a representative of Consumers Union and the Consumers Federation of America, and one or two representatives of customers of the bottlers. I believe with that, we will have had, I hope, sufficient testimony to make a determination as to whether or not we will or will not consider this legislation for purposes of reporting it to the House.

Thank you again, and that concludes this day's hearing.

Mr. DeLoach. Thank you, Mr. Chairman.

[Whereupon, at 1:33 p.m., the hearing was adjourned.]

SOFT DRINK INTERBRAND COMPETITION ACT

THURSDAY, APRIL 24, 1980

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON MONOPOLIES AND COMMERCIAL LAW
OF THE COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met at 9:35 a.m., in room 2141, Rayburn House Office Building, the Honorable Romano Mazzoli presiding.

Present: Representatives Mazzoli, Seiberling, Volkmer, Synar, McClory, Railsback, and Butler.

Staff present: Joseph L. Nellis, general counsel; Warren Grimes, chief counsel; Joel Ginsburg, counsel; Franklin G. Polk, and Charles E. Kern II, associate counsel.

Mr. MAZZOLI. The subcommittee will come to order.

I have a brief opening statement which would have been presented by Chairman Rodino, were he here at this moment.

This morning the Subcommittee on Monopolies and Commercial Law begins its final phase of hearings on bills that would create a special antitrust standard for the soft drink bottling industry.

Throughout these hearings, the subcommittee has sought to examine the proposed legislation against the guidelines for antitrust exemptions set by the National Commission for Review of Antitrust Laws and Procedures. Those guidelines call upon us to exempt activity only when a convincing public interest rationale exists for abandoning competition, and to frame the exemption in the narrowest possible terms.

Careful legislative consideration is particularly important in cases such as this where judicial review of the FTC's decision is pending. The recent resolutions of the antitrust section of the American Bar Association offered strong support for the antitrust activities of the Federal Trade Commission and urged that, except in the most compelling circumstances, legislative actions should await the completion of the judicial review function.

One of the primary rationales for this legislation is that it is required to save the refillable soft drink container. Information received by the subcommittee to date suggests that the refillable container is rapidly losing ground, even under the existing system of exclusive territories.

Thus, while 100 percent of soft drink containers were refillable in 1950, the Comptroller General reports that less than 38 percent of the soft drink containers sold in 1975 were refillable. In major metropolitan areas such as New York, Philadelphia, and Boston, the refillable bottle has almost totally disappeared. Pepsi-Cola has provided us with information that 34 of its franchised bottlers produce no or insignificant numbers of, soft drinks in refillable bottles.

In light of this information, the subcommittee may wish to probe carefully whether the proposed legislation creating an antitrust exemption will truly save the refillable bottle which already has lost well over half the market.

We are also concerned whether legislation will raise the cost of soft drinks to the average consumer. We anticipate hearing testimony this morning from one of the vendors who buys soft drinks from the bottlers. I hope that his testimony may shed some light on the question of consumer cost.

We are honored this morning to have with us one of the distinguished Members of the House of Representatives with us, and one of the movers of the legislation, the Honorable Les AuCoin, from the sovereign State of Oregon.

Excuse me. I indicated I'd yield to the gentleman from Illinois.

Mr. McClory. Thank you, Mr. Chairman. I note that we have this day of hearings and then a final day of hearings next week. This issue, which has been too long before this committee, and in which a large number of Members of the House, as well as various economic interest groups around the country are extremely interested, deserves expeditious action on the part of this committee.

I am not a sponsor of this legislation. I don't want to predict my own position with regard to the bill we mark up. I do want to say, however, that it seems to me it's about time that we resolved this issue in the committee and forward a bill, if the committee agrees, to the House of Representatives for their action, so that the House can work its will.

I am looking forward to the testimony today and next Tuesday and thereafter to prompt action on the part of this committee, and, hopefully, some decisive action on the part of the House.

Thank you, Mr. Chairman.

Mr. Mazzoli. I thank the gentleman from Illinois, the ranking minority member of our full committee.

As I momentarily mentioned, we have with us the distinguished Congressman from Oregon, the Honorable Les AuCoin. Les is a cosponsor of H.R. 3567 and believes it is necessary to preserve the returnable container. He also has been a principal sponsor of H.R. 2812, the national deposit legislation.

Les, we welcome you and invite you to come forward.

TESTIMONY OF HON. LES AuCOIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OREGON

Mr. AuCoin. Mr. Chairman, members of the committee, I thank you for this opportunity to testify before the committee today. I am here for two reasons:

No. 1, as you have mentioned, I am a cosponsor of H.R. 3567 for reasons that I think are compelling in and of themselves.

I am also, however, a strong advocate of the national bottle bill, and want to achieve at the earliest possible time legislation of that kind.

I am here today in what I guess I would call a split panel, because Congressman Jeffords of Vermont is joining with me in urging the committee to adopt an amendment to the legislation before you that would provide the compelling reason for this exemption for the industry that it seeks; that compelling reason being the conservation of energy, the reduction of litter in our environment, all the positive features that a bottle bill can provide.

We say positive features because in both the case of Congressman Jeffords in his State of Vermont, and in the case of Oregon, we have bottle bills. We know that these are the results that are achieved. Experience in our States proves that.

We also want to offer this suggested amendment to the committee because in addition to providing what needs to be a compelling reason for an exemption of this kind, this amendment would also provide the justification or make real the justification that has been used and as passed by all the advocates of the legislation before you, and that is protecting what remains of the returnable bottle.

So, Mr. Chairman, if I may, you have my statement, I would like to highlight it, if I may.

Mr. MAZZOLI. You certainly may, and it will be made a part of the record. You may proceed.

Mr. AUCOIN. Having said what I just said, the point is the consideration of the bills before this committee to give the subcommittee an opportunity, a rare opportunity, to focus national policy regarding returnable beverage containers, to do some public good for the environment, for the economy, for the industry, in this case, and fundamentally for the consumer.

While I was representing and served in the State legislature, it was at that time that Oregon passed the Nation's pioneering bottling bill. I am an author and a drafter of that State statute, and I want to tell you unequivocally that the bottle bill in Oregon does work. It works because it reduces litter, it works because it does save energy, it works because it does create jobs, it works because it does save consumers money. And despite the overwhelming success and enormous popularity of Oregon's bottle bill and similar legislation in other States, including Vermont, in the State represented by my colleague who is joining me in this effort before you today, it is a shame that national container deposit legislation has been subjected to abuse and ridicule and in some cases outright lies on the part of those who have attempted to defeat it here in the Congress.

Certainly it can be said that the concept of a national bottle bill or anything close to it has been studied and restudied and studied to death. I think the subcommittee is to be highly commended for its vision in linking the issue of competition within the industry, with the issue or performance standards of the industry when it comes to container returnables.

I support H.R. 3567 because it is the only way, in my judgment on the merits, to keep small bottlers in business. Industry sources tell me that 1,400 of some 2,000 bottlers nationwide employ fewer than 50 workers.

In Oregon, we have 30 bottlers, and 26 of them employ fewer than 50 people.

Without these small bottlers, who are extremely sensitive to local consumer demands, the changes for maintaining or increasing the number of returnable containers in the market is extremely doubtful.

A lesson can be learned, I think, from the beer industry. That industry used to be highly localized. Without the protection of exclusive territories in that case when throwaways were introduced in the late 1940's, we saw a drastic change. In 1935, there were 765 brewers. In 1947, there were only 457 of those brewers. In 1977, there were only 47 breweries in the whole country.

And what happened at the same time to returnable containers in that industry, they dropped from a holding of 85 percent of the market in 1947 to only 12 percent of the market in 1977.

If you translate that into the soft drink industry, I think we are looking at a scenario that is sure to eliminate not only small bottlers, but also the returnable container in the consumer market.

What we need to do, I think, in a way that is suggested and will be suggested in a few moments in my testimony, and will be repeated again by Mr. Jeffords when he arrives, in thinking about this amendment and thinking about ways to make a specific linkage between the bill before you and the justification for this bill, which is the saving of the throwaways, I think the committee should consider the fact that throwaway bottles are socially an easy way out for consumers, for super markets, and for the industry.

Unfortunately, it is not the cheapest way. On the average, a consumer pays 57 percent higher costs for Coca-Cola in a throwaway bottle than in a returnable container, and for a very simple economic reason, and that is if a bottle is used more than once, the cost of the container is spread over several purchases and is paid by several consumers. And, of course, the returnable container must be collected, stored, transported back to a bottler and washed, and all that, we know is for a cost. But that cost pales in contrast to the cost of throwing the container away and having to replace it with another one.

I want to call to the attention of the subcommittee a study by Franklin Associates, an independent research consultant group, in resource and environmental planning. That group indicated that a mere 5-percent drop, 5-percentage-point drop in market share of returnable containers would mean the following:

First, consumption of additional 5.1 billion pounds of raw materials.

Second, generation of additional 385 million pounds of air pollutants, and 67 million pounds of water pollutants.

Third, use of an additional 102 trillion Btu's of energy, enough electricity to power a city of a population of 100,000 people for 34 years.

And fourth, the consumption of 43 billion additional gallons of water.

I think those statistics are significant, Mr. Chairman, and I hope the committee will pay great heed to them. One of the most reliable and recent independent analyses of returnable container legislation was conducted by the Resource Conservation Committee. I would like to call that to the attention of the subcommittee.

It concludes that if we had a variety of packages on the market, between 40 and 60 percent of the containers were in refillable form, we could reduce energy consumption by 70 to 130 trillion Btu's a year.

Yet another piece of solid evidence that legislation of this kind and an amendment of the kind we are proposing is sound.

That figure that I just mentioned, the 70 to 130 trillion Btu's factor, is the equivalent to between 12 and 23 million barrels of oil a year.

It seems to me, Mr. Chairman, at a time when we are trying to conserve energy, the time when we are trying to reduce waste, in a time when we are trying to save money, to combat inflation, we really can't afford the extravagance of throwaway bottles, and we cannot afford to allow minor inconveniences to blind us to the very tough choices that face us in the future.

The truth is that returnable containers represent no loss in standard of living. After the enactment of Oregon's bottle bill in 1972, consumption of beer in my State, based on the actual tax receipts, increased, not decreased, but increased by 6.35-million gallons a year. Profits for bottlers have not suffered, either. The Pepsi-Cola bottler in Portland, Oreg. confirmed that his sales and profits were up in the year following the adoption of the Oregon bottle bill and prices then, as they still are, were comparable to other Western States.

The same is true in jobs. We saw a case of shifting, job shifts from container manufacturing to bottle plants and retail stores. The shift, however, was hardly noticeable. In Oregon, over 300 new jobs were created.

But another jobs aspect that was much more noticeable, and again we can look to the beer industry for the example, with the rise of throwaways, breweries were able to make their product in regional centers. The number of breweries dropped, the number of people employed in those breweries as a consequence also dropped.

Minnesota alone, because of this phenomenon, lost seven breweries and untold numbers of jobs between the years 1962 and 1974.

A major obstacle to national consumer reuse legislation has been the argument that skilled jobs would be lost somehow and replaced with unskilled labor. I want to call the subcommittee's attention to the finding of the Resource Conservation Committee which determined that in fact, if in fact we had a national deposit system, we would get a net increase of approximately 50,000 to 55,000 jobs by 1985.

Even more significant is the committee's conclusion that not only would those new jobs employ some of our unskilled, unemployed youth, but that many of the jobs we would be creating would be high paying employment for skilled head-of-household workers.

The fact is, Mr. Chairman, we have worried about a job shift. We have been talking about this kind of legislation, and as we have been worrying about that job shift, we have been paying a price with more energy consumption and environmental degradation.

The returnable bottle used 10 times consumes less than a third of the energy of a throwaway steel can, and one-sixth of the energy of a throwaway aluminum can. The returnable converts that energy savings into jobs, which brings us to the legislation at hand today.

Mr. Chairman, the situation with regard to returnable bottles is in fact getting worse. I listened with great interest to the opening statement that you read for Chairman Rodino. We are using more throwaways today and fewer returnables. According to the National Soft Drink Association figures, throwaways now represent 62 percent of the soft drink market. Returnables at 38 percent of the market, are down from a 44-percent share just 4 short years ago.

In 1966, returnables represented 80 percent of the market. In 1958, just two decades ago, returnables stood at 98 percent of the market. The direction is obviously clear. The direction is even clearer when you examine the breakdown of where the throwaways dominate. They dominate in large urban centers such as Boston, Philadelphia, New York, where the share of returnable containers on the market is less than one-tenth of 1 percent.

The amendment that Congressman Jeffords and I are putting forward this morning is a reasonable beginning to reverse this trend from refillable containers, this trend away from refillable containers.

The amendment, quite simply, would require the bottlers who had exclusive territories to maintain at least 10-percent refillable bottles in the first year; 20 percent in the second year; and 35 percent in the following year.

We think this is sensible and necessary to assure the returnable containers' existence.

In fact, I regard it as an absolute minimum, and think that a mechanism should be provided to raise the production of returnables to 10 percent over a period of time.

Mr. Chairman, it seems to me that a rationing system of this kind makes a concrete reality out of the rhetoric that this committee has heard in the name of returnable, refillable bottles, on the part of advocates of this legislation. I number myself as one of those advocates. We need to translate rhetoric into reality.

An amendment of the kind Congressman Jeffords and I are proposing would do precisely that, and it seems to me that that provides the justification for an exemption for the perpetuation of the exclusive territories that the bottlers now have, and it also strikes a sound blow for energy conservation and for environmental protection.

And so I would say to you that this amendment that we suggest that you add to the bill is sound, it's reasonable, it's a minimum step, and it puts the advocates in the position of putting their money where their mouth is, in terms of advocating support by this committee for the significant legislation before you.

I thank the committee for the time that you have given me to come forward to express these views, and I hope you will think seriously about the ideas that Congressman Jeffords and I have advanced this morning.

Mr. Mazzoli. We certainly thank you, Les, for your statement, and I understand that you have a fairly tight time frame, as most of us do.

Let me just ask you one question. In all of your research and discussion, have you considered what at least is an argument that's been put to the committee, that by the time you have trucks chasing back and forth with this heavy load of thicker bottles and dropping off and picking up and everything else, that you're really consuming a considerable amount of energy that's in particularly short supply, petroleum energy, gasolines, and fuel oils? Has that been factored into your studies, and do you find those arguments persuasive?

Mr. AuCoin. Well, Mr. Chairman, if we are able to keep the small bottler alive and retain for him small compact markets, you do have the opportunity for the returnable container to be operated on an effective basis.

If we have the elimination of small regional bottlers and the continuation of the trend for large and fewer bottlers, then obviously those transportation costs far outstrip any energy savings on a Btu basis that you would find by having returnable bottles in a significant way.

All of the evidence that we have seen indicates that whatever transportation that is required to pick up the bottles, take them to a cleaning place, and be reused, if kept within this small kind of small market area that we are trying to preserve, that those energy costs are minimal compared to the energy savings on a Btu basis that come from the reuse of those containers.

Mr. Mazzoli. One last question. As a proponent of the underlying bill, H.R. 3567, would your position be that it should not pass without the amendment that you and Jim Jeffords are sponsoring?

Mr. AuCoin. Mr. Chairman, let me put it this way: I think the bill should pass, but I think the committee has an opportunity to do not just one thing, I think the committee has an opportunity to do two things:

It has an opportunity to preserve the small bottler, and the possibility within the exclusive territory of perpetuating the returnable container, and at the same time, do a second thing, and that is to add specific language guaranteeing that that hope becomes a reality, that that hope of the perpetuation of the returnable bottle will in fact become a reality.

So I'm suggesting, and I think Congressman Jeffords is suggesting, that as you look at the significant step that is being proposed before you in the legislation before you, don't do just one thing, do two things, and together they are, I think, sound, sensible, and they meet the test—clearly, if there is any doubt, they meet the test of filling that significant public need and necessity.

Mr. Mazzoli. We certainly thank you very much. The gentleman from Illinois is recognized for 5 minutes.

Mr. McClory. Thank you very much. And thank you, Mr. AuCoin, for the major contribution which you're making to this subject through your testimony this morning, and your very laudable and constructive proposal for amending the legislation.

Since this committee has jurisdiction with regard to antitrust monopolies and in the context of this legislation we are considering a qualified exemption from the antitrust laws, I would assume that your recommendation in the form of an amendment that you and Mr. Jeffords are offering, would be regarded as a condition upon which the exclusive geographical territorial exemption would be granted.

Mr. AuCoin. That's exactly right, Mr. McClory, and I had hoped that I had made that clear. It seems to me that we strengthen the

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legislation before you if we add as a condition a language that would guarantee that a certain percentage of containers be refillable, for all of the public interest aspects that are served by that language.

We would say that would be a condition, and if that condition was not met, then the exclusive territory would be lost. That's exactly what we are intending.

Mr. McClory. One of the earlier witnesses, a vice president for PepsiCo company, testified that what the industry does is to meet the demand of the public with regard to packaging, quality, taste, and so on.

Now, as you indicated in your testimony, the percentage of returnables in the Northeast has declined from 23 percent to 10 percent between 1976 and 1978. Do you feel that the industry is just responding to the public demand for nonreturnable containers?

Mr. AuCoin. I've heard that argument so many times by so many groups that it is almost threadbare by now. Detroit used to be telling us the American public didn't want small cars, and as a consequence built a fleet of gas guzzlers that are now being rejected in droves by the American consumer, and we see a market penetration of foreign imports, the likes of which scare the dickens out of almost all of us, and we are seeing people proposing surcharges on those imports to protect that fleet.

It used to be that we were told the American public wouldn't buy the smaller car. So we heard that then. I've heard that same argument that you've just expressed with regard to returnables in Oregon, when I was in the legislature drafting the Oregon bottle bill.

It turned out, however, that the polls in Oregon indicated that some 80 percent of the Oregonians wanted returnable containers. They weren't given them because there were some market economies that the industry itself wanted to realize, and that worked against what the consumers wanted. They were being force-fed, the consumers were being forced-fed a kind of container that they didn't want.

Mr. McClory. In other words, in addition to enjoying the taste, the flavor, the refreshing effect of Pepsi-Cola, you feel that the consumer likewise would enjoy the opportunity of consuming it from a bottle that is returnable, and from which the person could get a refund if a deposit was paid on the bottle.

Mr. AuCoin. Yes, that's exactly what I'm suggesting, and I think that there are polls, recent surveys, if the committee wants to analyze those, that indicate that some 70 percent of the American people agree with that. And I am also suggesting that, yes, the consumer would enjoy the opportunity through the use of that kind of container to save the amount of electricity that I've mentioned on a Btu basis.

Mr. McClory. I think your testimony is very, very persuasive, and I thank you very much.

Mr. AuCoin. I thank you for your questions.

Mr. Mazzoli. Mr. Synar is recognized for 5 minutes.

Mr. Synar. I just have one question. How have the votes on returnable bottles turned out in the States that have addressed this issue?

Mr. AuCoin. I can't recall the total number of States that have voted on the proposition, but I do know that there are at least six States, approximately six States now, that have statutes similar to the bill and the statute passed in the State of Oregon in 1971. Vermont is one, Michigan is another. The committee, I'm sure, has the information on the other States, and I have it before me, but it's approximately a half dozen, if my memory serves me. There have been some defeats, but I don't regard that as an absolute perfect measurement of public opinion, in terms of public support for a national movement in this direction. I am sure you are well aware of how much money is spent in campaigns of this kind by certain special interest groups to defeat propositions of this manner, and I think in the State of Massachusetts, where there was a defeat, there was an enormous amount of money spent, and the people of Massachusetts defeated it.

But I would rather look toward public opinion polls that are current on a national basis. They give you, I think, a far more accurate reading.

It is encouraging to me that there have been so many States that have joined the ranks of Oregon and Vermont in recent years, and I think that's a strong indicator of the kind of support I referred to as well.

Mr. Synar. Thank you, Mr. Chairman.

Mr. Mazzoli. Thank you. The gentleman's time has expired. The gentleman from Illinois, Mr. Railsback.

Mr. Railsback. I have no questions.

Mr. Mazzoli. The gentleman from Virginia, Mr. Butler, is recognized for 5 minutes.

Mr. Butler. Thank you, Mr. Chairman. I, too, want to express appreciation to the witness for bringing forward the suggested amendment, and for your interest in this legislation.

It was a very impressive statement. I'm going to address myself for a moment to what you are calling the Jeffords-AuCoin amendment, which would require that bottlers of exclusive territories maintain 20 percent of their production in returnable form.

Mr. AuCoin. Mr. Butler, if I can interrupt for just one moment.

Mr. Butler. Yes.

Mr. AuCoin. I realize that the printed statement before the committee does say 20 percent. Mr. Jeffords and I are trying our best to present this committee with a reasonable proposal, one that ought to be free of criticism from any reasonable person, even within the industry, and for that reason we have modified that 20 percent figure, and have offered instead the idea and the suggestion that that percentage of the first year be 10 percent; and that it be 20 percent in the second year; and the percentage in the third year be 35 percent in a ratcheting up process, if you will. And I apologize that the statement before you represents our earlier best attempt to address the problem.

But the testimony I am giving you today, and the suggestion that we make to you today, is that 10, 20, 35 over a 3-year basis.

Mr. Butler. Well, I thank you for that clarification, and I apologize for not listening that closely to your testimony. I had read your statement, and didn't realize you were departing from the script, but that's permitted.

Regardless of whether it's progressive or across the board, it's still a basic question of what's the magic in 10 percent, 20 percent, 30 percent, or any other percent. Let's look at the problem.

If we adopt this amendment, and in two adjacent territories, let's say franchisee A meets the returnable standards and keeps his territory franchise antitrust exemption. Then franchisee B deliberately does not and loses his.

Now, what's to prevent B from shipping his product into A's territory, skimming the cream off A's business, against which A, bound by the restrictions of his franchise, can't retaliate by shipping into B's territory?

Mr. AuCoin. The intent behind the suggestion is to protect—I've lost track of your A and B, but the intent behind the suggestion is to protect that exclusive territory for that bottler who meets these percentages, and not to expose him to raids, if you will, on the part of anyone else offering the same product line. It's the further intention behind the suggestion that we make to the subcommittee that any bottler who fails to meet these percentage tests therefore loses the exclusive territory, and that's the price he pays for not meeting the test of public need, necessity, and convenience that an exemption of this kind, we feel, requires.

So the intent—and maybe there is a need for some very careful drafting to make sure that that is precisely the result that is achieved. I don't see any economic flaw in the suggestion we are laying out before you.

Mr. Butler. Thank you. My question was directed pretty much to the bottler who decides not to go for 20 percent; he has a competitive advantage over a bottler who's bound by his franchise.

Mr. AuCoin. The bottler who opts not to meet the percentage therefore loses his exclusive territory. You are afraid that he might move in on the bottler who is abiding by these percentage rules?

Mr. Butler. Slip in by night.

Mr. AuCoin. Well, the suggestion we make is that an exclusive territory be an exclusive territory, and it has that protection against that kind of raid. And I think language can be written in such a way as to make sure that that protection is in place, is solid, is impregnable. That's the suggestion we make.

Mr. Butler. All right. Well, I understand your suggestion, and I have pointed to a problem which I don't think you've solved. But have you considered making territorial franchise antitrust exemptions contingent upon the entire industry meeting a returnable standard, so that we don't have this problem of local franchisees—that is industrywide all bottlers must meet the returnable standard in order for anyone to have it? Wouldn't that be a better approach?

Mr. Mazzoli. The gentleman's time has expired, but the witness may answer the question.

Mr. AuCoin. Well, in truth, I have not considered that approach.

Mr. Butler. Mr. Chairman, let's don't force him to an answer, but I wish you'd think about that, and if you want to file an answer with the record, I would appreciate it.

Mr. AuCoin. I would be pleased to do so.

Mr. Mazzoli. Do it at your pleasure, Les. We thank you.

Mr. MAZZOLI. The gentleman from Illinois—would the gentleman withhold for a moment? The gentleman from Oklahoma has a request that can be taken out of order.

Mr. SYNAR. Mr. Chairman, I ask unanimous consent that the subcommittee permit the meeting this morning to be covered in whole or in part by television broadcast, radio broadcast, or still photography, pursuant to rule 5 of the committee rules.

Mr. MAZZOLI. Is there an objection? The Chair hearing none, the gentleman's request is granted.

The gentleman from Illinois is recognized.

Mr. RAILSBACK. May I ask an informational question on a point which I'm not sure I quite understand. Were you recommending that the conditions apply only to returnable bottles? I'm wondering about returnable cans. I understand there would be possibly more savings in using returnable bottles. And then with respect to Mr. Jeffords' statement, I wanted to ask I would like to read a portion of it to you——

Mr. AuCOIN. I have it before me, if you'll point to the page.

Mr. RAILSBACK. It's found on page 3, where he says at the top of the page, "As I will explain in more detail below, the latest figures given by the National Soft Drink Association quote a national average for returnable containers to be 37.8 percent."

I am wondering if that includes returnable cans as well as bottles. It is my understanding that your legislation would relate only to returnable bottles, and I wonder if you would clarify this point.

Mr. AuCOIN. Yes, the suggestion that Mr. Jeffords and I make is that it apply to bottles. I did not draft Mr. Jeffords' statement, so when he refers to containers, I don't know if that is a term he is using for bottles, or whether it's a more inclusive term. You will have to ask him when he arrives.

Mr. RAILSBACK. Let met ask you this. I am curious as to why the emphasis is on returnable bottles only. I understand it is your suggestion. What about returnable cans?

Mr. AuCOIN. Well, if you want my preference, I would like to see returnable cans, I would like to see the percentage beyond 10 percent in the first year. I would like to see 100 percent cans and bottles, as is the case in Oregon. But I think what we are dealing here with is a suggestion recognizing realities, a suggestion that has the possibility of creating a beginning, and that is the reason bottles have been chosen. That's the reason why the percentage we suggest.

Mr. RAILSBACK. What about Oregon? How does the Oregon law apply, and does it apply to cans as well as bottles?

Mr. AuCOIN. Cans and bottles, yes.

Mr. RAILSBACK. Thank you. We appreciate your contribution.

Mr. MAZZOLI. The gentleman's time has expired. The gentleman from Ohio, Mr. Seiberling, is recognized.

Mr. SEIBERLING. Thank you. I am a cosponsor of the bill to require returnable containers, and so I start out sympathetic to that point of view.

I am also impressed by the studies commissioned by some of the bottlers—small bottlers—to the effect that if we adopt the FTC rule, we are spelling out the demise of returnable containers, as far as soft drink distribution is concerned, as well as the probable demise of small bottlers.

So the two things seem to coincide. However, when I have asked the bottlers what they feel about a requirement that only returnables be used, they don't like that, either.

Well, obviously, they'd like to have the flexibility, maybe someone even might say, to have their cake and eat it, too. But it does seem to me that one of the objectives, and perhaps the principal objective, of the legislation that we are considering would be achieved if we had a ban on nonreturnables, and I am going to press them for a position on that, that if worse came to worst, which would they rather have? The FTC decision or a ban on nonreturnables?

Do you have any thoughts on that?

Mr. AuCoin. I have a number of thoughts on the point you make, Mr. Seiberling, and I appreciate your making them. I have seen the same studies, and really what this committee—the choice facing this committee is whether or not the possibility of the demise of the returnable bottle, because of the demise of the small bottler, will be simply a possibility, whether or not—maybe I should state it another way:

The choice facing this committee is by passing legislation that provides protection for the small bottler, you create then a possibility for the continuation of the returnable bottle. That's a possibility. A possibility.

What we need to do is make it a likelihood and a certainty, and the certainty comes by adding language, it seems to me, to the legislation that puts percentage targets and percentage requirements in the legislation, so that this isn't just rhetoric used to justify an exemption from antitrust, although I think there are reasons to do it. But it's not just a use for that purpose. It will in fact do what the advocates are saying it could achieve, and that is to help save the returnable bottle. But you used the term "ban," and I would really hope that the subcommittee would not offer amendments such as I believe will be proposed, that there be a 100-percent requirement for returnable bottles.

No one cares more about returnable containers than I do, and I think I speak for Congressman Jeffords, as well. My political involvement, my government experience, began in the Oregon Legislature with the first-in-the-nation bottle bill. That was the first major piece of legislation I had any involvement with.

I am saying to this committee if you offer a 100-percent requirement, that is so onerous, so immediate, the impact would be so heavy, the political realities so difficult that you would doom the best chance we have to make a major step forward toward achieving at some future date 100 percentage on returnables.

Mr. Seiberling. I certainly concur in your forecast of doom, because we just had a referendum in Ohio on whether to require returnable bottles, or whether to put a charge on containers, and it was defeated quite substantially, but not because, I think, it shows any tremendous sentiment one way or the other.

In fact, the sentiment among the voters is probably generally in favor of cutting out the litter, and lowering the cost, but the tremendous lobbying campaign by the steel industry, the can industry, and the unions affiliated with them just snowed the opposition.

Mr. AuCoin. The gentleman makes an excellent point. It's one that I attempted to make myself a moment ago. And I would say to him that on page 3 of Congressman Jeffords' statement, he refers to a national survey conducted by the Federal Energy Administration in February of 1975, which concluded that 73 percent of those surveyed would favor a national deposit law, and I think that is a clearer reflector, perhaps, of public opinion than some of these supercharged, high-spending referendums.

Mr. Seiberling. I ask the Chair's indulgence to proceed.

Mr. Mazzoli. Without objection, the gentleman is recognized.

Mr. Seiberling. The difficulty I have with considering this legislation is I don't think the committee has jurisdiction to deal with this problem in the manner that you are referring to. Maybe we do, but I suspect that it comes more likely in the Commerce Committee. So we can only deal with antitrust questions, as far as this issue is concerned, if I am right.

And if that's the case, we are back to the question of should we pass the bill or not. One of the problems I have with the bill before us is that I am very reluctant to start opening the door—the House unfortunately has already tried to open—of intimidating the Federal Trade Commission in the discharge of its function, particularly when the decision is still pending in the courts on appeal.

So we have a multiple set of dilemmas here, and I am not sure I see the way out, but I think it is important we get these considerations out so that we can all take a look at them and see where we are.

Mr. Mazzoli. The gentleman's time has again expired. If there are no further questions, the witness is thanked for his attendance and help today, and excused.

Mr. AuCoin. Thank you, Mr. Chairman. I thank the committee.

[The statement follows:]

Statement of Hon. Les AuCoin

I am pleased to be here today along with my Colleague, Congressman Jim Jeffords of Vermont, in support of H.R. 3567 and H.R. 3573. My purpose in testifying today is to urge adoption of an amendment to this legislation that encourages preservation of the returnable container in our soft drink market and brings us significantly closer to a true "National Bottle Bill."

Consideration of the bills before this subcommittee affords a real opportunity to focus on our nation's policy regarding returnable beverage containers, and to do some public good—good for the environment, good for the economy, good for the industry, good for the consumer.

I represent Oregon, the pioneer in Bottle Bill legislation. I am here today to tell you unequivocally that the Bottle Bill works. It works because it reduces litter and solid waste. It works because it saves energy. It works because it creates jobs. It works because it saves consumers money.

Despite the overwhelming success and enormous popularity of Oregon's Bottle Bill and of similar legislation in other states, including Vermont, national container deposit legislation has been subjected to abuse, ridicule and lies. It has literally been studied to death.

This subcommittee is to be highly commended for its broad vision in linking the issue of competition within the industry with issue of performance standards of the industry when it comes to returnable containers.

As you know, I am a co-sponsor of HR 3567. I support it because it is the only way to keep small bottlers in business. Industry sources tell me that 1,409 of the 2,042 bottlers nationwide employ fewer than 50 workers. In Oregon, we have 30 bottlers, and 26 of them employ fewer than 50 people.

Without these small bottlers, who are extremely sensitive to local consumer demands, the chances for maintaining or increasing the number of returnable containers in the market is doubtful.

A lesson can be learned from the beer industry. Their industry used to be highly localized. Without the protection of exclusive territories when throwaways were introduced in the late 40's, we saw a drastic change. In 1935 there were 765 brewers, in 1947 there were 457, and in 1977 there were only 47 breweries in the whole country. What happened to returnable containers in that industry? They dropped from holding 85 percent of the market in 1947 to only 12 percent of the market in 1977. Translate that to the soft drink industry and we're looking at a scenario sure to eliminate the returnable container in the container market.

Throwaway bottles are an easy way out—for consumers, for supermarkets, for the industry. Unfortunately, it is not the cheapest way.

On the average, a customer pays a 57 percent higher cost for a Coca-Cola in a throwaway container than in a returnable container—and for a very simple economic reason. If a bottle is used more than once, the cost of that container is spread over several purchases and is paid by several customers.

Of course, a returnable container must be collected at a store, transported back to the bottler and washed—all for a cost. But that cost pales in contrast to the true "cost" of throwing a container away and replacing it with another one.

According to a study by Franklin Associates, independent research consultants in resources and environmental planning, a mere 5 percentage point annual drop in the market share of returnable containers would mean:

Consumption of an additional 5.1 billion pounds of raw materials; generation of an additional 385 million pounds of air pollutants and 67 million pounds of water pollutants; use of an additional 102 trillion BTUs of energy—enough to supply electricity to power a city with a population of 100,000 for 34 years; and consumption of an additional 43 billion gallons of water.

One of the most reliable and recent independent analyses of returnable container legislation was conducted by the Resource Conservation Committee. It concludes that if we had a variety of packages on the market and between 40 and 60 percent of the containers were in refillable form we could reduce energy consumption by 70 to 130 trillion BTUs per year.

That is the equivalent of 12 to 23 million barrels of oil per year.

At a time when we are trying to conserve energy, reduce waste and save money to combat inflation, we cannot afford the extravagance of throwaway bottles. We cannot afford to allow minor inconveniences to blind us to the very tough choices that face us.

The truth is returnable containers represent no loss in standard of living. After enactment of Oregon's Bottle Bill in 1972, consumption of beer in my state, based on actual tax receipts, increased by 6.35 million gallons. Profits for bottlers have not suffered, either. The Pepsi-Cola bottler in Portland, Oregon, confirmed that his sales and profits were up the year following adoption of the Oregon Bottle Bill, and prices then, as they still are, were comparable to other Western states.

And what about jobs? True, there was a shift from container manufacturing to bottling plants and retail stores. The shift was hardly noticeable, and in Oregon over 300 new jobs were created. But another jobs aspect was more noticeable—and again, we can look to the beer industry. With the rise of throwaways, breweries were able to make their product in regional centers. The number of breweries dropped, and the number of employes dropped. Minnesota alone lost seven breweries from 1962 to 1974. A major obstacle to national container reuse legislation has been the argument that skilled jobs would be lost and replaced with unskilled labor. The Resource Conservation Committee determined that if in fact we had a national deposit system, we would get a net increase of approximately 50 to 55,000 jobs by 1985. Even more significant is the committee's conclusion that not only would those new jobs employ some of our unskilled unemployed youth, but that many of them would provide high-paying employment for skilled, head-of-household workers.

The fact is we have been worried about a job shift and paying the price with more energy consumption. A returnable bottle used 10 times consumes less than a third of the energy of a throwaway steel can and one-sixth of the energy in a throwaway aluminum can. The returnable converts that energy savings into jobs.

A final question has arisen about the constitutionality of container deposit legislation. The Oregon Court of Appeals, in declaring Oregon's Bottle Bill constitutional, summed up the issue well when it said:

"The availability of land and revenues for solid waste disposal, the cost of litter collection on our highways and in our public parks, the depletion of mineral and energy resources, the injuries to humans and animals caused by discarded pull-tops, and the blight to our landscape are all economic, safety and esthetic burdens of great consequences, which are being borne by every member of the public."

Which brings us to the legislation at hand today. The situation is getting worse. We are using more throwaways and fewer returnables. According to National Soft Drink Association figures, throwaways now represent 62 percent of the soft drink market. Returnables, at 38 percent of the market, are down from a 44 percent share just four years ago. In 1966, returnables represented 80 percent of the market, and in 1958, just two decades ago, returnables stood at 98 percent of the market. The direction is surely clear.

The direction is even clearer when you examine a breakdown of where throwaways dominate—in large urban centers such as Boston, Philadelphia and New York where the share of returnable containers in the market is less than 0.1 percent.

The amendment Congressman Jeffords and I are putting forward this morning will be a reasonable beginning to reverse this trend away from refillable containers. The amendment, quite simply, would require that bottlers who have exclusive territories maintain 20 percent in returnable form. It's not only reasonable to ask this modest percentage, half of the national average of 40 percent, it's sensible and necessary to assure the returnable container's existence. In fact, I regard this as an absolute minimum and think a mechanism should be provided to raise the production of returnables to 100 percent over time.

It just makes common sense to rid ourselves of the convenience mentality we developed when resources and energy were cheap. We're waging a war against inflation now, and in the long run legislation that helps us save energy and raw materials helps us counter inflation.

These bills will be strengthened by adding the Jeffords-AuCoin Amendment because it gives the consumer assurances of long-term savings through returnable container use. It's a balanced approach and it's one we can live with, and profit by.

This hearing is an appropriate forum, and these bills appropriate vehicles, for the kind of amendment Congressman Jeffords and I am advocating. The legislation before you recognizes it is in the public interest to keep small bottling companies in business. This amendment clearly addresses the same interest.

Americans want answers to the difficult issues facing our nation. Not all the answers are grandiose. Some are as simple as insisting on returnable bottles.

Your subcommittee has a rare opportunity to strike a blow for the small business man and for the consumer, and save energy to boot. The Jeffords-AuCoin amendment, added to HR 3567 and HR 3573, will produce that result, and so I urge your favorable consideration of the amendment.

Mr. MAZZOLI. The Chair would like to invite forward as a panel two distinguished members of the House of Representatives, the Honorable Ted Weiss of the State of New York, and the Honorable Pete Stark of the State of California, both of whom are here, and both of whom are sponsors of the bill, H.R. 7128, a bill which would grant an antitrust exemption for exclusive territories which offer returnable containers.

The two gentlemen who are before us statements are made a part of the record, and they can proceed in whatever manner they may have decided upon.

TESTIMONY OF HON. FORTNEY H. STARK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA; AND HON. TED WEISS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. STARK. Thank you, Mr. Chairman. I appreciate the invitation to testify before your subcommittee in opposition to the bottlers' charity and subsidy act. It is interesting that this morning I received two bits of news with my early coffee. One that the Federal Government had made arrangements to lend the Hunt brothers $800 million in an effort to fight inflation; on the other hand, from my daughter saying the Bank of America had called in her credit card.

I got a feeling that if you're very, very rich and in very much trouble, we the Federal Government will bail you out; and if you're just trying to get through college, we will fight inflation on the backs of the average citizen.

I'm not a lawyer, and I testify before you with some temerity, as I know that this distinguished panel is composed of legal experts, and some of you have specialized in the area of antitrust. I do think, however, that quite clearly the history of this country has been in step with the FTC's ruling. We have seen auto agencies go the way of not having exclusive territories on the theory that all Chevys are alike, and this huge investment would go down the drain, and the fact is that when we took away the exclusivity of territory for the auto dealers, they all got bigger and they all sold more cars and they were all more prosperous. We saw the corner druggist fight for years—and this happens to be a field in which I had some academic experiences, as well as commerical experience, in the area of marketing. We saw the price protection done away, and again listening to the tunes of demise of the corner druggist, in fact when the corner druggist did what he or she does best, which is compound prescriptions, they prospered and the professional pharmacies grew and prospered, and those who wanted to be merchandisers became merchandisers. They grew and prospered without the fair trade laws which, as you all know, were only fair to the druggists' pocketbook and completely unfair to the consumers.

So we are faced here with a group of people, most whom own their businesses for the second or third generation, and all of which are highly profitable. It would take a genius to run a bottling company today with an exclusive territory and lose money. Now they are asking for a perpetual built-in profit for the rest of their lives and their family's lives.

The NSDA, interestingly enough, has the third largest pact, if that hasn't been brought home to most of the Members of the House, and you can look at it, as I look at it, in no other way but they're using economic, translatable into political, muscle to buy a profit to which they are not entitled by virtue of any investment of capital or labor or creativity or enterprise or entrepreneurship that will be paid for out of the pockets of the consumers.

So that in effect there can be really no reason to pass this bill except for us to admit we've been bought off by the bottlers and their lobbyists, and there are 300 and some odd of my colleagues who have testified to that by cosponsoring the bill which would protect the exclusive territories.

On the other hand, being a political realist, and being able to count beyond 20 with my shoes and socks on, it's likely that the bottlers are going to win. As a fall-back position, could we not save a litte energy and create a few jobs and do something for the social good at the same time? The bill that Mr. Weiss and I have introduced, 7128, in effect requires that the bottlers use all returnables.

I could even compromise so far as to get halfway between Mr. AuCoin's position and ours, and say let's phase that in at 10 percent a year, if I was sure that they couldn't beat it somewhere along the line; that would be in the spirit of brotherly compromise. But I think that might follow the realities of the situation.

I can only hope that this committee has jurisdiction. Our bill was jointly referred, I might add, to this committee and to the Commerce Committee, so the question of jurisdiction is correct, but I think it can be solved, and I would hope that as I see the bottlers getting their insured profit at the expense of the American consumer, that we can do a little bit of good for the country and the consumer, and probably even for the bottlers, by making them a little more competitive. Competition, I believe, is the backbone of American business, but that doesn't seem to be so in the bottling case.

I would like to ask that my prepared remarks be put into the record. I would also like to submit to the Chair for the record a research paper by the Library of Congress on the subject of laws protecting small businesses from predatory pricing practices of large companies, which has been used by some of the bottlers.

[The statement follows:]

PREPARED STATEMENT OF HON. FORTNEY H. (PETE) STARK, JR.

Mr. Chairman, I first became aware of this legislation, the Soft Drink Interband Competition Act (H.R. 3567), in early 1979 when I received several dozen letters from constituents of mine who were employed by the local Pepsi Cola bottler. They were alarmed about the Federal Trade Commission's ruling that the exclusive sales territories enjoyed by soft drink bottlers constituted an unreasonable restraint of trade. They had been told their jobs would disappear if the FTC ruling remained intact.

The bottlers' argument for the preservation of their exclusive territories and in favor of this proposed exemption from the antitrust laws is simple: If the territories are eliminated and they are forced to enter into competition with bottlers of the same brand, then the larger bottlers will, through ruthless price competition, either absorb or force out of business smaller bottlers in the industry.

In response to this mail and subsequent discussions with several California bottlers and the National Soft Drink Association, I asked the Congressional Research Service to let me know what Federal laws existed to protect the small bottler-businessman from predatory, "below cost" pricing by larger bottlers.

Although I'm not an attorney, the CRS memo convinced me the bottlers do not have a case. There are Federal laws and in most cases, state laws, which protect businesses from predatory competition to the extent the government should in a free enterprise economy. I am including a copy of the CRS memo with my testimony.

As an alternative to the legislation you are considering, Representative Weiss and I have introduced a bill (H.R. 7128) which would allow bottlers to retain their exclusive territorial boundaries only if they offer products in refundable containers.

This proposal not only makes federal law that part of the FTC ruling which the bottlers liked, but it makes an important statement of economic policy. That is, if the Congress for any reason sanctions anticompetitive practices, then the industry enjoying the privilege should be required to contribute something in return.

The Congressional guarantee of extreme profits and insurance against competition forever deserves reciprocal concessions from the bottling industry. In this case, the concession to recycle bottles and cans would benefit consumers and save energy while preserving the vitality of the bottling franchise.

Bottlers ought to be most supportive of my proposal since they argue that the FTC decision, if allowed to stand, would mean the end of the returnable bottle. This may or may not be true, but the returnable bottle is quickly becoming an extinct item, without the prodding of the FTC.

According to the "Survey of Sales" by the National Soft Drink Association, the sales of soft drinks in returnable containers in the Pacific region, which includes my home state, dropped from 52 percent in 1976 to 40.7 percent in 1978, a decrease of more than 20 percent.

With all the overriding concern in this country with inflation, Iran and the elections, this is not one of those issues which is going to attract a great deal of press coverage or the attention of our constituents.

I wonder, however, how they would want us to vote on a measure which would permanently insulate soft drink bottlers from simple competition and at the same time permit unchecked, inflationary price increases.

I urge this committee to either reject the bill you have before you or amend it to deal fairly with consumers and the economy.

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Congressional Research Service

WASHINGTON, D.C. 20540

March 15, 1979

TO: Honorable Pete Stark
Attention: Rod Kuckro

FROM: American Law Division

SUBJECT: Laws Protecting Small Businesses From Predatory Pricing Practices of Larger Companies

This is in response to your request of March 5, 1979 for a discussion of the above mentioned subject. Enclosed is a report on statutory protection available to persons whose businesses are injured as a result of anticompetitive pricing of others.

It should be noted that there must be a finding that pricing transactions, which constitute the bases for suits brought under federal statutes, occurred in interstate commerce, i.e. between states. If all the relevant activities took place within one state, then the federal provision would not apply. "Unfair trade" laws, however, do exist in most states, including California, which cover intrastate transactions. A general discussion of such state statutes appears in the report, in addition to a description of federal statutes. Relevant sections of California's Unfair Practices Act Cal. Bus. & Prof. Code §§17000-17100, have been copied and are enclosed.

Christine Persichetti

Christine Persichetti
Legislative Attorney

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WASHINGTON, D.C. 20540

LAWS PROTECTING SMALL BUSINESSES FROM PREDATORY PRICING PRACTICES OF LARGER COMPANIES

The soft drink industry currently operates under an exclusive territorial franchise system -- exclusive because the manufacturer agrees that he will supply his product to a wholesaler in a certain district and also that he will supply his product to no other in that district; territorial because the manufacturer also requires that the wholesaler sell only within a certain territory. The FTC has recently ruled that this franchise system is illegal and has issued a cease and desist order. This ruling has been appealed by the syrup manufacturers to the Court of Appeals of the District of Columbia Circuit, but no decision has yet been handed down by the Court. Meanwhile, there have been numerous legislative proposals introduced to counteract the FTC's decision which would permit the soft drink industry's structure to remain, unless an absence of substantial and effective competition on the interbrand level is found.

The impetus behind such legislation is the fear that small bottlers will be put out of business if the territorial system no longer exists. This reasoning does not include the possibility of small bottlers protecting themselves from predatory pricing by bringing suit against competitors who use such tactics. The major federal statute invoked in situations of "below cost" pricing is the Robinson-Patman Act, 15 U.S.C. §13, 13a 13b, 21a (1970)).

Robinson-Patman Act

This statute was enacted June 19, 1936 principally to amend the price discrimination provisions of Section 2 of the Clayton Act. It imposes civil liability through governmental enforcement and private treble damage actions. By custom, not law, virtually all civil governmental actions have been brought by the FTC. The Department of Justice has concurrent authority with the FTC to enforce the Robinson-Patman Act. It has sole jurisdiction to enforce Section 3 of the Robinson-Patman Act, a seldom used provision, which makes it unlawful for any person engaged in commerce, in the course of such commerce:

> [1] to be a party to, or assist in, any transaction of sale, or contract to sell, which discriminates to his knowledge against competitors of the purchaser, in that, any discount, rebate, allowance, or advertising service charge is granted to the purchaser over and above any discount, rebate, allowance, or advertising service charge available at the time of such transaction to said competitors in respect of a sale of goods of like grade, quality, and quantity;
>
> [2] to sell, or contract to sell, goods in any part of the United States at prices lower than those exacted by said person elsewhere in the United States for the purpose of destroying competition, or eliminating a competitor in such part of the United States; or,
>
> [3] to sell, or contract to sell, goods at unreasonably low prices for the purpose of destroying competition or eliminating a competitor.[1]

A fine of not more than $5,000 and imprisonment for not more than one year may be imposed for each violation. The Supreme Court has found that the civil sanctions of the Clayton Act - treble damages and injunctions - do not apply to violations of Section 3 of the Robinson-Patman Act.[2/]

1/ 15 U.S.C. §13a. These clauses have been assigned numbers for purposes of clarity.

2/ Nashville Milk Co. v. Carnation Co., 355 U.S. 373 (1958).

As already mentioned, treble damages (plus the cost of bringing suit and attorneys' fees) is the remedy available "to any person who shall be injured in his business or property"[3/] by reason of anything forbidden in the Robinson-Patman Act or any antitrust law.

Section 2 of the Clayton Act, which imposes civil prohibitions is divided into six parts. It should be kept in mind that in order for these provisions to apply it must be proved that specified jurisdictional elements, such as the "in commerce" requirement, are present in the fact situation. A brief summary of these parts follows.

Section 2(a) is the heart of the Act. It prohibits sellers from discriminating in price. The plaintiff or enforcing authority must establish that goods "of like grade and quality" have been sold to different purchasers at different prices and the effect of this may be substantially injurious to competition. The factor of time must be considered in comparing two prices to see if there is a difference. If sales are made at different times, a variation in price between customers who do not buy simultaneously would not ordinarily be discriminatory. In determining whether competition has been injured, destroyed or prevented any one of three levels of competition can be examined for this effect: (1) competition with the seller who grants a favorable price-known as primary-level competition; (2) competition among the seller's customers, some of whom are charged less than others-secondary-level competition; and

3/ Section 4 of the Clayton Act, 15 U.S.C. §15.

(3) competition with a person buying from a favored customer of the seller - tertiary-level competition.

Primary-level competitive effect may be found even though the seller's competing customers are all treated alike.4/ For example, a seller who prices by territory may not affect buyers who compete with each other in reselling the product in the same locality since they both paid the same price; but the seller's own competitors may nevertheless be affected. There is no requirement that a seller had predatory intent in order to find primary-level injury.5/

A violation of the Act may also be found when a seller's customers are not accorded like price treatment. In most cases, the favored and disfavored customers must be in actual competition in the resale of the seller's commodity for a difference in price to have any likely competitive effect at the secondary - level. There may, however, be a finding of price discrimination in "dual distribution" systems, e.g. where a wholesale sells in part to retailers and in part directly to consumers.

An example of tertiary-level injury to competition is where an oil company sold gas in tank car quantities to certain jobbers at a lower price than the tank-wagon price charged to direct buying retailers.6/ The FTC found tertiary-level competitive injury when one of these jobbers resold to retailers

4/ Federal Trade Commission v. Anheuser-Busch, Inc., 363 U.S. 536 (1960).
5/ Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 703 (1967).
6/ Federal Trade Commission v. Standard Oil Co., 355 U.S. 396 (1958).

at a lower price than the oil company had charged its own retail customers.

Section 2(b) of the Robinson-Patman Act permits a seller to rebut a case of *prima facie* violation by showing that he acted in good faith to meet the equally low price of his competitors.

Other defenses recognized under this Act include: cost justification; changing market conditions; and the right of a seller to select his own customers. 7/

Section 2(c) prohibits a seller from paying a commission or brokerage, or any discount in lieu of commission or brokerage, to a buyer or to anyone acting for a buyer. It also prohibits a buyer from receiving the forbidden payment.

Sections 2(d) and (e) have been construed as companion sections. Section 2(d) prohibits a seller from making any payment to a customer as compensation for service or facilities provided by the buyer in connection with the processing, handling, resale, or offering for resale of the goods purchased unless such payment is available on proportionally equal terms to all other competing customers. Section 2(e) prohibits the furnishing of services or facilities by a seller to a customer unless accorded to competing customers on proportionally equal terms.

Section 2(f) imposes buyer liability for knowingly inducing or receiving a discrimination in price prohibited by Section 2(a).

7/ Section 2(a) of the Robinson-Patman Act, 15 U.S.C. §13.

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Other Federal Statutes Which Cover Predatory Pricing

Section 5 of the Federal Trade Commission Act[8/] supplements the Robinson-Patman Act by prohibiting unfair methods of competition. This is particularly useful when collusive pricing is involved.[9/] The Federal Trade Commission Act also covers the discrimination in the sale of services, while the Robinson-Patman Act only deals with the sale of commodities.[10/]

Section 2 of the Sherman Act which bans monopolistic practices may also be applied to predatory price-cutting in local markets where the seller intends to gain monopoly power with an eye to raising prices later.[11/]

Statutes Covering Intrastate Transactions

As mentioned earlier, if transactions occur totally within one state the federal statutes do not reach sellers engaging in discriminatory or predatory pricing practices. Thirty-five states have by legislation or by case law prohibited unusually low prices or other acts whose purpose and intent is driving another out of business.[12/] These state laws provide a cause of action to injured persons in the course of intrastate commerce. It is also possible, in cases where there is concurrent jurisdiction, i.e. transactions occurred in interstate commerce, to invoke the protection of both federal and state statutes.

8/ 15 U.S.C. §§41-44.
9/ Federal Trade Commission v. Cement Institute, 333 U.S. 683 (1948).
10/ Grand Union Co. v. Federal Trade Commission, 300 F.2d 92 (2d Cir. 1962); See also Federal Trade Commission v. Sperry & Hutchinson Co., 405 U.S. 233 (1972).
11/ 15 U.S.C. §2. See United States v. New York Great Atlantic & Pacific Tea Co., 67 F.Supp. 626 (E.D. Ill. 1946), aff'd., 173 F.2d 79 (7th Cir. 1949).
12/ Antitrust Adviser 351, 352 (2d ed. 1971).

In general, state sales-below-cost statutes prohibit sales, offers of sales, or advertisements of sales below the seller's cost, and provide both criminal and civil sanctions.[13/] Most state statutes provide successful plaintiffs with the remedy of treble damages. The defenses of "cost justification" and "meeting competition" are available under most state statutes. With respect to predatory pricing, the most common provision found in the state statutes indicates that a sale below cost is not unlawful unless the proscribed purpose, intent or effect is shown. Specifically intent to destroy competition or to injure a competitor must be shown. Under most state statutes, the attorneys general are permitted to enjoin and prevent future violations; to sue to recover damages in a private suit; or to sue to punish violators under a provision which allows criminal sanctions.

13/ See Comment, 58 Michigan L. Rev. 905 (1960) for a general discussion of state below-cost-sales statutes; and McCarthy, "Whatever Happened to the Small Businessman?", 2 U. of San Francisco L.Rev. 165 (1968), for a discussion of the California Unfair Practices Act, Cal. Bus. & Prof. Code §§17000-17100 which is typical of many state statutes.

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96TH CONGRESS
2D SESSION

H. R. 7128

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.

IN THE HOUSE OF REPRESENTATIVES

APRIL 22, 1980

Mr. STARK (for himself and Mr. WEISS) introduced the following bill; which was referred jointly to the Committees on the Judiciary and Interstate and Foreign Commerce

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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, That this Act may be cited as the "Soft Drink Interbrand Competition and Reuse and Recycling Act of 1979".

SEC. 2. (a) Nothing contained in any antitrust law shall render unlawful the inclusion and enforcement in any trademark licensing contract or agreement, pursuant to which the licensee engages in the manufacture (including manufacture by any sublicensee, agent, or subcontractor thereof), 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 if—

(1) after the date of the enactment of this Act, such product and the licensee are in substantial and effective competition with other trademarked soft drink products of the same general class, and the licensees of those other products, respectively, within the geographic area covered by the license;

(2) after the date of the enactment of this Act, the licensor retains control over the nature and quality of such product in accordance with the Trademark Act of 1946 (15 U.S.C. 1051 et seq.); and

(3) after the six-month period beginning on the date of the enactment of this Act, the licensee (and any subcontractor or sublicensee on the licensee's behalf)—

(A) sells or offers for sale the trademarked soft drink product only in refundable beverage containers;

(B) provides that each retailer to which such trademarked soft drink products are sold (or were sold within the previous six months) will promptly pay a consumer, for the consumer's tender of an empty and unbroken refundable beverage container in which the trademarked soft drink product was sold, the amount of the refund value stated on the container; and

(C) promptly pays to each retailer to which such trademarked soft drink products are sold (or have been sold within the previous six months), for the retailer's tender of an empty and unbroken refundable beverage container in which the trademarked soft drink product was sold, the amount of the refund value stated on the container.

For purposes of subparagraphs (B) and (C), the opening of a beverage container in a manner in which it was designed to be opened shall not constitute the breaking of the container.

(b) As used in this Act—

(1) the term "antitrust law" means the Sherman Act (15 U.S.C. 1 et seq.), the Federal Trade Commis-

sion Act (15 U.S.C. 41 et seq.), and the Clayton Act (15 U.S.C. 12 et seq.);

(2) the term "beverage container" means a container designed to contain a soft drink product under pressure of carbonation; and

(3) the term "refundable beverage container" means a beverage container which has clearly, prominently, and securely affixed to, or printed on, it a statement of the amount of the refund value of the container, such amount being not less than 5 cents.

SEC. 3. (a) The General Accounting Office, in consultation with the Environmental Protection Agency, shall monitor, before and after the effective dates of the conditions imposed by section 2(a)(3), the rate of reuse and recycling of beverage containers, and shall evaluate and report to Congress annually during each of the first three years after the date of the enactment of this Act and biennially thereafter on the impact of the provisions of this Act on—

(1) competition and employment in the soft drink industry;

(2) resource recovery and reduction of solid waste and litter; and

(3) the economy.

(b) The Administrator of the Environmental Protection Agency shall provide such technical assistance and information to licensees, retailers, and consumers, and to manufacturers of beverage containers, as is necessary to assist in complying with the condition established under section 2(a)(3).

SEC. 4. The provisions of this Act shall apply to any contract or agreement in effect on the date of the enactment of this Act and any contract or agreement entered into after such date of enactment.

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Mr. STARK. I have one more honest bottler in my district who said contrary to that, all that is required is that the former, meaning large, bottlers take advantage of his volume, economic scale, sophistication and capital resources to offer a better—not predatory—price. Now he's right.

All you have to do in a competitive economy is be sophisticated and employ capital and offer a better price and/or indeed a better product at the same price, and you will grow larger and somebody else may grow smaller. But as near as I can recall, through many years of academic training in economics and business, and many years in the business world, that's been the law of the land for 200 years, and I just am inviting the bottlers to join with the rest of us who had to work hard to make a living under the laws of the land.

Thank you.

Mr. MAZZOLI. I thank the gentleman. His statement, as well as his study, will be made a part of the record.

The gentleman from New York, Mr. Weiss, is welcomed.

Mr. WEISS. Thank you very much, Mr. Chairman and members of the subcommittee. I do want to express my appreciation to you for giving me the opportunity to appear before you this morning. It is really a privilege to appear both with my distinguished colleague from California and at the same time following directly Mr. AuCoin.

Mr. AuCoin is indeed the pioneer in the effort to try and preserve and get a return back to the returnable beverage container situation.

When I served on the city council in New York, we attempted to have legislation based on the Oregon experience enacted, but the very same people who have been successful in getting 310 cosponsors on a bill pending in this House were also very, very successful at the New York City Council level, and the bill never saw the light of day, never was reported out of committee.

Basically I don't believe that the bills that are before us are either procompetition or proconsumer legislation, as the proposers of the so-called Soft Drink Interbrand Competition Act would suggest.

Rather, I think they are an attempt to exempt an entire industry from the antitrust standards enacted by this Congress many years ago. Nor will the bill aid its intended beneficiaries, the small bottlers.

I do not believe that the legislation will result in any reduction in the already inflated costs of soft drinks to the consumer. And I don't believe, finally, that the enactment of this bill at this time would be proper legislative procedure, given the fact that the matter is in the courts at this point.

I do believe that the bill is inflationary, and that it is special interest legislation, unwarranted and directly contrary to the public good. I think that there was good and valid reason for the Congress to adopt the Sherman Antitrust Act, and for this country to live by it.

I think that if we are going to grant exemptions at all, they should be very limited and then only if we are adopting some other counterveiling measure which outweighs the disadvantage of the waiver. I think that the legislation that Mr. Stark and I have introduced would do that, in that it would provide permission for the territorial franchises only in those situations where you had returnable beverage containers. You would then have at least a counterveiling benefit to society in the form of energy saving, price saving, and I think it would provide a justification for the exemption.

In any event, I do not believe that this committee or this Congress ought to now attempt to override the courts which are immediately in the process of determining whether the FTC ruling in this situation was or was not appropriate.

And, Mr. Chairman, I would ask permission of you to have my entire statement entered into the record.

Mr. MAZZOLI. The gentleman's statement will be made a part of the record, and I thank him.

[The statement follows:]

PREPARED STATEMENT OF CONGRESSMAN TED WEISS

Mr. Chairman, and members of the subcommittee, I appreciate the opportunity to appear before you today regarding the soft drink interbrand competition act, and want to commend you for the detailed study of this industry that I know the subcommittee has already undertaken. I believe that the issues presented by this legislation present difficult decisions for the Congress and could well set us on a course of special interest legislation from which there would be no return. As I believe the members are already aware, I am steadfastly opposed to the passage of these bills, without major changes, and would like to briefly outline some of the concerns which have led me to this position.

Basically, I do not believe that this bill is either "pro-competition or pro-consumer legislation" as its proponents would suggest, but rather an attempt to exempt an entire industry from the anti-trust standards enacted by this Congress many years ago. Nor will the bill aid its intended beneficiaries—small bottlers; I do not believe that the legislation will result in any reduction in the already inflated cost of soft drinks to the consumer; and finally, I do not believe that the enactment of the bill at this time would be proper legislative procedure. What I do believe is that this is inflationary, special interest legislation which is unwarranted and directly contrary to the public good.

Antitrust laws are premised upon the belief that true competition should be fostered in all industries, unless there can be a very strong showing that the overriding public interest is served by the granting of limited exceptions. As a matter of economic principle I believe that unregulated exceptions to the antitrust laws, in the form of monopolies or oligopolies, such as are in evidence in this industry, preclude real price and service competition, ensuring artificially high profits and prices. Luckily, the Congress has been extremely reluctant to grant individual exceptions to the antitrust laws, and I believe that the softdrink industry has fallen far short of proving the need for any deviance from this policy.

What is at issue is the antitrust standard which will be used to determine the legality of exclusive territorial franchises which predominate this industry. There has been substantial litigation in this field, the most recent being the Supreme Court decision in the *Continental T.V.* v. *GTE Sylvania*, 433 U.S. 35 (1977) in that case, the court adopted what is known as a "rule of reason" test, overturning a previous standard of "per se" illegality, a test which requires a balancing of all competitive factors in the determination of antitrust exemptions. It is indeed interesting to note that it is this very "rule of reason" test which was sought by the industry in legislation introduced in the 92nd (S. 3133), 93rd (S. 978) and 94th (S. 3421, H.R. 6684) Congresses, but which has now been abandoned by the industry after its adoption by the Supreme Court and its use in the FTC decision in this very case. Now the industry comes to the Congress seeking exemption from the "rule of reason" standard and its replacement by an undefined standard of "substantial and effective competition with other products of the same general class" in the case of H.R. 3567, or, in the case of H.R. 5818, that "other competing products of the same general class are not generally available to consumers." These standards are significant reductions in the antitrust tests which would, I believe, have the effect of totally exempting this industry from Federal antitrust statutes. As the Department of Justice has already stated before this subcommittee, "these standards would unfairly deny the consuming public the protection of the antitrust laws" in order to protect business interests. This is clearly not the intention of the framers of the Federal antitrust legislation.

But what business interest is it that is being protected? Is it the small "Mom and Pop" local bottler as is claimed by the bills' proponents, or is it the large concentrated corporation which already controls through direct ownership and the "Piggy Back" system, a major portion of the industry sales?

It is well known that the soft drink industry becomes increasingly more concentrated with each passing day—even under the present territorial franchise system. From a high of somewhere around 7000 production sites in the 1950's, the industry shrank to an estimated 2096 plants in 1978, a trend which even the industry states is irreversible. Already the 21 largest Coke, 10 largest Pepsi, and 10 largest 7-Up bottlers serve respectively 58%, 45%, and 37% of the U.S. population. In large metropolitan areas a very small number of bottlers control the distribution system through the sale of not only their own brands, but additionally by the piggybacking of other brands. This distribution method has also been amply discussed before the committee.

It simply cannot be said with any validity that passage of this bill will guarantee survival of the small bottler. All economic data and the history of the industry point to the continuing decrease in the numbers of bottlers, regardless of the system of distribution. Clearly, the "Mom and Pop" bottler has little long-range future whether or not these bills are passed.

In the FTC's determination of this case, and the previous testimony before this subcommittee, much of the discussion was focused upon the degree of *inter*brand competition, and compared with the clear lack of *intra*brand competition in the industry. But the competition among brands is almost meaningless unless those brands are produced by different companies. In the soft drink industry, this is not the case. Quite the contrary, it is more likely that one syrup manufacturer will have a number of different brands, and that a dozen or two dozen soft drink brands might well be distributed at the local level by only a few bottling companies. Competition of this type is more corporate imagination than market reality.

As the committee is similarly aware, the FTC did not disturb the exclusive territorial relationships with regard to returnable bottles. This conclusion *is* supported by additional market facts not present in the non-returnable situation—primarily the concepts of *bottle trippage* (which is the average number of reuses of bottles), and *recapture.* These factors, which clearly and directly affect the investment costs to the bottler, would be extremely difficult to control without the territorial system.

The absence of that system for returnables in turn would directly raise the soft drink's cost to consumers.

It is only in this last situation, then, where elimination of the exclusive franchise arrangement would result in increased consumer prices that business protection offered by H.R. 3567 and H.R. 5818 should be tolerated.

In conclusion, I submit that the soft drink industry has not met the burden of justification for this special interest legislation. It is contrary to a free competitive economy—and sets a dangerous precedent for other industries who, with sufficient lobbying organization, will doubtless follow this lead should the Congress adopt these proposals. I fervently urge the Committee's rejection of H.R. 5818 and H.R. 3567 as presently drafted.

Thank you.

Mr. MAZZOLI. Let me ask just a couple questions. Pete, you were saying that you're really not too concerned if this territorial legislation were not enacted. As a matter of fact, you think it's not good for the consumer. You're not persuaded with respect to the need for, at least within the framework of the bill, interbrand competition and interbrand pricing activities? Would that not satisfy the problem of getting the consumer a delivered product at a low price?

Mr. STARK. If you mean competition between Pepsi-Cola and Coca-Cola, for example——

Mr. MAZZOLI. No; because what we're doing here, if I understand this bill correctly, is preserving the present system. We are preventing, in a sense, intrabrand competition to Coca-Cola franchises.

Mr. STARK. Actually, Mr. Chairman, I am afraid the question goes deeper than that. The practice in the industry is for many of the bottlers to have several brands, and competition in the industry is more based on vending machine location and shelf space than it is competition between brands, as to people's habits, as it might be with cigarettes or something else.

Consumption studies have shown very little brand preference among the various soft drinks. People will switch back and forth almost at will. So there could be intrabrand competition as well—and also it might enable, if it's all right to use the trade names, somebody selling Kligo Klub, which is not exactly a household word, to also start buying Coca-Cola syrup and name, and thereby gain entry into the kind of supermarkets or large factories where this person might want to operate a vending machine. Whereby that small new entrepreneur who is creating new jobs and starting a new business would be denied entry because, as a matter of fact, to get into the business without one of these major brand names, there is no entry. So it goes both ways.

Mr. MAZZOLI. One of the arguments made to the committee is that there is not brand loyalty. If there is a lower priced cola offered, even if it's not the No. 1 national brand, then people would buy the lower priced cola. If we are to understand these arguments, there is this rather intense interbrand competition which does then deliver to the consumer a low-priced product, which is really what we are all trying to accomplish through competition.

Mr. STARK. I think the gentleman's children and wife could attest to the fact that if this were the case, Safeway and A. & P. would be the largest sellers, would have the largest cola brands. In my long history of hot summers and drinking lots of soda pop, you still, if you could afford it, bought Pepsi or Coca-Cola. It used to be the "two-for" appeal of Pepsi when it wasn't as popular, but A. & P. and Safeway consistently undersold. I think today they are still a buck a case on their sales in the summer, and they can't compete with the tremendous investments and advertising and sales promotion that the major brands do, and so price alone will not move a product.

Mr. MAZZOLI. Ted, let me ask you this question. What if the consumers' preference is not for heavy bottles, but is for lighter cans or lightweight nonreturnable bottles? If a 20- or 30-percent requirement is written in to the legislation that 20 or 30 percent returnable containers gather dust on the shelf, what happens in all of these bills?

How do we in a sense encourage the movement of 20 percent or 30 percent of returnables if people just don't want them. They prefer the alternative on the same shelf, which is a lightweight, carry-home throwaway?

Mr. WEISS. The legislation that Mr. Stark and I have, of course, does not at this point provide an incremental phasing in. What we are saying is that you have a totally returnable bottle situation. I don't know what the reality of those problems might or might not be other than the fact that our bill is not limited to only bottles, but also to lighter cans or other containers.

Mr. STARK. If I might speak to that, Mr. Chairman. The reality is that the canning companies or the bottling companies can indeed sell in cans or lightweight containers. They've just got to buy them back. They can buy them back and crush them and recycle them.

Mr. MAZZOLI. Well, my time has expired, but it occurs to me that it's hard to have a percentage less than 100 percent in this kind of a bill, because it would not be effective.

Mr. STARK. I agree.

Mr. MAZZOLI. The gentleman from Illinois, Mr. McClory, is recognized for 5 miniutes.

Mr. MCCLORY. I appreciate the testimony that you gentlemen are giving. On the other hand, Mr. Stark, I'm going to reject any suggestion you make that the die is cast and that consumers are destined to go down the tube in a very dramatic way, a fate in which you set forth in a very strong antibusiness position. Maybe it's something that would have fit very well the other day with Ralph Nader.

Mr. STARK. I'd be proud to be identified with him, Mr. McClory.

Mr. MCCLORY. Well, I want to emphasize very strongly that there is no anticonsumer attitude present in this committee, nor would I suggest that this legislation or the hearings up to the present time have indicated that there is some kind of a conspiracy being promoted by more than 300 Members of the House to "get" the consumer through the legislative process.

As a matter of fact, it's quite to the contrary. It has been emphasized to the committee in a great deal of testimony that the interest of the consumer in promoting competition is precisely what is inherent in this legislation.

I don't happen to be a sponsor of the legislation.

Mr. STARK. I'm aware of that.

Mr. MCCLORY. I haven't announced what my position on the legislation is. I think we have had some constructive suggestions here this morning. The whole subject of exemptions—qualified exemptions, exemptions for labor unions, exemptions of farm cooperatives and so on—are very sensitive. These exemptions affect the consumer price, but we don't denounce them, as it seems to be popular to do with regard to the business community.

So I think that the suggestion which you and Mr. Weiss seem to be making, and which is in line with the earlier testimony from Mr. AuCoin and Mr. Jeffords, may help us resolve this problem. But it seems to me that in resolving it, we are going to try to protect interests of all Americans. We are not going to provide some special-interest legislation here, or punish the American consumer, which I presume means all of us. I just want to indicate that there is no gigantic conspiracy about to be undertaken here; rather, there is a definite attempt to resolve a legislative problem that's been around too long, and which deserves to be acted upon.

Thank you, Mr. Chairman.

Mr. MAZZOLI. The gentleman's time has expired. The gentleman from Oklahoma is recognized for 5 minutes.

Mr. SYNAR. Mr. Chairman, I only have one question, to you, Pete. You know, we talk about competition, and I don't think there is a person who serves within the House who doesn't feel that good healthy competition is the best protection for the American consumer. But as I listened to your statement this morning, I got the impression that you were talking about competition in the abstract, reality, the history of this industry for 90 years, is of a highly competitive industry.

Mr. STARK. It is not abstract at all. The FTC is absolutely right. Literally I spent summers washing the bottles in a returnable soda pop plant. I am familiar with the problems of returnable bottles and how heavy they are. I've probably hefted more cases of soda pop in doing that than many of my colleagues.

The point is that as the markets change, the need for the territorial exclusivity has disappeared, and laws therefore should change. It seems to me laws are made to be flexible. There was indeed a reason that made some sense; thin, but a reason for allowing these exclusive territories. As we are all aware, the heavy bottles have disappeared, and now there is no real need to protect the bottlers from competiton, interbrand competition, because the original need for the exemption has in effect gone away by custom. And I think that's the reality. And the reality is that they have an old law that's protecting them and giving them a competitive edge or advantage that other industries don't have, and understandably they don't want to lose it. That's the practical approach.

Mr. SYNAR. For the last 9 years, there has been such indecision from the FTC. In not ruling one way or the other on the issue that indecision has caused an anticompetitive atmosphere among the bottlers. I would just like to have your comments on how long does the legislative branch wait for the executive branch to give direction in some area, whether it be bottlers——

Mr. STARK. I couldn't agree with you more. One of the greatest problems business operates under today is a lack of any kind of defined Government direction or policy toward business. Whether it's controlling inflation, ruling on antitrust, FDA drug policy, or environmental things. A businessman needs a defined and certain climate to make advanced plans, whether it's capital expansion or contraction, or decide to sell out.

There is absolutely no question a businessman is entitled to a quick decision, and to know what the Government policy will be, and that it will be consistent. I fully agree with you.

Mr. SYNAR. I might even suggest the number of sponsors on the bill itself is a reflection of what I think has been an inappropriate amount of time to leave a very basic industry in a state of indecision for 9 years. It would be less than accepting our responsibility not to say it has been too long. Nine years is not a reasonable amount of time to wait for that type of direction. I think that a number of us who have joined with me supporting this legislation, though we disagree with you on the competition aspect, are even more disturbed by the fact of this lack of decision for such a long period. The FTC is a legitimate body, which I personally support and think there is a great need for in this Government. As you mentioned, it is critical that we give direction and we have understanding so that people can follow.

It's just beyond me that 9 years could pass in an industry, and there is a history in the last 9 years that has been very countercompetitive due to the indecision of the FTC.

Mr. WEISS. Could I comment on that, Mr. Chairman? It seems to me that we are now in a situation where the FTC has in fact acted, has ruled that the territorial franchise system which has been in effect for some 75 years is illegal, and that decision is now being appealed. And it seems to me this is exactly the wrong time for

Congress to get in the way, when in fact we are going to have a legal decision as to what the rights and wrongs are of that situation.

Now as far as competition is concerned, you know, one of the suggestions that was sort of implicit, although it's not set forth very strongly. is the plight of the so-called mom-and-pop small bottlers that are involved in this thing.

The fact is that perhaps competition extended 75 or 50 or 30 or 20 years ago, but today in fact it is the major, large bottlers, who are concentrating on the field and controlling it.

Mr. SYNAR. If I could ask one question.

Mr. MAZZOLI. The gentleman's time has expired, but he can ask permission for additional time.

Mr. SYNAR. I ask consent.

Mr. MAZZOLI. Without objection, the gentleman is recognized for 1 additional minute.

Mr. SYNAR. Let me just ask you one question, and I think its an interesting one. Here we have an industry that's been operating under a set of ground rules for 50 years, and the whole industry was built up under those guidelines. All of a sudden we are saying the rules are no longer going to be the same. I really think there is an injustice here. If you have educated, prepared, and sent an industry in a certain direction, and then all of a sudden we are changing the rules. There are some severe problems with that.

Mr. WEISS. Could I comment on that?

Mr. SYNAR. Sure.

Mr. WEISS. In the first place, if in fact the FTC ruling is correct, they have been in violation of the Sherman Antitrust Act for all of those years, and simply because they have acted in that manner for so long doesn't mean they were right in doing it.

Second, even with that violation, the fact is that the industry has shrunk from a high of somewhere around 7,000 production sites in the 1950's to 2,096 plants in 1978. Already the 21 largest Coke, 10 largest Pepsi, and 10 largest 7-Up bottlers serve respectively 58 percent, 45 percent, and 37 percent of the U.S. population. You don't have competition here that's been generated and saved because of their violation.

In fact, they have swallowed up most of the small bottlers in the process, and I think you'd probably restore some competition by eliminating the special privilege that now exists.

Mr. MAZZOLI. The gentleman's time has expired. The gentleman from Virginia is recognized for 5 minutes.

Mr. BUTLER. Thank you, Mr. Chairman. I appreciate the contribution of the gentlemen. I'm not going to pursue the question of whether it's time for Congress to act or not, but I hope you will understand when I don't pursue that point, it doesn't necessarily mean I'm in favor of it.

Mr. WEISS. I appreciate that.

Mr. BUTLER. If I understand H.R. 7128, which I have only looked at this morning, what it amounts to is a codification of what the Federal Trade Commission has done as far as what we're talking about today. Is that a fair statement?

Mr. WEISS. Yes; as far as I'm concerned, that's right. It's for good societal reasons, it's a tradeoff, and we in fact accept the premise of a waiver or an exemption for good and valid reasons.

Mr. BUTLER. All right. Now the problem I have is with regard to mandating use of the returnable bottle for in order to have franchised protection—that is if you use only the returnable bottle, then you are entitled to the exemption.

Mr. STARK. Mr. Butler, if I may address myself to that. It goes a step further. It would not prohibit the bottlers from using cans or paper cartons or anything they want, as long as they in effect buy them back. So the societal reasons Mr. Weiss addresses himself to is that—if it is more economical and more acceptable to the consumer to use an aluminum can, then the bottler buys it back for 2 or 3 cents——

Mr. BUTLER. You're making a distinction between a returnable bottle and a refundable bottle. Is it that refillable and refundable are now fungible legally? [Laughter.]

The problem I have with it is the bottler who does not want the exclusive franchise and who is still available to sell his product where he wishes—the nonrefundable, nonreturnable beverage container. And I'm asking you, much along the lines that I asked Mr. AuCoin earlier, doesn't this expose the franchised protected bottler to raiding by any bottler who doesn't care whether he has a franchise or not?

Mr. WEISS. No; because if I may, Mr. Butler, if in fact you have a bottler who is franchised in a particular area, he in fact has a returnable beverage container policy, then exclusivity continues, and no outsider who does not adhere to the same rules can come into his exclusive territory. That's the tradeoff that we're proposing in the bill.

He would in fact have the right to maintain and enforce the exclusive franchise area.

Mr. BUTLER. Your legislation says that you can't sell Coca-Cola in nonreturnable cans where a bottler who agrees to buy them back has the franchise?

Mr. WEISS. What we are saying is that currently, in fact, they've got the area divided up, and without any kind of societal benefit. What we say in our legislation is that if in return for the societal benefit of returnables, the returnable policy, that the franchiser could maintain his exclusivity, that's right, and that no outside raider who doesn't adhere to that same policy could come in and raid that area.

Mr. BUTLER. All right. Perhaps my perception of the industry is different. I thought an exclusive franchise was a limit on where you could sell, and a man who does not sign such a contract is not inhibited as to where he may sell.

Mr. WEISS. What kind of exclusive franchise do you have?

Mr. BUTLER. He has none. That's why he's a real threat to the guy who has one.

Mr. WEISS. But the protection runs to the bottler who has the exclusive franchise, and he would have the legal right to keep out anybody who does not adhere to the same societal policy, and if he did that, he would have no exclusive franchise himself.

Mr. STARK. Best of all worlds.

Mr. BUTLER. I think it's a dream world. I just don't think life is like that. You know, I don't think they even sell returnable bottles in your district, do they, Mr. Weiss? According to the trends set forth there in these statistics, you can't get a returnable bottle in your district.

Mr. WEISS. That's right, Mr. Butler. They do not. Hardly at all. And, of course, we have an awful lot of people who would be delighted to have the opportunity to return the containers. They've got no choice about it at all right now.

Mr. BUTLER. Obviously my time has expired, but my curiosity has not been satisfied.

Mr. MAZZOLI. Your curiosity has not abated even though your time has expired.

The gentleman from Ohio, Mr. Seiberling, is recognized for 5 minutes.

Mr. SEIBERLING. My first reaction upon hearing about your bill was that in substance it does the same thing as H.R. 3567, because it makes an exception to the antitrust laws unless certain conditions are applied. So, in effect, it gives an optional exemption to the antitrust laws as interpreted by the FTC.

Mr. WEISS. Mr. Seiberling, could I stop you there? As I read this, unless it's been amended or incorporates the Jeffords-AuCoin proposed amendment, as of now there is no tradeoff in H.R. 3567. It just simply grants the exemption, I think.

Mr. SEIBERLING. Well, that's true, but what I'm saying is that if someone wants to comply with the conditions in H.R. 7128, then he has what the FTC has ruled would be an exemption to the antitrust law. So to that extent, it overrules FTC.

Mr. WEISS. No, it would go along with FTC.

Mr. SEIBERLING. By saying you can have this exclusive territoriality provided you use returnable bottles.

Mr. WEISS. That's what the FTC says in its ruling.

Mr. SEIBERLING. That's true, but in effect, nevertheless, it creates an exemption by pushing, it creates a pro tanto exemption by pushing people in the direction of using exclusively returnable bottles.

However, I don't think it's a bad proposal because it gives them the option if they don't want to go to returnable bottles, then they don't have to. They give up exclusivity. So the consumer profits from the economy of scale on the one hand, and the consumer profits from the returnable containers which are, I think, demonstrably less costly, on the other hand.

I think, however, before we go this route, if we ever do, we ought to have some understanding as to what the implications would be. Would it really make a difference? Would it really enable the bottlers to survive, for example, if in truth they survive the perils of independent bottlers? Because the companies themselves, the syrup manufacturers that own their own distribution in certain areas, would be free to go ahead and sell nonreturnable containers in the territories of the bottlers, the independent bottlers, as I understand it. Unless they had an agreement, and they still retained the option of having that exclusive agreement with their franchisees or not. So I wonder what would be the implications if your bill is adopted in terms of whether it would really arrest the tendency of the syrup to take over areas or not. Can you comment on that?

Mr. WEISS. Only very briefly. There is no way of knowing whether in fact we would halt the concentration. The point I would like to make is that the concentration has been going on apace, and it simply is not accurate, I don't think, to say that it's this measure, that is the removal of the special franchising privilege or conditioning it on returnables that would accelerate the concentration. The concentration is there right now.

But the other point, I think there may still be some confusion about, and I suspect I haven't answered the question that Mr. Butler raised or the one you just alluded to clearly enough; and that is whether somebody who chose not to provide the returnables in return for the exclusive franchise could come into the area of someone who did make that kind of commitment, and therefore have an exclusive.

Again, it is the intention of our bill, and I think the language reflects that, that once you have a franchised bottler who makes the commitment that he will have returnables, nobody could come into his particular area, because he's got exclusivity.

Mr. MAZZOLI. The gentleman's time has expired.

Mr. SEIBERLING. I ask unanimous consent to proceed for 1 additional minute.

Mr. MAZZOLI. The gentleman has permission.

Mr. SEIBERLING. H.R. 3567 would mandate exclusivity, it seems to me, whereas your proposal would leave it open as to whether the sirup manufacturer wanted to grant exclusive franchises or not. He still might decide that he's going to make more money by selling it to the big mass distributors on a nonexclusive basis, or selling it himself, having his own distribution system. I think it is unclear as to which way to go or what the long-term effects would be. All this would certainly give an edge to the existing small bottlers, as long as they have the franchise agreement.

Mr. STARK. I think you could make a case either way, John. You can look at the breweries that don't sell sirup, who in fact produce in ever-greater concentration and distribute to their own distributors.

There isn't really much to making the soda pop. The expensive part is in the distribution equipment, storage equipment, and the vending and installations. That is the real capital investment. Mixing the water and the sirup together is not a big item in terms of where it is done, but the final line, no matter what happens, whether it is more bottlers or fewer bottlers, the social good would be in effect that we are paying or putting in place as best we can—and this may not even work—a system of cleaning up the litter, or trying to save energy through recycling and placing the cost where it ought to be.

So I favor that particular objective.

Mr. MAZZOLI. The gentleman's time again has expired. The gentleman from Virginia seeks recognition for 1 minute.

Mr. BUTLER. I would just ask the witnesses to consider that there are those of us who are having difficultry understanding how you are going to police exclusive franchises where there is a possibility of invasion.

My time is limited, but what I want you to reflect upon, consider, that maybe you ought to consider making the availability of territorial franchise antitrust exemption contingent upon an industrywide standard, whatever it is, 10 percent, 20 percent, whatever. You could take all of them, which I think would be quite a big step. But I would like for you to consider and for the record later tell us, based on your experience as a bottle washer——

Mr. STARK. If I may respond very quickly, Mr. Butler, as an old bottle washer, the exclusivity would be protected by the sirup manufacturer. If you had the State of Virginia as an exclusive franchise and I was the Coca-Cola sirup maker, and you were having only returnable, not heavy bottles and plastic and everything else, that you would pay to get back, then I would say to you, I'm not going to sell sirup to Mr. Weiss' New York company if he comes in your territory.

So I'll protect, as the sirup manufacturer, under an exemption from the antitrust law, your right to your exclusive territory, because you and I have an exclusive franchise agreement. It wouldn't be enforced by the Government, it would be enforced by the industry, as it is now.

Mr. BUTLER. I thank the gentleman. I misinterpreted the predatory nature of the sirup manufacturer. [Laughter.]

Mr. MAZZOLI. The gentleman's time has expired. Counsel has a question.

Mr. NELLIS. Gentlemen, I wonder if either or both of you have given any thought or examined any information with reference to the question whether or not your bill, H.R. 7128, or the bill that is presently before the subcommittee would increase pressure on inflation. Would we have a situation in price discrimination, for example, which would increase the price of the ultimate product to the consumer?

Mr. STARK. Joe, I don't think so. I think it was merely transfer costs. These costs are currently being borne by society, by the community at large, it's the cost of cleaning up litter. Our bill estimates it would save 80,000 barrels of oil a day, in higher energy costs, caused by not recycling or reusing containers.

So these costs, in the aggregate economy, are there now. It's just a question of who is going to transfer them, either away from a city trash collection and back to the consumer of the beverage, or the manufacturer, where it should properly be borne.

Mr. NELLIS. If the total proportion of refillable bottles is reduced, you have constant increases in the costs of aluminum, steel, and other raw materials, which are passed on.

Mr. STARK. Those would be returned. It's highly recyclable, so if it's collected——

Mr. NELLIS. A year ago, but not under the bill the subcommittee has. Is that not correct?

Mr. STARK. That's correct.

Mr. NELLIS. Mr. Weiss, do you have any thoughts on that?

Mr. WEISS. No, I think that's been expressed quite well. I think perhaps you could even make an argument that ultimately the cost might be reduced and there would be a negative effect on inflation that if people in fact are saving, some of the saving would be passed on to the consumer.

Mr. NELLIS. Thank you.

Mr. SEIBERLING. Mr. Chairman, I'd like to ask unanimous consent to ask a couple of questions.

Mr. MAZZOLI. If the gentleman will hold just a moment, counsel has asked for time, and then we'll go back.

The gentleman is recognized.

Mr. POLK. Thank you, Mr. Chairman. I'm not sure that my reading of H.R. 7128 produces the same result as your interpretation. I don't see that the bill accords a protection against transshipment for such a bottler who would conform to the standards, but I assume that language could be drafted to accomplish that. So for purposes of this, I would assume that that has been done. And let me just raise the distinction between the FTC standard and your bill.

You indicated the bill would codify the FTC decision. However, as I see it, under the FTC decision, if a bottler voluntarily inaugurates a policy of 100 percent refundables, he would not be protected against transshipment from another bottler who, say, was selling cans all over the country. Under the FTC decision——

Mr. WEISS. I'm not sure that that is spelled out.

Mr. POLK. I take it that under your bill you wish to protect bottlers from such transactions?

Mr. WEISS. That's right. It is our intention, but I'm not sure that the FTC decision really says anything on it either way, and I'm not sure whether in fact it would not be implicit in your decision.

Mr. MAZZOLI. The gentleman from Missouri wishes recognition. The chairman recognizes Mr. Volkmer.

Mr. VOLKMER. I won't take a full 5 minutes. I'd like to ask the gentleman from New York a question. As a former member of the city council of the city of New York, and a longstanding resident of the city of New York, you indicated in your testimony here earlier when we had this bill up before, the city of New York has no returnable bottles. Is that right?

Mr. WEISS. That's right.

Mr. VOLKMER. Has the city council ever done anything about it?

Mr. WEISS. Well, you know, we tried. I was the cosponsor with a number of other members of the city of council of legislation to mandate returnables in the city of New York, based on the Oregon legislation, and as I indicated in my earlier testimony, the effectiveness of the same people who are responsible for being able to encourage 310 Members to sign onto the legislation before you was also evident in the city of New York.

Mr. VOLKMER. You don't believe the people of the city of New York would be willing to carry returnables up flights of steps and back down to the local stores?

Mr. WEISS. You know, the interesting thing, I answered very quickly to your question that there are, practically speaking, no returnables, and practically speaking, that is true. But there are still some small bottling companies, primarily those who are involved in the delivery of seltzer—I don't know if you have seen those quart seltzer bottles, but it is still an industry in the city of New York, and those same people also distribute and bottle soda, basically in the larger bottles. And in those instances those are returnables, but the seltzer cases, as well as the soda bottles, and the drivers and deliverers on those trucks go up the stairs or take the elevator or whatever and people give them a great deal of trade.

You know, it used to be, and we're getting to the same point in our economy, when kids used to walk through the streets and along the beaches of the city, making their pocket money for the week on the basis of returnables.

It's not that they don't want to do it. They're not given the option of doing it, for the most part.

Mr. VOLKMER. You don't believe, then, that the people of the city of New York, the majority of the people of the city of New York, want returnables?

Mr. WEISS. Well, it is hard to tell what the majority want but it's my sense of it that the statistics would seem to indicate that in the rural, nonurban part of the country, something like 40 percent of the soda business is still in returnables, and it is my suspicion that the urban population is no less intent on taking advantage of the returnables than the people in the rural or nonurban areas.

Mr. VOLKMER. Thank you very much.

Mr. MAZZOLI. The gentleman's time has expired. The gentleman from Ohio is recognized.

Mr. SEIBERLING. Thank you. Just a comment on the remarks by the gentleman from Missouri. The returnables could be aluminum cans, so rather than carrying a heavy box—the problem of carrying heavy bottles would still be handled, so if they returned it they'd get a nickel or more back on the can.

On further reflection, to go back to the previous colloquy that we had, I don't think there would be any difference between H.R. 3567 and H.R. 7128 in terms of the incentive to the sirup manufacturer to give exclusive rights, because I don't really see any significant difference, and if there is, I hope somebody in the audience will provide us with the information.

So, in effect, what you are doing is saying that you're going to permit exclusivity, which you don't like; but in return for an additional social good, namely controlling wasting of materials and litter, which I think is an important social good. It might be a workable solution and counsel advised me that as the condition to an exemption to the antitrust laws it could be within the jurisdiction of the committee. Your bill has been jointly referred to the Commerce and Judiciary Committee, I am told.

I think it is a very worthwhile alternative that you have suggested, one that we ought to consider. And the more I learn about this, the more I feel we need to do something.

The small bottlers, as I understand it, don't want a requirement of returnables. I don't know whether they would accept it as a condition to maintaining exclusive territories. I have asked some of them whether they would accept a requirement of solely using returnables containers and they have said no. Have you discussed this with the bottlers to get their reaction?

Mr. STARK. No. There would be several reasons. There are two reasons they wouldn't want it, if they are thinking of returnables as heavy glass which would require bottle washing machines. There could be some real reason such as the investment in new equipment to handle returnables of that type.

The bottles would have to be washed and resterilized. The reusables could be too expensive for the small bottler.

On the other hand, if they are also thinking in terms of recyclables, the only objection a small bottler could have is the investment. It comes as an investment—there is a float, if you will, in the banker's terms. There are cans and bottles out there that represent a liability to the bottlers, some of which may never come back, but some of which may, and they have to set up some kind of reserve that, lest they all get turned in one day, and the small bottler doesn't have the funds to pick it up. There is some question of his having to pay—there used to be bottling exchanges—his paying the driver or retailer 2 or 4 cents for somebody else's aluminum can. So there are some problems there that the industry is going to have to deal with, and I am not unaware of those, but that's a cost that's transmitted from an industry that ought to pay it, rather than people who have to pick up the trash, or excess energy consumption, which all of us have to pay.

Mr. SEIBERLING. But you agree that returnables are an economic gain to the consumer and society?

Mr. STARK. To the consumer, maybe a little more, but that may keep the consumer from pitching it out the window on the side of the highway.

Mr. SEIBERLING. Bottlers had some studies made that indicate that returnables actually result in lower costs to the consumer, and that offsets the economies of scale that would be gained if you didn't have exclusivity. So it seems to me that argument would tend to support your proposal.

Mr. MAZZOLI. The gentleman from Missouri.

Mr. VOLKMER. I didn't use up all my time. I'd like to ask a question. If we say returnables for the soft drinks, what about returnables for others? Beer, wine, things like that?

Mr. STARK. As far as this gentleman is concerned, I would support that. Anyway, we can recycle——

Mr. VOLKMER. It would seem logical to me.

Mr. STARK. Absolutely. I might point out, as the gentleman is probably aware, in many other nations, they are still delivering beer, for instance, in Germany in returnable bottles from the local brewery, just like the milkman used to deliver milk in returnable bottles. I have no quarrel with that. Sometimes you change a nation's habits and how they consume, and I think we would all agree that we have to turn away from this disposable binge that we are on, where everything is in disposable plastic, because we don't have the energy resources to constantly manufacture and clean up after ourselves. So, yes, philosophically I'd agree.

Mr. MAZZOLI. The gentleman's time has finally expired, and gentlemen, we thank you very much for your help today, and I'd like to call forward the gentleman from Vermont, Mr. Jeffords, about whom much was stated in his absence earlier this morning.

Jim is a cosponsor of the bill H.R. 3567, and also a co-sponsor of H.R. 2812, our national deposit bill. I might say certainly your statement will be made a part of the record, Congressman. Before you arrived today, Congressman AuCoin spoke at length about the bills, so you may want to summarize your statement.

[The statement follows:]

PREPARED STATEMENT OF HON. JAMES M. JEFFORDS

Mr. Chairman and members of the subcommittee, I am addressing you today as a supporter of the legislation before you, H.R. 3567 and H.R. 3573. I support these proposals primarily because they would help protect the refillable bottle. However, I am concerned that the bills, as presently written, do not go far enough to insure that the returnable bottle remains a viable alternative on the market shelves. I am concerned that the consumers and the general public will get the short-end of the deal if this legislation is passed as presently written.

As the sponsor of national deposit legislation, I am very supportive of the extent Representatives Weiss and Stark's bill goes to insure that the returnable bottle does in fact remain available. Their bill, as you know, would require that all soft drink containers be returned if the antitrust exemption is to be granted. I sincerely hope that the subcommittee members will give their bill every consideration should it come before them at some future date. At this time, however, Mr. AuCoin and I are offering a more modest, graduated proposal which will believe would greatly strengthen the intent of the legislation being considered today.

If Congress is to go outside the antitrust laws and grant special consideration to the soft drink industry, there must be a strong reason for the exemption. The Report to the President of the National Commission for the Review of Anti-Trust Laws and Procedures, of which Chairman Rodino, Mr. McClory and Mr. Seiberling were members, recommendations were made as to when anti-trust exemptions should be made. The Commission concluded that exemptions from the general principle of anti-trust laws should be made only when there is "compelling evidence of the unworkability of competition or a clearly paramount social purpose."

In keeping with the Commission's conclusion, we propose that if Congress is to grant the Soft Drink industry an exemption, then the local franchises should be required to meet minimum requirements in their sales of beverages in returnable bottles. Such an additional requirement would ensure fair competition through the availability of the returnable bottle. In addition, a "clearly paramount social purpose" would be realized through reduced costs to the consumer, as well as substantial energy and environmental savings for society as a whole.

It is our recommendation that within 1 year of passage of this bill, 10 percent of each franchise's beverage containers must be made available in returnable bottles. Within 2 years after passage, this percentage must be increased to 20 percent, and within 3 years, 35 percent of all soft drinks must be packaged in returnable bottles.

Mr. Chairman, these requirements will not place an undue hardship on the soft drink industry. As I will explain in more detail below, the latest printed figures given by the National Soft Drink Association quote a national average for returnable containers to be 37.8 percent; we are only asking for 10 percent from each franchise holder. There would not be that many plants affected by this proposal within the first year. Pepsi Cola, for example, which presently holds approximately 25 percent of the soft drink market, would only have to make conversions in 34 of its 426 plants. And further, our proposal would only become obligatory if the local bottler wanted to retain the privilege of having exclusive territorial rights. If he requests an exemption from the anti-trust laws, then it is not unfair to ask his assistance in alleviating a national problem, by meeting minimum requirements to ensure the availability of the less expensive returnable bottle.

As the sponsor of national deposit legislation, I am very familiar with the benefits to be gained through a returnable system. Countless studies have been done to determine the effects a national deposit system on all beer and soda containers would have on consumer savings, the environment and on our nation's energy needs.

Concerning consumer savings, the results of price surveys are summarized in the Environmental Protection Agency's Fourth Report. The report concludes that savings are often in the range of 3 to 8 cents per 12 ounce of beverage in refillable containers. This is equivalent to a price difference of about 10 to 30 percent. In Vermont, consumers who choose to purchase their beer and soft drinks in returnable bottles save approximately $80 per year.

A 1978 report by the Office of Technological Assessment summarized the findings of seven major Federal studies on beverage container deposit legislation. It concluded that "*every* study has found that beverage delivery system energy use would *decrease* under a deposit system," with average projected net savings of the energy equivalent of 80,000 barrels of oil per day. Further, those states which already have a deposit law in effect, (Vermont, Oregon, Maine, Michigan, Iowa and Connecticut) are all experiencing drastic reductions in roadside litter. Within each of these States, the return rate for beverage containers averages 95 percent. That's an appreciably cleaner State not only for the residents to enjoy, but also for the State's maintenance crew. In my home State of Vermont, we paid $88.96 per mile for litter clean-up in fiscal year 1972-73, the year before the law went into effect. In fiscal year 1978-79, however, the State paid only $38.84 per mile, despite the rather substantial inflation which had occurred. As would be expected, the man-hours required for litter clean-up were reduced in these same years from 57,439 to 32,550, even though there were an additional 140 miles of roadside to patrol. In this day of skyrocketing energy prices and budgetary constraints, the returnable system has afforded Vermont and the other States having deposit legislation with a viable means to conserve on both precious oil and dollars. I might also add that a national survey conducted for the Federal Energy Administration in February of 1975 concluded that 73 percent of those surveyed would favor a national deposit law.

Mr. Chairman, I could document numerous other gains to be realized through the implementation of a national deposit system. I have countless reports in my office that I would be more than pleased to share with you. As I said earlier, I have been dedicated to this subject for many years now. As such, I feel that I am very informed on the issue.

You have already heard from numerous witnesses in the soft drink industry who are well-known proponents of the legislation. In addition to arguing that the legislation is necessary to protect the small businessmen, they also contend that it will protect the refillable bottle, and thus promote consumer choice. For example, Mr. J. Lucian Smith, a past president of Cola-Cola and a present member of the Board of Directors and consultant to the company, made this point when he addressed you on March 19th, 1980. In his written testimony, he stated, ". . . exclusive territorial arrangements for all types of containers are essential to preserving bottler interest in using refillable containers." (Page 6.)

Similarly, Mr. Sydney P. Mudd, the past president and present Chairman of the National Soft Drink Association's Special Franchise Committee, as well as a 7-Up soft drink bottler, also addressed this subject when testifying before you on October 24th of last year. "The territorial system has enabled the industry to be broadly responsive to consumer desires for different kinds of containers. Thus, local bottlers respond the the demand for returnable containers, convenience containers, single-service and large economy-size containers." (Page 4.)

Our colleague, Mr. Luken, also addressed the importance of preserving the returnable bottle from an environmental standpoint when he testified before the Subcommittee on March 19th. As a cosponsor of H.R. 3573, he spoke of its superiority to H.R. 3567 in that "H.R. 3573 places greater emphasis on the need for the legislation to protect the environment, to avoid unnecessary energy consumption and to make possible the continued availability of soft drink products in the lowest cost package form—the returnable bottle." (Page 1.)

Both Mr. Smith and Mr. Mudd have cited the value and importance of preserving the consumer's option to purchase soft drinks in returnable bottles. But I suggest to you Mr. Chairman, that this option will soon be gone if the legislation before you is passed as presently written. Back in 1947, 100 percent of the soft drinks manufactured were sold in returnable bottles. (Report to Congress by the Comptroller General on "Potential Effects of a National Mandatory Deposit on Beverage Containers.") In 1978, using the National Soft Drink Association's figures from their latest annual report, refillables nationwide comprised 37.8 percent of the industry's market as compared to 44 percent in 1976. Within the northeastern region, which includes my home State of Vermont as well as New York, Delaware, Pennsylvania, the District of Columbia, Maryland, and the other New England States, returnable bottles comprised only 10.2 percent of the market in 1978. In 1976, this same percentage for the northeastern region was 23 percent. Thus, in just two years, there was a reduction by more than 50 percent. In fact, in some areas, returnable bottles already comprise less than 1 percent of the market. I believe that consumer choice has already been denied in these areas as "substantial and effective" competition has already been precluded.

Mr. Chairman, I would like to reemphasize the point that soft drinks purchases in returnable bottles offer the consumer substantial savings by again quoting from one of the witnesses in the soft drink industry. An excerpt from Mr. Smith's testimony demonstrates this fact most dramatically. "At the beginning of my testimony, I cited the most persuasive evidence of the success of the special kind of interbrand competition fostered by the system of exclusive territories: the fact that today the American consumer can purchase Coca-Cola in returnable containers at about the same price it was available 80 years ago."

I would like to develop this point by drawing upon some of the conclusions reached in several studies done by Franklin Associates, Ltd., which were submitted to you by the Central Investment Corporation. The studies project that if the FTC ruling is upheld, the returnable bottle will have disappeared from the marketplace by 1982. The studies concluded that by comparing the prices of the 12-ounce can with the 16-ounce bottle, the can system costs up to 103 percent more per fluid ounce than the refillable bottle system. This significant difference in cost is mainly due to packaging, which can be 9 times higher than in the can system per ounce of beverage.

Protecting the refillable bottle is not only important for the consumer, but will also provide major energy and environmental benefits. I would like again to draw on some of the conclusions reached by the Franklin Associates' studies. Assuming that the returnable bottle will disappear by 1982 if no protective clause is written into the proposed legislation, consider some of the other consequences we will have to face.

Energy consumption in the soft drink industry can be expected to increase per year by the equivalencies of: (1) Electricity for a city of 100,000 people for 69 years; (2) gas to heat 100,000 midwestern homes for 4.9 years; (3) 129 million gallons of gasoline; and (4) a coal train 686 miles long.

The impact of the present language of the legislation would have on environmental concerns is equally disconcerting. Consider if you will, the following percentage increases if the returable bottle disappears. The Franklin Associates' studies warn that by 1982, air pollution in the soft drink industry will have increased by 37.6 percent, water pollution will have increased by 28.7 percent and solid waste will have increased by 34.8 percent.

Mr. Chairman, I have listed numerous costs to be incurred should the returnable system disappear from the marketplace. And likewise, I have listed numerous benefits to be gained if it remains. In this day of skyrocketing energy prices and dwindling natural resources, the savings afforded through a returnable system should be maximized to the greatest extent possible. Congress cannot responsibly grant the soft drink industry an antitrust exemption without a purpose. The benefits to be gained by requiring a certain percentage of beverages to be sold in returnable containers would provide such a purpose. Consumers would be guaranteed the freedom to choose which kind of beverage container they desired, and society as a whole would be afforded a cleaner, more environmentally sound country in which to live.

Mr. Chairman, I hope you and the subcommittee members will give careful consideration to the recommendation Mr. AuCoin and I have made. If the soft drink industry sincerely believes that there presently is "substantial and effective" competition; and if the soft drink industry sincerely believes that the loss of their exclusive territorial rights will jeopardize this fair competition through the loss of the returnable bottle, then let's assure the industry that we in Congress will do all we can to insure that their fair competitive practices are not lost. Let's write into the proposed legislation a clause which will protect the returnable bottle as an option for the consumer. If the industry is sincere in its support of preserving the returnable bottle, then we would expect them to heartily support our recommendation.

Mr. Chairman, we will be more than pleased to work with you and your staff in the drafting or our recommendation.

Thank you, Mr. Chairman, for the opportunity to appear before you today.

TESTIMONY OF HON. JAMES M. JEFFORDS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VERMONT

Mr. JEFFORDS. I hope I can help the committee with some of your questions. I come from a State that has faced many of the problems which you were just recently disscusing. We have a deposit law covering all beverage containers in our State, and it has worked extremely well. It's very popular with the people. There's about a 95-percent acceptability among our public now for the law, and it is hard for those of us who have been involved with deposit legislation like Congressman AuCoin and myself, to understand why we don't do it nationwide. And certainly I am sympathetic with the proposal that Mr. Stark and Mr. Weiss have introduced.

On the other hand, Mr. Aucoin and I are proposing what we think is a more moderate, perhaps more acceptable situation, than Mr. Stark and Mr. Weiss proposed. As much as I would like to see theirs adopted, I don't think it would be realistic to go quite that far at this time.

Just to focus attention on the issue which Mr. Seiberling was addressing, and one many have been concerned with, the question of acceptance. The soft drink industry in our State has been very acceptable to the returnable system, perhaps a lot more so than the beer distributors. But more importantly, the public's acceptance is almost totally in favor of deposit legislation.

But let me read from a report which I filed along with Donald Webster, the head of our environmental protection division, which has the administration of our law. Though it was written in 1977, it will give you an idea of what we found in Vermont with respect to soft drink distributors.

A few soda distributors have been remarkably candid in discussing the economics of refillables. One distributor says his gross profit with refillables is now 53 percent compared to an historic gross profit of about 18 percent with nonreturnable bottles and cans before the deposit law went into effect. Much of the additional gross has been invested in new bottling equipment and other capital costs, but it is clear that the firm has profited by working with rather than against, the set of economic incentives inherent in the deposit law.

These savings are also seen when comparing our soft drink prices with those of our adjoining State, New Hampshire. Traditionally, New Hampshire has had lower prices for various reasons, even before our law went into effect. We find on an average today, however, Vermonters are paying an average of 5 cents a quart less for soft drinks, even with the returnable bottle law.

As it has been pointed out, returnables, when available and used, do present an overall savings to the consumer the soft drink industry, the public. We have seen that in our State.

So some of the concerns that have been expressed about consumer costs really are not appropriate. That is one reason why the soft drink people having franchises have argued in favor of returnables. With a franchise system, the bottler is able to offer returnables, and thus increases his gross profits.

So I think that any concern that one might have about say forcing a returnable bottle on a franchiser is probably not going to be disagreed with by the distributor, because the returnables will increase his profits.

So if the bottler has a franchise and has a returnable bottle system, then there should be a net savings to both the bottler and the consumer.

Just briefly, Vermont's experience has been totally acceptable all across the board, even in regards to beer. We find that with refillables, you can buy beer cheaper in Vermont now than you could before the law. The difference in our cost between our neighboring States has been reduced by having the refillable option available. We are not talking about beer here, but I just wanted to let you know that in those States having a 100-percent returnable situation, it's been very positive. I see no reason, therefore, with the very moderate approach we have taken, more moderate than the FTC ruling. Our proposal will not be a detriment to the distributors. It will enhance the total social goals which we have of reducing litter, reducing energy, reducing costs to the consumer, and in essence, an overall goal of providing more jobs.

Mr. MAZZOLI. Thank you very much, Jim. I just have one question. You mentioned the experience in Vermont has been very positive. Has that been displayed in polls and samples of reaction from people? Just from being in the area across the river in Alexandria, in that part where they have a deposit type of system, there is rather a split opinion, to say the very least, and I wondered if you have ascertained that as empirically as you could.

Mr. JEFFORDS. Yes, through our questionnaire, we asked if they would like to see the Vermont law made a national law. Over 90 percent of those who responded said yes. Similar support was expressed in the Maine experience. Their referendum originally passed by a relatively low percentage; the vote to repeal the law, however, was knocked down overwhelming. I haven't been able to confirm it this morning, a recent poll taken in Michigan indicated the acceptance there now is greater than when first passed. This is so despite some serious problems they are having with pricing. The price hikes are currently under investigation by a grand jury to discern if there is collusion among the beer companies.

So, in the areas that have deposit legislation the response has been overwhelming. The same was true in Oregon, and I expect the same will be true in Iowa, Connecticut, as well as the other States that have gone to a total returnable program.

Mr. MAZZOLI. Is there something wrong with the people who live in Virginia, do you think?

Mr. JEFFORDS. No, I don't think so. I think there are explanations which may cause more friction in an area which is surrounded by a dense population, a factor we may not face in our State. There may be some inconvenience in Virginia of having to return empties to the same store where you buy the beverages, whereas in Vermont you are more apt to go back to the same store. In the Virginia area you may be at one shopping center one day, because of a sale, and you may be at a shopping center in a different county the next day because of a different sale. It's much harder to have a cohesive system in this kind of a situation. This is what I think leads to the friction.

In our State, you can return empties at any store that's available.

Mr. MAZZOLI. Well, I certainly thank you. The gentleman from Virginia is recognized for 5 minutes.

Mr. BUTLER. Well, I thank the gentleman for his testimony. I understand that you are in favor of the AuCoin proposal. He thought it was 20 percent in his original testimony. Now it's a sliding scale, a progressive scale or something, and that's also your proposal, too, I understand.

Mr. JEFFORDS. That is correct. We end up at a percentage which is below the national average at present, so it shouldn't cause any real serious burdens upon a distributor. We don't want to try and get a percentage which is higher than apparent public acceptance, or even a national average, even though the public acceptance in some areas is much greater.

But our attempt is not to cause any serious disruptions in the present shares or in the business operations of a distributor. Rather our attempt is to reach a national goal for which I have cited figures.

Mr. BUTLER. I thank you, and I appreciate the explanation of how you arrived at those figures. Now, tell me, the gentleman from California, Mr. Stark, made a distinction between returnable bottles and refundable bottles. What do they do in Vermont? Do they require it to be refillable bottles, or do they have just an obligation to purchase the container?

Mr. JEFFORDS. In Vermont, all beverage containers must have a deposit. All beer and soda cans and bottles carry a deposit even a one-way throw-away bottle. All are put on a par on that basis, whether they're cans, plastic, nonreturnable bottles, or whatever.

Mr. BUTLER. And is that Oregon's experience, too, or do you know?

Mr. JEFFORDS. Oregon has a different situation, to some extent. In a sense they give an additional incentive to certain bottles, as they have a two-tiered system. If you have a refillable bottle which meets their State standards, then your deposit is only 2 cents versus a minimum of a 5-cent deposit on containers which do not meet their refillable bottle standards. Vermont has just one standard.

Mr. BUTLER. The problem I had with your proposal is that you're granted an exclusive territory by meeting the conditions, and it exposes you as owner of that franchise to possible raiding by an adjoining bottler who does not choose to meet your standard and take the risk of not having an exclusive franchise, but uses that platform or that neighboring base to invade your territory and skim off the cream. He will take unfair advantages of his neighbor, the guy who's pledged himself to returnables to gain an exclusive franchise.

Mr. JEFFORDS. I don't think that our proposal poses those disadvantages. Again, we are not prohibiting the use of cans or plastics or whatever as an alternative. We're just saying that if you have bottles, a certain percentage must be returnable.

If you look at the national trend now on throwaways, you'll find that it's declining. Even though some other alternatives are coming in, we do not want to disrupt the ability of that franchise holder to provide the choice in cans or any other containers. We are proposing that at least a certain percentage of their product be available in returnable bottles. We are not saying that you cannot have a franchise to sell cans. Yes, you can have a franchise to sell cans, but you have to have a certain percentage of your product also being sold in returnable bottles.

Mr. BUTLER. One more question along the lines that I addressed to all the other witnesses. Basically, wouldn't it be wiser, if we go on to have a returnable, refillable, or refundable standard, to make it an industrywide or productwide antitrust exemption contingent upon all bottlers meeting whatever standard we choose, rather than granting or denying it to the individual franchisee.

Mr. JEFFORDS. Well, my initial gut reaction to that would be yes, but I found that in this body I can't always get everything that I'd like, and I have to accept what is available. Though I'd have to examine that, I haven't really looked at it from the perspective totally of an antitrust exemption. Certainly though anything that moves in this direction would seem to me to meet the national goals to which I think the country ought to move in this area.

Mr. BUTLER. Thank you very much.

Mr. MAZZOLI. The gentleman't time has expired. The gentleman from Ohio is recognized for 5 minutes.

Mr. SEIBERLING. Thank you. Well, I take it, Mr. Jeffords, that you agree with the Franklin Associates study that indicates that it costs less to supply these drinks in returnables than in nonreturnables?

Mr. JEFFORDS. Yes, not only that study, but to my knowledge, every study that has gone into this particular subject has demonstrated this. In fact, the soft drink industry itself on several occasions has testified to this, that it is less expensive for them to provide soft drinks in refillable bottles than it is in nonreturnable bottles, or cans.

Mr. SEIBERLING. OK. Now I think your approach is a good one to phase in, because if you required it at the outset, you would find probably a lot of people saying they couldn't do it, and therefore you'd end up in knocking out the ability to retain exclusive franchise privileges. But I'm wondering why you stopped at 35 percent, in view of the important social benefits you foresee.

Vermont has 100 percent; right?

Mr. JEFFORDS. That is correct.

Mr. SEIBERLING. If you want to have that exclusive franchise?

Mr. JEFFORDS. The difference is, there can be the problem of raiding. Wholesalers or retailers could purchase from outside the franchise area, and then come in and act as distributors.

For instance, if you required 100-percent refillable bottles, there'd certainly be a social goal met. But it wouldn't be met if the public wants cans. Presently, market shares indicate that 40 or 50 percent of the public do in fact wants cans. So if you were to prevent the franchise holder——

Mr. SEIBERLING. They'd still return the can.

Mr. JEFFORDS. Beg your pardon?

Mr. SEIBERLING. They'd still return the can.

Mr. JEFFORDS. For deposit?

Mr. SEIBERLING. Yes.

Mr. JEFFORDS. But if you don't have a requirement on a nonfranchise holder, whoever is wholesaling could purchase from someone else because he is not bound by restrictions.

Now if it were general enough so that you will also require this of nonfranchise holders, then certainly there would be a lot of merit to that.

Mr. SEIBERLING. Well, I think the exclusive franchise means nothing unless the franchisor has put limits on other customers in terms of going into that territory. How is it enforced now?

Mr. JEFFORDS. Well, I'm sure that might be true if he's a Coca-Cola franchise holder, but if the desire of the public is to purchase cola in cans then you might get some other cola brand in. I don't know whether that would present a serious problem or not.

Mr. SEIBERLING. Well, the distributor can also obtain that other cola, presumably, but he would still have a brand to fight the competition with. The end result may be more "X" brands sold and less Coca-Cola, for example. And I guess that in itself is a limitation on your proposal as well as the Stark proposal.

Mr. JEFFORDS. I believe it is. Our proposal involves somewhat of a different area than I'm used to dealing with, so I'm less than knowledgeable on what would happen in market shares if you get into the franchised and nonfranchised competition. I'm more familiar with the implications of a 100-percent returnable system.

Mr. SEIBERLING. But, of course, that problem exists today. It seems to me, even if the FTC decision is wiped out, then you still have exclusivity, there's still going to be nonname brands competing with the name brands.

Mr. JEFFORDS. That is correct, but certainly in our situation we would be requiring that refillables be made available on an increasing basis to the consumer. The option to purchase the cheaper refillable bottle would be an advantage to the consumer.

Mr. SEIBERLING. So your 35-percent limitation is to give the purchaser and the bottler some flexibility in nonreturnables?

Mr. JEFFORDS. Or other containers, yes.

Mr. SEIBERLING. I have trouble creating an exemption from the antitrust laws as interpreted by FTC, if we are only in effect preserving the status quo on returnables versus nonreturnables, and that's all you're doing here.

Mr. JEFFORDS. In a sense, but if you take a look at the national distribution of container shares, our proposal would significantly increase the number of refillables in certain areas.

Mr. SEIBERLING. Thank you.

Mr. MAZZOLI. The gentleman's time has expired. The gentleman from Illinois, Mr. McClory, is recognized for 5 minutes.

Mr. MCCLORY. Thank you, Mr. Chairman. I want to compliment the gentleman on his testimony and on his initiative, and particularly on the initiative in which Mr. AuCoin joined, which is directed toward a resolution of the whole controversy regarding territorial exclusivity in the small bottler business.

You conclude your statement by saying as follows:

"If the industry is sincere in its support of preserving the returnable bottle, then I would expect them to heartily support my recommendations."

Do you have any contact or do you have any reaction from the industry with regard to their attitude toward the amendment that you and Mr. AuCoin are recommending?

Mr. JEFFORDS. To be honest with you, I have not, and that has just been due to the exigencies of time. I just know from my own Vermont experience, which I testified to earlier, that the experience they have had under a total refundable situation has been very positive, with an increase of their gross profits in some cases from 18 to 53 percent, thus providing a substantial benefit to both the consumer and the distributor. Documentation of this is a problem because of the very emotional nature of the issue. Whether or not they would be able to give us a candid feeling, or whether it would be based upon a rather structured opposition to any interference in this area is difficult to say. I would expect the industry to answer that we want our franchises, and nothing else. To date, that's been the sort of line that has been taken.

I would be willing to speculate, however, that if you were able to talk to individual franchise holders who held no fear of reprisal, that you'd find many agreeing with us.

Mr. MCCLORY. It's your expectation that they would agree with your amendment, that indeed not only the public would be greatly benefited, but that they would be benefited as well?

Mr. JEFFORDS. Yes, at least from the Vermont experience. That is why our proposal is to a phase in. We do not want to go above the national average for beverages sold in returnables. We want to ensure that our proposal will benefit the industry as well as the general public. We do not want it to be a detriment. In Vermont, the experience has been most helpful.

Mr. McCLORY. Well, I thank the gentleman.

Mr. MAZZOLI. Will the gentleman yield his time? I was just thinking of a question that I haven't asked, and maybe it was asked and I wasn't paying absolutely close attention.

Jim, what happens if the people just don't want returnables, and maybe the experience is not like, for instance, in Vermont, where they've willingly gone into this, and they have found that there is something utilitarian in these returnables, but they just simply don't want them? What happens to the manufacturer of the bottle who has his 20 percent gathering dust, or 35 percent? How does he handle the situation?

Mr. JEFFORDS. That is another advantage, of course, of the phase-in situation. We would be able to review it on an ongoing time basis without a flat requirement. If the increased savings to the consumer do not entice him to purchase more in refillable bottles, then they might have to give some consideration to modifying the proposal.

But certainly my experience, has lead me to believe that that would not be the case. If the people are given the choice, they will accept it. If you take into consideration the area where they have the least percentage of refillables available, that is the area where the greatest impetus should be spent right now to modify the law to require all refundable bottles. This is the case, for instance, in the Northeast. Most of the deposit legislation action in recent years has been in the Northeast—Maine, Vermont, Massachusetts, and Rhode Island. They've had some problems with vetos in Massachusetts as well as in Rhode Island. Rhode Island has passed the deposit legislation in the House; it's now awaiting Senate action.

The strongest interest in deposit legislation has been in those areas where you'd think there would most likely be problems. And certainly, if the people are pushing for a total refundable situation in these areas, there must be great public acceptance for the deposit law. The same is true for Delaware and other States and counties having passed similar legislation.

Mr. MAZZOLI. I thank the gentleman for his yielded time. The gentleman from Missouri is recognized for 5 minutes.

Mr. VOLKMER. I'd like to know a little bit more about the experience in Vermont. You have a deposit law?

Mr. JEFFORDS. That's correct.

Mr. VOLKMER. And what is the deposit?

Mr. JEFFORDS. The deposit is a minimum of 5 cents per container. The wholesalers are allowed to go above that. The larger quart bottles usually carry a 10-cent deposit per container.

Mr. VOLKMER. What is the present—and I know it may be hard for you to say, but you can give your opinion—breakdown, would you say, in Vermont as to refillables as against nonrefillables?

Mr. JEFFORDS. The——

Mr. VOLKMER. That's the total beverage. Beer, soft drinks.

Mr. JEFFORDS. I'm trying to think. The amount of refillables is increasing, particularly in the beer industry. Refillable bottles have gone up 30 to 35 percent in Vermont, with cans comprising approximately 42 percent. The differential is in nonreturnables.

Mr. VOLKMER. You don't see any plastic nonrefillables, then?

Mr. JEFFORDS. We have not seen any significant plastics coming into our area, to my knowledge. At least I have never seen any on the shelves. This may be another advantage to the 100 percent deposit system in that it apparently has not attracted the plastic bottle.

Mr. VOLKMER. What's the procedure to reprocess nonrefillables?

Mr. JEFFORDS. The nonrefillable bottles are primarily ground up and shipped back to a glass manufacturer. Or, in some cases, they're mixed with road materials for surfacing highways. The aluminum cans, of course, are all recycled. The refillable bottles, except for those that are broken, are washed and———

Mr. VOLKMER. If I had a large grocery store, what would I do with all those cans?

Mr. JEFFORDS. The cans are picked up under the deposit system by the wholesaler. In other words, when the wholesaler comes and delivers your new supply of beverages in full containers, he picks up and removes the empties.

The fate of the steel can is less than certain, depending on market conditions. Some are sold as waste. When market conditions are not favorable, they are disposed of as solid waste. The aluminum cans, because of market conditions, are all recycled and———

Mr. VOLKMER. But steel cans are not?

Mr. JEFFORDS. It depends on the market conditions. Sometimes they are, and sometimes they aren't.

Mr. VOLKMER. I have no further questions.

Mr. MAZZOLI. Are there any further questions? If not, Jim, we thank you very much for your attendance and appreciate your observations and insights.

The committee will now be pleased to hear from a panel composed of Mr. John C. Edenfield—and I hope I'm pronouncing that correctly. Mr. Edenfield is president of Edenfield Food Services, which is a large user of soft drink products, and I understand Mr. Edenfield feels that this legislation would not help him as a small businessman. Our other witness is Mr. Mark Silbergeld, who represents Consumers Union and Consumer Federation of America, organizations which oppose H.R. 3567 because they feel it will force increases in prices and disrupt the normal panel of judicial review in antitrust matters.

Gentlemen, you are welcome to step forward. Mr. Edenfield, perhaps you could proceed, and your statement will be made a part of the record.

TESTIMONY OF JOHN C. EDENFIELD, PRESIDENT, EDENFIELD FOOD SERVICE; AND MARK SILBERGELD, DIRECTOR, CONSUMERS UNION, WASHINGTON OFFICE

Mr. EDENFIELD. Thank you, Mr. Chairman. I appreciate you and the committee giving me an opportunity to testify this morning.

Mr. MAZZOLI. Pardon me. Could you pull that just a bit closer. Thank you.

Mr. EDENFIELD. I appreciate your giving me the opportunity to testify this morning and present to you and members of the committee how this bill might affect my company, as well as many other companies in the industry.

So that you might understand why it affects us, let me tell you a little bit about what we do and who we serve. We are known as a full line vending company, which means that we service industrial plants, colleges, schools, hospitals, with a full line vending service, offering food service, soft drinks, milk, coffee, anything that their employees may need within that plant.

In most instances—in fact, all instances with us, it's offered on an exclusive basis. We would be the only person authorized to sell any type of merchandise within those bounds.

In order to do this, we serve a tremendous amount of soft drinks, sodas, It constitutes probably 20 percent of our total volume.

We are a very small vendor. We operate out in the rural areas of Georgia. We are just a little country boy trying to make a living.

The way that it affects us is primarily with soft drinks in cans. We are able to buy sirup directly from the manufacturer, go through a postmix machine, served in cups, and this presents no problem to anyone. But when we go to cans—and I might mention when we do serve cans, it's in response to a customer asking for it. We don't care to haul it around on our vehicles, either, but if the consumer wants it, then this is what we try to do, is serve them.

So we have reached a stage where are able to buy cans as well as bottles as we have to use them. We are able to buy those in trailerload lots, the bottler delivering to our central warehouse.

We in turn then distribute with our trucks and our modes of distribution to our subwarehouses, who in turn get it to the industrial plant or to the college or wherever it may be going, the account that we're going to serve.

And so in doing this, here's where we run into a problem with the bottlers. And I sympathize with them, I sympathize with the small bottler. I'm not here to knock him. I'm just here to present a problem that his bill is going to bring about on some people that some of you might not have thought about.

But our buying area and main warehouse is located in one bottling territory. Eight miles to my west from my warehouse we go into another bottling territory. 15 miles south, we go into another bottling territory. And as a result, of course, we are serving these canned drinks in probably 6 or 8—I know at least 6, and probably 8 or 10—different bottling company territories; whether it be Coca-Cola, Pepsi-Cola, or who.

So if I understand this bill correctly, this means that I will not be able to do that. It means that I'm going to have to buy the product from the local bottler where I have the machines or the plant in his territory.

That being the case, then I will immediately lose my trailer-buying ability, because I couldn't use a trailerload for one plant that might be in another bottler's territory. So when that happens, then I start paying the same price for the drinks that the store-door delivery offers, and as an example, in our area it's $6.40 a case.

Now our buying price is $4.30, $2.10 a case cheaper, by buying trailerload lots and doing our own distribution, and doing this, why, this is quite a savings—$4,000 to $5,000 a trailerload—and this would affect us tremendously. We would not be able to compete with the local bottler who would be vending in competition with us. We would not be able to compete with a large vending company that happens to be in the area that is able to buy in trailerload lots from the individual bottlers, and in fact, the consumer, for us to meet that, would have to pay at least 10 cents a can more for the drink.

At the present time, with the system we are operating under now, we are able to meet any competition. We are selling at a very reasonable price. In fact, most times 5 cents a can cheaper to the consumer than is being sold to anyone else.

Another one of the main objections I have to the bill is the fact that when does the product become mine? When can I do what I want to with it? When I buy and pay for it, it seems that I should be able to do what I want to with it; pour it our or sell it, or whatever I want to.

Under this rule, as I understand the rule, I couldn't move it from my central warehouse to another warehouse in another territory. And this is one of the main reasons that I object to it.

At the same time I'm a distributor for a snack food industry, and I am confined to a limited territory there, but we are able to move this product out into these other areas. I feel that if this special interest legislation on the soft drinks passes, you will have snack food industries beating a path to your door, wanting the same thing. Though I don't know that to be a fact.

Of course, you folks have gotten involved in throwaways and this type thing, and I'm not familiar with it and don't know anything about it, and I'm familiar with the concept of tying it onto the bill. Our main concern is cans. Very few bottles do we use, and I don't think the bottles would present any problem with us. But if we were to get involved in a can situation where we had to require a deposit on the can, and then we had to redeem it because we were the seller, I don't know how we'd do it, in an industrial plant or a college or a hospital. I think it would be a burden beyond—something we couldn't possibly handle, I don't think.

And again, I thank you for giving me the opportunity to present my problem, and this not only affects me, but it will affect a tremendous amount—I don't know how many, I'm sure several thousand workers—of the same category that mine is.

Mr. MAZZOLI. Thank you, Mr. Edenfield. We appreciate it.

[The statement follows:]

EDENFIELD FOOD SERVICE,
Thomaston, Ga., April 17, 1980.

HON. Peter W. Rodino, Jr.,
Chairman, Committee on the Judiciary,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: I appreciate your giving me the opportunity to testify before the Subcommittee on H.R. 3567. My reason for appearing is to present to you testimony as to how this bill will affect my Company and thousands of other small companies of similar nature.

My company is known as Edenfield Food Service, providing full-line vending and food service to industrial plants, colleges, schools and hospitals. We are know as a full-line vendor, which means we vend and manually serve Food Items, Snacks, Cigarettes, Coffee, and Soft Drinks (Cans, Cups and Bottles.) In the locations that we serve, we are the only vendor serving this account.

In supplying the needs of our customers, it is imperative that we have all of the popular brand soft drinks.

Our Home Office is located in Thomaston, Upson County, Georgia, which in turn is located in the Atlanta Coca-Cola Bottling Company territory and the Newnan, Georgia Pepsi Cola Bottling Company territory. We are presently buying our can and bottle drinks in trailer-load lots (2000 cases or more), and receiving a discount of $2.10 per case by buying in trailer-load lots. Out of our Home Office warehouse, we distribute these products to our various vending locations. These products are then sold through a vending machine only. At the present time, we are selling these products in at least six (6) different bottling company territories. As I understand H.R. 3567, it would prohibit me from selling these products in these other bottling company territories. If this should become law, it would mean that I would be paying about $6.40 per case instead of $4.30 per case—the reason being, of course, that I would not be able to use the trailer-load lots from each of these bottling company territories.

I am enclosing a copy of a price list showing regular store door delivery, marked Exhibit "A". Also, I am enclosing a copy of an invoice showing my discount by buying in trailer-load lots, market Exhibit "B".

In comparing these two Exhibits, you can see that I am talking about a savings of at least Four Thousand Two Hundred Dollars ($4,200.00) per trailer-load, which in turn is passed on to the consumer. If we were not buying in trailer-load lots, our retail price per can would have to be increased by 10¢ per can. If we had to do this, it would completely put us out of business so far as the can drinks were concerned.

There are literally thousands of small vendors such as my company over the United States that would be similarly affected by this bill.

In closing, I would like to mention one other thing that bothers me considerably about H.R. 3567. The Coca-Cola Bottler, or any other bottler, delivers to my warehouse a trailer-load of product. I give him a check for $8,600.00, and this product belongs to Edenfield Food Service. Even though I have bought it and paid for it and it becomes my property—then the bottling companies want to tell me how and where to dispose of it. If this isn't infringing on my rights, I would like to know why not.

Again, I thank you for giving this opportunity of testifying before the Committee.

JOHN C. EDENFIELD.

[EXHIBIT A]

THE ATLANTA COCA-COLA BOTTLING CO.,
Atlanta, Ga., January 2, 1980.

To Our Customers:

Due to increased cost in sugar, glass, cans, plastic, trucks, coolers, cases, labor and other materials, it is necessary for us to increase the wholesale prices of our beverage products. Effective, Monday, January 7, 1980, the wholesale prices of our beverage products will be those shown in the schedule below.

Size	Pack	Cost
6½ and 10-oz. ret.	(24) 6-pack	$3.85
16-oz. ret.	(24) 8-pack	4.35
1-liter ret.	(12) 6-pack	4.35
10-oz. OWB	(24) 6-pack	5.40
16-oz. OWB	(24) 6-pack	6.40
1-liter OWB	(12)	6.75
2-liter OWB	(6)	6.26
Cans	(24) 6-pack	6.40

This price adjustment applies to these Sales Centers: Central Metro. North Metro, West Metro, South Metro, Dublin, Gainesville, Griffin, Jasper, Lawrenceville, Macon, Newnan, Thomaston and Warner Robins, which make up The Atlanta Coca-Cola Bottling Company.

Products inlcuded are Coca-Cola, Sprite, TAB, Fanta, Fresca, Mr. PiBB, Mello Yello, S/F Mr. PiBB, S/F Sprite, Dr. Pepper and Hi-C. The Dr. Pepper packages are in the Macon area only. Schweppes products will be handled separately.

We appreciate your business and look forward to continuing to serve you in the future.

Kindest regards,

JOHN H. KING.

[Exhibit B]

INVOICE

THE ATLANTA Coca-Cola BOTTLING CO.

312 NORTH HIGHTOWER ST. 647-6638

P.O. BOX 108 THOMASTON • GEORGIA • 30286

SOLD TO	Edenfield Vending Co.	ACCOUNT NO.
	Thomaston Ga.	

PLT		ROUTE	DATE	INVOICE NO.
			3-3-80	454791

	PACKAGE	COKE	SPRITE	TAB	FANTA	FRESCA	S.F. SPRITE	MR. PIBB	S.F. MR. PIBB	SCHWEPPES	HI-C	TOTAL	PRICE	AMOUNT
RETURNABLE	6½ oz.													
	10 oz.													
	16 oz.													
	LITER													
	2 LITER													
ONE-WAY	10 oz.													
	16 oz.													
	LITER													
	2 LITER													
	CANS	1335	77									2002	6.40	12,812.80
PRE-MIX														
FIGALS														
GALLONS														

MISC. MERCHANDISE

	ITEM	QTY.	PRICE	AMOUNT
CUPS	7 OZ.			
	9-10 oz.			
	12 oz.			
	14 oz.			
	16 oz.			
LIDS				
	TOTAL			

TOTAL TAXABLE SALE			12,812.80
SALES TAX			
TOTAL MISC. MERCHANDISE			
CASE DEPOSIT	QTY.	PRICE	
TOTAL CHARGES			$ 12,812.80

CREDITS	TOTAL	PRICE	AMOUNT
REFUND CASE DEPOSIT			
BOTTLES ONLY			
TRAYS			
Quantity Disc.	2002	2.10	
TOTAL CREDITS			4204.20
NET AMOUNT			$ 8608.60

RETAIN COPY FOR YOUR RECORDS

CUSTOMER ____________________

SALESMAN ____________________

Mr. MAZZOLI. I was prepared to guess that your distributing area was not Brooklyn, from that warm and wonderful accent of yours, so you didn't really have to go beyond just a general description. I didn't think you had any part of the Northeast.

Mr. EDENFIELD. I don't work upstate New York.

Mr. MAZZOLI. Mr. Silbergeld, you are welcome, and you may proceed.

Mr. SILBERGELD. Thank you, Mr. Chairman. I'd like to mention that I testify not only for Consumers Union, but also Consumer Federation of America, which joins me in this statement.

The testimony this morning, of course, is very interesting, because the bottom line for consumers here is money. Consumers pay the additional cost of a product, whether that additional cost results from less than effective competition, or whether it results from uneconomic packaging or distribution of packages, or whether it results from the choice of packaging and distributing techniques which use more energy than other techniques might.

The concepts presented in the legislation that Mr. AuCoin and Mr. Jeffords, Mr. Stark, and Mr. Weiss—which was discussed this morning—are very interesting in that they offer the possibility that consumers, if in fact some legislation is going to go forward, as seems certainly at least within the realm of possibility, and I won't try and measure the probabilities, have the opportunity to recoup some and perhaps much of what we believe the Federal Trade Commission's order, if that should go into final effect, would recoup for the consumer in the marketplace.

The thing that baffles me about the argument in favor of the main bill, the bill that has been before this committee for these many years, is the argument that it's necessary to protect small business, and the concomitant argument that it's necessary to save the returnable bottle. Because if we look at what's been happening under the existing system, which this bill is intended to preserve, what we see is that small business has been ever decreasing in the industry, and indeed, Beverage Industry magazine, which is a leading publication regarding the industry, says that this trend is increasing.

At the end of World War II, there were about 6,000 bottlers, and there are now approximately a little more or less than 2,000 bottlers, and most of the bottlers that have gone out of business are small businesses.

In my prepared statement you will find some detailed figures showing that concentration in this industry is very substantial and, of course, in what economists and antitrust lawyers call the relevant territory, that is in each individual franchised territory, with respect to any given brand, there is 100-percent concentration.

And so the argument that this bill will save small business seems to be contradicted not only by the data showing the trends in the industry, but by one of the most respected publications that specializes in this industry.

Futhermore, if we give some form of antitrust exemption, we are talking about giving antitrust exemption to some very large firms. The two largest bottlers just happen to be the parent sirup companies, the Coca-Cola Co. and PepsiCo, Inc. I can see absolutely no justification for giving corporations of that size an antitrust exemption. But they aren't the only ones. We also have the Liggett group, the corporation formerly known as Liggett & Myers, General Tire & Rubber, Warner Communications, and other conglomerates of that sort, that this bill would give an antitrust—limited antitrust exemption to.

We are also talking about some giant companies that specialize in bottling, including Coke of New York, Coke of Los Angeles, Associated Coca-Cola. You look at upstate New York and look at the way Coca-Cola is bottled and distributed there, you will find that two corporations virtually monopolize—have split the territory, really share monopoly, the entire upstate area.

These are not small—excuse the expression, somebody else used it before—"mom and pop" operations. These are large business corporations.

In my prepared testimony, I have described between some of these large corporations some very substantial sized proposed mergers and takeover efforts. This is big business. While the numbers may include a larger number of small businesses, most of the business is done by large coroporations. Whether they specialize in bottling or whether they're conglomerates.

The fact is that these territorial limits hurt the small bottler, not help him. They may well have added to the demise of the small bottler, the virtual demise, in what Beverage Industry says is the inevitable demise of the small bottler, because they do not permit the small bottler to reach economies of scale. And it's quite the contrary of the assertion offered in favor of the bill. It's the very situation that exists now that is contributing, in my view, to the elimination of small business in this industry.

There are other principles to consider. The American Bar Association and antitrust academics have held for many years that the burden of proof is very heavy on one who seeks an antitrust exemption to show that the exemption is justified. And to be charitable, at best, the arguments offered by the industry in favor of this bill make an argument for the case. They don't make the case, they certainly don't make an undisputable case or a case which can only be tangentially disputed. At best they make an argument for the case. And I would urge the committee to consider very seriously that this does not meet the standard for an antitrust exemption that respected institutions expert in the area of antitrust laws have argued for years should be met, if the antitrust laws are not simply to become a set of meaningless principles from which industries can come up to Congress and get exemptions whenever enforcement treatens somebody's private interest.

Indeed, early this year the American Bar Association's antitrust section enunciated the principle that at the very least the Congress should not adopt legislation that interferes with outstanding antitrust administrative orders while they are in the process of judicial review.

As previous witnesses, including Mr. Stark, pointed out this morning, the FTC's order is now under review in the U.S. Court of Appeals for the D.C. Circuit, and whichever way that goes, there is the opportunity for the losing party to seek review by the Supreme Court. Congressional interference with the judicial process at this time sends a signal to the Federal Trade Commission and perhaps to other agencies that enforce the antitrust laws, primarily the Antitrust Division, that if they step on the wrong toes, they are going to get legislative interference with their enforcement of the Sherman Act and other antitrust laws. I think that is a very bad signal to be sending at a time when we are concerned about trying to handle inflation and rely in part on competition to do that, when we are trying to increase rather than decrease productivity in the economy. Competition promotes productivity. I think it's not a good signal to be sending to those agencies at this time

My prepared statement, of course, Mr. Chairman, is for the record, and I would be delighted to answer any questions.

Mr. MAZZOLI. Thank you very much, and your statement will be made a part of the record.

[The statement follows:]

PREPARED STATEMENT OF MARK SILBERGELD, DIRECTOR CONSUMERS UNION, WASHINGTON OFFICE

Mr. Chairman and members of the subcommittee, Consumers Union[1] greatly appreciates this opportunity to testify on H.R. 3567, a bill which would grant a special exemption from the antitrust laws to producers and distributors in the soft drink industry. I am testifying today also on behalf of Consumer Federation of America[2] on whose Board of Directors I sit as a member. Consumers Union and CFA strongly oppose this Bill.

This legislation would protect the exclusive territory franchising practices of the soft drink industry from application of the antitrust laws, designed to protect and foster competition, despite the fact that the Federal Trade Commission has examined this territorial allocation system under a "rule of reason" test and finds no economic justification for the practice—except with respect to returnable bottles. The Bill's basic assumption is that competition is an economic disease. We believe, to the contrary, that competition is the tonic that keeps the economy healthy.

Not only would this legislation prevent an infusion of competition into the soft drink industry; it also would start a flood of demands for equal treatment by other industries which do or could utilize, as a marketing tool, this form of agreement not to compete. These include the automobile industry, the bicycle industry, the mattress industry, the independent grocers, and others which either have lost cases related to similar marketing arrangements, or which at present utilize similar arrangements.

When this legislation was first proposed, the monopoly overcharge attributed to the effects of the exclusive territory system in the soft drink industry was estimated by the Federal Trade Commission to be approximately one quarter billion dollars annually. The high level of inflation in the ensuing eight years justifies a very hefty increase in the level of that estimate. Other, generally lower, estimates also have been made. But—we can be certain—the costs of this legislation eventually will go far beyond those involving the soft drink industry. For, once these exemptions have been granted, it will be difficult, if not impossible, to say "no" to those other industries which will be in a position to demand the equal right to stand under that umbrella which provides a shield against full and effective competition.

This proposed legislation would overturn a decision of the Federal Trade Commission which is now under judicial review before the U.S. Court of Appeals for the District of Columbia Circuit. The FTC and Court of Appeals reviews—as will be the Supreme Court review, if judicial review reaches that level—are based on an exten-

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[1] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide information, education, and counsel about consumer goods and services and the management of the family income. Consumers Union's income is derived solely from the sale of *Consumer Reports*, its other publications and films. Expenses of occasional public service efforts may be met, in part, by nonrestrictive, noncommercial grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports*, with over 2 million circulation, regularly carries articles on health, product safety, marketplace economics, and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[2] Consumer Federation of America (CFA) is a non-profit corporation incorporated in the State of New York and exempt from tax under Section 501(c)(4) of the Internal Revenue Code. It is a federation of more than 200 state, local and national organizations, representing more than 30 million consumers, which advocates the consumer viewpoint before government bodies including Congress and federal agencies.

sive hearing record. The industry now asks the Congress, based on highly selective arguments culled from the record and on assertions not even contained in the record, to reverse the FTC decision. These will not be subject to the same rigorous, adversarial examination afforded by the FTC's administrative process. In fact, the legislation now before you would shortcut the Congressionally-established process for determining such complex questions of economic fact and law. This, in itself, is reason not to act on this legislation, at least until the judicial review process has been completed.

It is fair to state that the soft drink exemption legislation would never have reached this point but for a massive, extended lobbying campaign directed at virtually every Member who has served in the Congress since 1972. This campaign has been relatively successful primarily because of the geographical distribution of the soft drink industry, which has at least one, and in many cases several, bottling entities doing business in each Congressional district. Had the industry involved consisted of a few producers located in a few districts, it seems safe to assert, the legislation would not have come this far on its own merits. A look at the merits of the arguments underlying this campaign is appropriate—and revealing.

The industry's approach to the Congress is cloaked in the guise of an industry consisting substantially of small, family-operated businesses which could not survive under conditions of competition. The argument advanced is that only preservation of the exclusive territory franchise system will preserve the small businesses in this industry. Quite aside from long-standing public policy which assumes competition to be a healthy and necessary condition, rather than a fatal disease, this representation is simply inaccurate.

The soft drink industry is no longer characterized primarily by small businesses. The number of small businesses has declined drastically since the end of World War II. These have given way to large, conglomerate firms and to very large bottling interests with substantial multiple-plant, multiple-territory, multi-state franchise holdings.

In 1950, there were more than 6,000 soft drink plants in operation. By 1960, there were less than 4,600. Presently, the number barely exceeds 2,000. Indeed, as recently as June 1977, Beverage Industry, a trade publication knowledgeable about the soft drink trade, stated that the trend is irreversible. The National Soft Drink Association reports that from 1970-77, 890 bottling and canning plants were out of production. And over 70 soft drink firms were acquired by other companies during the period 1970-77, according to the American Institute of Food Distribution.

Until the controversy over this legislation in the early 1970s made the fact notorious, the Coca Cola Company maintained a "Bottler Consolidations" unit, designed to assist mergers and acquisitions among bottlers, pursuant to a plan to reduce the number of its franchises from several hundred to less than one hundred. Four and one-half percent of all bottling plants produced almost thirty percent of industry output and seventeen percent of the plants produced about sixty-five percent of output, as of 1973.

Thus, whatever effect may be predicted as a result of the FTC's ruling, one thing is clear. The soft drink industry under the territorial franchising system is increasingly concentrated and decreasingly small business. Preservation of the system FTC has found unlawful will not prevent this trend.

The corporations which would receive antitrust exemption under the proposed legislation include the nation's two largest soft drink bottlers—the Coca Cola Company and PepsiCo, Inc., which reserve for themselves some of the nation's choice geographical markets in which to bottle and wholesale soft drinks. There is a very good argument that the primary effect of the exclusive territory agreements is to protect Pepsi and Coke from competition at the bottling level of soft drink production.

Other so-called "small businesses" engaged in soft drink bottling under franchises from one or more of the nation's eight largest soft drink syrup producers—or from themselves as one of those eight—which would benefit from protection under S. 598 include:

The Liggett Group (Liggett & Myers), (Pepsi Cola.)
General Tire and Rubber Co. (Pepsi Cola.)
IC (formerly Illinois Central Industries) (Pepsi Cola.)
Cantrell & Cochrane (Division of ITT) (Cott.)
Norton Simon, Inc. (owner and bottler of Canada Dry.)
General Cinema Corporation (Pepsi Cola, Seven-Up, Dr. Pepper.)
Southdown, Inc. (Royal Crown.)
Beatrice Foods (Royal Crown Cola.)
Warner Communications (Coca Cola.)
Twentieth Century Fox (Coca Cola.)

Even companies which are engaged primarily in bottling may be very large. Two firms, Associated Coca-Cola Bottling Co. and Coca-Cola Bottling Co. of N.Y. have cartelized the bottling of Coca-Cola across huge portions of the populous state of New York. A very few companies control the territories for the bottling and sale of Coca-Cola, Pepsi-Cola, or each of these brands, in market areas of heavy population density or heavy retirement areas of Florida and Nevada, and the northeast corridor from New York to Boston.

The size and power that an independent bottling company can attain under the exclusive territory franchise system—which supposedly protects small bottlers—is best illustrated by the 1977-78 acquisition efforts of the Coca Cola Bottling Co. of New York. This giant firm spent $85 million over eleven months to acquire bottling companies in Maine, Kentucky, Kansas, Nebraska and Colorado. Other large interests merged during this period as another giant, Coca-Cola Bottling Co. of Los Angeles, purchase more than 98.3 percent of Coca-Cola Mid-America.

In view of these trends, it seems clear that the only way—if, indeed, there remains a way—for a small bottler to survive eventual extinction is to overcome the diseconomies of small scale operation by increasing its volume of business. And, especially with a leveling off of population growth, this is precisely what territorial restrictions prevent. Thus, small businesses' chance for survival can only be hurt, not helped, by these restrictions.

One segment of the small business community which has been little heard from on this issue is comprised of the small businesses which retail soft drinks and cannot find price-competitive sources for the popular brands of soft drinks they sell. These small businesses, as well as the consumers they serve, are entitled to competition among their suppliers. But the exclusive territory franchise system, by eliminating intrabrand competition, denies them that right in great part.

The American Bar Association as well as academic antitrust specialists long have held to the principle that those who seek special antitrust treatment bear a very heavy burden of proof. What justification—other than the spurious small business plea—can be made for the grant of some form of antitrust exemption, as this legislation proposes? The evidence relating to this industry, to the contrary, seems to call for the very antitrust enforcement action which the FTC has taken, rather than for legislatively-mandated antitrust forebearance.

A primary economic justification offered is that there is sufficient inter-brand competition to assure competitive pricing of soft drinks. However, the FTC has ruled that this is not the case. Little wonder. 1978 data show that the brands franchised by the two largest syrup manufacturers—the Coca Cola Co. and Pepsi Co, Inc.—hold 59.6 percent of the national market. And the brands franchised by the four largest syrup manufacturers hold 73.1 percent of the national market.

The relevant markets, of course, as the local or regional markets, for most of which concentration figures are not readily available. But to the extent that the national market figures overstate concentration in some markets they must understate them in others. And the national figures meet and surpass standard industrial analysis criteria for shared oligopoly.

The other primary justification which has been advanced is that the territorial system is necessary to survival of the returnable bottle. But the FTC order permits exclusive territories to be maintained for this submarket because it finds that the hearing record provides reasonable justification for this claim. One of the bills that you are considering, H.R. 3573, claims to provide for protection of the returnable bottle as an energy efficient and ecologically sound package for soft drinks. Both the bill's "findings" section and its "declaration of policy" section propound at length and with great patriotism on these subjects. However, the operative section of the bill, while providing strong standards for preservation of exclusive franchise territories, makes absolutely no mention of the returnable bottle. This form of soft drink package could disappear from the market and the protective standards of that bill would remain. This is not surprising, however, for an industry interest drafted the bill and its packaging obviously is intended to be more important than its content.

It is theoretically possible that some optimal mix of returnables in the totality of soft drink consumer packages—perhaps containing more returnables than the present mix—would yield a lower weighted average retail price for soft drinks than would mere prohibition of exclusive territory franchising. This possibility is based on the claimed lower production costs for returnables. However, to evaluate this claim thoroughly would require an independent, thorough economic inquiry into a number of relevant factors. These include, among other considerations, the recovery rate for returnables, the effect of returnables on backhauling by soft drink delivery vehicles, the shifting of some marketing costs of returnables into the price of non-returnables, as well as the cost of producing returnables and non-returnables.

Additionally, in order to consider a public policy ensuring an optimal mix of returnables, it would be necessary to compare such alternatives as a ban on non-returnables and a requirement for a minimum percentage of returnables in each bottlers' mix.[3] Without consideration of these factors, any action related to the use of returnable soft drink containers can address only the bottling industry's special interests, not the consumer's interest in an optimal balancing of competitive prices, energy conservation and the ecology of solid waste control. And, at that, the industry still would carry the very heavy burden of justifying an exception to the antitrust laws.

In conclusion, Mr. Chairman, we oppose H.R. 3567. It is not the small business protection measure that the soft drink industry claims it to be. Indeed, it cannot be so, because the industry is now characterized primarily by large—and some giant corporations.

Further, enactment of this legislation at this time would interfere with the established process of judicial review of agency decisions before that process is completed. This would signal that every FTC antitrust action not to the liking of the industry involved is fair game for political reversal. To give such a signal would threaten FTC enforcement of the antitrust laws and their restraining effect on inflation. And, because the American consumer is the ultimate beneficiary of these laws, it would add to the already heavy burden of high prices and inflation now borne by consumers.

The antitrust laws are key to assuring the lowest prices consistent with a fair return on investment. The American Bar Association's Antitrust Law Section Council in a resolution adopted February 26, 1980, strongly opposed the imposition of legislative prohibitions on FTC's enforcement of these laws prior to completion of judicial review. The respondents in these cases may win their argument in the Court of Appeals or in the U.S. Supreme Court. We urge the Subcommittee not to undercut the purpose of the antitrust laws through recommendation of H.R. 3567 at this time.

Thank you, Mr. Chairman.

Mr. MAZZOLI. I thank both the witnesses for being aware of our time constraints, too. We thank you for your brevity.

Mr. Silbergeld, I'm not overwhelmed by your argument that we should not to do anything until this judgment is in, because I would be willing to bet that there's a number of decisions that have been rendered by various courts in the District of Columbia and in the appellate levels around the country that I would imagine you and your groups that you represent today, have probably urged Congress to make plans to reverse. In fact, they probably have drafted bills to do that same thing.

Again, I just say with great respect, I'm just not persuaded that we ought not to proceed.

Mr. SILBERGELD. I think that's not accurate, Mr. Chairman. Indeed, the Consumers Union and other groups have asked Congress to review and take action with respect, for instance, to the *Illinois Brick* decision, but only after the Supreme Court handed down a final decision on that.

Mr. MAZZOLI. Well, I would imagine that bill was probably the result of a lot of preparation ahead of time, and a lot of activity, so I'm not sure that we're disabled or we proceeded incautiously simply to move before there's a final action.

You mentioned these gigantic bottlers in upper New York State and other places. Would you believe that the likelihood is that without some bill, that the big will get bigger and the small will disappear?

Mr. SILBERGELD. That seems to be the trend in the industry. Given the present situation, without some bill, if the FTC order does not take effect, that will happen. The effect of the FTC order

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[3] See *Materials and Energy From Municipal Waste—Beverage Container Deposit Legislation*, Office of Technology Assessment, July 1979.

at this time would seem to give those small bottlers who remain a chance to increase their territory, increase their sales, and reach economies of scale.

There's always a question as to if you wait until the next to last moment in history can you reverse the situation. I frankly don't know what the answer to that is.

But it seems to me that unless legislation going exactly the opposite direction of this legislation creates the opportunity for competition by small bottlers right now, that only the FTC order will give us a chance to keep small business going.

Mr. MAZZOLI. Well, let me ask you this question. It's been asked by others here today. If, for instance—and if I understand the FTC order, it talks about returnables, and if you are in that type of activity, then you are given a territory. What happens if there's an option, if someone opts out, they don't handle returnables? Would they be prevented from penetrating the district that has with returnables?

Mr. SILBERGELD. Well, we are talking about a couple of possible situations. One would be under the FTC order; another would be under the returnable amendment that was offered.

Mr. MAZZOLI. Are you saying that without the FTC order, there would be the continuation of this trend to giganticism. You think that that order is not perfect, in itself; is that right?

Mr. SILBERGELD. That's not clear to me. The FTC order does provide that with respect to returnables, a bottler can maintain an exclusive territory, and the industry has argued that unless you have an exclusive territory for all of your product, that you have to maintain in effect separate operations for returnables and for non-returnables, and that that's not economically feasible. I really have no way at this time to assess those arguments either way.

Mr. MAZZOLI. Could that person's exclusive territory be penetrated?

Mr. SILBERGELD. Under an FTC order?

Mr. MAZZOLI. Under the FTC order, where the other one just doesn't engage in returnables, doesn't really care about returnables and——

Mr. SILBERGELD. My understanding is that it's simply——

Mr. MAZZOLI. In a sense, is a franchise a right to sell to a border, or does it also give you the right to keep a seller out of that area?

Mr. SILBERGELD. Well, right now, the franchise, as the contracts are written, is a contract between sirup manufacturers and the bottler and the franchise in effect grants exclusive rights in that territory and prohibits and limits the franchiser to operation in that territory. What the sirup manufacturers do is they enforce those provisions in any number of ways, including limiting the amount of sirup that can be obtained.

Mr. MAZZOLI. Well, I could pursue this. I did want to get to the gentleman from Georgia for a moment, but I can see a situation of two different sirup manufacturers where one just doesn't cooperate with the other.

Mr. SILBERGELD. Well, of course, Coke can't give an exclusive territory with regard to the bottling of Pepsi. So we're only really talking about single brand.

Mr. MAZZOLI. Thank you. Mr. Edenfield, you had mentioned that you didn't think you could function because you buy in truckload lots, and if this were carved into certain territories, you couldn't buy that large a quantity. I think you are being very modest about the size of your operation. I don't think yours is just a little ol' country boy operation. I'm relatively sure that you're a rather substantial operator.

Could you not offer to any seller a great opportunity to sell and buy thousands of cases in the course of months or years, and would they not then serve you like your present people?

Mr. EDENFIELD. I would like to continue to, like in other words, I'm buying now in trailerload lots, and what would be my penalty if I carried it across the river into another bottler's territory and put it in vending machines? That's my question. This doesn't state—what has been brought up so far is that the bottler himself can't cross over and sell it. Now can it?

Mr. MAZZOLI. I understand.

Mr. EDENFIELD. When I buy and pay for it, is it mine? This is what Coca Cola tells me I can't do, and I've told them to—well——

Mr. MAZZOLI. Well, my time has expired, but maybe I'll get back. Thank you very much. The gentleman from Virginia is recognized for 5 minutes.

Mr. BUTLER. I think, Mr. Chairman, that what he says is his business is just for peanuts, you know.

Mr. EDENFIELD. Well, it is, Tom's Roasted Peanuts, that's right.

Mr. BUTLER. Well, of course, you can sell Pepsi if it doesn't satisfy.

Mr. EDENFIELD. But the Pepsi, sir, may be in the other territory also.

Mr. BUTLER. Well, help me a little bit with your situation, because don't territorial franchise restrictions already exist in your area, and aren't you violating those restrictions with your procedures now?

Mr. EDENFIELD. The president of the company said it didn't.

Mr. BUTLER. The president of the company said what?

Mr. EDENFIELD. Says it does not. He says that he will not ship anything into these other territories, but he ships it to me. I can do what I want to with it. That's what the president of the company told a bunch of people that were complaining about me. And this is what's happening with the soft drink, you see. I'm buying it and paying for it, it's mine, and I'm taking it to my vendors in other bottling territories, and as I understand this bill, it's not the Coke bottler that's selling it over there, it's me, you see. I'm not wholesaling, I'm bringing in a vending machine as my business.

Mr. BUTLER. I guess I'm having problems with understanding exactly what your situation would be after this bill as opposed to what it is now. I think you're at the mercy of the Coca-Cola Co. anyway, right now, are you not?

Mr. EDENFIELD. Well, the FTC ruling is that, you know, they can't, as I understand it——

Mr. BUTLER. No, I'm not——

Mr. EDENFIELD. See, they freed it up, wherever they can.

Mr. BUTLER. Oh, I see. We're having a time problem. But let's go back—you were in business before the FTC decision; were you not?

Mr. EDENFIELD. Right.

Mr. BUTLER. Has the character of your business changed?

Mr. EDENFIELD. Considerably. I don't know how long it's been in effect, but it's changed, because we have grown a little in the last few years, yes, sir.

Mr. BUTLER. You have what?

Mr. EDENFIELD. Grown. Our business has expanded. Right.

Mr. BUTLER. That's not character, that's prosperity. [Laughter.]

Mr. EDENFIELD. That's hard work.

Mr. BUTLER. Hard work, I'm sure.

Mr. EDENFIELD. That's hard work, yes, sir. It didn't just happen.

Mr. BUTLER. No; I understand that, but your relationship with Coca-Cola hasn't changed as a result of the FTC decision, has it?

Mr. EDENFIELD. Well, I think I was sticking within the bounds of the bottling company I was buying from for a long time.

Mr. BUTLER. You were?

Mr. EDENFIELD. We were, yes, sir. And here we expanded and we just went on with it, anyway.

Mr. BUTLER. But the FTC decision didn't have anything to do with your decision to expand or not?

Mr. EDENFIELD. No, sir; but the bottler came down with a contract for me to sign, stating that I wouldn't sell it outside of the territory.

Mr. BUTLER. The bottler did?

Mr. EDENFIELD. Yes, sir.

Mr. BUTLER. But you still do it?

Mr. EDENFIELD. Yes, sir. [Laughter.]

Mr. BUTLER. Well, you're getting away with it, now. What makes you think you wouldn't get away with it after the——

Mr. EDENFIELD. Well, I figured you gentlemen might write something in that bill to stop me from doing it. It has been done. What's going to be my penalty if I do? That's what I'm wondering.

Mr. BUTLER. Whatever it is, it is my perception of the bill that whatever sanctions are available presently, they will be available after this legislation is enacted.

Mr. EDENFIELD. That will be fine with me.

Mr. BUTLER. Well, good. Well, that, I think maybe——

Mr. EDENFIELD. I guess I was misinterpreting the bill.

Mr. BUTLER. No. No, I don't think you are. I just think you're getting away with something, and you'll probably continue to get away with it as long as you sell a lot of Coca-Cola. that's the secret of the free enterprise system. [Laughter.]

Well, I want to thank you for your testimony. It seems to me that a person in your position has to have a certain amount of courage to oppose a bill when the big boys are asking for it, so I want to express my appreciation for your willingness to testify. You may be in the position of the man who told his wife she was getting a little heavy. You had to admire his courage, but not his judgment. [Laughter.]

But we thank you for your testimoney here.

Mr. EDENFIELD. I admit I feel like the illegitimate child at a family reunion, I'll tell you that.

Mr. BUTLER. Well, they're the ones that make the money.

If I may turn to the other witness, with what little time I have. What would be your reaction to an amendment predicating an antitrust exemption for territorial franchise arrangements from the existence of a certain percentage of returnable, refundable container sales? By each bottler, or industrywise.

Mr. SILBERGELD. Yes, Mr. Butler, that clearly would be preferable to the bill that was originally under committee consideration, because there are, as the previous witnesses indicated, savings to the consumer from returnables, and any additional savings to the consumer that would result from the combination of legislation and FTC order would be preferable to what is in the proposal in H.R. 3567.

Mr. BUTLER. Well, now, along the cost line, do you believe the cost of retrieving, cleaning, refilling, and redistributing returnable refillables several times really represents a dollar and cents savings, ignoring the environmental and the energy arguments, over the cost of moving several times the product in one nonreturnable container?

Mr. SILBERGELD. You're asking me if we removed the external costs, whether the operator's direct costs are a savings. I really don't know how that breaks down between the external costs and the operator's costs, but the fact is that if you have returnables, you have the external costs savings as well.

In addition, of course, there are the tremendous energy costs involved in manufacturing the container, and so you can't simply separate out the operator's cost of handling the returnable versus handling the throwaway package. You have to look at the operator's cost of acquiring the returnable and acquiring the throwaway package.

Mr. MAZZOLI. The gentleman's time has expired. Counsel have questions.

Mr. NELLIS. Mr. Edenfield, what is the retail price of 32 ounces of Coca-Cola in your territory and the retail price of 32 ounces of Pepsi in your territory?

Mr. EDENFIELD. I really don't know. I don't handle that. Ours is strictly cans, individually consumed.

Mr. NELLIS. Can you give me any price comparison at all?

Mr. EDENFIELD. The 12-ounce cans are retailing for 35 cents. In most cases, they're 40, 45 cents.

Mr. NELLIS. Is there a differential between the two, generally?

Mr. EDENFIELD. In what respect do you mean?

Mr. NELLIS. Is there a lower price for Coca-Cola than there is for Pepsi or vice versa.

Mr. EDENFIELD. No, sir, generally they're the same.

Mr. NELLIS. They're almost always the same?

Mr. EDENFIELD. Right.

Mr. NELLIS. And Mr. Silbergeld, is that not generally true in all these territories that now have these exclusive franchise agreements, it's pretty much the same?

Mr. SILBERGELD. Well, it's generally true with respect to vending machine products. Of course, with respect to supermarket distributed productors, there are all sorts of promotions constantly going on, those produce a situation where at any given time they may or may not be the same. The question is how they average out.

Mr. NELLIS. What I'm getting at then is what would be the price differential, if any, in interbrand competition if this bill were to pass?

Mr. SILBERGELD. If this bill were to pass? Small.

Mr. NELLIS. There would be very little difference?

Mr. SILBERGELD. Small, if any.

Mr. NELLIS. And even if specials were run, the difference would still be small?

Mr. SILBERGELD. They could be expected to average out over time.

Mr. NELLIS. So the consumer has very little choice between Pepsi and Coke; is that right?

Mr. SILBERGELD. Right.

Mr. NELLIS. Would that be true as to other soft drinks as well?

Mr. SILBERFELD. Well, there is a theory the house brands are cheaper, but I think that differential has been creeping and intends to creep closer and closer to the national brand price, and I think there may even be cases where promotions for the national brands make the house brand higher at times.

Mr. NELLIS. So in your view, what we would have would be more or less administered retail price instead of competition at the retail level; is that correct?

Mr. SILBERGELD. That's correct.

Mr. MAZZOLI. Yes. We recognize counsel.

Mr. KERN. Mr. Silbergeld, what would you say to an amendment to this legislation which would require divestiture of existing local bottling subsidiaries by the sirup companies—which would force Pepsi Co., for instance, to divest itself of its New York, Boston, and Philadelphia franchises—as a condition of the antitrust exemption?

Mr. SILBERGELD. Well, that's a difficult question to answer, one of the reasons being that I'm concerned about amendments in which there have been no hearings, and there have been no hearings on that. Clearly there is—if you're talking about an amendment to 3567 as the committee now has that.

Mr. KERN. Yes.

Mr. SILBERGELD. Yes, I'd say if you are going to maintain the territorial interbrand monopolies, then definitely there should be a divestitute provision that prevents the sirup manufacturer as the grantor of those monopolies from granting itself a monopoly.

Mr. KERN. Mr. Edenfield, if bottlers are not given territory or marketing protection, two representatives of Coca-Cola argued that a portion of the market is going to go unserved. Do you think this is consistent with the fact that vendors such as yourself typically deliver across territorial lines despite the restrictions and evidently seek to serve the market wherever it can be found?

Mr. EDENFIELD. I don't think the vendors do, no. You don't find many vendors in the drink business, period. They are a full line vendor or they are a snack-and-drink vendor, and I don't know of any that wholesale. This is what they are complaining about in some instances. Some of the vendors might have been wholesaling. I won't argue that point. This cuts into the route man with a Coca-Cola, and I can readily—in other words, if I buy a trailerload lot, I shouldn't go out and compete with Coca-Cola on the street market. And I think that's one of the main complaints they have.

Mr. KERN. We are talking about market penetration, and they paint a picture of there being areas that are not going to be served unless we preserve the system. It seems to me your operation typifies the fact that there are a lot of entrepreneurs who want to go out there and reach that last customer.

Mr. EDENFIELD. We do that, that's for sure, and in our area the bottlers of the soft drink industry does a tremendous job doing it right now.

Mr. KERN. So that will be done.

Mr. EDENFIELD. I don't know why it would affect it. We are in the wholesale business—the wholesale snack food business, and we sell all over. We don't see anybody that wants a Coke that can't get it, or Pepsi, either one. They all have it.

Mr. KERN. Thank you.

Mr. EDENFIELD. The only thing that sometimes happens in different territories, the bottlers will have different wholesale prices, and that is consistent. I don't know what effect this bill might have on that.

Mr. POLK. Mr. Edenfield, I think there may be some things in H.R. 3567 which might trouble you and which are not part of current practice or current law.

For example, on page 3, lines 9 through 11, it indicates that it is OK to limit the bottler, directly or indirectly, to sales of the product only for ultimate resale to consumers with a defined geographic area.

Mr. EDENFIELD. That's the reason I am here.

Mr. POLK. I take it that's the reason you are here.

Mr. EDENFIELD. Yes, sir.

Mr. POLK. I'm not sure whether present law would affect you. This language that is now in the bill might. Let me ask you, if you are covering several territories with your vending operation, do you buy from the bottler who offers you the cheapest price?

Mr. EDENFIELD. I have never priced it other than where my home office is.

Mr. POLK. I see. So you don't know the prices of Coca-Cola within the territories that you serve with your vending operations?

Mr. EDENFIELD. No, sir.

Mr. POLK. Thank you.

Mr. EDENFIELD. But the penalty is going to be written into the law, as it now stands, as I understand it.

Mr. MAZZOLI. The gentleman's time has expired, and I don't believe there are any more questions.

Let me thank the two witnesses for your help and your insights on this bill, and your observations.

I would like to call attention to the fact that the subcommittee will have another session of hearings on April 29th at 1:30. That, I believe, is Tuesday of next week, and without further business, the subcommittee stands adjourned.

[Whereupon, at 12:25 p.m., the subcommittee was adjourned, to reconvene at 1:30 p.m., Tuesday, April 29, 1980.]

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SOFT DRINK INTERBRAND COMPETITION ACT

TUESDAY, APRIL 29, 1980

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON MONOPOLIES AND COMMERCIAL LAW
OF THE COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met at 1:40 p.m., in room 2141, Rayburn House Office Building, Hon. Romano Mazzoli presiding.

Present: Representatives Mazzoli, Seiberling, Hughes, Volkmer, Harris, McClory, Railsback and Butler.

Staff present: Joseph L. Nellis, general counsel; Warren S. Grimes, chief counsel; Joel Ginsburg, counsel; Franklin G. Polk and Charles E. Kern II, associate counsel.

Mr. MAZZOLI. Our subcommittee will come to order.

This afternoon the Subcommittee on Monopolies and Commercial Law meets to complete scheduled hearings on the bills to create a special antitrust standard for the soft drink bottling industry.

I might say, I am reading for the record the statement of Chairman Rodino, who is unavoidably detained at the moment.

Last week we heard testimony from members suggesting possible amendments or alternative versions of legislation dealing with the bottlers.

Today we will hear from two distinguished law professors concerning their views on this proposed legislation, and both are experts in the field of antitrust law.

Prof. Ernest Gellhorn from the University of Virginia Law School will be testifying in favor of H.R. 3567. His participation in these hearings is being supported by the National Soft Drink Association.

Prof. Jonathan Rose from the College of Law at Arizona State University will be testifying against H.R. 3567, and Professor Rose is appearing in his own behalf.

Failing the presence for the moment of the ranking member of our committee, Mr. McClory, we will proceed with the testimony and hear from Professor Gellhorn first, and then Professor Rose. The committee will then be disposed to asking questions.

Professors, thank you both; and Professor Gellhorn, you may proceed.

TESTIMONY OF PROF. ERNEST GELLHORN, UNIVERSITY OF VIRGINIA LAW SCHOOL

Professor GELLHORN. Thank you very much, Mr. Chairman. I am pleased at the invitation and for the opportunity to participate in these hearings, particularly with my former law school classmate and colleague, Jon Rose.

We have had a long history of looking at antitrust questions together, and sometimes differently.

I have prepared a statement. It has been submitted to the committee in advance of these hearings.

Mr. MAZZOLI. Without objection, Professor, that statement will be made a part of our record.

Professor GELLHORN. Thank you.

[The statement follows:]

PREPARED STATEMENT OF PROF. ERNEST GELLHORN

My name is Ernest Gellhorn and I am currently T. Munford Boyd Professor of Law at the University of Virginia Law School. My principal areas of teaching and scholarly experience have been in antitrust and administrative law. My participation in these hearings is being supported by the National Soft Drink Association. The views which I will express here, however, are not made on behalf of any group or organization and reflect my independent teaching and writing in antitrust.

I

The primary question raised by H.R. 3567 is simply whether territorial distribution arrangements—specifically the allocation of exclusive territories to franchised bottlers—should be allowed where substantial and effective competition exists among trademarked soft drink products. If, as I believe, the goal of antitrust is to protect and improve consumer welfare through competition, then this proposed bill is consistent with the antitrust laws.

Where substantial and effective competition exists among soft drink products, franchised bottlers would be allowed by this legislation to retain their historic territories to bottle and sell soft drinks without fear of lawsuit by the government or private claimants. With the consumer protected by interbrand competition, this bill would assure that soft drink producers could seek the benefits of vertical integration by contract. These contract arrangements are generally designed to increase the efficiency of each firm's distribution system; in a competitive market these efficiency gains should result in lower product prices or, at least in intensification of competition among branded competing soft drinks. On the other hand, where markets lack strong and vigorous competition, this legislation would have no effect. That is, the usual rules of antitrust which measure such vertical arrangements under a rule of reason analysis would apply.

As will be described below, this proposed legislation is supported by the rationale of, and is consistent with, the Supreme Court's recent decision in *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36 (1977). It would, in other words, codify existing legal rules. Yet, as illustrated by the Federal Trade Commission's opinions in *Coca-Cola*, Dkt. No. 8855, and *PepsiCo Inc.*, Dkt. No. 8856 (FTC April 7, 1978), (the *Cola* cases), alternative interpretations apparently are possible. Thus without this legislation it may take years of litigation and numerous hearings and appeals to resolve the question. Adoption of H.R. 3567 would establish the legal standard in a way likely to protect the consumer interest.

II

An understanding of the role which H.R. 3567 would play in the antitrust laws requires analysis of these laws and the practices they prohibit. In serving the consumer interest, the antitrust laws seek to prevent individual firms, either acting alone or with each other, from restricting output and thereby raising price (or its equivalents) above competitive levels. Reduced to their primary elements, two practices are attacked by the antitrust laws: (1) collusion among competing sellers to raise price directly or indirectly; and (2) individual or group efforts to exclude other sellers from competing and thereby to gain a larger share of the market.

Under this framework, collusive practices have been banned by legal prohibitions of price fixing and market division. Each involves a horizontal agreement by competing firms where the effect on rivalry has seemed clear and little justification could be offered. Thus, per se rules have been applied to make such horizontal agreements illegal without further consideration of their purpose, justification or effect. However, where the horizontal arrangement does not fit within these categories—such as a trade associations publication distribution of market statistics from its members, or a cooperative program of institutional advertising by all or some firms in an industry—the courts have applied a more lenient rule of reason test in order to determine whether some justification might support the practice and whether it outweighs any adverse effects. When this latter rule of reason measure is applied, the courts usually examine the purpose of the arrangement, the market power of the participants and the effect of the arrangements on competition.

A similar approach has been followed in examining exclusionary practices by individual firms (monopolization or attempts to monopolize) or joint actions such as vertical tie-in agreements, horizontal group boycotts and similar arrangements. In situations where the exclusionary practice raises serious antitrust questions, those in or seeking a monopoly position are trading today's monopoly returns for a larger share of the market by making it unprofitable for others to compete with them. Here the law is in a state of flux as both per se and rule of reason tests are applied.

One reason for this lack of legal clarity, especially in regard to the rules governing territorial restrictions in vertical distribution arrangements, is that the courts and agencies have often tried to borrow antitrust concepts developed for collusive horizontal practices. However, they have applied these horizontal rules without careful consideration of their analytical foundations or whether they have any relevance for vertical agreements whose only possible harm could be exclusionary. On the other hand, many, perhaps almost all, vertical restraints are designed for another purpose. That is, rather than being aimed at restricting output, their likely goal is to increase firm efficiencies. For example, vertical sales restrictions required by firms without market power are generally conceded as having no possible effect on price or interfirm competition; yet the aim and result of horizontal sales restrictions are to restrict output and thereby to affect price. It is therefore not surprising that attempts to apply horizontal, per se, rules to their vertical counterparts have proved unsatisfactory and been unstable.

As will be explained below, this borrowing of horizontal case rules to vertical arrangements without qualification was first developed in the area of vertical price fixing. Subsequently, it was extended to territorial and customer allocations. In both areas the horizontal case rules are clear. Price-fixing among competing firms has been condemned on a per se basis without regard to the reasonableness of the prices, any justification for the arrangement, or other supposed beneficial effects, since 1897. See *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897); *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927); *United States v. Socony Vacuum Oil Co.*, 310 U.S. 150 (1940). Horizontal agreements to divide markets by allocating exclusive territories, assigning customer classes, or like arrangements similarly provide participants with an opportunity to restrict output and thereby to raise prices. Therefore, beginning in 1898 courts have condemned such territorial restrictions under increasingly rigid per se rules. See *United States v. Addyston Pipe & Steel Co.*, 85 Fed. 271 (6th Cir. 1898); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951); *United States v. Sealy, Inc.*, 388 U.S. 350 (1967); *United States v. Topco Assoc., Inc.*, 405 U.S. 596 (1972). The application of these rules to similar vertical arrangements has long been criticized and with telling effect in recent years, at least in regard to vertical territorial restraints.

III

The development of the law regarding restrictions on the distribution of goods and services began with early efforts by manufacturers to set prices below which retailers could not subsequently resell their products. In the still leading case of *Dr. Miles Medical Co. v. John O. Park & Sons, Co.*, 220 U.S. 373 (1911), the Supreme Court ruled that a manufacturer who sells medicine to a wholesaler is not entitled to restrict resale through interference with the purchaser's pricing decisions. It relied on ancient property law rules making restraints on resale invalid. Where the purpose of the arrangement is to destroy competition by fixing prices, the Court held, the restraint is "injurious to the public interest and void." In reaching this result, the Court equated vertical price-fixing with horizontal cartel behavior. Since the latter was per se illegal, it followed that resale price maintenance was similarly prohibited.

The Court's assumption that a manufacturer's interest in eliminating price competition among its resellers is based on the same motives and consequences as those by resellers in forming a cartel, however, was badly flawed. That is, unless forced to do so by his retailers, the manufacturer would seem to have no interest in assuring retailers a monopoly profit, especially since it would be done at his expense. As one leading antitrust critic has correctly observed, a "rule of per se illegality was thus created on an erroneous economic assumption." R. Bork, *The Antitrust Paradox* 33 (1978).

Perhaps recognizing the infirmity of its own rule, the Supreme Court shortly cut back its prohibition of vertical price fixing by creating an exception to the per se rule in *United States v. Colgate & Co.*, 250 U.S. 300 (1919). There the Court allowed a manufacturer to control resale prices by the simple expedient of announcing his intention not to sell to price-cutters and then unilaterally refusing to sell to any retailer who failed to comply. However, the exception, which was based on the absence of any agreement essential to a Sherman Act contract, combination, or conspiracy, quickly proved illusory. Subsequent cases established that the "fatal element of agreement" might be found in price discussions with retailers, in their assurance that they would comply with the condition, or in the reinstatement of errant dealers after a disciplinary waiting period.

The *Dr. Miles* approach to vertical price fixing—that it denied the retailer his "right" to resell his property—led to another exception where the retailer was the manufacturer's agent and, instead of taking title, received the products on consignment. Thus in *United States v. General Elec. Co.*, 272 U.S. 476 (1926), the Court held that where it is clear that the arrangement is legitimate and that the manufacturer both retains title and bears substantial risks of ownership, the antitrust laws do not prevent him from dictating the terms of sale, including retail prices. In this circumstance the Court held that vertical price fixing is not illegal.

Here too the exception proved unreliable. First the legitimacy of consignment arrangements was attacked, the question being whether the retailers were in fact the manufacturer's agents. And then in *Simpson Oil v. Union Oil Co.*, 377 U.S. 13 (1964), the Court ruled that an oil company supplier had violated the antitrust laws of fixing the retail prices of its service station-consignees because the consignment arrangement was being used as a device to "coerce" nominal agents "who are in reality small struggling competitors seeking retail gas customers." Whether any form of consignment now provides safe passage for resale price agreements is uncertain. They were approved for nonprice restraints in *United States v. Arnold Schwinn & Co.*, 388 U.S. 365 (1967), where the consignment provided that "title, dominion and risk" remained with the manufacturer, and this part of the *Schwinn* decision was not overturned in *Sylvania* (discussed below).

The rigidity of the rule against all price-fixing is further shown by the Court's restatement of the rule in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), when it held that a publisher's effort to fix maximum resale prices charged by independent newspaper carriers was illegal per se. The Court was unmoved by the fact that such price fixing seemingly protected the consumer's interest and was justified by the paper's independent interest in keeping prices down (to increase circulation and advertising revenues).

The continued strength of the per se rule against vertical price fixing was further revealed in 1977 in the *Sylvania* decision. Even though the Court there recognized that vertical restrictions serve different purposes from horizontal cartels, it expressly reaffirmed its earlier commitment to a per se rule against vertical price fixing. 433 U.S. at 51 n.18. On the other hand, the Court did support a different rationale for its early ruling in *Dr. Miles* prohibiting resale price maintenance, namely that it reduces "price competition not only among sellers of the affected product, but quite as much between that product and competing brands." About all this suggests, however, is that the Court may ultimately back away from its rule against maximum price-fixing. Accord, Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions,* 78 Colum. L. Rev. 1, 16 n.59 (1978).

With the opportunity for vertical price restrictions essentially proscribed, especially after the "fair trade" law exception for the States was repealed in 1976, attention has focused on other distribution restrictions and in particular on manufacturer limitations on dealer territories and customers. Until the 1940's these arrangements were not challenged by the government and their lawfulness was upheld in several private actions. Then in 1948 the Department of Justice, relying on a Supreme Court opinion holding vertical territorial restrictions illegal per se if they were an integral part of an agreement to fix prices (*United States* v. *Bausch & Lomb Optical Co.,* 321 U.S. 701, 721 (1944)), announced that it would henceforth treat simple vertical territorial and customer restraints foreclosing intrabrand competition on the same basis. For several years this position went unchallenged; consent agreements negotiated by the Department of Justice enforced this view, but no case supported its position. However, during the past fifteen years the law has swung violently, from uncertainty to per se illegality and more recently to a flexible rule of reason approach, in three very different Supreme Court opinions.

Seemingly overturning the Justice Department's contention, the Court first reversed a summary judgment holding vertical territorial and customer restrictions illegal per se. *White Motor Co.* v. *United States,* 372 U.S. 253 (1963). White Motor had sold its trucks to dealers who agreed to resell them to customers not otherwise reserved to the manufacturer and who had a place of business within the assigned territory. Because of the meager summary judgment record and the Court's admitted inexperience with franchise limitations, the Court concluded that it did not "know enough of the economic and business stuff out of which these arrangements emerge" to be certain whether they stifle or invigorate competition. It therefore remanded the case for a trial on the merits. The opinion was widely interpreted, however, as adopting a rule of reason approach to vertical limitations—especially since three dissenters called for a per se rule. In fact the Court carefully held "that the legality of the territorial and customer limitations should be determined only after a trial." Following remand the case was settled, and the Court therefore did not have an opportunity to develop a rule on a full record.

It seemed, nevertheless, that a rule of reason approach would be applied as two Courts of Appeals subsequently upheld territorial restraints, and in each instance the court overturned a stringent Federal Trade Commission decision in order to apply a more flexible test. See *Sandura Co.* v. *FTC,* 339 F.2d 847 (6th Cir. 1964) (territorial restraints used in rebuilding a dealer organization after its market position had deteriorated); *Snap-On Tools Corp.* v. *FTC,* 321 F.2d 825 (7th Cir. 1963) (manufacturer was one of 80 firms in an intensely competitively industry with high dealer turnover). As indicated, each case presented appealing facts to support the territorial restrictions. and in light of subsequent developments, it is particularly noteworthy that neither *White Motor* nor the circuit court cases paid heed to the doctrinal distinctions developed in the vertical price fixing cases, namely, whether the provisions violated property law rights to resell property or whether title was retained by the manufacturer.

When the next case came before the Supreme Court four years after *White Motor,* the government retreated somewhat from its per se position and argued, in its brief, for a rule of presumptive illegality which would have required the defendant to justify any territorial rstrictions. It thus came as a surprise to antitrust followers, when, in *United States* v. *Arnold Schwinn & Co.,* 388 U.S. 365 (1967), the Supreme Court adopted a position even more restrictive than that put forward by the government. In condemning nonprice vertical restrictions, the Court ruled that "once the manufacturer has parted with title and risk. . . his effort thereafter to restrict territory or persons to whom the product may be transferred. . . is a per se violation of § 1 of the Sherman Act." Relying on the same rationale used a half-century earlier in *Dr. Miles* to condemn vertical price fixing, the Court said that such restrictions violate the "ancient rule against restraints on alienation." Thus the Court concluded that "under the Sherman Act it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it."

With this sweeping language the Court "threw into doubt the legality of every sort of post-sale vertical restriction on distributions other than exclusive dealing arrangements, regardless of the type of restriction or the market power of the supplier and dealers." Pitofsky, supra at 6. Not surprisingly, this abrupt change of directon drew a spate of criticism seldom matched in a decade of bitter debate about various antitrust rulings of the Supreme Court. See, e.g., Handler, *Twenty-Five years of Antitrust,* 73 Colum. L. Rev. 415, 458-59 (1973) (*Schwinn* is "the most egregious error in all of antitrust."); A.B.A. Antitrust Section, *Monograph No. 2, Vertical Restrictions Limiting Intra-Brand Competition* 9 n.24 (1977) (citing other criticisms).

Nor was all criticism mere hyperbole. As numerous scholars, both lawyers and economists, patiently explained, vertical territorial restrictions served many useful ends, usually to increase distributional efficiencies and lower costs. While occasional theoretical possibilities may exist for the misuse of such restrictions, primarily to facilitate horizontal cartels by manufacturers or retailers, the risk seems insubstantial where substantial and effective interbrand competition exists. That is, where firms selling different products compete vigorously, efforts by individual firms to achieve market efficiencies should be encouraged. The market will become even more competitive as a result, and in any case no individual firm's marketing strategy can have an adverse effect on competition in that circumstance. Moreover, since other avenues for vertical integration are open—especially by internal growth—barring integration by contract would be futile, except that it might force a manufacturer to select a less efficient distribution scheme (reducing competitive pressures) and in fact foreclosing opportunities for smaller retail firms.

As this analysis makes evident, whether vertical restrictions on distribution by customer and territory should be allowed is unrelated to the manufacturer retention of title or the dealer's appointment as his agent. Thus it seemed anomalous or worse to have the Supreme Court resolve a question of economic policy by resort to ancient (and unrelated) property law rules governing resale of personal property. The policy question is whether these restraints serve to make product distribution more efficient and interbrand rivalry more vigorous. To allow legal formalisms developed three centuries earlier for another purpose to dominate and decide antitrust law seemed absurd. With such an unstable base, it was only a question of time before the *Schwinn* per se rule would be distinguished and restricted.

Again, however, the process was not gradual and business was not allowed time to adjust and react. Rather, the law was changed abruptly and without warning by the Supreme Court. In the next case to reach its docket, shortly after the tenth anniversary of the Court's application of a per se rule to vertical territorial restrictions in *Schwinn*, the Court sharply reversed its direction, directly overruled *Schwinn*, and applied a rule of reason for every sort of nonprice vertically imposed dealer limitation. Although the case in fact involved dealer store location clauses, the Court's opinion was not so limited and it appeared to suggest that a flexible rule of reason test—balancing the benefits (in particular, business efficiency) against demonstrated costs—was to be applied in almost every circumstance where nonprice vertical restraints are under challenge. The critical factor in *Sylvania* was the Court's clear recognition that several significant efficiencies could be achieved by distribution restrictions. Among those cited by the Court are retailer investments, promotional activities, and quality controls. In reaching this result, the Court recognized the economic interests of competing suppliers and the value of allowing them almost untrammelled freedom in deciding which distribution system will serve their interests (and those of their customers). And it appeared to hold that the burden was on the government to show that the competitive "costs" overrode those possible gains.

That the Supreme Court announced a broad and flexible rule of reason test for nonprice vertical restrictions in *Sylvania* is indisputable. But as always seems to be the case with legal issues, or at least those involving antitrust, questions remained. The case, for example, involved location clauses which usually have only slight intrabrand effects—but the Court expressly chose not to limit its discussion so narrowly. In addition, the respondent accounted for less than five percent of the market; thus the clause could not have had a serious interbrand impact. Yet the Court appeared to place no reliance on *Sylvania's* size or market share as long as interbrand rivalry was present. Indeed, the Court specifically indicated that a supplier's market power would not justify reliance on a per se rule. 433 U.S. at 46 n.12. On the other hand, in a final passage seemingly constructed to assure a solid majority, the *Sylvania* Court carefully reserved the possibility that some vertical restrictions might justify per se prohibition in particular applications and that others might not survive a case examination of their competitive effects. Neither situation, however, was explained, although it seems difficult to imagine what circumstances the Court has in mind (if any).

These uncertainties were expanded and compounded by the Federal Trade Commission's recent decision in the *Cola* cases, that the territorial restraints historically required of franchised bottlers are unreasonable and violate Section 5 of the Federal Trade Commission Act. There the Commission's law judge had approved the legality of territorial provisions in trademark licenses to bottle and sell Coca-Cola and Pepsi-Cola. After making over 200 detailed findings of fact, he determined that the effect of the restraint on intrabrand competition among bottlers of these brands was far outweighed by its beneficial effect on competition in the marketplace as a whole. He therefore concluded that on balance the challenged territorial restrictions promote competition.

Two and one-half years later, a two member majority of the FTC, over the dissent of the other Commissioner participating in the decision, ruled that the territorial provisions were illegal because they eliminated intrabrand competition. In order to reach this result the majority first decided, as a matter of law, that the burden was on Coca-Cola and PepsiCo and their bottlers to demonstrate that the business justifications and the effect of the provisions to foster competition with other soft drinks outweighed any loss of rivalry among the bottlers. And this burden, the two person majority held, had not been met by the respondents. Even so, the majority recognized that the territorial provisions were justified when first adopted and all participating Commissioners found that the clauses did not involve horizontal collusion or other per se illegal conduct.

Whether the FTC's opinion in the *Cola* cases has improperly misconceived and misapplied the *Sylvania* standard for nonprice vertical restrictions such as the territorial provisions common in the soft drink industry—even under the limited judicial review standard applicable to administrative agency decisions—is now before the District of Columbia Court of Appeals and prediction of the legal outcome would be gratuitous. As a matter of antitrust policy, however, affirmance would seem a disturbing backward step and a retreat to the illogic of *Schwinn's* per se approach. For the essence of the Federal Trade Commission's two member position is that admittedly efficiency enhancing territorial provisions will not be saved if the intrabrand effect is not insignificant. The Commission's rule would place the burden on the respondent—a burden which few seem likely to satisfy—and in direct opposition to settled antitrust doctrine as well as the provisions of the Administrative Procedure Act. See 5 U.S.C. § 556(d).

That this approach misunderstands the Supreme Court's purpose in *Sylvania*—which has been so highly praised by every commentator (of whatever persusaion)—seems clear. There, it will be recalled, the Court found that the consumer welfare is best served by promoting interfirm competition. And if that competition is substantial and effective, as was undisputed in the *Cola* cases, then internal efforts to achieve efficiency can only be procompetitive and beneficial to consumer interests (even though intrabrand competition is eliminated). To prohibit such efforts to achieve vertical efficiencies runs the risk that competitive vigor will be diminished and consumer welfare decreased. It also places undue emphasis on the elimination of intrabrand rivalry, an automatic but unusually insignificant casualty of every move toward vertical integration.

The Commission's decision in the *Cola* cases is also disturbing for the instability it has reintroduced to the rules governing nonprice vertical restrictions just one year after the Supreme Court sought to resettle matters in *Sylvania*. Instead of focusing its attention on the use of such restrictions where interbrand competition is limited and therefore more deserving of careful scrutiny, the Commission has sought to read the rule of reason standard so as to condemn restrictions which should be of no concern—when competition is substantial and effective.

IV

In reviewing the primary substantive provision of H.R. 3567—Section 2's directive that territorial customer restrictions in trademark licenses for soft drink products *are not unlawful under the antitrust laws if substantial and effective interbrand* competition exists—three questions need to be addressed: (1) what is the meaning of H.R. 3567? (2) what is the relationship of H.R. 3567 to the Supreme Court's decision in *Sylvania*? and (3) what will be the likely effect of H.R. 3567 if adopted?

The operative provisions of H.R. 3567 regarding the legality of nonprice vertical restrictions are simple and forthright. The bill is limited, first, to trademarked soft drink products where similar provisions have been relied upon for decades to support a large industry. Second, the proposed legislation only applies to territorial and customer restrictions. It does not involve other vertical restrictions such as price fixing or tie-ins which are usually subject to more stringent legal constraints. Rather it would govern in an area of well accepted territorial and customer restrictions whose purposes have been carefully considered and thoroughly explored, with the result that they are generally viewed as enhancing competition. Finally, and most importantly, H.R. 3567 would protect such contract clauses from antitrust liability only where "substantial and effective competition" exists. That is to say, there must be vigorous rivalry among competing soft drink products before relationships between the syrup manufacturer (and trademark owner) and the bottler are protected by this legislation. The result of H.R. 3567, then, is generally to limit the required inquiry, at least initially, to a determination of whether such competition exists. If that finding can be made, the practice would be upheld. On the other hand, if this level of competitive activity cannot be found, the restrictions would be subject to the *Sylvania* tests.

A reading of H.R. 3567 alongside the Supreme Court's decision in *Sylvania* reflects their similar purposes. Each is based on the understanding that competition is enhanced through interfirm rivalry and that it is this area of antitrust law enforcement that should be the primary concern. That is, consumer welfare is generally improved through competitive efforts by independent firms seeking to increase their position in the market. This rivalry may involve lower prices, improved quality, enhanced flavor, better service, increased information through advertising, and so forth, all designed to attract consumer support. In this connection, the competitive efforts of independent firms may be strengthened by lowering distribution costs, attracting effective dealers, retaining dealer loyalty and support, and focusing their efforts on developing increased customer purchases. These "efficiencies," the Supreme Court found in *Sylvania*, are aided by territorial and customer limitations. It therefore concluded that such nonprice restrictions should be tested under a rule of reason analysis. Where interbrand competition exists—and thus is strengthened as a consequence of the territorial or customer restrictions—the restrictions are lawful.

In this connection, both the law judge and all FTC Commissioners also agreed in the *Cola* cases that the territorial and customer clauses used in the soft drink industry were designed for similar purposes. Thus, a legislative determination in H.R. 3567 that such nonprice vertical restrictions satisfy the antitrust laws if "substantial and effective competition" exists among soft drink products seems fully congruent with the general thrust and particular applications of the Court in *Sylvania*—and the findings of fact in the *Cola* cases. H.R. 3567, in other words, would be a declaration by Congress that the rule of reason test restated in *Sylvania* is satisfied by a showing that the market place in which the firm uses a territorial or customer clause exhibits substantial and effective competition.

The effect of H.R. 3567's passage is specific and clear. It would remove the confusion generated by the FTC's two member decision in the *Cola* cases and assure stability and continuity to the Supreme Court's ruling in *Sylvania* that nonprice vertical restraints are subject to a rule of reason analysis. In addition, H.R. 3567 would build on the primary theory of *Sylvania* and specify that territorial and customer restrictions in the soft drink industry are lawful under the antitrust laws where "substantial and effective competition" exists. Recognizing that these restrictions are generally used for efficiency enhancing purposes, and supported by the FTC law judge's findings of fact that in the soft drink industry territorial and customer restrictions have been used to promote interfirm competition, the Congress would be making a determination that the rule of reason is fully satisfied by a finding that competition is vigorous and significant.

One further result of H.R. 3567, consistent with the recommendations made by the President's National Commission for Review of Antitrust Laws and Procedures, is to shorten and simplify antitrust trials where the lawfulness of nonprice vertical restrictions on territories and customers in the soft drink industry is being questioned. This alone is an important objective. For example, the FTC's administrative trial in *Coca-Cola* lasted six weeks, heard from 43 witnesses, and developed a record of 4,000 pages of trial transcript, 14 stipulations encompassing 500 pages, and 1,300 exhibits in still more thousands of pages. The law judge's initial decision upholding the legality of territorial provisions in the trademark licenses to bottle and sell Coca-Cola required an added 91 pages.[1] And the Commission and courts are now supplementing this page log.

Under H.R. 3567 the initial and, in most instances, deciding question would be whether substantial and effective competition exists. This issue is narrowly focused and confined, and would usually be answered after only a brief round of discovery and a short trial—or even without a hearing since the evidence could be submitted to the trial judge for decision upon expert submissions. Simplifying and expediting the resolution of antitrust cases by revision of substantive rules of law is an important national objective, a point that was reinforced by the President when he made this the first responsibility of the National Commission. See Executive Order 12022, § 2(a)(1) (December 1, 1977). Where policy and law make it clear that territorial and customer restrictions cannot have adverse effects—because vigorous competition exists in the market—no purpose is served by lenghty antitrust trials.

Nor is H.R. 3567 written so broadly that it will confer protection on any collusive or exclusionary practices. That is, where territorial or other nonprice restrictions are being used for such pernicious purposes—and this can be demonstrated by other evidence—H.R. 3567 provides no immunity. Price fixing by competing firms or market divisions by producers of competing soft drink products, for example, would continue to be fully subject to antitrust scrutiny and legal prohibition; and if used in conjunction with vertical territorial or customer restrictions, these actions would not be insulated in any way by H.R. 3567. The aim and effect of H.R. 3567 is solely to guarantee that the syrup producers and the distributors of trademarked soft drink products are free to select the most efficient means of distribution available and to assure consumers the benefits of substantial and effective competition.

V

There is one final question I want to address, and that is whether H.R. 3567 is necessary in light of the Supreme Court's sensitive and sophisticated treatment of vertical territorial and customer restrictions by *Sylvania* in 1977. When similar legislation was first considered by Congress, the Court had issued its rigid and surprising *Schwinn* rule and the Federal Trade Commission was threatening to dismantle this system of arrangements by which the soft drink industry had been built. Had the Congress acted then, the objections now being raised to this legislation would seen insubstantial.

The answer to this argument and its many variations before this Committee is, it seems to me, both reasonable and compelling. The threat of antitrust enforcement action challenging territorial and customer restrictions is as real today as it was after *Schwinn* was first decided in 1967. Antitrust enforcement agencies such as the Federal Trade Commission have not understood the clear message of *Sylvania* and have been undeterred by it in their challenge to these vertical nonprice restaints. Indeed the FTC acts almost as if the law had never changed.

[1] The contemporaneous *PepsiCo* cased required an additional 278 pages of transcript and initial decision.

For example, the Commission first challenged these agreements by issuing an administrative complaint against Coca Cola and PepsiCo in 1971. The matter was then tried before an FTC Administrative Law Judge whose findings included a determination that substantial and effective competition existed among syrup makers and bottle distributors. He further found that these historic territorial and customer restrictions were not adopted for any anticompetitive purpose and, anticipating the Supreme Court's analysis in *Sylvania,* that they enhanced interfirm competition by protecting bottler investment in plants, promotional efforts, sales and service arrangements and other efforts to develop customer loyalty. Despite the clarity and soundness of the Law Judge's findings and rulings, the FTC's prosecutorial staff appealed the case to the full Trade Commission. In the meantime, of course, in 1977 the Supreme Court rendered its historic *Sylvania* decision announcing a new rule of law and seemingly undercutting the entire ground on which the FTC's original *Cola* complaint was based. Underterred by change of circumstance, new law or well developed legal findings, the FTC's staff counsel pursued the case and ultimately persuaded two commissioners that the territorial/customer arrangements here constituted unreasonable restrainst of trade. In doing so the two commissioners adopted a curious and novel interpretation of *Sylvania*—that its finding of an adverse effect on *intra*brand competition from the territorial constraints (a necessary effect if they were to accomplish their procompetitive purpose) was a sufficient basis on which to condemn them without regard to the existence of substantial and effective interbrand rivalry.

What this legislation would do, then, is preserve Congress' historic oversight function of the executive branch and the independent agencies. That the Federal Trade Commission needs, deserves and justifies close control is well documented [2] and Congress has already taken steps in other areas to impose restrictions on this and other areas to impose restrictions on this and other agencies. However, the Federal Trade Commission and a few others have criticized such efforts at control when attached to appropriations requests and during an ongoing investigation or prosecution. Whatever their validity elsewhere, neither argument seems well-placed in this instance. Here the substantive antitrust issue raised by H.R. 3567 is being considered separately from other questions and only after exhaustive and careful legislative hearings and investigation. To be sure the FTC's *Cola* case is still before the Court of Appeals for the District of Columbia. That matter, however, is approaching its tenth anniversary and the FTC should no longer be heard to argue that it is not appropriate for Congress' determination. In addition, the FTC *Cola* case was considered by the court of appeals over one and one-half years ago. In the meantime, one member of that panel has since died, and the case thus may not be close to resolution. In any case, a decision of one circuit court, while significant, would not be dispositive; and it seems unlikely that the Supreme Court would be willing to examine the issue once again after having announced a major shift in the law but three years ago.

A final and related argument sometimes made against this legislation is that it favors one industry and special interest exemptions should not be written into the antitrust laws. History certainly would support this argument if it were true. Again the point is misplaced. First H.R. 3567 does not write an exemption into the antitrust laws. It merely focuses attention on the correct analysis that where a market is competitive and the consumers are therefore receiving the benefits of firm rivalry—and that standard and goal is the one Congress established in the antitrust laws—then it serves no purpose to threaten firms operating in this market with antitrust liability and damage actions because they have adopted vertical nonprice restrictions that can have no effect on interbrand rivalry. That is to say, this legislation directs the courts, agency and antitrust plaintiffs to prosecute more significant matters which may injure consumers and the economy. While a strong case can be made to include all products, services or goods in this rule, H.R. 3567 adopts a more cautious approach. It is limited to trademarked soft drink products because the evidence is clear and convincing—as distinguished economists such as Oliver Williamson, Lee Preston and Victor Goldberg have carefully demonstrated—that interbrand rivalry at the manufacturer and distributor levels in this industry is intense. This industry thus seems an appropriate place to draw the line and provide further guidance. It is also necessary because such nonprice restrictions follow a historic tradition in this industry, and have led to the competition now present in the field; thus their threatened removal poses a substantial danger not only to the firms in the industry but also to the consumers who are the beneficiaries of this competition.

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[2] *See* Gellhorn, *The New Gibberish at the FTC,* 2 Regulation 37 (May/June 1978); Gellhorn, *The Wages of Zealotry: The FTC Under Seige,* 4 Regulation 33 (Jan./Feb. 1980).

In sum, adoption of this proposed legislation not only poses no threat to competition, but it also is designed to preserve and foster that rivalry which has made this industry so competitive today.

Professor GELHORN. I appreciate your inclusion of my statement in the record. As a consequence, I will summarize the essence of it on the basis of my support of H.R. 3567.

I would like to take a few moments to look at three issues which I think are central to this committee's consideration and to your evaluation of this proposed amendment of the antitrust laws.

First, I want to draw your attention to the distinction between horizontal and vertical restrictions.

Second, I would like to focus on the law regarding vertical restraints.

And third, I will consider specifically what the effect of H.R. 3567 would be any why I believe it is necessary.

Antitrust is an effort to keep markets open and free because of two concerns:

One is a concern that a firm with market power, essentially a monopolist, might use that power to exclude others. These are called exclusionary tactics.

The second area of concern is that independent firms would get together and achieve the effects of monopoly power, specifically to divide markets between them, or to fix prices.

The concern in either case, whether we are talking monopoly or collusive activities to achieve monopoly power, is that the firm or firms will get together, restrict the output of that industry, and raise prices.

This is a concern to consumers because they will pay more. Resources will not be used effectively. Pressures to reduce costs, to innovate, will eliminate themselves from the marketplace.

These are the concerns also created by horizontal market arrangements. However, vertical restrictions, that is between a manufacturer and a retailer, usually have no such effect. In general, economists have assessed vertical arrangements and suggested that their primary effect is to improve the efficiency in the delivery of goods and services.

As a consequence, although the law started out originally very hostile to vertical arrangements, in recent years, and particularly in 1977, the Supreme Court said that such arrangements should be viewed under what is called a "rule of reason," to determine whether or not they are likely to be effective in benefiting the marketplace; or whether there is a possibility, because of other factors (such as horizontal market arrangements or monopoly power) they might be used to impair the effectiveness of competition in the marketplace.

As I indicated, the law initially was very hostile to vertical arrangements. Starting in 1911, the Supreme Court in *Dr. Miles* said that resale price maintenance agreements whereby the manufacturer set the price at which the retailer distributed his goods were illegal automatically.

It did so, however, not looking at the effect of such arrangements, but rather by adopting essentially the idea that since horizontal price fixing was undesirable it therefore followed that price fixing shouldn't be available in vertical arrangements.

In reaching that conclusion, in fact, the Court relied not on an economic assessment of the market, nor on the purposes of the antitrust law, but rather on ancient property law rules, that one who had sold the property was no longer in a position to restrain its use.

As the Court said, the common law rule restraints against alienation, which we lawyers are fond of, for example, in dealing with the rule of perpetuities, should be applied in this instance. Though the Court didn't use this precise language, that was the effect of its decision.

Dr. Miles was, however, a special rule of price fixing, and the Court relatively quickly determined that it was not particularly effective in dealing with marketing arrangements. Thus it began to build some exceptions.

First in 1919, in the *Colgate* case, it allowed manufacturers the right to refuse to deal if they could determine that it was better for their business not to deal with a particular customer.

And then in 1926, building on an exception in the *Colgate* case, the Court carved out a second exception—in the *GE* case—to say that if the manufacturer or producer did not part with the title for the goods, but rather distributed them on a consignment basis and retained title, dominion and risk, that that would not be subject to the *Dr. Miles* rule.

This was a rule essentially of vertical pricefixing, and until the mid-1940's, it was long assumed and had been held by many lower courts that nonprice restrictions, allocations of territories and customers, areas of primary responsibility, locations, tie-ins, et cetera, were not subject to the same rigorous or rigid rule.

However, in 1948, the Justice Department decided, based on a 1944 Supreme Court decision focusing on vertical price restrictions, to propose a per se rule, making it automatically illegal for a manufacturer to assign exclusive territories for customers to his retailers or distributors.

There was no Supreme Court test of this proposal by the Justice Department until 1963 in the *White Motor* case. There the district court had accepted the Justice Department's proposal and applied a per se rule to customer and territorial allocations, on appeal, the Supreme Court reversed in 1963, saying, "We don't know enough about these business arrangements and the stuff out of which they are made," to use the Court's language, "for us to apply a rigid rule." They said, "We have to be more adequately informed."

The Federal Trade Commission, following that decision, in 1963 and 1964, nevertheless persisted in applying a very rigorous and rigid rule against vertical nonprice restrictions.

However, the courts of appeals—in one case, the Seventh Circuit in *Snap-On Tools,* and in other case, the Sixth Circuit in *Sandura*—said that it was inappropriate to apply an automatic rule of illegality. This it appeared that a rule of reason would be applied.

Nonetheless, the Justice Department persisted in its per se approach, and by 1967, in the *Schwinn* case, persuaded the Supreme Court to adopt and transfer its rigid rule against price fixing on a vertical basis from *Dr. Miles* over to the *Schwinn* situation, even though these were merely customer allocations and territorial provisions.

They followed what every commentator, to my knowledge, bar one, has viewed as a formalistic, arid property law distinction to govern business arrangements, saying only 4 years after *White Motor*—when the Court said it didn't know enough about such arrangements to apply a per se rule—to say that as soon as the manufacturer has parted with title, domination or risk, that vertical nonprice restrictions are automatically illegal.

It was a decision, however, that was doomed to fail ultimately. It was formalistic, it had no apparent rationale, it was grounded in property law and ignored the business stuff out of which it was developed. It therefore was not surprising that the lower courts, following the commentators, constantly distinguished, excepted, and to some degree, frankly, misapplied the *Schwinn* rule, in order to avoid its effects.

Then 3 years ago, in 1977, the Supreme Court, in what I think is an extraordinarily sophisticated and sensitive opinion, in examining a location clause—though it said its opinion went far beyond location clauses and also went to territorial allocations and customer assignments—said that even though a location clause has the purpose "to decrease the number of competing retailers in the hope of attracting more aggressive and competent retailers, thought necessary to the improvement of the company's market position," despite that adverse effect intraband, within a company, nevertheless, we should not be applying a per se rule.

The Court said instead, "We should look at what is the economic basis for this arrangement." Even though there will be fewer retailers of the product, even though it will limit the retailers' freedom, even though the intraband competitive effect may range from partial to complete, in terms of barring such competition, the arrangement should be measured by its economic effect. The Court nevertheless rejected the *Schwinn* rule, rejected the argument of the Justice Department in *Schwinn*, and said that a rule of reason, an understanding of this business arrangement, was necessary.

Why did it say so? It said so because what we need to do is promote interbrand competition; what counts in the marketplace in terms of price, service, quality, is the struggle between competing firms; and we should permit firms to select their own most efficient way of distributing their product. It said that this is not something the Justice Department, the Federal Trade Commission, or others, can advise this businessman as to how to do most effectively.

The difficulty—and now I want to pass from the law to the support for this bill—is that the Court's message apparently has not been received by all enforcement agencies, and in this case particularly the Federal Trade Commission. For in 1971, the Federal Trade Commission, when the *Schwinn* rule was still applied, filed a complaint against Coca-Cola and PepsiCo and six other sirup manufacturers, claiming that their territorial restrictions and customer allocations and their franchise arrangements were illegal.

Complaint counsel, on behalf of the Federal Trade Commission, filed a motion for summary judgment based on the per se rule, however, the administrative law judge, anticipating the switch in law, ruled that that motion for partial summary judgment was inappropriate and tried the case on a rule-of-reason basis.

The administrative law judge's opinion is a sensitive, thoughtful, and careful assessment of that industry. He made 200 detailed findings of fact, and said that the effect of these arrangements was to promote rigorous rivalry among the brands; that price competition was keen, to use his word; that competition within the industry generally, to use his words again, was intense.

Therefore, he ruled that these restrictions were permissible under the antitrust laws.

Following his decision the FTC staff appealed. By then, at least when the case was finally heard by the Commission, the *Sylvania* case had been decided.

Despite the switch in law, the Federal Trade Commission staff appealed on alternative grounds, one of which was we still need to apply a per se rule here.

A two-member majority of the Federal Trade Commission overturned the administrative law judge's findings, and adopted what I would suggest is a disguised per se rule here, ignoring the Supreme Court's mandate.

It said that even though the administrative law judge determined that competition was intense among these brands, and that in localized markets there was intense price competition, nevertheless, the majority pointed to the fact that intraband competition was not only reduced, but eliminated by the arrangements. To which, of course, the immediate response is, "Of course, that's the purpose for adopting them."

That's precisely what the Supreme Court understood in 1977 when it adopted the *Sylvania* case.

OK. Now specifically to the legislation, in light of that turbulent and somewhat confused history in the courts and the agencies.

The bill provides that where substantial and effective competition exists, territorial and customer restrictions would be lawful under the antitrust laws.

What this bill does, in essence, then, is enact into legislation the standard approved by the Supreme Court in essence in Sylvania. It is, in other words, a direction to the Federal Trade Commission in part.

[NOTE.—This bill would not exempt and does not exempt in any way the trademarked soft drink producers, that is the sirup makers or the bottlers, from the antitrust laws.]

It says only that if substantial and effective competition exists that the antitrust laws cannot be used to hold them liable for vertical nonprice arrangements, specifically territorial and customer allocations.

This bill would, in other words, reflect a legislative judgment that where competition exists, as for example found by the administrative law judge, nonprice vertical restrictions generally pose no danger to competition, and would be in accord with the views of virtually all reputable economists who have studied the field, particularly Oliver Williamson of Pennsylvania; Lee Preston of Buffalo; and Victor Goldberg of California.

Why this legislation if the Supreme Court has already spoken in this regard? If the Federal Trade Commission were more sensitive and attuned to what the Supreme Court had said, I would be less insistent in terms of my arguments. But in light of the Federal

Trade Commission's persistence, and in light of the threat of treble damage liability, it would be desirable in this instance, I believe, to clarify the legal rule in connection with trademarked soft drink territorial and customer allocations. These restrictions are part of an industry history which the administrative law judge and the two-member majority of the Federal Trade Commission acknowledged, were adopted for pro-competitive purposes. In addition the economic evidence indicates that intense rivalry exists.

[NOTE.—This legislation is a flexible response since it does not permit any exemption, but rather is a ruling that where substantial and effective competition exists, the antitrust laws should not be applies, to bar nonprice vertical restrictions.]

Its effect would be to simplify and speed trials in this area, because the only question would be, does substantial and effective competition exist. If it does, that is the end of the case. If it does not exist, of course, then a *Sylvania* type trial should be held.

It would also provide specific, and I think clear instruction, to both the Federal Trade Commission and the circuit courts.

Thank you very much.

Mr. MAZZOLI. Professor Gelhorn, thank you very much for your statement, and now we hear from Professor Rose. Thank you very much for your attendance, sir.

TESTIMONY OF PROF. JONATHAN ROSE, COLLEGE OF LAW, ARIZONA STATE UNIVERSITY

Professor ROSE. Thank you very much. My name is Jonathan Rose, and I teach at the College of Law in Arizona State University. I am honored to have been invited to appear before the committee, and I am always anxious to let people know that between the football stadium and the baseball diamond, there is a law school as well.

I have a lengthy prepared statement that I would ask be made a part of the record.

Mr. MAZZOLI. The gentleman's statement will certainly be made part of the record, and we will certainly acknowledge for the record, that Arizona State is more than just simply the athletic situation. [Laughter.]

[The statement follows:]

Statement of

JONATHAN ROSE
Professor of Law
College of Law
Arizona State University
Tempe, Arizona

on

H.R. 3567
"The Soft Drink Interbrand Competition Act"

Before the

Subcommittee on Monopolies and Commercial Law
House Judiciary Committee

Washington, D.C.

April 29, 1980

My name is Jonathan Rose and I am currently a Professor of Law at Arizona State University, College of Law, in Tempe, Arizona. My principal areas of teaching and scholarly experience have been in antitrust and economic regulation. My curriculum vitae is attached. I am honored to have been invited by this Committee to testify on H.R. 3567, the "Soft Drink Interbrand Competition Act."

I. Introduction

The main thrust on H.R. 3567 is to insure that the use of exclusive geographic territories in trademark licenses involving the distribution and sale of trademarked soft drink products is lawful under the federal antitrust laws provided that the products are "in substantial and effective competition with other products of the same general class." This practical effect of this bill would be to create a rule of presumptive legality under the described conditions, with the presumption overcome only by proof that the soft drink products were not "in substantial and effective competition with other products of the same general class." The bill would also severely limit the right of injured parties to sue for treble damages. In particular, Section 3 of the bill provides that no private damage action regarding an exclusive territorial provision in a trademark licensing agreement for soft drink products may be maintained under Section 4 of the Clayton Act prior to any final determination that such a provision was unlawful.

This legislation apparently originates out of the efforts of the FTC to eliminate the use of exclusive geographic territories in the soft drink industry. Since these activities and decisions have been described in some detail elsewhere, I will only briefly summarize these events. Initially, the FTC brought actions against Coca Cola and Pepsico, Inc., alleging that the use of exclusive territories violated Section 5 of the Federal Trade Commission Act. The administrative law judge found for the respondents, holding, in a long opinion, that the exclusive territories did not violate Section 5 of the FTC Act. The decision of the administrative law judge was overturned by a two-to-one decision of the Federal Trade Commission, which held that the exclusive territories did violate Section 5 of the Federal Trade Commission Act and appropriate remedial orders were entered.[1] In summary, the Commission held that the use of exclusive territorial restrictions by Coca Cola and Pepsico unreasonably restrained both intrabrand and interbrand competition in the soft drink industry. The FTC rejected the respondent's arguments that the territorial restrictions promoted competition and were specifically necessary in order to spur necessary capital investment by bottlers, to promote delivery to low-volume customers, to encourage bottlers to engage in local advertising, to insure quality control, and to protect small bottlers. With regard to such contentions, the Commission

1. In the matter of the Coca Cola Company, 91 FTC 517, 607 (1978); In the matter of Pepsico, Inc., 91 FTC 680, 691 (1978).

held that either the restrictions would not have produced such benefits and their elimination would in fact increase rather than diminish competition, that there were less restrictive alternatives for achieving the benefits or that the benefits were inconsistent with the history and purpose of the Federal Trade Commission Act as well as the policies of competition and efficiency. The FTC decision has been appealed in the Court of Appeals for the District of Columbia.

In general, this legislation attempts to create a different and special standard that would govern the use of exclusive territories in the soft drink industry than would be the case under current antitrust principles. Thus, this legislation does not really create an exemption from the antitrust laws as is the case, for example, with the insurance industry,[2] or agriculture.[3] Instead, the bill would amend the antitrust laws to create a new substantive standard to guide the application of those laws to the soft drink industry, as Congress has done with the newspaper industry[4] and the banking industry.[5]

I oppose this legislation for three reasons: 1) it is not needed; 2) it adopts a standard that is inappropriate and

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2. See, 15 U.S.C. §§ 1011-15, the McCarran-Ferguson Act.

3. See, 7 U.S.C. §§ 291-292, the Capper-Volstad Act.

4. See, 15 U.S.C. §§ 1801-1804 (1973), the Newspaper Preservation Act.

5. See, 12 U.S.C. § 1828 (1973), the Bank Merger Act of 1966.

unwise; and 3) it involves special legislation. In the subsequent portions of this testimony, these three points will be developed in greater detail.

II. H.R. 3567 is Unnecessary

Existing standards under the antitrust laws are adequate to deal with exclusive geographical territories; and therefore this legislation is not needed. In order to understand why further legislation is unnecessary, it is useful to summarize the treatment of exclusive territories under the antitrust laws. Since there has been other testimony on this matter, this summary will be brief. The first significant case in which the Supreme Court dealt with this problem was White Motor Co. v. United States.[6] In White Motor, the Department of Justice argued that the vertical territorial restrictions involved in that case should be treated as per se violations of the Sherman Act. After reviewing the rationale and application of the per se rule in antitrust law, the Supreme Court refused to adopt it in the case of vertical territorial limitations. The Court stated with regard to effect of such restrictions that

> we do not know enough of the economic and business stuff out of which these arrangements emerge to be certain. . . . We need to know more than we do about the actual impact of these arrangements on competition to decide whether they have such a 'perni-

6. 372 U.S. 253 (1963).

> cious effect on competition to decide any redeeming virtue' and therefore should be classified as per se violations of the Sherman Act.[7]

Consequently, the Supreme Court reversed and remanded the case for determination after a trial. Thus, it appeared that the rule of reason, not the per se rule, would govern the legality of exclusive territorial arrangements under the antitrust laws. In fact, shortly after the Supreme Court decision in White Motor, two courts of appeals reversed FTC decisions that had applied a test more stringent than the rule of reason to vertical territorial restrictions.[8] The legality of vertical territorial restrictions under the antitrust laws was again presented to the Supreme Court in United States v. Arnold Schwinn & Co.[9] In a well known, and, probably more accurately, an infamous opinion, the Supreme Court held that vertical territorial restrictions were per se unlawful in sales transactions since a manufacturer's attempt to confine territories would

> violate the ancient rule against restraint on alienations. . . . Once the manufacturer has parted with title and risk, he has parted with dominion over the product, and his effort thereafter to restrict territory or persons to whom the product may be transferred--whether by explicit agreement or by silent combination or understanding

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7. 372 U.S. at 262. (Citations omitted)

8. See, Sandura Co. v. FTC, 339 F.2d 847 (6th Cir. 1964) (territorial restrictions promoted competition because of declining market position of firm); Snap-On Tools Corp. v. FTC, 325 F.2d 825 (7th Cir. 1963)(highly competitive industry with numerous firms and high dealer turnover).

9. 388 U.S. 365 (1967).

with his vendee--is a per se violation of Section 1 of the Sherman Act.[10]

The Supreme Court held further that a rule of reason would be applied in non-sale transactions since there were possible redeeming virtues. The precise meaning of the Schwinn decision was not completely clear in light of particular language in the Court's opinion. Nevertheless, the Court's holding and its approach distinguishing between sale and non-sale transactions was heavily criticized by numerous antitrust lawyers and scholars.[11] Moreover, lower courts frequently limited the holding of Schwinn and seemed to find ways to treat vertical territorial restrictions less stringently.[12]

The last, and most important, chapter in the Supreme Court's development of the antitrust principles to be applied to vertical territorial restrictions was its recent holding in Continental T.V., Inc. v. GTE Sylvania, Inc.[13] In Sylvania, the Supreme Court indicated quite clearly that all vertical territorial restrictions should be judged under the rule of reason, not the per se rule. The Supreme Court could have narrowed and distinguished Schwinn since Sylvania involved a location clause, not an exclusive territory as in Schwinn. However, and wisely according to most antitrust commentators,

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10. 388 U.S. at 382.

11. For a partial list of critical authorities, see, Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 48 n.13 (1977).

12. See, e.g., Tripoli Co. v. Wella Corp., 425 F.2d 932 (3d Cir. 1969, cert. denied, 400 U.S. 831 (1970).

13. 433 U.S. 36 (1977).

the Court eschewed a narrow approach to the problem and used the occasion to overrule Schwinn expressly. The Court stated "accordingly, we conclude that the per se rule stated in Schwinn must be overruled."[14] While the Court did leave some ambiguity regarding a continuing role for the per se rule in this area, it stated "in sum, we conclude that the appropriate decision is to return to the rule of reason that governed vertical restrictions prior to Schwinn."[15] Therefore, antitrust lawyers and commentators now generally state that under the existing antitrust standards prevailing today, vertical territorial restrictions are governed by the rule of reason.

In overruling Schwinn and announcing a rule of reason for testing vertical territorial restrictions, the Supreme Court recognized that such vertical restrictions might promote interbrand competition as well as reducing intrabrand competition. The Court recognized that in numerous situations the benefits to interbrand competition may outweigh any harm that resulted from restricting intrabrand competition. In particular, the Court recognized that "vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products."[16] In particular, the Court recognized that such restrictions facilitated

14. 433 U.S. at 58.

15. 433 U.S. at 59.

16. 433 U.S. at 54.

entry into new markets and induced "retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products."[17] The Court also recognized that vertical territorial restrictions would induce retailers to engage in these activities by eliminating the possibility that other retailers would take advantage of their efforts, the "free rider" effect.

Despite the use of the rule of reason with vertical territorial restrictions, horizontal territorial restrictions are treated as per se illegal,[18] and resale price maintenance (vertical price fixing) is per se illegal.[19] In its opinion in Sylvania, the Supreme Court made it clear that it did not intend to alter the per se rules applied to horizontal market restrictions and resale price maintenance.[20]

The standard developed by the Supreme Court in Sylvania is adequate and appropriate to deal with the social harms and benefits involved in the use of vertical territorial restrictions. Thus this legislation is unnecessary. In fact, the initial position of the soft drink industry as reflected in the earlier legislation presented to Congress was that Congress

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17. 433 U.S. at 55.

18. See, United States v. Topco Associates, Inc., 405 U.S. 596 (1972).

19. See, e.g., Albrecht v. The Hearld Co., 390 U.S. 145 (1968); Dr. Miles Medical Co. v. John D. Park & Sons, Co., 220 U.S. 373 (1911).

20. See, 433 U.S. at 51 n.18, 57-58 n.27-28.

should legislate a standard identical to that which the Supreme Court has now adopted in the Sylvania decision.

It is important to point out that the issue before Congress is not whether territorial restrictions promote efficiency, are otherwise beneficial or whether the use of the per se rule is inappropriate in the case of vertical territorial restrictions. The issue is whether legislation is necessary given the current state of the law. Emphasizing this distinction is important since much of the testimony before Congress has identified the benefits of territorial restrictions. For example, Professors Posner and Williamson have testified regarding a variety of efficiency gains that result from the use of vertical territorial restrictions. Professor Posner and others have also written widely on this subject.[21] Professor Posner has emphasized the utility of exclusive territorial restrictions in inducing retailers to engage in promotional activities and provide necessary service and repair facilities since the restrictions eliminate the free rider problem. In fact, these were the types of benefits recognized in Sylvania by the Supreme Court, which was clearly influenced by Professor Posner's writings. Professor Williamson has pointed out that vertical territorial restrictions may achieve

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21. See, e.g., Posner, The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision, 45 U. of Chi. L. Rev. 1 (1977); Posner, Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions, 75 Colum. L. Rev. 282 (1975).

transactional efficienies by permitting a firm to minimize the uncertainties and difficulties that would arise if it were forced to use nonrestrictive market arrangements for the distribution of its products. Professor Williamson has written widely on the significance of transaction efficiencies in motivating firms and in shaping a wise antitrust policy.[22] It would not seem necessary to describe in further detail the possible efficiency gains and other benefits that may result from the use of vertical territorial restrictions in light of previous testimony on these matters. Other scholars have pointed out that vertical territorial restrictions may also have anticompetitive effects.[23]

I would agree with many of the arguments advanced by Professors Posner, Williamson and others regarding the efficiency gains that may result from vertical territorial restrictions. In many instances they may promote interbrand competition and such benefits may outweigh the harm resulting from restrictions on intrabrand competition. However, the validity to these arguments regarding efficiency and territorial restrictions does not mean that territorial restrictions in the soft drink industry, or in the factual settings presented to FTC in Coca Cola and Pepsico, Inc., promote efficiency or that their net effect is

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22. See, e.g., O. Williamson, Markets and Hierarchies: Analysis and Antitrust Implications (1975); Williamson, Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach, 127 U. Pa. L. Rev. 953 (1979).

23. See, e.g., Comanor, Vertical Territorial & Customer Restrictions: White Motor & Its Aftermath, 81 Harv. L. Rev. 1419 (1968).

positive. In fact one study has concluded that "the principle effect" of territorial restrictions in the soft drink industry is to raise costs and prices and protect inefficiency.[24] I would also agree that a per se approach to vertical territorial restrictions is inappropriate and unwise. However, as indicated, these questions are not the critical issues nor disputes before Congress. The issue before Congress is whether additional legislation is necessary.

Further legislation is not necessary since the standard articulated by the Supreme Court in Sylvania is responsive to these considerations. Under the rule of reason the courts are permitted to balance the harms and benefits of particular conduct. Certainly the rule of reason permits the courts to take into account the type of efficiency gains described by Professors Posner, Williamson, and others. While the Supreme Court's opinion is not as clear and certain as some would like--a common problem in antitrust, it is not without meaningful guidelines. As indicated above, the Court in Sylvania expressly talked about weighing the benefits to interbrand competition against the harms to intrabrand competition; it expressly considered facilitating new entry; it expressly talked about the free rider problem and inducing promotional and service activities. Moreover absolute certainty is frequently unobtainable and at some times unwise. Even the per

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24. See, Larner, The Economics of Territorial Restrictions in the Soft Drink Industry, 22 Antitrust Bulletin 145, 153 (1977).

se rule is not as clear as it appears and, as the history of the antitrust treatment of vertical territorial restriction indicates, a rule of reason may be preferable to the per se rule despite the relatively greater certainty of the latter.

Furthermore, the standard developed by the Court in Sylvania will be further developed beyond the guidelines given by the Court; and that is true of any new standard. As the history of legal institutions indicates, subsequent judicial action and scholarly contributions in fact do further develop legal standards. After all, that is the essence of the common law process, a process that is very much a part of antitrust jurisprudence. More importantly, that process has already begun with the standard developed by the Supreme Court in Sylvania and the developing antitrust doctrine applicable to vertical territorial restrictions. There have been a number of court decisions, subsequent to Sylvania, that have developed and applied this test to new factual situations.[25] In fact, the Ninth Circuit, relying on the Sylvania standard, has recently upheld the legality of exclusive vertical territorial restrictions in the soft drink industry.[26] Of course, the Court of Appeals for the District of Columbia may overrule the FTC's decisions in the Coca Cola and Pepsico cases. In any event, while the appeal is pending legislation is at least

25. See, e.g., Kestenbaum v. The Flagstaff Brewing Corp., 575 F.2d 564, 570-73 (5th Cir. 1978).

26. See, First Beverages, Inc. of Las Vegas v. Royal Crown Cola Co., 1980-1 CCH Trade Cases ¶ 63,162 (9th Cir. 1980).

premature. Moreover, the commentators have also begun to develop the meaning of the Sylvania standard and provide guidance for the courts.[27] Thus, for all these reasons, existing antitrust standards are adequate and no further legislation is necessary.

III. H.R. 3567 Adopts an Inappropriate and Unwise Standard

H.R. 3567 should not be enacted because it creates a standard that is not adequately responsive to all the relevant concerns of antitrust policy. The legislation is unwise additionally because the particular language used is unclear, and therefore creates significant problems of interpretation. Moreover, these interpretative problems may increase the possibility of erroneous results created by the generally improper standard.

A. H.R. 3567 Adopts a Generally Inappropriate Standard

The antitrust standard created by this legislation is that exclusive territorial arrangements in the soft drink industry are presumptively lawful subject to proof of the elements in the proviso. It is important to stress that this legislation does not enact the rule of reason as it is generally known in antitrust law and as it was described by the Supreme Court in Sylvania. The standard created by this legislation is different and more lenient than the traditional antitrust rule of

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27. See, e.g., Zelek, Stern & Dunfee, A Rule of Reason Decision Model After Sylvania, 68 Calif. L. Rev. 13 (1980).

reason. It appears that in selecting the particular language of this legislation, the proponents were influenced both by the similar language in the Fair Trade laws, the Miller-Tydings and McGuire Acts,[28] which have been repealed[29] and by the almost identical language in the opinion of the administrative law judge in the Coca Cola case.[30]

The essence of the rule of reason in antitrust law is a broad inquiry into all factors relevant to the overall competitive effect of particular conduct. The rule of reason approach requires inquiring into the existence and magnitude of harms and benefits, balancing them against each other and considering less restrictive alternatives.[31] In economic terms, the rule of reason attempts to balance the welfare gains associated with increased efficiency against the welfare losses associated with market power effects.[32] The application of this standard in the particular context of vertical restraints involves weighing the benefits to interbrand competition and the other efficiency gains from territorial restraint against the harms to intra-

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28. 50 Stat. 693 (1937); 66 Stat. 632 (1952). The particular language, which amended § 1 of the Sherman Act and § 5 of Federal Trade Commission Act, was "commodity . . . which is in free and open competition with commodities of the same general class. . . ."

29. Consumer Pricing Act of 1975, 89 Stat. 801 (1976).

30. See, 91 FTC at 589.

31. See, e.g., Broadcast Music, Inc. v. Columbia Broadcasting System, 99 S.Ct. 1551 (1979); Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918).

32. See, e.g., Williamson, Economies As An Antitrust Defense Revisited, 125 U. Pa. L. Rev. 699 (1977).

brand competition. As described above, this was essentially the approach of the Supreme Court in Sylvania. In making such judgments the strength of interbrand competition is significant. The existence and magnitude of anticompetitive effects are a function of the market power of the firm imposing the restraints, and that power is a function of the strength of interbrand competition. Thus the concern of this legislation with interbrand competition is appropriate and wise. Moreover, superficially this legislation seems similar to the standard encompassed in the traditional rule of reason.

However, a closer examination of the language of H.R. 3567 reveals important and significant differences between it and the traditional rule of reason. For example, under the language of this legislation, it is not clear that any weight will be given to factors such as the market share of the firm imposing the restraints, product differentiation in the products involved, the level of concentration among syrup manufacturers, barriers to entry, and other characteristics of the firms imposing the restraints and the markets in which they are imposed. Such factors would be clearly relevant in the application of the rule of reason. Thus it is likely that territorial restrictions might be unlawful under the rule of reason while lawful under the standard proposed by this bill. Conversely, it is not clear to what extent aiding failing firms or facilitating new entry is relevant under the language of this bill. Therefore, it is conceivable that a restraint might be unlawful under the standard proposed by this legislation, but lawful under the rule of reason. Of course, if the standard in this legislation were not different than the rule of reason, which was adopted by the Court in Sylvania, then this legislation would be unnecessary. Many of the problems of defining the standard proposed by this legislation arise because the particular language raises significant interpretative difficulties. Thus, it is probably best to explore the standard proposed by H.R. 3567 in the context of the particular language of the bill and the resulting interpretative problems.

B. Specific Interpretative Problems

Three phrases in H.R. 3567 give rise to particular interpretative problems: "substantial and effective competition," "other products of the same general class," and "nothing contained in antitrust law shall render unlawful the inclusion and enforcement . . . ."

The first interpretative problem concerns how the court will judge whether "substantial and effective competition" is present. There are a number of tests that might be used. For example, a court might simply count the number of competing brands in a particular geographical market or might use concentration statistics, relying on conventional inferences. However, counting the different brands would overstate the amount of competition in light of the practice of "piggy-backing" that is common in the soft drink industry. As a result of this practice, it is not uncommon in some geographical markets for one bottler to bottle and distribute the products of several syrup manufacturers. If such is the case, many local markets may be monopolies at the sale and distribution level. On the other hand, if one simply counts the number of sellers in particular geographical markets, it may understate the amount of competition present. Of course, any system that counts sellers or brands is at best a crude way to measure market power. More sophisticated methods might involve measuring price cost margins or attempting to make judgments about cross elasticity of demand. Further, it is unclear that weight is intended to be given to product differentiation in testing for the existence of "substantial and effective competition." It is possible, and perhaps likely, that the intent is simply to count the number of brands without giving sufficient weight to the existence of consumer loyalties and demand elasticity characteristics. Moreover, oligopoly among syrup manufacturers might be extended to the bottling level through the use of exclusive territories; or exclusive territories may facilitate tacit collusion among oligopolistic syrup manufacturers.[33] It is also unclear what, if any, weight is to be given these factors. Thus, because of piggy-backing and significant product differentiation, there might not be "substantial and effective competition" despite the presence of many brands. The language is at least vague, and at worst may ignore these factors.

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33. See, Larner, note 24 supra, at 149.

It is also unclear how dual distribution will affect the interpretation of this language. In the opinion, Commissioner Dole stated that Coca Cola operated 27 bottling plants encompassing about 14% of the United States population. Because of the language of the Fair Trade laws, the Fair Trade exemption to the antitrust laws was unavailable when dual distribution was present.[34] In its opinion, the Federal Trade Commission discussed this problem in some detail.[35] While the Commission concluded that dual distribution did not make the restraints primarily horizontal "for classification purposes," the Commission did say it was not "devoid of horizontal competitive implications."[36] While dual distribution might lessen the effectiveness and substantiality of competition, H.R. 3567 leaves in doubt whether it is a relevant factor.

Additional interpretative problems arise from the language "other products of the same general class." The vagueness of this standard is complicated by the fact that it employs language not traditionally used in the antitrust laws. The traditional approach to this problem in antitrust law is to define the product market. Such issues are common in many different types of antitrust cases. Instead of relying on this type of language, the bill employs the language of the repealed

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34. See, United States v. McKesson & Robbins, Inc., 351 U.S. 305 (1956); Esso Standard Oil Co. v. Secatores, Inc., 246 F.2d 398 (2d Cir.), cert. denied, 355 U.S. 834 (1957).

35. 91 FTC 517, 611-14 & n.n.11-16.

36. 91 FTC at 614.

Fair Trade laws. Therefore, it is likely that numerous non-soft drink items will be included within this language. For example, drinks such as iced tea, beer, fruit juices, milk and bottled waters might well be included in making this determination. Again the relevance of product differentiation is important. Products might well be determined to be in the "same general class" despite high degrees of product differentiation. Product differentiation, demand elasticity and physical dissimilarities between soft drinks and the other enumerated items would clearly be factors that would be given a great deal of weight in making the traditional antitrust determination of relevant product market. It seems quite likely that this traditional antitrust concept was intentionally not used in favor of the much broader language used in this bill. Use of such a broad standard will, in particular cases, seriously overstate the amount of "substantial and effective competition."

Actual experience with the fair trade laws supports the conclusion that the "in substantial and effective competition with other products of the same general class" language of this legislation will be interpreted very broadly. The "in free and open competition with commodities of the same general class," language of the Fair Trade laws was interpreted very broadly.[37] Professor Areeda stated, with regard to this lan-

37. See, e.g., Bowen v. New York News, Inc., 366 F. Supp. 651, 661-62 aff'd on this ground, rev'd on other grounds, 522 F.2d 1242, 1249 (2d Cir. 1975), cert. denied, 425 U.S. 936 (1976); Scovill Mfg. Co. v. Skaggs Pay Less Drug Stores, 275 P.2d 619, 625 (Cal. App. 1954), vacated on other grounds, 291 P.2d 936 (1955). Herman, "Free and Open Competition," 9 Stan. L. Rev. 323 (1957).

guage in the fair trade laws, that "usually the courts ignore the condition or hold it satisfied by a showing that two or more producers sell goods of the same general category."[38] Significantly this language was interpreted broadly despite the fact a firm could only fair trade successfully if it possessed market power--when meaningful interbrand competition was absent. For these reasons, it is quite likely that courts will interpret this language in H.R. 3567 very broadly, ignoring the type of relevant factors discussed above; and will find the requirements of the proviso met despite the absence of meaningful interbrand competition.

Finally, serious interpretative difficulties arise from the language "nothing contained in any antitrust laws shall render unlawful the inclusion and enforcement" of any provision that grants an exclusive geographic territory. In particular the difficulties arise from the words, "nothing" and "enforcement." These words could be interpreted to make lawful horizontal activity in enforcing exclusive territorial restrictions. Territorial restrictions can be either vertical, as they were found to be in the Coca Cola case, or horizontal, as they have been in other cases. Antitrust law distinguishes clearly and appropriately between horizontal and vertical activity. Horizontal market divisions are per se unlawful.[39] However, it is not uncommon for territorial restrictions to result from a

38. P. Areeda, Antitrust Law 517 (2d ed. 1974).

39. See, United States v. Topco Associates, Inc., 405 U.S. 596 (1972).

dealer cartel where the manufacturer is simply an enforcement mechanism for implementing the horizontal territorial division.[40] Professor Posner in his testimony supporting the earlier legislation, alerted the Committee to the possibility of dealer cartels and the "possibility for abuse."[41] Moreover, the existence of dual distribution may make horizontal enforcement activity more likely.[42] Perhaps such activity was one of the "horizontal competitive implications" referred to by the Commission in its discussion of dual distribution.[43] However, as presently drafted, the legislation may legitimate a dealer cartel. Similarly, resale price maintenance could be used as a method for enforcing a territorial restriction. It is not clear again whether it is the intent of the bill to legitimate this method as well. This intepretation is not wholly unlikely since one court has already indicated that resale price maintenance as a method of enforcing territorial agreements is not per se

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40. See, e.g., United States v. General Motors, Corp., 384 U.S. 127 (1966). Cf. Cernuto, Inc. v. United Cabinet Corp., 595 F.2d 164 (3d Cir. 1979); Comment, "Vertical Agreement as Horizontal Restraint: Cernuto, Inc. v. United Cabinet Corp.," 128 U. Pa. L. Rev. 622 (1980).

41. See, Exclusive Territorial and Customer Restrictions: Hearings on H.R. 6684 Before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary, 94th Cong., 2d Sess. 36-37 (1976). (Statement of Professor Richard Posner).

42. Cf. Guild Wineries & Distilleries v. J. Sosnick & Sons, 1 Civ. 42953 (Cal. Ct. App. 1/29/80), 953 BNA ATRR D-1 (Feb. 28, 1980).

43. 91 FTC at 614.

illegal.[44] Similarly, concerted refusals to deal could be used as a method for enforcing the territorial restrictions. Again it is not clear whether the bill intends to legitimate this enforcement method even though such conduct is per se illegal under the antitrust laws.[45] As can be seen therefore, the words, "nothing" and "enforcement" are both very broad and vague terms that could be interpreted to encompass many types of conduct that have previously been treated as serious antitrust violations.

In reviewing these three phrases, it is clear that the vagueness of the language of H.R. 3567 presents many interpretative problems. In addition it is quite likely that this legislation is intended to be very broad. As a result H.R. 3567 will lead to results that are not only different from those that would be reached under the rule of reason, but to results that are inconsistent with a wise and effective antitrust policy. Moreover, it seems incorrect to assert, as some have, that the language will lead to more simplified antitrust trials. As pointed out, the language is vague and new as well. Both of these factors are likely to lead to complicated litigation in some cases. Further, it is not clear who will bear the burden of proof on compliance with the proviso. Since many

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44. See, Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc., 572 F.2d 883 (1st Cir.), cert. denied, 99 S.Ct. 112 (1978).

45. See, e.g., Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959).

of the aspects are difficult to prove, the placing of the burden of proof could be dispositive in many cases. It is very possible that the burden of proof might well be placed on the defendants, treating the proviso in essence as an affirmative defense. In an analogous situation, this result occurred with the 1966 Amendment to the Bank Merger Act.[46] This issue makes it difficult to predict the practical effect that passage of this litigation would have on the outcome of antitrust litigation.

In summary, for all of these reasons, the standard articulated in this legislation is both inappropriate and unwise. The appropriate standard is the traditional rule of reason in antitrust law as recognized by the Supreme Court in Sylvania and by Professor Posner in his testimony supporting the earlier legislation.[47]

IV. H.R. 3567 is Objectionable Special Legislation

The purpose of this legislation is to create a special and different standard for applying the antitrust laws to the soft drink industry than is used in other industries. While, as indicated above, special antitrust legislation has been enacted in the antitrust field, special legislation would nor-

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46. See, United States v. First City National Bank, 386 U.S. 361 (1967)(Burden on defendants to prove that "anticompetitive effects . . . are clearly outweighed in public interest by the probable effect of the transaction in meeting the convenience and needs of the community served.").

47. See, Hearings, supra at 36.

mally seem to be an unwise method for dealing with a problem. First, the antitrust laws as presently drafted are more than capable of dealing with the problems raised by different industries. They have "a generality and adaptability comparable to that found to be desirable in constitutional provisions."[48] Moreover, this conclusion should be clear from the above discussion of the rule of reason and from the presentations to this Committee on antitrust law and policy generally. It has not been established that for some reason, the antitrust laws are inadequate for dealing with the problems of the soft drink industry. In fact, as indicated, the Ninth Circuit applied the Sylvania standard to territorial restriction in the soft drink industry and found them to be reasonable.[49] Nor has it been that the soft drink industry is faced with problems that are distinct or unique from those faced in other industries. Moreover, passage of this legislation is likely to encourage other industry to request antitrust amendments on their behalf. However, there is no principle for distinguishing the soft drink industry from other industries. Thus, there is a risk that the standard in this bill will be extended as will its undesirable consequences. Therefore, it would seem that this special legislation is both unnecessary and unwise.

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48. Appalachian Coals v. United States, 288 U.S. 344, 360 (1933).

49. See, First Beverages of Las Vegas v. Royal Crown Cola Co., supra.

Some have claimed that this legislation is necessary in order to help "small bottlers." Virtually every antitrust commentator and economist who has testified on this matter has made it clear that protection of small business as such is neither the goal of the antitrust laws nor wise economic policy. Protecting the competitive process and insuring maximum consumer welfare by promoting efficiency are the goals of the antitrust laws. Small business is only protected to the extent that it can survive in a competitive marketplace. It is not to be protected at the expense of efficiency. Small bottlers are entitled to a chance to compete effectively in the marketplace, but not to be protected at the expense of efficiency. Moreover, it is important to realize that this legislation cannot and will not protect the small bottlers from the actual impact of dynamic changes in the industry. For example, syrup manufacturers may find it more efficient to intergrate forward; or they may choose not to use exclusive territorial restrictions. This legislation does not compel the use of independent bottlers nor does it compel using exclusive territorial restrictions. Apparently there has already been a decline of small bottlers in this industry, reflecting technological and economic changes. This legislation will not alter the basic technological and efficiency considerations involved in the production, distribution and sale of soft drinks. Nor can it or will it insulate bottlers from those developments. Antitrust law can be changed, but the dynamics of the marketplace have an imperative of their own. Often, the market finds a way to evade the artificial restrictions that are created in efforts to promote or prohibit certain forms of organization or conduct.

A brief word is in order regarding Section 3 of H.R. 3567. This section would seriously limit the right to bring private treble damage actions regarding the use of exclusive territorial restrictions. The bill provides that no treble damage action may be instituted under Section 4 of the Clayton Act prior to a determination that the exclusive territorial arrangements are unlawful. This type of damage action certainly departs from traditional antitrust principles. The treble damage action is more than a private remedy; it is an important aspect of the public enforcement mechanism in antitrust law. The Supreme Court has emphasized the importance of private antitrust remedies and the role of plaintiffs as "private attorneys general."[50] Section 3 of H.R. 3567 would seriously restrict the use of treble damage action and undermine these important antitrust objectives.

In conclusion, I oppose H.R. 3567 since it is unnecessary in light of existing antitrust standards, since it adopts an inappropriate and unwise antitrust standard and since it is a form of objectionable special legislation.

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50. See, e.g., Hawaii v. Standard Oil of California, 405 U.S. 251, 262 (1972); Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968).

4/3/80

RESUME

Jonathan Rose
Professor of Law
Arizona State University
Tempe, Arizona 85281

Personal Data:

Date of birth: December 25, 1938.
Married; four children
Home address: 609 East Carter Drive
Tempe, Arizona 85282

Education:

B.A., University of Pennsylvania, 1960 (English).

LL.B., University of Minnesota, 1963.

Honors:

Senior Editor, Minnesota Law Review; Order of the Coif (University of Minnesota); Magna Cum Laude (University of Minnesota); Honors Graduate (University of Pennsylvania).

Employment History:

Summer Clerk, Dechert, Price & Rhoads, Philadelphia, Pennsylvania, 1962.

Attorney, Antitrust Division, Department of Justice (Honors Program), 1963-68; 1963-65 Trial Attorney, Public Counsel and Evaluation Section; 1965-68 Attorney, Public Policy and Evaluation Section.

Professor of Law, Arizona State University, 1968 - Present; Subjects taught: Contracts, Antitrust, Regulated Industries, Economic Regulation of Business.

Faculty Member, Southwest CLEO Institute, Arizona State University, Summer 1973; University of New Mexico, Summer 1974.

Special Consultant - Antitrust, Arizona Attorney General's Office, June - December 1975.

Visiting Professor, University of Southampton, England, Spring Semester 1976.

Special Consultant - Antitrust, Arizona Attorney General's Office, June 1977 to date.

Consultant - Transportation Deregulation, Governor of Arizona, 1978-80.

Publications:

Book Review, The Antitrust Laws and Administered Regulation, Free Enterprise and Economic Organization, Louis B. Schwartz, 51 Minn. L. Rev. 1186-1192 (May, 1967).

Book Review, Antitrust Casebooks and Current Issues in Antitrust Policy, Louis B. Schwartz, Free Enterprise and Economic Organization, 1969 Ariz. St. L.J. 493-507 (1969).

State Regulation of Agricultural Labor Regulations--The Arizona Farm Labor Law--A Constitutional Analysis, 1973 Ariz. St. L.J. 373-431.

State Regulation of Agricultural Labor Regulations--The Arizona Farm Labor Law--An Interpretive and Comparative Analysis, 1973 Ariz. St. L.J. 313-372 (with Warren H. Cohen).

Book Review, Mark J. Green, Ed., The Monopoly Makers: Ralph Nader's Study Group on Regulation and Competition, 19 Antitrust Bulletin 471-487 (Summer 1974).

"General Survey & Basic Concepts of Federal & State Antitrust Law," Arizona CLE Materials (Oct. 1976).

"Introduction to Antitrust Law," Proceedings, American Public Power Assn. Antitrust Seminar, Municipal Antitrust Liability 27-43 (1978).

"Antitrust & the Supreme Court--1977 Docket," 14 Ariz. Bar J. 14 (1978).

"Municipal Antitrust Liability After City of Lafayette," 42B Municipal Law Rev. 203 (1979).

"Antitrust, A New Liability," 29 Urban Georgia Nos. 2 & 3 (1979).

"A Perspective on Occupational Licensing," 1979 Ariz. St. L.J. 189 (1979).

"Antitrust and the Supreme Court," 15 Ariz. Bar J. 42 (1979).

"Municipal Activities and the Antitrust Laws After City of Lafayette, 57 U. Det. J. Urban L. No. 3 (1980).

"Contribution in Antitrust," ______ Antitrust L.J. ______ (1980).

Legislative Testimony:

United States Senate, Committee on the Judiciary, Subcommittee on Antitrust and Monopoly, June 12, 1975. The testimony was entitled Parens Patriae--A Needed and Desirable Antitrust Improvement. The oral testimony and prepared statement are printed at Hearings on S 1284, The Antitrust Improvements Act of 1975, before the Subcommittee on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 94th Cong., 1st Sess., pt. 1, at 474 (1975).

Various appearances before Federal and State legislative committees on matters dealing with antitrust and economic regulation.

On numerous occasions in the past several years I have also testified on a variety of subjects relating to antitrust, fair trade and economic regulation of business before the relevant committees of the Arizona Senate and the Arizona House.

Professional Memberships:

Bar of the Supreme Court of Minnesota, Supreme Court of Arizona, Supreme Court of the United States, 1st Circuit Court of Appeals.

Committees:

Association of American Law Schools, Section on Economic Regulation, 1969 - Present; Chairman, 1971-74, member of Executive Council, 1974 - Present; Past member and Chairman, University Patents Committee; Past member of Arizona State University Faculty Senate; Board of Directors, Maricopa County Legal Aid Society, 1972-1977. University Grants Committee; Board of Directors, ASU Faculty Association.

Other Professional Activities:

Arizona Board of Legal Specialization; Special Consultant, Arizona Attorney General's Office; Participant, Common Market Antitrust Seminar, University of London, London School of Economics. Participant in various seminars, Continuing Legal Education and television programs regarding antitrust. Special Antitrust Consultant, New Mexico Attorney General's Office. Arizona Bar Association: Section on Antitrust Law, Chairman; Arizona Center for Law in the Public Interest, Board of Directors. Participant in various CLE programs on Antitrust Law. Academic Director, BRI of Arizona; Statewide Steering Committee, Committee to Support Constitutional Referendum on Transportation Deregulation. Numerous speeches on antitrust, occupational licensing and economic regulation.

Professor ROSE. I oppose this legislation for three reasons:

One, I believe it is unnecessary.

Two, I believe it incorporates an unwise and inappropriate standard.

Three, I find it to be objectionable special legislation.

I find it a very rewarding opportunity to be able to appear on a panel with my former law review editor and former dean to show him how well I have learned, and I hope to be able to convince him as well as others that the bill should be opposed.

With regard to my first objection, that it is unnecessary, I am not going to go through a detailed recitation of antitrust law's treatment of exclusive territorial restrictions. I think that has been done on many occasions for the committee, and the committee is, I am sure, as aware as it needs to be of everything from Dr. Miles through Sylvania.

My point is simply that existing antitrust standards are adequate to deal with the problems presented by exclusive territorial arrangements. Whatever the law has been, or whatever its tortured path has been, Sylvania is now the law, and incorporates a rule of reason.

The Supreme Court has specifically endorsed the notion that we don't only look at restrictions on intrabrand competition, we look at the benefits and the promotion of interbrand and the two are to be balanced.

The Supreme Court has specifically endorsed the notion that vertical territorial restrictions may enhance efficiency, both of the distributional and transactional variety, that they may encourage presale services, prevent the free rider problem, and all the positive effects.

I think it is important to emphasize to the committee that the issue before this committee is whether legislation is needed, not whether vertical territorial restrictions are generally positive, sometimes positive, sometimes not, or positive in the soft drink industry.

The question is whether existing antitrust law is adequate to deal with the analysis, the positive effects, the benefits, and the harms raised by these types of contractual arrangements; and I think that the Sylvania standard is adequate and appropriate to deal with these social and economic harms, and the benefits of vertical territorial restrictions.

Under the Sylvania test, the Court is permitted to consider all of these factors. The Court has indicated its endorsement of the efficiencies and positive effects and the Court is entitled to balance them in particular cases, and therefore I feel no further legislation is needed.

My second objection is that the bill adopts an inappropriate and unwise standard. I first feel that the language used in the bill enacts a standard that is generally inappropriate. I think one thing that is very important to stress, and a point on which I take issue with Professor Gelhorn, is that this bill does not enact the rule of reason as it is traditionally known in antitrust law. It is a different standard. It is a more lenient standard than the traditional rule of reason.

It uses the language from the repealed fair trade laws as part of its standard. I think that the concern of the bill with interbrand competition is a very useful starting point. I think all the witnesses before this committee, who testified about antitrust law and economics would agree that the strength of interbrand competition has a great bearing on the anticompetitive effect of vertical restraints, and that whether or not vertical restraints will have an anticompetitive effect depends on the market power of the firm imposing them, and the market power of that firm depends on how many other firms it has to compete with. Or, in other words, the extent of interbrand competition.

However, even though this bill uses the language interbrand "competition," it uses it in a way that is really misleading. The bill is really quite different than the rule of reason. The way it incorporates interbrand competition has practical effects that make the standard quite different from the rule of reason. When you examine the whole standard closely, I think it is clear that there are important and significant differences between the standard of this legislation and the rule of reason.

For example, it is not clear under the standard incorporated by the bill, which I would add is substantial and effective competition between products of the same general class, how much weight will be given to the market share of the firm imposing the restraint; it is not clear how much weight will be given to product differentiation—in other words, how much loyalty is shown to different brands and buyers willingness to buy those brands, even if the price is higher. It is not clear what weight will be given to the level of concentration among sirup manufacturers, for that may be a significant factor affecting the effect of imposing vertical territorial restraints.

It is clear that these factors would clearly be relevant under the Supreme Court's Sylvania test. It is not clear that they will be relevant under the test of H.R. 3567, and there is some reason to believe that they were intended not to be relevant.

Let me explore that in more detail by looking at some of the particular language pointing out of the interpretative problems and why I have come to this conclusion that the bill is quite different than the traditional rule of reason in antitrust law.

The first problem arises by the language, substantial and effective competition. How is that to be measured? Is the Court simply to count brands and say well, there are five brands of soft drinks being sold, and therefore there is substantial and effective competition? This would clearly overstate the amount of competition because of the practice of piggybacking, the fact that one bottle may bottle the brands of several manufacturers. How much weight is to be given to product differentiation? If the demand of consumers is highly inelastic, in other words, if they will not switch to other brands, despite price differentials, is that a factor that this bill will give weight to?

It appears to me the language was intended to make it very difficult to prove the absence of substantial and effective competition; that the bill enacts a broad notion, ignoring many of the factors that would otherwise be relevant, and that it could be concluded that there was substantial and effective competition, despite the fact that that might be a dubious conclusion.

Now, a critical part of this argument really goes to the next statutory language, "other products of the same general class." It seems to me that much of the dangers of interpreting this bill broadly, and the support for my conclusion that the bill enacts a standard that is broader and more lenient than the rule of reason, is the notion that the substantial competition required is not between trademarked soft drink products, it is between products of the same general class.

I think that has to be seen as a choice of intentionally very broad language. That is the language of the repealed fair trade laws. It is quite different than the normal antitrust process, which is to define the relevant market.

When you look at the normal antitrust process of defining the relevant market, and then you see that this bill incorporates the language of the repealed fair trade laws, and if you look at how they were interpreted, you come to the conclusion that far more products would be included in the definition, "other products of the same general class," than would be included in making the judgment on substantial competition under the Sylvania rule of reason.

For example, I would think that the term, products of the same general class, would not be limited to trademarked soft drinks. It certainly could include iced tea, beer, fruit juices, milk, bottled water. In fact, if one looks at the repealed fair trade laws, it seems to me it could be legitimately construed to include anything that you could drink. The important point to make is that the use of the words, products of the same general class, has a drastic effect on when a court is supposed to conclude that substantial and effective competition exists or does not exist. Thus, it seems to me that it makes it very hard to prove that substantial and effective competition does not exist.

Moreover, it is misleading to suggest that this standard will just simplify things and eliminate the uncertainty that some of the soft drink bottlers, or that anyone who has to live under the antitrust laws, is unhappy about. It is a new standard. Its meaning will have to be litigated. There will be questions of how do you measure substantial and effective competition. There will be questions of what is a product of the same general class? Those are not easy questions to resolve and I suspect economists and complicated testimony will be brought in under those standards, so I think it is misleading to suggest that it will simplify antitrust trials.

There are also some problems with the language, nothing contained in the antitrust laws shall render unlawful, the inclusion and enforcement of these types of clauses. I think I will simply rely on what my statement says about those problems and move on to my third objection.

My third objection is that the bill incorporates objectionable special legislation. I don't see the soft drink industry and its problems as being distinct or unique from the problems of other American industries. That means not only that they are not entitled to special bills governing their industries; it means that when other industries come in, as they surely do all the time, it will be difficult to distinguish on principle why they are not entitled to relief, if the soft drink bottlers were. And therefore there is a great danger that this broad standard will not only be one that will govern the soft drink industry, but will extend more generally to antitrust and therefore the harmful consequences will be extended. The antitrust laws and the rule of reason are very flexible and adaptable instruments, and I think that they are adequate to deal with these kinds of problems.

This bill has also been termed somewhat as an effort to protect small business, and I suppose, as seen in that light, that some people laud that and some people attack that. Such a policy is a well debated controversial issue in antitrust law. I personally—and I know Professor Gelhorn would agree with me completely on this—would feel that the notion of a law to protect small business, apart from its efficiency, is not an appropriate goal of antitrust law. I certainly don't want to put words in his mouth, but I am familiar with his writings. We have talked about these things very often, and it is a view held by most every economist and antitrust lawyer.

Moreover, it is also untrue that the bill will only protect small bottlers. Coca-Cola, Pepsi, Beatrice Foods, several firms in Fortune 500, would be beneficiaries of this bill.

Also there is serious question whether the bill would be effective, even if its purpose were to protect small business, and that were to be considered the legitimate purpose. The bill does not compel Coca-Cola or Pepsi-Cola to use any distributor. If they choose, they can vertically integrate forward. Nothing in this bill stops them from doing that. Nothing in this bill requires them to use an exclusive territory. They can choose nonexclusive territories. The soft drink sirup manaufacturers are going to choose those distributional systems that are most consistent with efficiency and their view of their own profit maximization. That may or may not coincide with what the small bottlers want. As technological and economic changes occur in the market, that will be reflected in the sirup manufacturers choice of the best way to distribute their products. The small bottlers cannot be protected from the dynamics of the marketplace, nor from the decisions of the manufacturers. So that if the syrip manufacturers decide to vertically integrate forward on a wider basis than they presently do, nothing in this bill will save the small bottlers from that fate.

Thus, I oppose the bill for these three reasons:

That it's unnecessary; that it enacts an inappropriate standard; and that it is objectionable special legislation.

It seems to me that it is a bill that is antiefficiency, not proefficiency. It seems to me it has flavors of being an antichain store piece of legislation. In all due respect, I think it might be fairer to entitle it, "The Soft Drink Anti-Competition Act," rather than "The Soft Drink Interbrand Competition Act."

Thank you very much.

Mr. MAZZOLI. Thank you very much, Professor Rose and Professor Gelhorn. It's been very interesting testimony.

I am forced to leave, and with the permission of my colleagues, I would like to ask my questions now and yield to another to chair until Mr. Rodino comes in.

Professor Gelhorn, would you comment on what I consider to be a fairly significant objection to this bill, which Professor Rose mentions as his third point, which is that it is special legislation, singling out one category of business for exemption and privilege as against all the others, and if it were to be granted, it could set a bad precedent?

Professor GELHORN. I notice that Professor Rose was very careful, however, in not answering the response that I had set forth in my initial comments and in the statement which he has had an opportunity to read, and that is that this is not a special exemption, for example, like the Reed-Bullwinkle Act is to the railroad industry, or that's available under the Capper-Volstead Act to the agricultural industry.

This legislation says instead very specifically that where substantial and effective competition exists, vertical nonprice restrictions are permitted, are not prohibited by the antitrust laws.

So it imposes a standard of competition, intense competition in the industry. If that condition is met, then the antitrust restrictions which have historically been applied, particularly by the Federal Trade Commission, should not apply.

You have, in other words, an efficiency criterion and an efficiency standard. That's the first answer.

Mr. MAZZOLI. That's an interesting point. Let me just ask because I'm going to be limited to a period of time. Am I to understand—and I'm not an expert in the field—the Reed-Bullwinkle, the Capper-Volstead, and the other types of exemptions, do not have any statement therein dealing with significant levels of competition, but that there is a total exemption carved out within which these preferred companies can deal as they wish?

Professor GELHORN. That's going to take a while to answer, if I were to be complete, but to be specific, they apply different standards. Some say the antitrust laws don't apply at all. Others permit administrative agencies to apply antitrust rules, though clearly each of them recognizes that competition is not the measure, the norm in those industries. That is the competition——

Mr. MAZZOLI. The competition is the measure?

Professor GELHORN. That is correct, and that is signed into legislation. Now we can quarrel, as Professor Rose and I might, as to what the precise language means and whether or not he could come up with better language, which I would be delighted to look at and examine and discuss, but the basic standard, let us be clear here, is quite different.

The second thing is, and I would have no objection to expanding this legislation, because the basic idea is sound, that the basic idea of allowing vertical nonprice restraints is supported by substantial economic testimony in Sylvania. And Professor Rose and I agree on that. I was interested in his spelling that out here.

However, we have had substantial legislative hearings, a lot of testimony, numerous economists, people from varying spectrums of the academic and legal enterprise. Oliver Williamson, Lee Preston, Victor Coleberg. All agree that this is an intensely competitive industry, and that therefore here it is appropriate to say to the antitrust enforcement agencies, spend your time on more important matters. Don't go after this industry for this particular issue. That's really all it is.

Mr. MAZZOLI. Professor Rose, let me ask you a question. Your second point dealt with the kind of standard that you called an unwise standard, and the standard in the bill deals with substantial and effective competition between products of the same general class you thought that maybe iced tea and beer and other kinds of beverages, say fruit juices, would be products in the same general class.

Again, I am a neophyte to this, but it wouldn't seem to me to be reasonable to think that the authors of this bill had anything much in mind except that you have two colas that would be, if they were not the same brand, substantially in competition; but not a cola against an iced tea or cola against, say, a noncarbonated fruit juice. And I wonder if there are cases or evidence that might show that reasonable people could consider these to be competitive products.

Professor ROSE. I think there are. Normally in antitrust law, in judging competition, the process is to look at relevant markets, both the geographic and product. While there is some difference between a legal concept of a relevant market and an economic concept, the effort is to look at what products really do compete, and under that kind of a standard you might well exclude bottled water and soft drinks. But that's not the language that this bill uses.

The language says substantial and effective competition with products of the same general class, and that is the language of the repealed McGuire Act and Miller-Tydings Act, and under those acts, it was construed very broadly. I think it is the reliance on that language and on that language distinct from the relevant product market notion, which is traditional to antitrust, that underlies my feeling that would be construed very broadly.

And it would only be seen, I think, as an attempt by Congress to choose a much broader standard, based on how that standard had been interpreted as opposed to the normal antitrust notion.

I might just say in conclusion, I note one thing, I disagree very much with Professor Gelhorn on his description of the language of the bill. It does not say whenever you find substantial and effective competition, it's over, as he has said several times in his oral testimony. It does not say, as he says several times in his written statement, that the bill permits territories only where there is substantial and effective competition among trademarked soft drinks. It doesn't say either one of those things.

It says products of the same general class, and there is a vast difference between that language and the language that Professor Gellhorn recites in his statement, that is, trademarked soft drinks, and products of the seme general class.

If it, for example, said—if the bill were to read that territorial restrictions shall be lawful when there is substantial and effective competition among trademarked soft drinks, I would react differently. While I would have to think about it, my initial reaction would be one not of opposition. That's a very different standard, and I think then it might end up being very similar to the rule of reason. So he has stated, I think, inaccurately the language of the bill.

Mr. MAZZOLI. Well, I certainly thank both of you. This is highly interesting testimony, and we appreciate the fact that you within yourselves will disagree. It is conducive to our thinking.

I thank you. My time has expired, I am sorry to say. The gentleman from Illinois, Mr. McClory, is recognized for 5 minutes. The gentleman is also recognized for any statement he wishes to make.

Mr. MCCLORY. Thank you, Mr. Chairman. I merely want to say I hope this is the last hearing we have, so we can get into markup and do something about this bill, vote it up or down, and get on with something else.

Mr. MAZZOLI. Very good.

Mr. MCCLORY. It's been in subcommittee for a long time.

Mr. MAZZOLI. The gentleman is recognized for 5 minutes.

Mr. MCCLORY. Thank you, Mr. Chairman.

At the last hearing we had a couple of witnesses who came before us and suggested that if we would only amend this bill a little bit, it would be highly desirable. It would then not only serve the needs of the bottling industry, including the small bottler, and give legislative approval of these geographical franchise arrangements, but, if we would phase in refillable bottles, we would also be alleviating the messy environmental problem to which soft drink suppliers and beer suppliers contribute, which is ruining the countryside with the litter of cans and nonreturnable bottles.

How would you react to that kind of amendment in order to get unanimous approval of this bill, gentlemen?

Professor ROSE. I'll go first this time, and let him go second. My feeling is that for starters, to use an old trite law professor's phrase that it involves "apples and oranges." Antitrust problems and environment concerns involve different problems. Were the bill to be amended to add language that sort of geared the permission to have exclusive territories to some use of refillable containers, my comments on the basis of antitrust policy would be no different. That would not alter the antitrust dimensions of the bill.

I should probably confess a certain amount of ignorance as to the merits of a lot of these arguments about the effect of this decision on refillable and nonrefillable containers. I am certainly not an expert in that environmental matter, nor in the specifics of the soft drink industry.

I think, however, that even though it would not make the bill more palatable to me from an antitrust standpoint, Congress might see a legitimate way to achieve another benefit. So I would see it as having the same antitrust problems but mixing things together and using antitrust to achieve another social benefit.

I suppose whether you want to mix the two things that I view essentially unrelated depends on how practical you are on one hand or how much of a purist you are on another hand. But that would be my reaction.

Mr. McClory. In other words, this bill, without the amendment, would be beneficial. But if we adopted the amendment, then would we get two benefits from this single piece of legislation?

Professor Rose. Well, my view is that the bill without the amendment is very harmful, and that with the amendment, it would be both harmful with another benefit that has nothing to do with antitrust.

Professor Gelhorn. I would respond somewhat differently with the same policy perspective. I think Professor Rose is correct, that a bill which addresses economic questions and competitive effect in the marketplace ought not to be confused with the introduction of a special issue relating to environmental impact. That does not mean, however, that it is inappropriate to consider the environmental impact of this bill. This bill does have an environmental impact, and it seems to me is an additional reason for supporting it.

If you will look, for example, at finding 113 made by the administrative law judge in the *Coca-Cola* case. He determined based on available evidence, that nationwide 55 percent of the sales of one of the major soft drink companies is sold in returnable bottles, particularly in this case Coca-Cola. And based on the evidence presented to him and on the evidence presented by the economists at other hearings that I have attended, there is a close coordination between the exclusive territories and the customer requirements in this bill, and returnable bottles, because what you have is an available bottler who will pick up and return bottles for retailers, who cares about an existing account, who seeks to exploit that market— exploit I use here in a favorable term—and he will do so because he has an assurance that there is no free rider lurking in the background.

Mr. McClory. By maintaining his exclusive territorial rights, we really contribute to enabling this kind of environmental improvement to take place.

Professor Gelhorn. Exactly. The administrative law judge's determination was that if you prohibit, as the FTC's complaint counsel and two-member majority would seek to do, exclusive territories, you will decrease returnable bottles, the use of returnable bottles, and have therefore that adverse environmental impact. Now he did not say that that is a reason under the antitrust laws for favoring this legislation.

Mr. McClory. My time is up.

Mr. Harris [presiding]. The gentleman's time has expired. I think it might be beneficial to the subcommittee, if the question asked by the previous chair of Professor Rose were to be responded to. We almost had a meeting of the minds, and that's what we strive for here. I think I heard Professor Rose say that if the language meant what you thought the language meant, he probably would be for it. But he said the language didn't mean that.

So, Professor, I wonder if you might respond to that. It would seem to me to be relevant. Do you feel that the language means what you think it means, or do you think Professor Rose is not correct?

Professor GELHORN. Well, the language we are talking about, I think he has unfortunately confused a couple of items in the legislation, between the operative provisions of section 2 of the bill, and the proviso.

Mr. HARRIS. I am talking about the language, "substantial and effective competition, with products of the same general class," and you say that means just the trademarked soft drinks?

Professor GELHORN. What it means, as I understand it, as legislative history in the Senate says it means, and as I understood the testimony before this committee by others to mean, is that what you look at, what are the products in competition with the trademarked soft drinks?

Today in a market, as the Federal Trade Commission determined, that means predominantly carbonated beverages. But when you write legislation, it is unwise, I would suggest, to confine the terminology so restrictively so that if the market changes on you, you can't take that into account. And this legislation, as I read the language, and as I read the legislative history, particularly specified before the Senate, which has published it, it is an effort to define and decide the relevant product market.

If you look at other antitrust laws, section 3 of the Clayton Act, section 7 of the Clayton Act, it doesn't say relevant product market. It uses such awkward terminology as line of commerce in any section of the country. But the courts have, over the years, particularly in recent years, clearly understood that to mean relevant product market.

If you could substitute the words, "relevant product market," here, and if Professor Rose agrees with that, I wouldn't dispute it. It seems to me, though, we have done precisely that with the language, "products of the same general class," because those are the terms as Professor Williamson, I believe, and Professor Preston in prior testimony said identified the relevant product market. That's what the reputable economists in the field have said.

Mr. HARRIS. Thank you.

Again you are probably convinced by now that you have heard that the language means what Professor Gelhorn——

Professor ROSE. I wonder if I could ask a question. Normally in class, in law school, I get to ask all the questions, but I wondered if you might do me a favor and ask Professor Gelhorn a question for me?

I wonder if he would agree to an amendment in the bill that struck the language, "products of the same general class," and substituted the language, "trademarked soft drinks." Then I wouldn't have to worry about the history of the fair trade laws.

Mr. HARRIS. Let's give you 1 minute to respond to that, Professor.

Professor GELHORN. I guess he didn't hear my earlier answer. If he could assure me that those were the only competitive products within that relevant market, I would accept it. But it seems to me the markets are constantly changing, and that would be a cramped and narrow and unfortunate definition to put in legislation.

Mr. HARRIS. It's startling how close the two of you are in objective, and how difficult you are in dealing with words. Are all professors that way? [Laughter.]

The gentleman from Ohio is recognized.

Mr. SEIBERLING. Well, thank you. This is a very interesting subject.

Professor Gelhorn, are you related to Walter Gelhorn?

Professor GELHORN. Yes, sir.

Mr. SEIBERLING. I was one of his less impressive students at Columbia Law School many years ago.

Well, Professor Gelhorn, you indicated several points in your written statement that H.R. 3567 will apply to protect the exclusive territories of bottlers where substantial and effective competition exists, but that is interbrand competition.

Do you believe that substantial and effective competition currently exists in the territories of every franchised bottler, or would you concede on a case-by-case basis?

Professor GELHORN. Based on the information currently available from the Federal Trade Commission's administrative law judge and the studies and the economic literature, there is evidence of substantial and effective competition in many markets. Certainly all markets have not been studied. And under this legislation it would be available to the antitrust enforcement agencies or to private claimants to demonstrate that a particular market was not competitive, and that exclusive territory and customer allocation scheme in fact impaired competition under the rule of reason standards.

Mr. SEIBERLING. Do you have any information as to whether effective interbrand competition now exists?

Professor GELHORN. Yes, sir.

Mr. SEIBERLING. And the extent to which it exists?

Professor GELHORN. Yes, sir. I stand by the administrative law judge who found, in 1975, on a general and nationwide basis, and in many localized markets, that there is keen price competition, service competition, and quality competition. There is competition in every element that we meet.

Now there are to be sure, pockets where the evidence is not persuasive, but the FTC complaint counsel, after lengthy hearings, was unable to present sufficient evidence that was persuasive to the administrative law judge.

Mr. SEIBERLING. Yet the commission found that interbrand competition was not effective.

Professor GELHORN. On the contrary. If I may, sir, respectfully suggest, all the Federal Trade Commission found in a very, it seems to me, novel, curious and astonishing reading of Sylvania, was that intrabrand competition was eliminated by these agreements, which everybody conceded.

Then it said in a rather curious reading of Sylvania that the burden was on the bottlers—excuse me, the sirup makers, the defendants here—to demonstrate effective interbrand competition. And that, according to the two-member commission, had not been demonstrated, even though as the dissent pointed out, and as the administrative law judge pointed out in numerous findings, there was evidence of intense general competition and keen price competition.

Mr. SEIBERLING. Let me read this language from the opinion. They stated:

It is difficult to avoid concluding that territorial restrictions, vertically imposed, have seriously impaired interbrand competition, not only at Pepsi-Cola bottlers and other soft drink suppliers shielded by respondent's restrictions from the competition of all but one Coca-Cola bottler for the business of virtually given retail outlet, the industrywide nature of the restraint insulates Coca-Cola bottlers from the unimpeded competition of potential interbrand bottlers.

Are you saying that they didn't have any foundation for that finding?

Professor GELHORN. It's very interesting you see no citations to the finding of the administrative law judge to support that conclusion.

Mr. SEIBERLING. That's RFP 17, whatever that is.

Professor GELHORN. That's respondent's proposed findings of fact. [Laughter.]

I think it's an odd case, and it's unfortunate, because I think it clouds up the issue here, and it is especially unfortunate after there was so much evidence before the administrative law judge. And it's also a situation in which every, virtually every, economist who has come before these committees has suggested that the competition here is quite intense.

Mr. SEIBERLING. Professor Rose, you pointed out that the current state-of-the-law is that the rule of reason applies in these territorial restrictions, and that, therefore, there is no necessity for this bill, and yet you recognize that there is a practical problem and that the commission has held that the FTC requires that they be prohibited from having these type of restrictions. I just wonder, suppose the FTC decision is upheld by the court, and eventually by the Supreme Court, then where do you come out? Does that change your positions?

Professor ROSE. Not necessarily. I mean I would want to read the Supreme Court's opinion or the court of appeals opinion and see the grounds for their decision. I think that there have been two cases now dealing with the legality of territory restrictions in the soft drink industry. The FTC found that violated the antitrust laws, but in a case coming out of, I believe, Nevada, *First Beverages,* they found that they didn't that they were reasonable.

It seems to me you have an analysis of different markets involved. I think Professor Gelhorn——

Mr. SEIBERLING. That's not much comfort to those who are affected by the first decision.

Professor ROSE. That's right, but it doesn't mean that the FTC will be upheld. I think that it doesn't do a lot of good to try to speculate on what a court would do. I think that Professor Gelhorn is inaccurate when he says all the FTC found was that they restricted intrabrand competition.

Now you can disagree with the FTC's conclusions for regarding the effect on interbrand competition, but the FTC did conclude that they restricted interbrand competition, and there are studies quite the contrary of the economists to those which Professor Gelhorn refers. By the way, Professor Williamson talked more generally about exclusive territory restrictions. He explicitly refused to talk about any particulars of the soft drink industry. There is a study cited in my statement by a man named Larner where he concludes that the effect of soft drink territorial restrictions has been antiefficiency.

So I think you come down eventually to the problem of what price do you want to pay for certain in the law? Do you want to let courts decide these things, with the possibility that some of the decisions may conflict? I don't think the plight of the soft drink industry in terms of coping with uncertainty is greatly different than others in the antitrust world.

Mr. HARRIS. The gentleman's time has expired. The gentleman from Ohio.

Mr. SEIBERLING. Could I just ask unanimous consent to allow Professor Gelhorn to comment on that, if he desires?

Mr. HARRIS. Professor, can you restrict your comment to 1 minute? Otherwise we will come back to you.

Professor GELHORN. Frankly I have to say that the record, I think, would just support a contrary conclusion.

Mr. SEIBERLING. Thank you.

Mr. HARRIS. The gentleman from Illinois.

Mr. RAILSBACK. Thank you, Mr. Chairman. If I could just ask the Professor, do I understand that what you are saying is that the legislation we have before us is, in your opinion, doing what should be done to try to get us into line with the *Sylvania* case, recognizing that where the rule of reason applies, but with the focus on the finding that there is interbrand competition, then there should be a determination in favor of the vertical nonprice restriction?

Professor GELHORN. Yes, sir, and the foundation for that analysis is that vertical nonprice restrictions almost invariably are designed to improve competition.

Mr. RAILSBACK. And make it more efficient?

Professor GELHORN. Between industries, and to allow the manufacturer of a product, in this case sirup, to select the most efficient way to distribute it. That's the purpose and it will benefit the consumers.

The danger in the circumstances is almost nil. It can occur if there were a monopoly at the producer level, or if there were a cartel at the bottle level. There is no evidence of either being present, and without those two conditions, it seems to me, and almost without exception—there are only a few I could identify—economists and others who have studied this kind of vertical area agree that there is no reason to prohibit them without those two preconditions.

Mr. RAILSBACK. The legislation that we have before us—if I could call your attention to page 3, about the middle of the page—states "provided that such product is in substantial and effective competition with other products of the same general class."

I am wondering, in talking about interbrand competition, if perhaps we should tighten that up. What if we had a case where there is no interbrand competition from a bottler standpoint since he obtains his sirup from many manufacturers? What is your feeling about that?

Professor GELHORN. It seems to me that kind of a specific amendment would not seek to serve the basic public interest of making sure that there is competition in the marketplace. Rather than focusing on particular arrangements, which was the vice of what the Justice Department was doing in the 1940's and the 1950's, and the Supreme Court did in the early 1960's.

Instead, one should look at the more general question: Are these products in interbrand competition both at the manufacturing and at the distributing level? If they are, the particular arrangement of on firm cannot have an effect, and therefore an amendment focused in that direction, it seems to me, would be contrary to the basic purpose of serving the consumer and assuring efficiency.

Mr. RAILSBACK. Let me ask you this: In respect to the FTC proceeding, I understand the FTC went with the rule of reason; I know they overturned the administrative law judge's decision. Is their finding that the elimination of intrabrand competition was in itself an antitrust violation, without taking into account what may have been the fostering of interbrand competition, the basis for your criticism of that decision?

Professor GELHORN. Yes; with one addition: The Commission said that the showing of an elimination of intrabrand competition is enough to make or to base a determination that the antitrust laws have been violated, and that once that level has been reached, it is the obligation of the bottlers and the sirupmakers to prove that the effect on interbrand competition outweighed the loss on intrabrand.

That, it seems to me, misreads——

Mr. RAILSBACK. So your feeling is that the Government not only should have to show the elimination of intrabrand competition, but, before that burden shifts, should also have to show that the elimination of the intrabrand competition outweighs the benefits that may accrue to be interbrand competition?

Professor GELHORN. That is what the Supreme Court held, and in fact, on that point, as I understood Professor Rose's express testimony, we are in complete agreement. The focus, as the Supreme Court said, it is predominantly an interbrand competition.

Mr. HARRIS. The gentleman's time has expired. The gentleman from New Jersey.

Mr. HUGHES. Thank you, Mr. Chairman. I want to thank both Professor Rose and Professor Gelhorn for a very interesting and informative exchange. It has been very helpful to me.

All the witnesses questioned by the committee have said that this bill does not authorize any per se violations of the antitrust laws. Do you believe that an amendment specifying H.R. 3567 does not authorize any per se violations of the antitrust laws would it make this bill clear on that subject?

Professor ROSE. I would answer that question, yes, it seems to me there is some ambiguity in the language of the bill contained in the language, "Nothing in the antitrust laws shall make unlawful the inclusion or the enforcement."

Professor GELHORN. I think it would be unnecessary. It would be redundant, because of the proviso. The proviso specifics that the language that Professor Rose read, "shall not apply if the product is in substantial and effective competition," and to my knowledge, there is no antitrust law applying a per se prohibition, when substantial and effective competition exists.

Mr. HUGHES. Let me ask you, can you tell us the difference between substantial and effective competition and competition?

Professor GELHORN. Yes, I think so. I will try. A market may have some degree of competition, but not meet that level of competition which is desirable in order to achieve competitive levels for price, service and quality. And it is for that reason that that precise language "substantial" is also in section 7 of the Clayton Act and section 3 of the Clayton Act.

Mr. HUGHES. Are you saying it is a matter of degree?

Professor GELHORN. Yes, sir.

Mr. HUGHES. I don't mean to cut you off, but I only have 5 minutes and I would like to go over a number of different issues.

Obviously it is your belief that the rule of reason should apply, and that we should not use the per se rule when that comes to this particular market.

Now my question is, are you familiar with the legislation that was developed in the 95th Congress, that was reported out by this committee?

Professor GELHORN. I have read it. How familiar I am with it at this point, I am not certain; but I have read it.

Mr. HUGHES. Well, am I to understand that you are supportive of the rule of reason. In essence you feel that the rule of reason should be applied, that if in fact there is substantial and effective competition, irrespective of whether there is intrabrand competition, then the court should look at those facts, and if indeed that competition exists, then it becomes somewhat irrelevant in essence that there is an absence of intrabrand competition?

Professor GELHORN. As you have stated it, sir, I agree 100 percent.

Mr. HUGHES. All right. If that's the case, then, why is it that in the legislation we are considering, it is essential to have the court make a finding first that there is in effect an absence of competition before sanctions will be applied?

If I understand section 2 of the bill—correction, section 3 of the bill, it reads that the existence or enforcement of territorial provisions in a trademarked licensing agreement for the manufacture or distribution or sale of trademarked soft drink products prior to any final determination that such provisions are unlawful, shall not be, et cetera.

So, actually, if I understand the legislation, and I think I do, until there is a final determination of a violation, there can be no finding of anticompetitive behavior? Now isn't that really beyond the rule of reason concept?

Professor GELHORN. Congressman, if I may, I think we are talking about two different sections of the bill, that have two different effects. Section 2 of the bill provides for a quicker determination, a speedier determination of the basic issue. If there is competition, we don't need to worry about the loss of interbrand competition. That's the end of the matter.

Section 3 of the bill says essentially in light of the uncertainty that has developed in vertical nonprice restrictions, with the Supreme Court, shifting course radically two times within the space of the decade, that it would be inappropriate to assess treble damages where the statute of limitation has been tolled by the Federal Trade Commission action for almost a decade. Without this provision we would be exposing this particular industry to treble damage liability beyond any reasonable measure or prophylactic effect because of the Trade Commission's almost lethargic procedures.

This second point only goes to damages; it does not go to the question of liability.

Mr. HUGHES. Just to damages, Professor Rose. Do you agree with that interpretation of section 3?

Professor ROSE. I think it's a little broader than that. It's just not an antitolling of the statute of limitations period, as Professor Gelhorn suggests.

What it basically says is that there must be a finding of illegality before an injured party can sue, and that they first have to establish as unlawful. This is very different than current antitrust law, it's not just an antitolling provision, and it considerably decreases the incentive for use of the private treble damage remedy.

Mr. HARRIS. The gentleman's time has expired. I am going to call on the majority counsel to ask a question for the record. Majority counsel, please.

Mr. GRIMES. Thank you. Professor Gelhorn, I wanted to follow up on the question that Mr. Seiberling was asking you. I notice that in your statement on page 21, you indicate that there is no dispute, that there is effective interbrand competition, that there is no dispute of this preposition in the FTC case, and yet I have that opinion in front of me, and there is 14 pages appended here that discuss the lack of interbrand—effective interbrand competition. In your statement were you referring to the administrative law judge or to the Commission's opinion?

Professor GELHORN. The Commission's opinion does not dispute the findings of the administrative law judge of the intensity of competition or price competition in the product markets raised by the staff counsel.

It said, however, that the burden is on the bottlers and sirup manufacturers to demonstrate that the loss of intrabrand competition was not outweighed by the benefits of interbrand competition.

So instead of looking at the existence of interbrand competition, which the commission does not dispute, it applies an assessment, a matter of degree, and says that that degree of desirability of necessity has not been shown.

The difficulty, of course, is nobody was ever asked to show it. Nobody ever expected that it had to be shown.

Mr. GRIMES. I hear what you are saying. I don't think you are addressing yourself to my question. It seems to me there is no question that the commission, as distinguished from the administrative law judge, did find that interbrand competition was adversely impacted by the existing territorial system.

Professor GELHORN. That's a different point. You asked me a question, not was it adversely affected. You asked me a more precise question which I sought to answer, whether there was an absence of interbrand competition.

That, it seems to me, was never disputed by the Federal Trade Commission, and there are substantial findings to the contrary by the administrative law judge.

Mr. GRIMES. I understand there is a disagreement there. Going back to section 3 of the proposed bill, I also wanted to follow up on the question Mr. Hughes asked. If the concern of the industry is treble damage actions, based upon the FTC's decision, isn't there a better way of exempting the industry from those suits than providing for permanent exemption from treble damages, as section 3 apparently does now?

Professor GELHORN. I wouldn't disagree with that.

Mr. GRIMES. Thank you.

Mr. HARRIS. I wonder if I may ask, after which I will recognize minority counsel for a question, if both of you would be kind enough to answer some written questions we might put to you with respect to these hearings, and may not have time to ask you?

Professor GELHORN. It would be an honor.

Professor ROSE. I would be happy to.

Mr. HARRIS. Minority counsel?

Mr. POLK. Thank you, Mr. Chairman. I'd like to direct Professor Gelhorn's attention to the proviso and ask him if in a given territory there were 25 different brands that appeared on the retail shelf, but in that territory there was only one bottler who bottled and put in containers all of these 25 products, would the competition standard and proviso be satisfied?

Professor GELHORN. With just those facts, it is impossible to answer, and let me explain why. You still might have substantial and effective competition if entry is easy, if it's a temporary situation, if there is price competition. It seems to me unlikely on the facts you gave me, but I would have to have those additional factors.

On the other hand, if you could show also—and I think a court would, under that standard, as well as under any other standard you picked, like substantial lessening of competition, et cetera—that entry was difficult, that this was a historic pattern, that others had attempted to enter and had been excluded, and the price here was substantially above price elsewhere, even where transportation costs were the same, then I would find an absence of substantial and effective competition.

What I am suggesting, of course, is that this language does permit the traditional assessment of competition that both economists and lawyers are used to.

Mr. POLK. Isn't that a little bit like measuring competition by measuring Chevette sales against Impala sales?

Professor GELHORN. Except today I would say that they are probably not in the same market. The way a sophisticated lawyer and economist will go at it is not to look at just numbers or at one or two criteria, but rather do precisely what the Supreme Court said in Sylvania, look at all the factors of competition.

Professor POLK. Even though there is only bottler bottling all these products, then you would say it was still possible, with other factors, for there to be competition?

Professor GELHORN. It's not likely, but it is certainly possible. And I didn't want to be heard as responding narrowly in a fashion which I would later regret.

Mr. HARRIS. I want to thank both the witnesses. I myself found it very illuminating, and I think the subcommittee did, too. The testimony was extremely helpful.

This concludes our scheduled hearings on the soft drink bills. After we have had a chance to receive any responses or follow-up questions to the witnesses, we will be able to close the record for these hearings.

It is at that time that the subcommittee will consider its next action. We currently have a rollcall to vote. On that basis, we will adjourn the subcommittee.

[Whereupon, at 3 p.m., the hearing was adjourned.]

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APPENDIXES

APPENDIX 1

Additional Statements

Statement of Hon. Ken Kramer, a Representative in Congress From the State of Colorado

Mr. Chairman, I want to thank the Subcommittee on Monopolies and Commercial Law for allowing me to go on record in support of the Soft Drink Interbrand Competition Act, HR 3567.

The Federal Trade Commission has ruled that the assignment of exclusive franchise territories is an unfair arrangement, hampering competition. This assertion ignores the reality of the market place for soft drink manufacturers. There is considerable interbrand competition in the marketing of soft drinks.

The assignment of territories to licensees is not intended as a tool to decrease competition, nor is that the effect. Territorial franchise assignments are a management tool to insure complete and even distribution of the soft drink product, and thus, add to interbrand competition throughout the nation.

If the FTC decision is not remedied by Congressional action, then the end result will be a lack of competition among soft drink manufacturers since the smaller bottlers, working close to their margins of profit, will be driven under by the added cost of doing business without the assured supply and distribution of their product.

If smaller bottlers are forced out of business, the larger bottlers will be in a position to deal with less, rather than more competition. The loss of jobs from local bottlers going out of business is also a consideration which highlights the need to overturn the FTC decision.

In light of this, I urge the Subcommittee to help prevent the banning of the assignment of territorial franchises by favorably reporting the Soft Drink Interbrand Competition Act, HR 3567.

56-865 O - 81 - 25

STATEMENT OF HON. RICHARD L. OTTINGER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman, thank you for giving me this opportunity to submit my statement in support of HR 3567, the Soft Drink Interbrand Competition Act.

It has been years since the federal government initiated action challenging the territorial provisions contained in bottlers' trademark licenses. As a result the industry is plagued by uncertainty. Many bottlers are torn between conflicting contractual obligations and threats by major chain store customers. Problems facing the soft drink industry, therefore, must be addressed immediately by Congressional action. Countless small bottlers are being driven out of business as the judicial process is exhausted. Indeed, failure to act on this legislation could jepordize an industry which in New York State alone employs over 6,000 people and generates over $1.2 billion in annual sales.

Standards under which the bottlers operate must be clarified. Previous rulings fail to fairly assess the unique characteristics of the soft drink industry. The proposed bill would take into account all aspects of competition applicable to the industry and thereby accomplish anti-trust objectives.

HR 3567 establishes a standard whereby soft drink products shall not be held in violation of anti-trust law if the soft drink products subject to such an arrangement are in "substantial and effective competition" with rival products. The words "substantial and effective" allow for flexibility as well as establish a standard by which the competitiveness of the industry can be judged. Factors to be taken into consideration include evidence of the intensity of price competition; responsiveness of output levels to consumer demand; and the quantity and quality of bottlers' competing products. Under such a criterion the industry will be tested and it will be expected to live up to competitive standards.

Evidence indicates that there is competition amongst bottlers and the arrangements used by the industry promote such competition. I believe this measure is an effective way to enhance that competition and insure the future viability of the countless small businesses involved in the industry.

STATEMENT OF HON. BALTASAR CORRADA, RESIDENT COMMISSIONER, PUERTO RICO

Hon. Peter W. Rodino, Jr.
Chairman
House Judiciary Committee
Washington, D. C. 20515

Dear Mr. Chairman:

Enclosed please find copy of the letter dated October 4, 1979, addressed to me by the Secretary of Justice of Puerto Rico, the Hon. Miguel Giménez-Muñoz, concerning S.287, 268, 598 and H.R. 1611, the Soft Drink Interbrand Competition Act.

In essence, Mr. Giménez-Muñoz opposes these bills since supporting them would entail going against the antitrust statutes which he has the duty of enforcing and because while these bills would protect a few small entrepreneurs this would be done at the expense of the consumers in general.

Please include this letter as well as Mr. Giménez' letter in the record of the hearings for these bills.

Cordially,

Baltasar Corrada, M. C.
Resident Commissioner, Puerto Rico

Enclosure

OCT 1 1 1979

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE ATTORNEY GENERAL
SAN JUAN

ADDRESS COMMUNICATIONS TO
THE ATTORNEY GENERAL

OCT. 4 1979

Honorable Baltasar Corrada del Río
Congress of the United States
House of Representatives
Washington, D.C. 20515

Re: S. 287, 268, 598; H.R. 1611

Dear Resident Commissioner:

I am herewith refering to the bills introduced in both the United States Senate and the House of Representatives with the purpose of clarifying the circumstances under which territorial provisions in licenses to manufacture, distribute, and sell trademarked soft drink products are lawful under the antitrust laws. Said statutes come in the midst of a Federal Trade Commission order, now under appeal, stating that exclusive territories for licensed bottlers of soft drinks are unreasonable restraints in commerce.

As you well know, there has been a tremendous amount of lobbying from soft drink bottlers urging the approval of these statutes. They have used many arguments to favor their contention, some of which merit serious consideration. The proponents of these measures first argue that the same will preserve a unique industry practice. Under the proposal, the local man would continue to rely on his territorial licenses as long as there is substantial and effective interbrand competition. The antitrust statutes, they claim, should not be used to restructure an industry, since such restructuring might change its form. Should territorial licenses be prohibited, small businesses would be swallowed up by larger ones. So, in the long run the Federal Trade Commission order would be anticompetitive, turning said industry into the classic oligopolistic situation.

The second claim is that uncertain legal prospects caused by the Federal Trade Commission ruling can be a major factor in increasing the cost of the product. The average soft drink bottler cannot survive without the franchise system. Vertical integration can be justified under the transaction cost approach as a means by which to economize on complex contracting costs. The same is true of intermediate forms of organization, such as franchsising, whereby franchisors introduce marketing restraints on franchisees.

A third disadvantage of doing away with this system, soft drink bottlers argue, is that with the absence of territorial restrictions, adjacent franchisees have the incentive to take a free ride upon the promotional and service efforts of one another, thus lacking an incentive to fully develop their own territories. Also, out side bottlers could easily expand into any market, using such inducements as the convenience of one certralized seller or participation in joint national or regional advertising.

Proponents of these statutes also claim that doing away with vertical restrictions would only damage the various services rendered by the bottlers. With the present system of exclusive territories, the consumer has unparalleled choice as to what soft drinks he will buy, where he will go to buy them, the sizes and packages he will select. Most of these choices would not be available if the franchise bottlers of national brands did not have exclusive manufacturing and marketing territories. Thus, this elimination would have profoundly unfortunate effects upon the industry and upon the consuming public.

Because of the substantial capital investment which almost makes it mandatory to grant exclusivity to bottlers, the effect of such an elimination would be felt initially by small bottlers, since they could no longer intensively develop their territories. On the other hand, retention of territorial franchises would tend to preserve the local deconcentrated structure of the soft drink industry.

They contend that elimination of soft drink territories would rapidly cause this industry to become highly concentrated. There would be extensive vertical integration, backward integration by the major chain stores, geographic market expansion by the largest and strongest established. Also, disappearance of minor brands, and disappearance or substantial contraction of a large number of smaller but currently viable and profitable bottling firms.

While all of the above-mentioned arguments do have some merit, specially when taken under a sociological context, the conclusions reached are not necessarily bad. They are, in fact, quite healthy if viewed under a competitive context, since consumers would largely benefit from these "incursions" into other markets. Eventhough, the Sylvania decision (Trade Cases, 75, 072, 1974) upholds that the rule of reason should be applied in deciding whether vertical restrictions regarding services do violate the antitrust statutes, the Federal Trade Commission sagely determined in In Re Coca Cola Co. (861 ATRR F-1) now on appeal in the Second Circuit, that these territorial restrictions do constitute unreasonable restraints in trade and commerce.

The basis for this decision is that territorial restrictions preclude the bottler from any procompetitive expansion into another geographical market and tend to eliminate potential competition. Furthermore, that these restrictions deprive retailers and consumers of the benefits of a free and open intrabrand competition for all brands of soft drinks marketed by Coca-Cola and Pepsi Co., also lessening interbrand competition among soft drink suppliers. Because of Coke's interbrand competitive force in the market, Commissioners Dole and Dixon note, its practice of eliminating intrabrand competition has adverse repercussions throughout the entire soft drink industry.

As to other subjective considerations, like the quality control question, the Commission indicates that the removal of the territorial restrictions should not adversely affect the quality of soft drinks sold under the various trademarks. The Commission is also of the opinion that, as a result of dismantling the territorial restrictions, there probably will be a substantial reduction in concentration because existing independent bottlers would expand into geographic areas previously captive of other bottlers, thus providing competitive stimulus. Therefore, these territorial restrictions were declared per se ilegal.

In addition to the arguments exposed in the Federal Trade Commission decision, there are some economic considerations which must be carefully reviewed. Territorial restrictions have two anticompetitive and profit increasing effects: (1) they suppress intrabrand competition by preventing dealers of the same manufacturer from competing with each other for sales to the same customer, and (2) in oligopolistic markets where product differentiation is significant, they diminish interbrand price competition because the higher gross margins dealers enjoy in the absence of intrabrand competition can be used to supplement the manufacturer's selling efforts, particularly at the point of purchase.

Soft drink manufacturing is neither purely competitive nor purely monopolistic. It can best be described as a differentiated oligopoly where product differentiation among soft drink brands is strong. Soft drink bottling is also highly concentrated, although in part because territorial restrictions prevent bottlers of the same brand from selling in one another's territories. So, operating in a market with high seller concentration and significant product differentiation, soft drink syrup manufacturers may have an incentive to restrict the territory in which a bottler may sell.

This combination of small territories and territorial restrictions means that most soft drink bottlers are producing at higher costs increase the bottlers' profit-maximizing prices and the prices retailers and consumers pay. The bottlers employ a "level pricing policy" charging customers in their territory the same price irrespective of the costs of serving that customer. Thus, the high cost customers are subsidized by the low cost ones. Exclusive territories prevent adjustment to a system yielding lower wholesale and, therefore, lower retail costs. As a consequence, syrup sales and profits are diminished.

In conclusion, the economics of soft drink manufacturing and bottling combined with the technological changes effected in the latter part of the twentieth century, has numbered the days of the small soft drink bottler. Economic studies reflect that the small bottler will disappear whether territorial restrictions end or remain. The important issue for public policy, and the underlying reason for bottlers' petitions to Congress to curb the Federal Trade Commission's challenge to territorial exclusivity, is whether the wealth of small bottlers will be maintained or decreased. If the system of territorial restrictions continues, the capital value of exclusive bottling franchises will be preserved, but so will higher production costs and prices to consumers.

This conflict between the efficiency and a reduction in market power which would be gained from ending territorial restrictions and the loss in wealth which this policy would impose on soft drink bottlers, is an issue which the antitrust laws are constantly trying to resolve. Under these statutes these type of restrictions are considered illegal because they are in restraint of trade. No matter how well we want to disguise them, the restriction exists, benefiting the few small entrepeneurs to the detriment of the numerous consumers. It is therefore impossible for our Department of Justice to endorse these measures, since doing so would entail going against the antitrust statute which it has the duty to enforce.

Cordially,

Miguel Giménez Muñoz
Secretary of Justice

STATEMENT OF SENATOR MARK O. HATFIELD FROM THE STATE OF OREGON

Mr. Chairman: I am very happy to support the proposal of my fellow Oregonian, Congressman Les AuCoin and his colleague, Jim Jeffords, in their testimony before this Committee regarding H.R. 3567 and H.R. 3573. Their proposal to set minimum standards for refillable and returnable containers is a direct and positive step to bring into existence national beverage container legislation, or the "Bottle Bill."

As you are aware, I have been a prime sponsor of national bottle return legislation. I have introduced several bills, including most recently S. 50, The Beverage Container Reuse and Recycling Act of 1979, to implement a national bottle law. One purpose of the legislation is to protect the reusable container as a viable alternative for the beverage industry.

Since 1958, we have seen a gradual, then rapid decline in the percentage of reusable beverage containers used in this country: from nearly 100 percent then, to less than 40 percent today. This is a grim statistic, considering the impact on solid waste. The Oregon experiment has proven, however, that this trend need not continue and that there are active alternatives to consider. One of these choices is evidenced by the action taken by Congressmen AuCoin and Jeffords.

The obvious logic of tying performance standards to legislation that would protect an industry, and at the same time attempting to reach long-term goals in solid waste management is commendable. I would hope that by placing these standards on the bottling industry, they would take a more positive stance toward deposit/returnable legislation, as they perceive the marked advantage to that course.

There is little doubt that returnable legislation on beverage containers is a concept here to stay. Since I introduced this legislation in the 95th Congress, the General Accounting Office released its study, "Potential Effects of a National Mandatory Deposit on Beverage Containers". That study reconfirms reports by the Federal Energy Administration (precursor to the Department of Energy) and the Environmental Protection Agency findings prior to the EPA approval of guidelines establishing a system of refundable deposits on all beer and soft drink containers sold on federal facilities. The GAO study notes that much of the pressure to switch from returnable to non-returnable containers comes from the intermediate customers' stores and distributors, rather than the ultimate consumer. It speculates that the consumer may have had little effect on the choice of container type.

If this is the case, Mr. Chairman, this amendment should not infringe on any consumer's rights or conveniences. In fact, it may extend one major consumer choice: the choice to return or not to return for refillable bottles. To lose a reasonable percentage of reusable bottles would, in effect, limit that choice. As a prime proponent of deposit legislation, I would prefer deposits on containers to obligate each user of a bottle, who discards that container, to pay something nearer to the true cost of that decision. But that will be discussed in another forum.

There are other considerations besides consumer and corporate choice. Each year trillions of BTUs of energy are expended in the manufacturing of beverage containers in the U.S. We could save 15 million BTUs through the return of bottles alone.* Millions of tons of solid waste can be immediately recycled if we protect the reusable bottle. Approximately 10.5 million tons could be saved with a mandatory deposit law.

The choice is clear. We must have some form of protection for returnables. This legislation is the vehicle for an appropriate response to this need.

I am a cosponsor of the companion bill to H.R. 3567 and H.R. 3573, S. 598, on the Senate side. I believe that this type amendment is appropriate for the Senate version but it may not take this exact form. It is obvious that one of the intents of this legislation is to form this protective barrier to prevent the loss of returnables.

The Soft Drink Bottlers Protection Act is a necessary attempt on the part of Congress to aid the small soft drink bottler and his fight to stay in business. I must concede that this legislation may be somewhat premature from a logistical standpoint, as the judiciary has yet to take final action. But we must not wait until we lose our bottlers to act.

The exclusive franchise system is a necessary component in the delivery of commercial soft drinks, and I hope that by strengthening the content of these bills we can assure stronger support for their passage.

Mr. Chairman, my position on returnable legislation is a matter of record. I cannot speak in strong enough terms to outline my support for this amendment. I am sure my colleagues have done an admirable job in presenting the statistical support for this amendment, and in doing so, have opened the eyes of those who may have questioned the purpose of this action, but I would like to insert a study article, into the record.*

Thank you, Mr. Chairman, for the opportunity to express my support in this forum.

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*Midwest Research Institute under contract to the EPA
*Environmental Action Foundation

BOTTLES & SENSE

(Researched and written by Patricia Taylor; edited and produced by Nancy Sachs, Carol Greenslit, Kathleen Painter, Davida Daemon; Production consultants: Philip Michael, Peg Averill; drawings by Michael Merchant)

The returnable bottle is a wonderful invention whose time has come—again. We didn't fully appreciate the returnable 15 years ago when it was the only way to buy beer and soft drinks. So nobody raised a fuss when the container manufacturers and brewers shifted to throwaway bottles and cans.

Over the past five years, however the returnable bottle has looked better and better to Americans who are tired of seeing throwaways littering their landscape. And it's not only the possibility of reducing litter that makes the returnable look good: it's a great money saver for the consumer, as well as an energy and materials saver.

The consumer doesn't buy a deposit bottle—he *borrows* it. No wonder returnables are cheaper than throwaway cans and bottles! A returnable bottle can be refilled an average of 15 times. No wonder returnables are more energy saving and materials conservative than throwaways. (We could save 116,000 barrels of oil a day and 7 million tons of reusable materials each year if we returned to returnables nationwide.)

The refillable bottle is making a comeback across the country as more and more cities, counties and states pass laws which require a deposit on all beverage containers. It's only a matter of time before refillable cans and bottles will be as fully available and in use as they were before the throwaway ethic began. Returnables make sense for today: they're a simple way to save energy, money and materials at a time when all of these resources are scarce.

The proliferation of one-way, throwaway beverage containers places a heavy and unnecessary burden on our national energy resources. According to the U.S. Environmental Protection Agency (EPA), we *waste* 224 trillion BTU's of energy each year manufacturing throwaway beer and soft drink cans and bottles. (1) That's enough energy to furnish all the electrical energy needs of New York and Chicago residents for an entire year. And it would be enough energy to meet the combined yearly requirements of 185 million people living in Asia, Africa and Central America. (2)

The Citizen's Advisory Committee on Environmental quality recognized the need for federal leadership in effective energy conservation. Therefore, the Committee recommended to the President that national legislation be enacted to require a refundable deposit on all beverage containers. Citing the energy shortage as "a critical national problem," the Committee reported that "refillable" beverage containers provide an inexpensive, . . . and energy-saving alternative to . . . energy-wasting disposable beer and soft drink containers." (3)

John Sawhill, former Administrator of the Federal Energy Administration, has said, "there are few other instances . . . where energy savings of this magnitude could be achieved as easily in terms of required capital investment and employment dislocations . . ." (4) Despite findings by government and private researchers of the potential for dramatic energy savings from nationwide returnable can and bottle use, we continue to produce billions of throwaways each year. So many, in fact, that one percent of our total national energy consumption is used solely to package the "leisure beverages" we drink.

Although some industry officials promote volunteer recycling and municipal resource recovery facilities as effective ways to reduce energy loads in the beverage industry, their claims are not borne out in fact. While recycling containers in some cases does use less energy than manufacturing new ones, refilling returnable containers uses much less energy than recycling. One throwaway can or bottle requires three times more energy to deliver the same amount of beverage than a returnable glass bottle used 10 times, less than the national average number of returns.

Energy Use of Different Containers

Environmental Impact:	Energy (million BTUs)
15 Trip Glass (Returnable)	16
All Steel	35
Bi-metallic Can	54
One-way Glass	63
Aluminum Can	69

Source: Midwest Research Institute under EPA contract.

Throwaway cans and bottles are an energy luxury we can no longer afford. With a nationwide all-returnable system, we could easily cut energy consumption in the beverage industry by 50 percent. Through a dramatic change in driving habits, Americans recently succeeded in saving 200,000 barrels of oil a day under the 55 mph speed limit conservation measure. By simply returning to returnables, we could save an additional 115,000 barrels of oil each day. (5)

MATERIALS

Manufacturing throwaways is a wasteful and expensive habit. One throwaway can or bottle uses four to six times more raw materials than one returnable bottle refilled 15 times, the current national average. Millions of tons of potentially useful materials end up discarded as garbage or litter.

In 1975, the U.S. beverage container industry used 7 million tons of glass, 2 million tons of steel and 500,000 tons of aluminum to make beer and soft drink containers, most of which were used once and thrown away. These materials represent a phenomenal 46 percent of all glass, six percent of all aluminum and two percent of all steel produced in the United States.(6) As William Coors, president of the nation's fourth largest brewery, recently testified, "We aren't going to have the materials in which to market our product if we don't start getting our containers back." (7)

Unless the "throwaway ethic" is reversed, the need for raw materials imports will continue to grow. Scientist Glenn T. Seaborg recently called for better planning of materials policy "As economic growth and industrialization accelerate over much of the world, the competition for mineral supplies will increase and the developing countries will exert more control over . . . their mineral resources. This situation has the seeds for crisis. . ." (8)

Dependence on overseas suppliers for materials is especially critical in the aluminum industry. The U.S. currently imports 85 percent of its aluminum and bauxite, the raw material used to make aluminum. When bauxite prices rose recently, Alcoa cut back production of aluminum for housing, construction materials, airplanes and household foil. Aluminum was still available, however, for beer can manufacture, one of the top three categories of aluminum consumption in the United States. (9)

It is time to recognize the folly of using precious imported materials to make throwaway beverage containers. Returning to returnables would safeguard these limited materials and more sensibly allocate our nation's resources.

LITTER

In 1973, over 60 billion beer and soft drink containers were manufactured in the United States. That figure will climb to 100 billion in 1985. (10) One beverage container in four ends up as litter on our landscape. (11) The ugliness of littered beer cans and broken pop bottles along roadsides, in parks and on beaches prompted the passage of beverage container legislation in the states of Oregon, South Dakota and Vermont. In addition, Oberlin, Ohio; Bowie and Montgomery County, Maryland; Berkeley, California; Cayuga County, New York; Fairfax and Loudon Counties, Virginia have all passed legislation curbing throwaways.

Beverage containers make up between 50 and 80 percent of litter by volume and 20 and 40 percent by item count (when one beer can equals one gum wrapper). (12) The efforts of container manufacturers and the brewing and soft drink industries to educate the public against littering have had little impact. Anti-litter laws around the country have proven unenforceable.

Beverage container legislation has been in effect in Oregon and Oberlin, Ohio since 1972 and in Vermont since 1973. Litter surveys in both states have shown substantial reductions in total litter and in beverage container litter. Of the littered beverage containers found by the Vermont State Department of Highways, only 25 percent were sold in Vermont; the rest were brought in by out-of-state tourists. (13)

The economic incentive of a deposit has now been shown to effectively reduce beverage container litter. About $535 million is currently spent each year for litter pick-up around the county.(14) A deposit on beverage containers provides a financial incentive to clean up littered containers. People will once again collect beer and soft drink containers along the roadsides and return them for extra spending money.

Buying returnables is a vote against litter and a positive action for a more beautiful America.

SOLID WASTE

The growth rate of throwaways is astronomical. The manufacture of throwaway cans and bottles has grown eight times faster than actual consumption of beer and soft drinks. Between 1955 and 1973, the number of containers produced skyrocketed 468 percent, while consumption of beer and soft drinks increased only 58 percent. (15)

Cutting down on wastes is a critical problem for cities and counties responsible for solid waste collection and disposal. Beverage containers are the fastest growing category of municipal solid waste, increasing eight percent annually. Although some states and localities have enacted their own legislation to control throwaways, the growing solid waste burden must ultimately be dealt with by the nation as a whole. Endorsing this philosophy, the National League of Cities/U.S. Conference of Mayors resolved that, "Unless we reduce the total volume of solid waste generated nationally, local governments will continue to be overburdened with the flow and financing of the nation's solid waste."

As the flow of materials increases, we can expect continued expansion of the amount of waste requiring disposal, according to the National Commission on Materials Policy. The Commission recommends that "the amount of solid waste be increasingly reduced where possible by methods of recycling, reuse and recovery."(16)

Recycling centers have been set up in many communities around the country in an attempt to recover some of the aluminum, glass and steel wasted in throwaway beverages container production. Facilities to mechanically recover aluminum and glass from solid waste are now being developed. Voluntary centers have been particularly encouraged by those in the beverage container business. Rather than curtail their expanding production of throwaway cans and bottles, these industries are eager to promote the image of citizens as litter-collectors.

However only one in seven aluminum cans is actually recycled. 10 billion of them continue to find their way onto refuse piles and roadsides every year. In 1973, only three percent of the steel cans were recycled. (17) Most steel cans can't even go through the recycling process because their aluminum flip-tops contaminate the steel, making recovery uneconomical.

Mechanical systems for the separation of glass and aluminum have not yet been demonstrated on a commercial scale. Even if the technology is successfully developed, most municipalities will not be able to afford these facilities and their construction will take many years. Therefore, resource recovery of a substantial portion of the country's throwaway cans and bottles in the near future is impossible.

It has been argued that a nationwide returnable system would reduce the aluminum can content and hence lower the market value of municipal waste available for recycling. Energy researcher Bruce Hannon of the University of Illinois has said that this logic is like having "each person swallow a little platinum to increase the value of sewage" so that the sewage treatment plant can operate efficiently. (18) In fact, there is no conflict between resource recovery systems and a nationwide returnable system. According to the EPA, "changing the composition of municipal waste through mandatory deposit legislation would not significantly affect the economics of most resource recovery plants." (19)

Our first priority should be to get rid of what we don't need; then when the technology is available, we should recover the rest. In the meantime, manual separation of recyclable materials by citizens is a viable alternative to expensive, energy-intensive resource recovery operations. With a nationwide deposit system, we could ensure that six to seven million tons of materials would be returned for reuse and recycling each year.

THE CONSUMER

Buying beer and soft drinks in returnable glass bottles instead of throwaways is a good way to save money. In New York state alone, consumers could save close to $40 million each year under mandatory deposit legislation.(20) That's how much extra they now spend for the "convenience" of throwaway containers. On the average, equivalent amounts of beverage sell for two or four cents more in a throwaway can or bottle than in returnables.

The reason for the higher prices is that the major expense in throwaway container production goes for packaging—not for labor, ingredients or transportation. According to a survey conducted by market analysts Sanford C. Bernstein & Co., "packaging is the major factor in the production of beer," accounting for as much as 56 percent of the costs while the ingredients account for only 12 percent (21) But with returnable bottles, the consumer saves money by borrowing the expensive packaging.

Currently it is difficult for consumers who want to save money to find returnables on store shelves. In Washington, D.C., for example, an Environmental Action survey found that less than 15 percent of the 361 liquor stores surveyed carried beer in returnables. And where beer was available in returnables, it was sold only in 24-bottle cases in one or two brands. The situation is similar—and often worse—in other communities around the country.

In January, 1975 the Falstaff Brewing Co. launched the first marketing of returnables in 12-bottle cases. According to Falstaff Vice-Chairman Joseph Griesedick, "Returnable bottles are the most economical for the consumers and the brewer." He noted that consumers would pay only $2.50 for a 12-bottle case of returnables as compared with $3.13 for the same amount of beer in cans—a 5-cent-per-bottle savings (22)

Returnable savings hold true in the soft drink industry as well. The president of

Coca-Cola, USA, testified before the Senate Judiciary Committee: "Coke sold in food stores in non-returnable packages is priced, on the average, 30 to 40 percent higher than Coca-Cola in returnable bottles. The difference lies essentially in the different costs of packaging. The cost of returnables is spread over many uses; the cost of the non-returnable package is absorbed in one use."(23)

Obviously many beverage-related industries prefer to continue this upwardly spiraling system of more throwaways and higher prices. Such industries no longer have to pay the costs of refilling and reusing beverage containers which are higher than the cost of the beverage ingredients. And as taxpayers, consumers must also foot the bill for collection and disposal of throwaways.

Attitude surveys and the experiences of Oregon and Vermont have shown that consumers are more than willing to forego "convenience" packaging for a return to returnables. The first nationwide poll on the issue of returnables was recently conducted by the Opinion Research Corporation for the Federal Energy Administration (FEA). An overwhelming 73 percent of those polled favored a law requiring that all soft drinks and beer be sold in returnable bottles and cans.

In Michigan, a private poll conducted for Governor William Milliken found that 73.3 percent of the people favored a state law banning the sale of non-returnable bottles and cans.(24) And, in the state of Oregon, an opinion poll taken one year after enactment of that state's law found 91 percent of the people approved, while only five percent voiced any disapproval at all.(25)

Consumers have found other reasons, in addition to saving money, for returning to returnables. The safety hazards of throwaway cans and bottles are a source of serious concern to consumers. In its spring, 1975 hearings, the Consumer Product Safety Commission verified that throwaway bottles break more easily than returnables. The Commission pointed out that splintering or exploding glass beverage bottles were responsible for 11,600 hospital emergency cases in one year. Detachable, "flip-top", "pull-top" tabs on metal cans are also a safety hazard to people who step on them or swallow them, according to the Journal of the American Medical Association.(26) The state of California recently [illegible] legislation prohibiting the use of [illegible] openings on beverage cans, and [illegible] flip-tops would be outlawed under national beverage container legislation.

Nationwide use of returnables would shift the cost of litter collection and container disposal back to the manufacturers and consumers of beverages, relieving the growing burden being placed on the general public. Returning to returnables would also mean a healthy financial boost for the nation's consumers.

EMPLOYMENT IMPACT

Thousands of workers have lost their jobs in the brewery and soft drink industries because of throwaways, according to Anthony Sapienza, president of Brewery and Soft Drink Workers Union Local 1164. "It requires fewer workers to process these containers than returnable bottles," Sapienza said in announcing his union's support of beverage container legislation. He added that "steelworkers make the throwaway cans, glass workers make the bottles, but we lose the jobs."(27)

Twenty-six thousand three hundred workers lost their jobs in the brewing industry between 1958 and 1974.(28) Concentration and consolidation in the beverage industry, along with the shift to throwaway containers, have led to the shutdown of many brewing and soft drink bottling companies. In 1935, for example, there were 765 brewing plants in the U.S. but by 1974 only 99 plants remained. These are owned by 55 companies, six of which control 68 percent of the market.(29) This trend is also being followed in the soft drink industry. Seven thousand nine hundred workers lost their jobs in the soft drink industry between 1970 and 1974.(30) Coca Cola plans to phase out 900 franchised bottling plants across the country and replace them with 73 centralized plants by 1980.

A recent development in beverage containers will mean even greater job loss in the future. The plastic bottle is already being used by soft drink manufacturers and is expected to capture 10 percent of the throwaway container market by 1980. The rapid introduction of this container will mean job losses for workers in the glass and can industries, as manufacturers in the brewing and soft drink industries switch to plastics.

A report commissioned by the Environmental Protection Agency predicts that continued expansion of the throwaway beverage container system will lead to further loss of jobs.(31) The job losses which have already occurred in the beverage container industry were the result of "natural" free market forces. Clearly, if we allow these market forces to prevail, thousands more workers in the soft drink, brewing and container manufacturing industries are bound to suffer major job losses and dislocation.

Passing national mandatory deposit legislation will affect the jobs of workers now manufacturing throwaway cans and bottles. Although the proposed legislation does not ban the manufacture of throwaway bottles and cans, it is expected that there will be a shift to the use of refillable bottles and recyclable cans. Thus the production of throwaway bottles and cans would be reduced. The Research Triangle Institute has estimated that after a five-year implementation period for the proposed law, about 90 percent of the containers sold would be refillable and 10 percent would be cans. During this period, the Institute estimated that 39,000 jobs would be lost;(32) yet at the same time, using RTI's methodology, approximately 107,000 new jobs would be created for small bottlers, distributors, truckers and retail clerks.

In every study conducted on the employment impact of federal or state beverage container legislation, there has been a net increase in employment. However, many of the jobs generated by a returnable system can not be substituted for jobs under a throwaway system, although many are of equal pay rate. Therefore, provision should be made for retraining and relocating displaced workers, while those presently unemployed gain the thousands of new jobs created by a shift to returnables.

It's true that there will be some job dislocations with a shift to returnables as there were in the past with the shift to throwaways. But by going back to returnables, jobs will be created instead of lost.

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NATIONAL ORGANIZATIONS WITH INFORMATION ON BEVERAGE CONTAINERS

The Crusade for a Cleaner Environment, 2000 L Street NW, Washington, D.C. 20036.

The Can Manufacturers Institute, 1625 Massachusetts Ave. NW, Washington, D.C. 20036.

Environmental Action, Inc., 1346 Connecticut Ave. NW, Room 731, Washington, D.C. 20036.

Glass Container Manufacturers Institute, 1800 K Street NW, Washington, D.C. 20006.

League of Women Voters of the U.S., 1730 M Street NW, Washington, D.C. 20036.

National Soft Drink Association, 1101 16th Street NW, Washington, D.C. 20009.

U.S. Brewers Association, 1750 K Street NW, Washington, D.C. 20009.

QUESTIONS AND ANSWERS ON RETURNABLE BEVERAGE CONTAINERS FOR BEER AND SOFT DRINKS

(Waste Reduction Branch, Resource Recovery Division, Office of Solid Waste Management Programs, U.S. Environmental Protection Agency, July 1975)

1. *What are returnable beverage containers?*

Returnable beverage containers are containers that are accepted for return after use. Usually a cash deposit is paid when the beverage is purchased and refunded when the container is returned. The purpose of the deposit is to provide an incentive for the return of the container either for refilling or for recycling of the container materials.

2. *What are the environmental and resource conservation benefits of returnable beverage containers?*

The return of beverage containers reduces the generation of beverage container waste and litter. Reuse and recycling of containers reduces air and water pollution resulting from the production of containers, and conserves energy and materials.

3. *What is mandatory beverage container deposit legislation?*

Mandatory deposit legislation is a law or ordinance which requires a deposit on all beverage containers sold in a particular jurisdiction.

4. *Is there mandatory deposit legislation in existence today?*

Three States have enacted mandatory deposit or returnable container laws for beer and carbonated soft drinks: Oregon, Vermont and South Dakota.

In Oregon, a refund value of 2 cents is carried by all "certified" containers, which can be reused by more than one manufacturer. All other containers carry a refund value of 5 cents. Metal containers with detachable tab tops are banned.

In Vermont, all beer and soft drink containers carry a refund value of at least 5 cents. The manufacturer or distributor is also required to pay the retailer a fee of 20 percent of the deposit (1 cent per 5 cent-deposit container) to cover the costs of handling the returned containers. In January 1977 nonrefillable bottles will be banned in Vermont, as will metal containers with detachable tops and non-biodegradable container carriers.

South Dakota has passed a law which requires that every beverage container sold in that State, subsequent to July 1, 1976 shall be either a reuseable container or a container which is biodegradable.

Several communities including Bowie, Maryland; Loudoun County, Virginia and Ann Arbor, Michigan have passed similar laws which have not been implemented due to legal challenges.

5. *Does mandatory deposit legislation eliminate the use of the metal can as a beverage container?*

Mandatory deposit legislation does not prohibit the use of metal cans. However, in Oregon, after passage of the law, the use of refillable bottles increased and the use of cans decreased. For soft drinks, refillable bottles increased from 53 percent of the market prior to the law to 88 percent of the market in the year following the law.[1] Soft drink cans decreased from 40 percent of the market to 12 percent.[2] Refillable beer bottles increased from 31 percent of the market before the law to 96 percent afterwards.[3] Beer cans declined from 40 percent to 3.5 percent.[4] The use of nonrefillable glass bottles was practically eliminated for both beer and soft drinks.

In Vermont comprehensive data on pre-law and post-law container usage is not available. However, as of April 1975, cans and nonrefillable bottles were still being sold for both beer and soft drinks, but a trend towards more widescale use of refillable bottles for soft drinks has been reported.[5]

Nationwide in 1972 approximately 39 percent of all soft drinks were packaged in refillable bottles, 27 percent in nonrefillable bottles and 34 percent in cans.[6] For beer the figures are approximately 18 percent for refillable bottles, 24 percent for nonrefillable bottles and 58 percent for cans.[7] The market mix of containers varies significantly for different geographic regions.

Mandatory deposit legislation would probably result in a shift towards the increased use of refillable bottles. Nonrefillable glass bottles may well disappear from the market (however for larger sizes nonrefillable bottles may remain). Cans would probably decline in market share but would remain in some quantities, especially in areas where they are currently predominant.

6. *How much solid waste can be prevented by such laws?*

On a national basis, beer and soft drink containers accounted for 8 million tons of solid waste in 1973.[7] This represented 6 percent of total municipal (household and commercial) waste. Beverage containers are a rapidly growing segment of municipal waste, with an estimated growth rate of 10 percent per year from 1962 to 1972.[8]

If 90 percent of the containers bearing a deposit were returned for refilling or recycling, there would be a reduction in beverage container waste of 70 to 75 percent, or 5 to 6 million tons on a national basis.

7. *What about littered beverage containers?*

Most studies show that beer and soft drink containers comprise between 20 to 30 percent of roadside litter by item count.[10,11,12] However many other littered items are smaller and less visible than beverage containers and degrade more rapidly in the natural environment. On a volume basis, which is a better measure of litter visibility, beverage containers have been found to represent 62 percent of highway litter.[11] For the year following enactment of deposit legislation, beverage container litter decreased by 66 percent in Oregon and by 67 percent in Vermont.[11,12]

Footnotes at end of article.

posit system in which nonrefillable containers were not completely eliminated. Capital losses would be reduced if time were allowed for normal amortization of current investments over a period of years. A 1975 study for the State of New York, assuming a 3 year phase-in to a market mix of 80 to 90 percent refillables, concluded that new investment requirements in that period would be $53 million per year, compared to a normal investment requirement of $30 million per year with no legislation.

It should also be noted that normal industry competition resulting in changes in relative container prices or introduction of new container types (such as the plastic bottle) could have similar impacts on the container industries.

14. *What would be the effect of National mandatory deposit legislation on employment?*

The impact of mandatory deposit legislation upon employment would also depend on the rate of change of container useage. A rapid shift toward the use of refillable bottles would eliminate some jobs, primarily skilled positions in the container manufacturing industries. It has been estimated that a complete ban of nonrefillable containers in 1969 would have resulted in the loss of 60,000 jobs that year. However it was also estimated that the establishment of a returnable system would also create a roughly equal number of new jobs, primarily jobs of lower skill classification and pay, in the retail and distribution sectors of the economy. It is important to note that the employees displaced would not be directly transferable to these new jobs. Employment dislocations would be reduced if nonrefillable bottles and metal cans continued to be sold or if the change in container useage took place over a period of time. A transition period would allow natural attrition in employment to absorb some of the job losses. Also it would provide time for employment to shift to other plants or industries manufacturing other containers or similar products. For example, it has been estimated that a gradual transition over a 5 year period to a 90 percent reduction in nonrefillable containers would result in the loss of 39,000 positions. A 10 year transition to a similar market would result in the loss of about 17,000 positions.

Studies conducted for the States of Maryland, Minnesota, New York, Connecticut, Illinois, Michigan and Maine all found that the job gains in the retail and distribution sectors would be greater than the losses in container manufacturing. In New York, for example, a job gain of 5,200 and a loss of 1,200 jobs was predicted, with a net annual payroll increase of $35 million.

In Oregon, where a deposit law is in effect, one study estimated an addition of 175 to 200 new jobs and a loss of 340 to 427 existing jobs but not not estimate job increases in retail stores. Another study estimated a net job gain of 365 jobs (including retail).

15. *Is mandatory deposit legislation at cross-purposes with plants built for the recovery of energy and materials from waste?*

A resource recovery plant processes mixed municipal waste in order to extract materials and other products which can be sold. Changing the composition of municipal waste through mandatory deposit legislation would not significantly affect the economics of most resource recovery plants. Approximately 80 percent of the municipal waste stream is organic materials—paper, plastics, etc. This fraction should be the primary concern of a resource recovery facility, as it represents the bulk of the waste, and provides the bulk of revenue ($10 to $15 per ton of waste processed) needed to make resource recovery economically feasible.

As a maximum result of mandatory deposit legislation, glass in the waste stream could be reduced by about 35 to 45 percent, ferrous metal wastes could be reduced by 15 percent, and, where use of aluminum cans is substantial, aluminum wastes could decline by 30 to 45 percent. Under favorable market conditions, gross revenues from the beverage container fraction of the waste stream amount to about $1 to $2 per ton of waste processed. When the costs of recovering and transporting these fractions are considered, the net revenue contribution is considerably less. Removal of the beverage container fraction through a mandatory deposit system would probably not cause a net revenue reduction in excess of $1 per ton of waste processed.

It should be emphasized that recovery technologies for glass and aluminum are for the most part not yet fully demonstrated and markets for recovered glass and metal resources have just begun to be developed. In light of the uncertainties of separating and marketing aluminum and glass from solid waste, beverage container legislation does not entail undue risk for the installation of resource recovery facilities.

Resource recovery system feasibility should not be decided solely on the basis of glass, aluminum and steel recovery economics. Other more important factors are the general uncertainty regarding future markets (especially for the organic fraction) and the institutional obstacles to organizing and implementing a venture of this sort. A significant number of future recovery investment decisions should not be adversely impacted by mandatory deposit legislation.

16. *Are there other mechanisms, such as the litter tax enacted by the State of Washington, that will achieve benefits similar to a mandatory deposit law?*

Litter taxes are generally very small taxes (a fraction of a cent per product) imposed at the time of sale of products likely to be littered. Such taxes could provide additional revenues to collect litter along streets, highways, and recreational areas. The major shortcoming of a litter tax is that it does not create a disincentive for littering (the tax is paid regardless of whether the individual purchasing the product litters the item or not). Furthermore, such a mechanism would not reduce the generation of solid waste, nor would it result in savings of energy or materials. Thus while a litter tax is not incompatible with mandatory deposit legislation, it is not a substitute for such legislation.

17. *Is there a sanitation problem in storing used containers?*

While there is a possibility of insect problems associated with the storage of bottles and cans containing beverage residues, it should be noted that returnable containers have been used for many years without significant adverse public health impacts. If public health laws and sanitation codes are strictly enforced, and containers are picked up on a frequent and timely basis, such problems should be minimized.

18. *Isn't there a loss of convenience to the consumer?*

A deposit law does not require return of the container, but does make the consumer who discards the container pay the amount of the deposit. A study for the State of Oregon found that 87 percent of those surveyed found no inconvenience with returnables. Furthermore this survey found that 91 percent of the respondents approved of the legislation and only 5 percent voiced any disapproval at all.

19. *What is the position of the U.S. Environmental Protection Agency on mandatory deposit legislation at the Federal, State and local levels?*

The U.S. Environmental Protection Agency has testified in favor of the adoption on a nationwide scale of a mandatory deposit system for beer and soft drink containers. Based upon several years of analysis and observations in the States which have enacted mandatory deposit laws, it is concluded that

8. *How much energy could be saved by use of returnable containers?*

Beverage containers that are refilled or recycled save energy and materials. A glass beverage container used 10 times consumes less than one-third of the energy of nonreusable containers used to deliver the equivalent quantity of beverage. Aluminum and all-steel cans that are recyled save 78 and 39 percent, respectively, of the energy required to manufacture a can from virgin raw materials.

The energy that would be saved through mandatory legislation depends upon the resulting container mix and the return and recycling rates for the containers. For example, if national mandatory deposit legislation had been in effect in 1973, and if the bottle and can container mix had not changed and if 90 percent of all bottles had been returned and refilled and 80 percent of all cans had been recycled, approximately 151 trillion British Thermal Units (BTU) of energy would have been saved. If on the other hand in 1973 refillable bottles had represented 80 percent of the market share (and bottle and cans had been returned and recycled at the above rates) approximately 209 trillion BTU's of energy would have been saved.

9. *How significant are these energy savings?*

A saving of 209 trillion BTU's is equivalent to the energy content of 39 million barrels of oil. It is also equal to about one-half of the energy used in producing the current mix of beverage containers. While this amounts to a saving of just 0.3 percent of total national energy use, it is important to note that it is of similar magnitude to the saving achievable through other energy conservation measures currently being considered. For example, it is equivalent to one-half of the energy saving that can be achieved from strict enforcement of a 55-mile per hour speed limit nationwide.

10. *How much materials could be saved through the use of returnable containers?*

If in 1973 90 percent of all bottles had been refilled and 80 percent of all cans had been recycled, between 5 and 6 million tons of raw materials would have been saved that year. This would represent a savings of 3.8 to 4.6 million tons of glass, 1.1 to 1.3 million tons of steel and 300,000 to 350,000 tons of aluminum.

11. *How would a returnable system affect beer and soft drink prices?*

Beer and soft drinks sold in refillable containers are generally cheaper to the consumer than beverages in one-way bottles and cans. Savings in the range of $.03 to $.05 per 12 ounce container have been frequently observed. However, it has been argued that the costs of handling and transporting returned containers are not fully reflected in retail prices. These costs have been estimated to range from less than $.01 to $.02 per container. Therefore, even if these costs are assumed not to have been reflected and are added, beverages in refillable containers cost less to the consumer. To the extent that mandatory deposit legislation induces a shift to refillable bottles, average prices for beer and soft drinks should decline.

However, it should be pointed out that a rapid widescale shift to an all refillable bottle system would require considerable equipment changeover in the brewing and soft drink industries and would result in additional costs that could be passed on to the consumer. If the transition to refillables takes place gradually over a period of years, the costs of rapid changeover would be avoided.

12. *How many times do containers have to be returned before energy and cost savings are achieved?*

For an energy saving to be achieved from use of a refillable bottle, it must make at least four trips or have a return rate of 75 percent. Refillable bottles generally become cheaper than one-way containers at return rates of 80 percent (5 trips), although this varies from bottler to bottler.

In Oregon one year after passage of the deposit law, refillable soft drink containers were returned at a 96 percent rate, and refillable beer containers at an 80 to 95 percent rate. Approximately 65 to 70 percent of all cans were being returned and this rate was increasing. Detailed data are not available from Vermont, although several bottlers have indicated return rates of 90 to 95 percent.

The subject of average national return rates for refillable bottles is a matter of considerable debate. An estimate calculated by dividing container fillings by container purchases results in an average return rate during the period 1963 to 1972 of 94 percent for soft drinks and 96 percent for beer. These figures may not represent actual return rates since bottle inventories may have been changing. Furthermore, these figures include both "on-premise" beverage consumption (in taverns and restaurants) where return rates would be expected to be higher than for "off-premise" consumption (e.g. beverages purchased from supermarkets or retail stores). Another estimate indicates soft drink container trippage of 10 to 15 (return rate of 90 to 94 percent) and a beer container trippage of 18 (return rate of 95 percent).

In any case, for a mandatory deposit system it appears reasonable to expect a return rate for beer and soft drink containers that would be much greater than that necessary for energy and cost savings.

13. *How would a mandatory deposit law impact on the beverage production, container manufacturing and distribution industries?*

The impacts of mandatory deposit legislation upon industry would depend upon the extent of the change in the market mix of containers and the time period over which this change takes place. Most estimates of economic impact have been based upon the extreme assumption of a complete and sudden switch to refillable bottles. Under these circumstances, facilities for the production, storage eand distribution of one-way containers, not convertible to returnable systems, would become obsolete and would have to be replaced. Glass and metal container production would decline. Bottlers and brewers would initially have to invest in additional bottle washing equipment and refillable container lines. Additional transportation costs would be incurred for the distribution of beverages and the return of containers. Some retailers would need additional storage space and would have to add employees to handle returned containers.

Based on 1969 data in an industry-sponsored study of the impacts of a ban on nonrefillables, tax writeoffs would amount to $1.3 billion, and total new investments $1.2 billion. More recently the brewing industry has claimed "conversion costs" of $5 billion for a sudden switch to refillables and a ban on one-way containers.

The 1969 study indicated that cost increases in the brewing and soft drink bottling industries would be more than offset by container cost savings. Some of these savings could also be passed on to beverage distributors and retailers to offset increased costs in these sectors. The study found that the aggregate cost to all sectors of the industry (beverage producers through retailers, inclusive) would be $250 million in the first year of a ban, but would actually become a $40 million gain in subsequent years due to container savings.

Tax losses and new investment requirements would be lower for a mandatory de-a mandatory deposit program would result in significant conservation of energy and materials, and a reduction in solid waste and litter caused by beverage containers. A sudden shift to a returnable system, however, would likely result in excessive economic disruption and unemployment. To minimize the adverse economic repercussions, it is recommended that a nationwide system be phased in over an extended period of time.

While ideally such legislation should be national, State-level legislation, based upon the experience in Oregon and Vermont, also appears to be effective in achieving the benefits. Below the State-level, ordinances requiring mandatory container deposits would probably be effective in large regions, counties or metropolitan areas. Not enough experience has been acquired to indicate whether local ordinances for smaller communities would be effective.

EPA neither supports nor opposes State or local deposit legislation. EPA favors national legislation in this area and has decided not to promote the adoption of State or local laws which may be superseded by a national law at a later time. Furthermore the Agency does not have the resources to analyze the economic impacts of different State laws. However EPA does not oppose State or local deposit legislation that is designed to reduce negative employment and economic impacts and contains provisions anticipating possible national laws.

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APPENDIX 2

Additional Material

CENTRAL INVESTMENT CORPORATION
4050 EXECUTIVE PARK DRIVE • CINCINNATI, OHIO 45241 • PHONE (513) 563-4700

November 5, 1979

Honorable Peter W. Rodino, Jr.
Chairman, Committee on the Judiciary
United States House of Representatives
2137 Rayburn House Office Building
Washington, D.C.

Dear Mr. Chairman:

I am writing briefly to supplement the record in connection with my testimony on Wednesday, October 24, 1979, before the Subcommittee on Monopolies and Commercial Law concerning the Soft Drink Bottling legislation.

You will recall that a major thrust of my testimony was the need to preserve the franchise territories in order to avoid the elimination of the returnable bottle, with all the adverse ecological and economic consequences which will flow from that. Questions came up as to whether the effort to preserve the returnable bottle should not be addressed separately, through mandatory beverage container deposit legislation (BCDL) or some other legislation specifically aimed at the environmental issues. It is my strong belief that the preservation of the returnable bottle cannot be separated from the preservation of the exclusive franchise territories, and I believe that the experience in Oregon, the one state with a mature BCDL law, bears me out on this.

In 1974, when BCDL went into effect in Oregon, local breweries (particularly Blitz-Weinhard and Olympia) were major factors in the beer market. Moreover, shortly after the BCDL was implemented, 96 percent of all beer sales were in returnable containers. The beer industry in the state, however, lacking franchise territories, was unable to stop the consistent trend toward concentration in that industry nationwide and the concomitant decline in the use of the returnable bottle. By 1979, Blitz-Weinhard had sold out to Pabst, four of the top five beer sellers in the state were national companies with a combined total of 63 percent of the market, and the leading brand (Miller) sold <u>no</u> beer in Oregon in returnables. By the end of 1978, the percentage of beer sales in returnables had dropped to 49.8, and by June 1979, the returnable market share was down to a mere 36 percent. Of course, beer purchasers were still paying deposits on all their containers. Thus, the price to the consumer was up considerably, but the returnable bottle was disappearing, and the grocery stores were accumulating huge deposit funds, the proper distribution of which was beginning to present a major problem.

By contrast, in the soft drink industry, where the bottlers have exclusive franchise territories, there has been no similar rush to concentration in distribution and sales patterns, and the returnable market share has remained remarkably stable. By the end of 1978, returnables still accounted for 80 percent of soft drink food store sales in Oregon.

This demonstrates, I believe, that consumer demand for returnables and friendly legislation are not enough. Where the giant conglomerates dominate the distribution patterns in an industry, they invariably centralize those patterns in a manner wholly inconsistent with the survival of the returnable bottle. The result is a distribution system which is indeed more "efficient" from the point of view of the few major centralized national manufacturers. The cost of that illusory "efficiency" is passed on directly to the consumer, who must pay for the more expensive packaging along with his product and thus is subjected to additional inflation and the obvious adverse enviornmental consequences. The only way to avoid this in the soft drink industry is to preserve exclusive franchise territories, without which the returnable bottle makes no sense.

Sincerely yours,

Richard W. Caudill

Richard W. Caudill

AMERICAN BAR ASSOCIATION

SECTION OF
ANTITRUST LAW

1155 EAST 60TH ST., CHICAGO, ILLINOIS 60637 TELEPHONE (312) 947-4000
PLEASE REPLY TO

(312) 876-8093

March 24, 1980

William L. Sippel, Esq.
Antitrust and Monopolies Subcommittee
of the House Judiciary Committee
U. S. House of Representatives
Washington, DC 20515

Dear Mr. Sippel:

Enclosed are resolutions of the Section of Antitrust Law of the American Bar Association concerning proposed legislative proposals to amend the Federal Trade Commission Act. The Board of Governors of the American Bar Association, without in any way binding the Association itself, or any other Section thereof, has authorized the Section of Antitrust Law to communicate the Section's views on this matter.

The Section's resolutions generally fall into four categories: procedural reform of FTC rulemaking and investigative powers; amendments designed to terminate particular ongoing adjudicatory and rulemaking proceedings; legislative veto of FTC rules; and curtailment or modification of the FTC's jurisdiction.

With respect to the legislative proposals currently under intensive consideration by Congress, the resolutions provide:

"1. Legislative proposals to curtail the substantive powers of the Federal Trade Commission, or to modify the administrative procedures by which such powers are exercised, raise highly important and interrelated issues central to the Commission's structure and role. These issues include, among others, the propriety of continuing to combine prosecutorial and adjudicative functions in the Commission; the scope of the FTC's remedial powers; the Commission's use of the "unfairness" doctrine; and appropriate substantive limitations on the FTC's rulemaking function. Such legislative proposals should be considered not on a piecemeal basis, but rather in a carefully planned, structured, and comprehensive Congressional study of the FTC's powers, structure, and procedures.

"2. In view of the potential for improving FTC rulemaking by procedural reform, and in view of the continuing beneficial effects of legislative oversight and judicial review of FTC rulemaking, it would be premature and possibly counterproductive to require Congressional review of every FTC rule. Therefore the ABA Section of Antitrust Law does not endorse procedures for legislative review and veto of FTC rules.

"3. With regard to legislative prohibitions of particular ongoing FTC cases or rules, action of this nature should be exercised judiciously and, absent compelling circumstances, only after completion of the regulatory decision-making and judicial review functions."

The resolutions are based on a report approved by the Council of the Section of Antitrust Law on February 7, 1980. A copy of that report (which, like the resolutions, has not been adopted or approved by the American Bar Association or any other Section) is also enclosed.

Very truly yours,

Earl E. Pollock
Chairman

EEP:ck

Enclosure

RESOLUTIONS

Of The

SECTION OF ANTITRUST LAW

AMERICAN BAR ASSOCIATION

Concerning

FEDERAL TRADE COMMISSION ACT

AMENDMENTS

Approved by the

Council of the Section of Antitrust Law

February 26, 1980

RESOLUTIONS

Concerning Proposed Amendments to the Federal Trade Commission Act

The 96th Congress has given active and extensive oversight to the activities of the Federal Trade Commission. While initially focusing on the manner in which the Commission has exercised rule-making powers granted to it in the 1975 Magnuson-Moss Warranty -- Federal Trade Commission Improvement Act, Congress now has before it proposals for significant procedural and substantive revision of the FTC's statutory powers which could have a far-reaching impact on the basic structure and role of the FTC.

These legislative proposals generally fall into one of four categories: procedural reform of FTC rulemaking and investigative powers; amendments designed to terminate particular ongoing FTC adjudicatory and rulemaking proceedings; legislative veto of FTC rules; and curtailment or modification of the FTC's jurisdiction. Each category represents a different form of legislative response to the substance and mode of FTC regulation.

The Section of Antitrust Law of the American Bar Association hereby submits its views concerning these proposed amendments to the Federal Trade Commission Act. These Resolutions represent a synthesis and consensus of individual contributions of the members of the Section of Antitrust Law, and are not necessarily an expression of the individual viewpoint of each Section (or Council) member as to each aspect of the Resolutions.

These Resolutions and the report upon which they are based have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the ABA.

BE IT RESOLVED, that

1. Legislative proposals to curtail the substantive powers of the Federal Trade Commission, or to modify the administrative procedures by which such powers are exercised, raise highly important and interrelated issues central to the Commission's structure and role. These issues include, among others, the propriety of continuing to combine prosecutorial and adjudicative functions in the Commission; the scope of the FTC's remedial powers; the Commission's use of the "unfairness" doctrine; and appropriate substantive limitations on the FTC's rulemaking function. Such legislative proposals should be considered not on a piecemeal basis, but rather in a carefully planned, structured, and comprehensive Congressional study of the FTC's powers, structure, and procedures.

2. In view of the potential for improving FTC rulemaking by procedural reform, and in view of the continuing beneficial effects of legislative oversight and judicial review of FTC rulemaking, it would be premature and possibly counterproductive to require Congressional review of every FTC rule. Therefore the ABA Section of Antitrust Law does not endorse procedures for legislative review and veto of FTC rules.

3. With regard to legislative prohibitions on particular ongoing FTC cases or rules, action of this nature should be exercised judiciously and, absent compelling circumstances, only after completion of the regulatory decision-making and judicial review functions.

4. Legislation designed to provide additional protection for confidential business information submitted to the FTC is appropriate and hereby endorsed.

5. Legislation designed to accomplish procedural refinements in FTC rulemaking is appropriate and is hereby endorsed. In particular, it is the position of the Section of Antitrust Law that:

a. Rulemaking by the Federal Trade Commission is a legitimate and important administrative procedure which should be preserved.

b. The FTC should obtain directly the views of its Bureau of Economics, and publish an advance notice of proposed rulemaking and solicit and entertain the views thereon of members of the public, before beginning the procedures specified by §18 of the FTC Act.

c. The FTC should expand the discussion, analysis, and information contained in its initial Notice and accompanying staff report to make those documents more useful to the participants in the rulemaking proceeding.

d. The FTC should use its staff of Administrative Law Judges, rather than its staff lawyers, as Presiding Officers in rulemaking proceedings.

e. The FTC should require its staff and group representatives to file, and should permit others to file:

i. pre-hearing non-binding statements of the facts they intend to prove, the evidence they intend to rely upon, and the legal theories they intend to advance with respect to the allegedly deceptive or unfair practices to which the proposed rule is addressed, the terms of the rule, and the nexus between them;

ii. post-hearing submissions of proposed findings of fact, conclusions of law, and proposed remedies and the rationale therefor.

f. Presiding Officers should be given the authority and mandate to direct and control the course and conduct of the rulemaking proceeding, including issuing prehearing orders concerning the disputed factual issues to be addressed through cross-examination, rebuttal, or both, the nature and order of proofs, the course of discovery, the scheduling of witnesses, the conduct of cross-examination, the service of documents, briefing of legal theories, and the like. This authority should continue until the Commission assumes control of the proceeding or takes final action.

g. Presiding Officers should be given the authority and mandate to weigh and reconcile all of the record evidence, to make initial findings of fact and conclusions of law, and to discuss the policy and any other issues raised in the proceeding.

h. The FTC staff should be given the authority and mandate to gather all evidence relevant to the Commission's consideration of the proposed rule. It should be the responsibility of the staff to develop specific and probative evidence to show:

i. the prevalence and regularity of the unlawful practices;

ii. the economic impact of the proposed rule on the affected industry and consumers;

iii. the practicality of alternatives proposed by other participants in the proceeding.

i. All staff communications to the Commission should be made public and subject to comment before a rule is adopted. Staff communications relating to the substance of the rule should be made in open Commission meetings. The Commission should provide for an expanded proceeding before the Commission at which the staff, group representatives, and others actively involved in the proceeding can appear, present their positions, question the basis for the final staff recommendations, and be questioned by the Commission. The Commission should allow ample time for this proceeding so that all views can be fully explored.

j. The FTC should apply more objective and discriminating standards for determining the identity and role of publicly-funded participants in rulemaking proceedings, and should develop pre-rulemaking evaluation procedures designed to permit the FTC to monitor and control more carefully the quality of the publicly-funded work.

k. FTC rulemaking of the "definitional" character should be encouraged as preferable, in most situations, to case-by-case adjudication and "preventive" rulemaking.

l. When FTC rulemaking of the "preventive" character is used:

i. to the extent that not all, or substantially all, members of the industry are engaged in the unlawful practices on a regular and continuing basis, a showing should first be made that a "definitional" rule will not cause the termination of the unlawful practices;

ii. the maximum choice of means of complying with the rules should be selected; in other words, wherever feasible, rules should be expressed in terms of performance requirements, and should impose the least adverse alternative approach;

iii. a procedure for obtaining exemption from the preventive rule is available for any person or class of persons to whom application of the rule is not necessary to prevent the unlawful act or practice; provided, however, that the FTC may prescribe a "definitional" rule for those exempted from the "preventive" rule.

BE IT FURTHER RESOLVED, that the Chairman of the Section or his designee be authorized to appear before the appropriate committees of Congress to present testimony in support of the Section's Resolutions and otherwise to communicate these Resolutions to such committees and their members.

THE WHITE HOUSE

WASHINGTON

December 20, 1979

Dear Chairman Rodino:

I understand that the House Judiciary Committee may soon consider S. 598, the Soft Drink Interbrand Competition Act. While I have not had an opportunity to study the bill thoroughly, I am familiar with its intent, and am concerned about its probable effects, if enacted.

S. 598 would create a broad antitrust exemption for the territorial restrictions that characterize the soft drink industry. I believe restrictions of this kind tend to be anti-competitive, particularly when applied by the dominant firms in an industry as concentrated as this one, and tend to raise prices.

Whether there are offsetting considerations in the soft drink industry is a question I have not yet had an opportunity to examine; and I do not mean to prejudge the evidence before you. But I view the dangers as particularly serious in view of the very high rates of inflation we are experiencing in our country today, and the recent increases that have occurred in the prices for soft drinks specifically -- a concern I expressed recently in a meeting I convened with representatives of this industry. For the past 13 months, cola prices, as measured by the CPI, increased 11.2%; in the last two months, the rate of increase has accelerated to 3%. Increases for other carbonated drinks have been less dramatic, but substantial nevertheless.

These increases alone are reason for concern. In view of the very real possibility that S. 598 would make matters worse, I urge you and your colleagues to proceed very cautiously as you consider this proposed legislation.

Sincerely,

Alfred E. Kahn
Advisor to the President
on Inflation

Honorable Peter W. Rodino
Chairman
House Judiciary Committee
House of Representatives
Washington, D. C. 20515

A Report on Vermont's Experience With Beverage Container Deposit Legislation Over A Four Year Period—Submitted by Hon. James M. Jeffords, A Representative in Congress From the State of Vermont

Beverage container deposit legislation is currently under consideration in many states and municipalities, and at the federal level. Debate is often heated, with supporters and opponents making conflicting claims regarding the effects of such legislation.

Because Vermont has played a pioneering role in this area, we are often asked for objective information on the state's experience with its container deposit law. The need for reliable information has been underscored by the many misrepresentations of the Vermont experience which have entered the debate elsewhere in the country.

It should be understood at the outset that Vermont's experience, though for the most part positive, cannot by itself provide all of the answers to questions raised on the impact deposit legislation would have elsewhere. Vermont is not a microcosm of the United States: it has no breweries, steel or aluminum plants, or container manufacturers. Consumption patterns and other relevant factors may not be the same in Vermont as in other regions. Likewise, there are substantial variations in the details of deposit legislation enacted or proposed in other regions.

Also, in a large state or at the national level, the chief benefits of deposit legislation may include conservation of energy and material resources. The conservation impact of Vermont's law, while not insignificant, is measured on a relatively small scale. However, the patterns which have emerged in Vermont may provide encouragement for those who maintain that substantial conservation of energy and other resources would be achieved through implementation of deposit legislation in a more heavily populated area.

Because of the benefits attainable on a larger scale, we are supportive of efforts to enact deposit systems elsewhere. Energy conservation in particular is a national issue, and Vermonters will share in the rewards of conservation efforts by all Americans.

But even without the advantages of scale, Vermont's law enjoys tremendous popularity among state residents, because it has proven effective in reducing litter and solid waste, holding down beverage costs for consumers, and providing a variety of other benefits.

It would be difficult to find a knowledgeable person who is neutral on the issue of deposit legislation. Like most Vermonters, the authors of this report, after extensive first-hand experience with the state law, believe it is a resounding success. Our intent in this report, however, is not to propagandize. We do not wish to add to the emotional misrepresentations of the Vermont experience which have in too many cases dominated the debate elsewhere. In any pioneering endeavor, problems are encountered and mistakes are made. In Vermont, we have learned from our early problems and mistakes, and as a result, the deposit system is continuing to evolve and improve. If we were to overstate the successes, or to gloss over any negative experiences, we would be performing a disservice to those who may seek to profit from what we have learned in order to formulate or advance their own deposit system proposals.

Our objective in this report is to provide reliable information, documented by the best available data and by careful first-hand observation, in all areas of contention which have been brought to our attention, by proponents and opponents of deposit legislation. If there are any omissions or errors, we would greatly appreciate receiving comments from any interested persons. Our research to date has been careful, but we do not claim infallibility. We are making every effort to accumulate additional information, to be used in future editions of this report.

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A BRIEF HISTORY

The first mandatory deposit system in the nation was adopted in Vermont in 1953. Although it contained flaws which are apparent in retrospect, the law was a model of brevity:

> *Section 1. Prohibitions. The sale of beer or ale in nonreturnable glass containers is hereby prohibited.*
> *Section 2. Penalty. Any person or corporation found guilty of violating this act shall be fined not more than $25.00 for each offense.*
> *Section 3. The provisions of this act shall terminate February 1, 1955.*[1]

In 1955, the act was extended for two more years, then allowed to expire in 1957, after an intensive lobbying campaign against it.

That early law was considerably different from the present statute, in that it only banned "no deposit no return" glass beer containers. Beer cans, and all soda containers, were unaffected. The measure was widely referred to as the "bottle ban" or "bottle bill", inaccurate descriptions which have plagued proponents of deposit legislation ever since.

Support for the 1953 law came primarily from citizens who were concerned about a growing litter problem, and from farm groups which maintained that broken glass from nonreturnable bottles posed a threat to farm animals and equipment.[2]

The beverage and container industries, setting a pattern which would be repeated in the future, launched a massive campaign against the legislation. They brought a legal challenge, and lost when the Vermont Supreme Court ruled that the deposit law was constitutional.[3]

Industry then geared its campaign toward a special state commission which was established to study the impact of the deposit law, and toward the legislature itself.

The commission, faced with conflicting claims and statistics, concluded that the law did not result in a particularly remarkable reduction of litter. Predictably, there were no longer many beer bottles on the roadsides, but just as predictably, the bottles were replaced by metal cans. The law made no attempt to deal with the soda container portion of litter. There were also other factors in the litter problem which have since been remedied: for example, some small communities and tourist areas had no dumps, so people were bringing household trash to the roadsides when nobody was looking. The industry also brought in witnesses to testify that ingestion of broken glass was not a major hazard to farm animals, and to rebut other claims of the law's proponents.[4]

Armed with the commission report, industry lobbyists made a strong pitch to the legislature, maintaining that the law was not achieving its desired objectives, and that it was an unnecessary infringement upon the consumer's "freedom of choice" to purchase the type of beer container he prefers.

Although the argument seemed convincing, and succeeded in bringing about expiration of the law in 1957, it should be noted that the industry's enthusiasm for freedom of choice for the consumer waned rapidly in the aftermath of its legislative victory. Within a very few years, refillable beer bottles were virtually unobtainable on store shelves in Vermont.

Proponents made several attempts to revive the deposit legislation, in one form or another, and finally succeeded in April, 1972, even though the industry's lobbying campaign had grown to massive proportions.

The new bill attempted to correct the shortcomings of the earlier legislation. It required a deposit on all beer and soda containers, without prohibiting any particular type of container. The assumption was that this would encourage use of refillable bottles, but would allow consumers the freedom to purchase other types of containers which, when returned, would be recycled. The terms "bottle bill" and "bottle ban" remained in the lexicon, leading to misimpressions elsewhere in the country as to what the new deposit bill called for. Many opponents compounded the confusion by referring to the legislation as a "ban the can bill". Although some environmentalists might have preferred a requirement that beer and soda be sold only in refillable bottles, that idea was never seriously considered by the state legislature. Yet, to this day, opponents have attempted to perpetuate the notion that Vermont's deposit law denies consumers the pleasure of consuming beverages in metal cans.

Although the new law was passed in 1972, opponents were successful in having actual implementation delayed for a year. During that year, the industry's preferred alternative, a "litter levy" (tax on nonreturnable containers) was imposed.[5]

The opponents gave two major reasons for requesting the delay:

1. The beverage industry, and grocers, needed the lead time to adapt to a returnable container system.

2. The "litter levy" approach should be given a fair test. At least one legislator who opposed the deposit bill maintained that the litter levy would turn out to be so popular and so effective that the deposit law would be repealed before its effective date, with a permanent litter levy in its place.

In retrospect, those reasons are somewhat contradictory. If the assumption was that the law would be repealed before its effective date, there would be no reason for the beverage industry and retailers to make use of the lead time to gear up for implementation. Indeed, that appeared to be the general attitude. When the legislature refused to repeal the law in 1973, the state had to postpone full implementation another two months (until September 1) to allow grocers time to clear their shelves of existing stock.

The litter levy was not popular. It raised about $800,000 to subsidize sanitary landfill operations, but did not generate sufficient funds for a recycling project, which had been one of its purported goals. A frequently heard complaint was that the tax was inefficient and regressive. As a general rule, beverage prices were raised by about a penny per container, with only four tenths of a cent going to the state. In theory, Vermonters had the option to avoid this tax by purchasing refillables, which were exempt. But in practice, the option did not exist, because the industry continued its refusal to make refillables available. The litter levy died a natural death on the effective date of the deposit law.

The new deposit system was relatively simple. A deposit of at least five cents was required on each beer and soda container sold in the state, and refunded when the container was returned to the store. Stores were required to accept containers of the size and type they sold, but were allowed to limit hours of redemption and to refuse to accept dirty or damaged containers.

The beverage distributors, who picked up the containers from the retailers, were required to reimburse retailers for their handling costs at a standard rate of 20 per cent of the amount of the deposit. In other words, the grocer was paid a penny for each five-cent container, or two cents for each ten cent container.

During the first two years of implementation, resistance by the industry and by many retailers remained extremely strong. Although some local soft drink distributors quickly converted to refillables, refillable beer bottles remained virtually non-existent, except in bars. Initially, there was little if any recycling, so Vermonters taking their trash to landfills on Saturday mornings often saw mountains of beverage containers, waiting in the paths of the bulldozers. The message was clear. The industry, continuing its hopes of repealing the law, wanted the public to see that the law was not working in the way it was intended to work.

The legislature, however, did not give up. In April of 1975, it passed a package of amendments designed to remove ambiguities and strengthen the law. The amendments passed by an overwhelming margin (110-31 in the House), effectively serving notice that the law was here to stay.

The major provisions of the amendments, implemented in January, 1977, were bans on nonrefillable bottles, cans with removable tabs, and nonbiodegradable plastic rings for six-packs.

The impact of the 1975 legislative action was felt far in advance of the effective date. The vote signalled to the industry that any further attempts to have the law repealed would be futile. The result was an immediate halt to some of the more blatant efforts to circumvent its intent. The industry began recycling virtually all redeemed aluminum cans, as well as the glass bottles which were not refilled. There has been some sluggishness, however, in complying with the full intent of the new amendments. Not all of the technically refillable beer bottles are actually being refilled, and many steel cans--which are less economic to recycle than aluminum--continue to be buried in landfills. Further refinements in the law are expected to be considered by the legislature next year.

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PUBLIC RESPONSE

By all measures, public support of the deposit law in Vermont is strong, and is growing with experience.

One measure of this is the series of actions by the state legislature, a large lay legislative body which is generally considered highly responsive to the public will. The bill passed initially by a slim margin in 1972, attempts to repeal it were rejected by a larger margin in 1973, and the law was strengthened by an overwhelming vote in 1975. The legislature has proceeded with patience, conceding to opponents areas of legitimate doubt, and consistently providing ample lead time for changes. But the momentum clearly lies with those who want the legislation to be strong and effective, and most observers feel there will be little resistance to strengthening amendments proposed for the 1978 session.

In early 1975, a professional poll of 800 adults conducted by Decision Research Corp. of Wellesley, Mass., for The Burlington Free Press showed that nearly 70 per cent of Vermonters supported the law as it existed or thought it should be strengthened, while 25 per cent opposed it. Later in the same year, Congressman Jeffords mailed a questionnaire to all Vermont households, seeking public opinion on a variety of national issues. While it did not address Vermont's deposit bill *per se*, the questionnaire asked whether Congress should pass national legislation "similar to Vermont's." Approximately 10,000 Vermonters responded, with 78.1 per cent saying "yes", 14.2 per cent saying "no", and the remainder not expressing an opinion.

The question was repeated in a similar questionnaire this year, and the results indicate that support has grown substantially since 1975. Approximately 11,000 Vermont adults responded in 1977, with 93 per cent saying a national deposit law should be passed. Among the relative handful who said they opposed the idea of a national deposit law, several wrote in the margin that they liked Vermont's legislation, but felt it should remain within the state's jurisdiction.

These questionnaires are not "scientific" polls, as the "samples" are self selecting. In other words, the respondents consist of Vermont adults who are willing to spend approximately 20 minutes filling out a questionnaire, and to contribute the price of a postage stamp in order to let their views be known. However, 11,000 adults in a state composed of approximately 180,000 households is an extremely large "sample", and the reliability of the questionnaires has been demonstrated by cross-checks with professional polls on a number of the issues covered. In the absence of a recent scientific poll on the issue, the 1977 congressional questionnaire serves as the best available indication of Vermont opinion.

An objective analysis may indicate that the 93 per cent figure is a slight overstatement of enthusiasm for Vermont's deposit law, because the question is directed toward national legislation. There is fairly widespread awareness in Vermont that energy conservation and other benefits would be substantially magnified if deposits were mandated on a larger (or national) scale. There is also a perception by some--including many grocers doing business near the state borders--that implementation would be simplified if deposits were required in neighboring states.

But despite the qualifications which must accompany use of any specific figure, there is no question that support for the state deposit law is strong, and is growing with experience. People have grown accustomed to it, and they like it. The initial return rate for empty containers has grown from an initial level of 83 per cent to more than 95 per cent, and beverage sales in the state are booming. Politicians running for office talk about improving and strengthening the deposit law, but never about repealing it.

In a state populated primarily by thrifty Yankees who believe in common sense solutions to problems with minimal government interference, this is probably the strongest possible evidence that the law is working well. As any knowledgeable Vermont political observer will testify, the law could not have obtained its widespread popularity if it had been causing the problems which opponents insist would be brought on by deposit legislation, or if the benefits were not visible, tangible, and significant.

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RETAIL GROCERS: RISING TO THE TASK

Although the most forceful opposition to the Vermont legislation has come from out-of-state interests, there was, initially, significant opposition within the state as well. An important milestone was crossed in 1973 when two very important interest groups--the Vermont Labor Council (AFL-CIO) and the Vermont League of Cities and Towns--withdrew their opposition upon instruction from their memberships.

The most significant opposition which remained within the state after passage of the bill came from retailers, represented by the Vermont Retail Grocers' Association. The grocers feared the law would result in decreased sales, and would add new burdens to their already busy workdays. While Vermont legislators may have felt some satisfaction in standing up against the highly paid lobbyists representing huge out-of-state corporations and trade associations, the concerns of "Mom and Pop", the people who run the corner store, were another matter.

In passing the law, the legislature made concessions to many of the legitimate concerns of the grocers. To compensate them for their handling costs, storekeepers were provided reimbursement from distributors at a rate of a penny for each five cent container. To avoid sanitation problems, they were allowed to refuse to redeem dirty containers. To minimize the need to hire additional help, retailers were allowed to limit container redemption to 40 hours a week, and to limit the amount of refunds for each customer visit. The legislature made a carefully considered judgement that with these provisions, the deposit system would not create undue problems for retailers.

The grocers were initially unconvinced. Through their association, they united in an impressive effort to have the law repealed. The centerpiece of this effort was a 1973 petition campaign. Virtually every time a person entered a store, he was asked to sign a petition favoring a comprehensive recycling program, as an alternative to the deposit legislation. (This was a common argument used by opponents, although the deposit legislation and comprehensive recycling are hardly mutually exclusive.)

In all, 45,000 signatures were reportedly collected. The list undoubtedly contained many duplicate signatures, and names of people who just didn't want to argue the point with their neighborhood grocers--as well as those who thought they were supporting recycling rather than opposing the deposit law. Even so, the total fell far short of the pre-announced goal of 100,000 to 150,000 signatures. But in any event, it was an impressive effort, which clearly showed the grocers' active dedication to the cause.

By all other indications, the grocers were virtually alone among Vermonters in actively opposing the legislation during that period. For example, from July of 1973 through May of 1974, the administration of then-Governor Thomas P. Salmon received a total of 2,345 letters from Vermonters, other than grocers, commenting on the deposit law. A tabulation of these unsolicited letters by the state Agency of Environmental Conservation showed that 2,343 of those writing supported the legislation, and only two opposed it.

Since "Mom and Pop" were the primary source of initial opposition within the state, it is significant to note that now, after several years of experience with the deposit law, their opposition has all but disappeared. The turnaround has been quiet, but pervasive. James Holmes, the current executive secretary of the Vermont Retail Grocers Association, estimates that 95 per cent of Vermont's grocers are now supportive of the legislation.[6]

By no means have the grocers, or their association, lost interest in the legislation. But instead of opposing it, they are finding better and more efficient ways to deal with it, and are suggesting changes which would--from their point of view--improve the law.

Our own conversations with grocers in several areas of Vermont have generally confirmed Holmes' estimation of their widespread support of the legislation. Many said it is clear that the vast majority of their customers support the deposit system, and that it is in their interest as businessmen and as Vermonters to help make the law a continuing success. There is a consensus that at least the worst of the grocers' initial fears--fears which had been suggested by outside opponents--have simply not materialized. Any burdens and inconveniences have been of manageable proportions, and under the reimbursement provision of the legislation, they are compensated for their efforts. Many grocers feel their experience with the deposit system could be improved through changes in the legislation, or by extending it to neighboring states.

While we cannot speak for the grocers, we shall attempt to summarize recent comments they have made to us regarding their reactions to, and experience with, the legislation.

SORTING. Sorting of containers is not an insignificant task. Customers tend to bring in varied assortments of containers, which must be separated so they can be picked up by different distributors. Several grocers have commented that the task would be far simpler if the legislation incorporated a certified, refillable bottle, similar to the provisions in Oregon. (This, it should be noted, is strongly opposed by most Vermont distributors.)

A common complaint among grocers is that several brands of beer and soda are marked with very inconspicuous notations of their refund value--for example, a lightly engraved marking on top of a can. This means the containers must be examined closely, and even so, refunds are occasionally paid, inadvertantly, on beer and soda containers which were purchased outside the state. Many grocers feel the state should require clearer markings in contrasting colors, a step which would shorten sorting time and reduce losses from fraudulent returns.

REIMBURSEMENT. While the reimbursement (20 per cent of the deposit price) is not a financial bonanza by any means, most grocers consider it to be a realistic figure. The economics of handling containers, of course, varies in different stores. In a small store, sorting may be done by the owner or by a regular employee during slack sales times. In a large supermarket, one or two part time employees--often high school students--may be hired to do the job. A large combination beverage store/redemption center may have several full time employees.

Most store owners we have talked with have not prepared detailed analyses of the economics of handling containers. Those who have generally find the operation to be marginally profitable, or at least that losses are not substantial enough to worry about. The manager of one Burlington supermarket says his store redeems containers with total refund value of between $500 and $600 each week, for which the store is reimbursed $100 to $120. After paying part-time wages to two young workers, the store's net profit is $35 to $40 a week.

Proof that the reimbursement is profitable, at least with an efficient and high volume operation, is provided by the proliferation of new redemption centers which have been established throughout the state. These centers profit from the 20 per cent reimbursement. They also offer to relieve other retailers of their bottles and cans, if the retailers do not feel it is economic to handle their own containers. Although some retailers welcome this offer, others turn it down--which must be considered as evidence that the reimbursement is adequate.

STORAGE. Some space is required for storage of empties, although many Vermont grocers have minimized the need for space through highly efficient operation. Some grocers have used basements or back rooms for sorting and storage, while others have erected small prefabricated steel sheds or set aside some space within their stores. But there have been few serious complaints. If a grocer has a particular tactical problem with handling or storage, he usually has the option of having his empties handled by a redemption center.

REDEMPTION CENTERS. More than 100 privately operated redemption centers have opened throughout the state since enactment of the legislation.[7] Typically, the centers sell beer and soda, as well as providing convenient locations for the return of varied assortments of bottles and cans. These generally are highly efficient operations, which profit from the 20 per cent reimbursement from distributors.

As we have mentioned, in addition to accepting containers directly from consumers, these centers usually pick up unsorted empties from neighborhood stores. This has been a welcome development for those store owners who, for whatever reason, prefer not to sort and store their own containers. In other words, the neighborhood grocer has an option: he can take care of his own containers and be reimbursed for the job, or he can turn over the work to a redemption center.

While this option is not available to all neighborhood grocers, those who are located within the pick-up routes of the redemption centers have a free choice as to whether the reimbursement is worth the effort.

SANITATION. Contrary to the fears expressed by some opponents prior to passage of the law, there have been no sanitation or health problems created by the storage of bottles and cans. Several grocers have commented that they require the services of an exterminator more frequently now than they did prior to passage of the law, but that this is simply a precaution, a sound operating practice rather than a response to any problem. The state Health Department confirms that there have been absolutely no health or sanitation problems associated in any way with the deposit legislation.[8]

SALES. A number of grocers maintain that when the law was first enacted, some Vermonters made "runs" to New Hampshire and other neighboring states to purchase beverages. There is some doubt as to whether this practice was ever widespread, but in any event, the consensus now is that any such activity has stopped. Beverage sales in Vermont have, clearly, not suffered, as discussed later in this report.

Grocers also report that very few customers bring in large amounts of varied containers for redemption without shopping in the store. "People don't dump bottles on us--99 per cent of what we get back are ones we sell, and most people spend their refunds right in the store," one grocer commented.

RESTRICTIONS ON REDEMPTION. Very few grocers take full advantage of the provisions in the law which allow them to limit hours of redemption or the dollar amount of refunds per customer visit. Grocers generally feel such policies would result in a loss of good customers. However, many stores do impose some limits: for example, a common practice is to refuse to make refunds on Sundays, when they are operating with reduced staff. In short, grocers generally appreciate the flexibility allowed by the law, and do not abuse it because abuse would hurt their businesses. Under the law, any such limits must be clearly posted, so inconveniences for consumers are minimal.

GENERAL COMMENTS. Perhaps because of the time and effort they devote to the deposit system, grocers tend to be highly sensitive to what they perceive as imperfections in the system, whether or not those imperfections bear directly upon their businesses. As one grocer put it recently, "We've done our part, now it's time for them (the major brewers) to do their part." There is some resentment among grocers over the fact that not all of the technically refillable beer bottles are actually being refilled, and not all of the steel cans (as opposed to aluminum cans) are being recycled. Consequently, strengthening of the law to encourage more pervasive re-use and recycling is supported by many grocers.

In addition, a number of grocers have commented that, while it's no skin off their backs, they find it incongruous that the law does not apply to such products as noncarbonated soft drinks and iced tea, which are sold in containers identical to those for soda.

There is also a widespread feeling among Vermont grocers that while the deposit law makes good sense for Vermont, it would make even better sense on a regional or national scale. There may be some element of self interest in that position, as extension of the deposit system beyond Vermont's borders would eliminate the need to keep a watchful eye out for out-of-state bottles and cans. But there also appears to be a genuine element of pride in the groundwork which has been done in Vermont--a feeling that most of the kinks have been worked out and the worth of the law has been proven, so the time has come to begin enjoying the energy savings and other benefits which would be made possible by a larger scale deposit system.

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THE DISTRIBUTORS: A MIXED RESPONSE

There are 15 soft drink distributors in Vermont, of which 9 bottle their products. The state has 18 beer distributors, but no brewers or beer bottlers.

The reactions and experiences of distributors under the law have been mixed. Generally speaking the beer distributors, consistent with the views of the brewers with whom they are affiliated, continue to oppose the deposit law, even though they have given up any realistic hope of having it repealed. The soft drink distributors, on the other hand, have for the most part found they can live with the law quite well.

The difference seems to lie in the fact that most of the soft drink industry adapted quickly to the law by converting to widespread use of refillable bottles--recognizing that the law would help assure a good return rate for the bottles, thus making them by far the most economical type of container. Although there has always been some consumer demand for soft drink cans (and in fact the demand now seems to be on the increase) the refillable is the dominant container for soft drinks in Vermont now. Consequently, the soft drink industry has been able to cut costs, keeping consumer prices low while maintaining good profits.

Most of the beer industry, however, has strongly resisted the economic incentive for use of refillables. The apparent position of the major brewers is that use of refillables would be a sign of capitulation. The biggest brands, and their representatives in Vermont, seem to feel they would be exhibiting weakness in battle if they were to go beyond the technical requirements of the law and comply with its full intent. Throwaway-type bottles, along with steel and aluminum cans, were the dominant beer containers in Vermont until January, 1977, when the amendments went into effect requiring that all glass bottles be refillable. Even now, "true" refillables for beer are not available on a widespread basis for many major brands.

(Our use of the term "true" refillables refers to the heavy bar-type bottles and stubbies which are widely recognized as refillable wherever they are used. In practice, when these containers are used, they are refilled after redemption. This contrasts with the lighter glass containers now widely used in Vermont which are similar to the no-deposit-no-return bottle, but which are technically refillable. The latter type of bottle complies with the legal requirement that bottles be <u>capable</u> of being refilled at least five times, although in practice the redeemed glass is usually crushed for recycling.)

By no means does the resistance to "true" refillables signify that the law is a failure: beer containers are returned rather than thrown onto the roadsides, and recycling is pervasive for most of the containers which are not refilled.

But the source of frustration among beer distributors is clear. They have additional handling costs, and must reimburse retailers for their handling costs. The total of these costs exceeds the recycling value of the aluminum, steel, and glass. Unlike the soft drink industry, the beer industry has not taken full advantage of the savings which could be achieved through greater use of refillables.

One major Burlington beer distributor, whose experience seems fairly representative, pointed out that since passage of the deposit law, he has increased his warehouse space from 18,000 to 33,000 square feet. While this is largely attributable to "very healthy growth", the distributor says the need to store empties is also a factor. His truck fleet of 15 vehicles, he says, is larger than what he would need without the deposit system. Other capital expenditures include a shredder to expedite recycling of cans.

Although he distributes two relatively minor beer brands in "true" refillables, the larger part of his business is in cans and unrefilled bottles. Although his business is clearly prospering and his prices are consistent with those of distributors in neighboring states without deposit laws, this beer distributor expresses his displeasure with Vermont's legislation by saying he pays a high price for Vermont's tidy roadsides.

Soft drink distributors are generally far more positive in their assessment of the law. One major distributor summarized his position by saying, "I can't knock it (the deposit law). The only reason I get up at six o'clock in the morning and come to work is to make money, and I'm making more money now than ever before."

As with most of the soft drink industry in Vermont, the bulk of this distributor's business is in refillable bottles, although cans are re-emerging because of consumer demand. He reintroduced cans in April of this year after three years of exclusive use of refillables, and his can sales have now risen to 2,000 cases per week, a figure which he projects will continue to rise even without active promotion. (This is still, however, a small percentage of his total volume.)

We can safely say that local soda distributors have found the refillable bottle to be an extremely attractive container. Some, who do their own bottling, say it gives them greater control over their businesses--that they can keep costs down and profits up by running efficient bottling operations, whereas they must purchase canned beverages at whatever the wholesale market price happens to be. But even those who do not bottle their products have found that with the high return rate made possible by the deposit system, refillables are by far the most economically viable container. Cans are generally made available because some consumers want them, but the soda distributors generally prefer refillables.

A few soda distributors have been remarkably candid in discussing the economics of refillables. One distributor says his gross profit with refillables is now 53 per cent, compared to a historic gross profit of about 18 per cent with nonreturnable bottles and cans before the deposit law went into effect. Much of the additional gross has been invested in new bottling equipment and other capital costs, but it is clear that the firm has profited by working with, rather than against, the set of economic incentives inherent in the deposit law.

This firm has experienced a return rate of 96 per cent, after breakage, and has been able to bring container costs down to 28 cents per case, compared to the more than $1.50 per case the firm would be paying if nonreturnable bottles were used.

Although other distributors have been less willing to discuss specific figures, they generally concur that by using refillable bottles, they have been able to keep profits up and costs down, whether or not they do their own bottling.

It should be emphasized that the soft drink distributors are not active supporters of the deposit legislation. For the most part, they are affiliated with national concerns which oppose mandatory deposits. But they have benefited from early recognition of the law's economic incentive for making at least some use of "true" refillable bottles.

Beer distributors are generally reluctant to discuss the reasons for the beer industry's resistance to refillables. They do maintain that the economies of refillables are not quite as great for beer as for soda, because of the greater distance between Vermont and the beer bottling operations. In a few instances, this is a highly convincing argument: Leo Van Munching Jr., of Van Munching and Co., notes it would be uneconomic to return Vermont's Heineken bottles to Rotterdam, for example.[9] But it seems clear that in the case of major U.S. brands, the decision results more from overall political opposition to deposit legislation than from the economics of their Vermont sales.

Although any tactical problems could probably be overcome by adoption of a standard certified bottle, similar to the provisions of Oregon's law, such a move is generally opposed by Vermont distributors of both beer and soda. They maintain that the distinctive bottles used for Miller's and some other beer brands, and for such soft drinks as Coke, Pepsi, and 7-Up, are an important part of the successful marketing campaigns for those products. Another factor is that when "true" refillables are used, the distributors <u>want</u> to get their bottles back. (When it costs 13 cents to buy a new bottle, it is a bargain for the distributor to get one back for 6 cents--the nickel deposit refund plus a penny for the retailer.) Most distributors would prefer to be assured of the return of their own refillable bottles, rather than competing for their share of the general pool of bottles.

But with growing support for certified bottles from retail grocers, and from environmentalists and consumer groups who see this step as the key to assuring actual refilling of beer bottles in the future, legislation for certified bottles--or other means of assuring refilling--is sure to be given serious consideration by the legislature in the near future.

There is some controversy among soft drink distributors regarding the provision of the legislation delineating which products are covered. Soft drink distributors who market only carbonated beverages hold some resentment over the fact that their noncarbonated competitors are not covered by the law. One such distributor says his competitive disadvantage is not significant now, but could be compounded in the future if his firm raises deposit prices in order to get more bottles back. Distributors are reportedly working with state legislators to seek changes in this section of the law.

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LITTER REDUCTION: THE ORIGINAL OBJECTIVE

Initial passage of the Vermont deposit law predated widespread consciousness of the urgent need to conserve energy in this country. There was general concern over the waste of natural resources, but no immediate crisis to respond to. (The Arab oil embargo would come a year later.)

Litter, although not a life-or-death problem, was a conspicuous eyesore. Vermont's scenic beauty is one of its greatest attributes: it is an important factor in the quality of life for residents, and in the state's economically important tourist industry. The unsightly blanket of trash uncovered by the melting of snow each spring was a problem of concern to most Vermonters.

In 1970, under then-Governor Deane C. Davis, Vermonters organized an effort to clean up the state, known as Green-Up Day. About 300,000 people, nearly three quarters of the state's population, volunteered their time to pick up tons of trash along the roadsides, river banks, and wherever else it had accumulated.

Green-Up Day continued as an annual event for the next few years, but enthusiasm declined markedly. People began grumbling that their volunteer labor was to little avail. The roadsides would become more attractive temporarily, but the trash would reappear within a few weeks.

The futility of the roadside cleanup effort perhaps became more apparent to Vermonters because they were participating in it directly, rather than just paying for it through taxes. Litter pickup began to seem like the task of Sisyphus--the legendary figure who was condemned in Hades to push a heavy rock up a steep hill for eternity, only to have it roll down again each time he approached the top.

The Vermont deposit law was passed largely in response to that frustration, and the results have been dramatic. The best evidence of the success of the law in controlling litter is visual. As any recent visitor to Vermont will testify, trash along our roadsides and other public areas is now virtually nonexistent.

The statistics on litter reduction usually cited by both proponents and opponents of the legislation were developed by the State Highway Department, in spot checks throughout the state before and immediately after implementation of the law. At that time, the state estimated the deposit law brought about an immediate reduction of the beverage container portion of litter by 76 per cent, and a reduction of total litter volume by 35 per cent.[10]

These figures, however, are outdated. They reflect only the immediate experience under a new law; a law which was still essentially in an experimental stage. While there are no up-to-date formal surveys of litter volume, related statistics, as well as visual examination of the roadsides and other public areas, verify that the law's impact on litter has grown substantially in recent years.

A key statistic is the return rate for beverage containers. The initial return rate was 83 per cent, but has grown to 95 per cent of all beverage containers sold in the state. As a result, fewer containers are finding their way to the roadsides.[11]

This result is borne out by all available roadside litter figures reported by the State Highway Department. Since passage of the law, the Department has reduced its employee man-hours for litter pickup by 56.5 per cent, even though there are more miles of road to clean and there is no longer massive assistance from Green-Up volunteers. During the four years of the law's duration, inflation has had its toll on all state programs. For litter pickup, the Department reports that rates for labor have increased by more than 18 per cent, and rates paid for equipment have gone up more than 90 per cent. But even in inflation-ravaged dollars, without adjusting, the cost to the state for litter pickup has been reduced by 31.3 per cent. The precise figures reported by the Department are as follows:[12]

Fiscal Year	2-Lane Mileage	Man Hours	Cost
Fiscal 1973 (Pre-Law)	2,814 miles	57,439 hrs.	$250,346
Fiscal 1977	2,923 miles	24,983 hrs.	$172,030
(% Change)	UP 3.87%	DOWN 56.5%	DOWN 31.3%

These statistics are even more impressive when consideration is given to the fact that even with the dramatic reduction in state effort, Vermont now has spotlessly clean roadsides, an attribute we did not enjoy prior to passage of the deposit law.

In interpreting these statistics, R.W. Fraser, assistant maintenance engineer for the Vermont Highway Department, commented:

> *There can be little doubt that the bottle law has greatly influenced the reduction of litter volume along Vermont roadsides and it is noticeable. We receive considerable correspondence from tourists and transient motorists who express amazed pleasure at the cleanliness of our highways.*[13]

Some Vermonters have commented that the law's impact goes well beyond the expected reduction in beverage container litter: that the symbolic step away from our "throw-away society" has influenced the attitudes of Vermonters and visitors, who are now less inclined to discard any form of litter on the roadsides. There is no absolute statistical proof of this, but the figures cited above would seem to support the theory.

Incidentally, Green-Up Day was revived this year by Governor Richard Snelling. An estimated 1,000 volunteers participated, picking up whatever litter they could find, but focusing primarily on other beautification projects such as tree planting. Comparing this year's effort to Green-Up days in the past, one highway official was quoted in the press as saying, "We're not even in the same ball game."[14]

Times have changed since passage of the law, and few Vermonters now would consider litter reduction to be the only--or even the primary objective of the legislation. But in a state which prides itself on its scenic beauty, which has an economically important tourist industry, and which attracts new industry partly on its promise of an attractive living environment, the outstanding success in achieving this objective is no small consideration.

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CONSUMER SAVINGS

One of the most disturbing aspects of the campaigns of deposit bill opponents in other states has been their misrepresentation of the consumer impact of Vermont's law.

During the 1976 referenda campaigns on deposit proposals in Michigan, Massachusetts, Colorado, and Maine, opponents stated in media advertisements that the deposit system in our state is costing the average Vermont family about $100 per year. Although we are attempting to be both cautious and fair in our characterizations of arguments raised by opponents, that assertion can only be described as blatantly false.[15]

More recently, in a series of advertisements in national publications, U.S. Steel Corp. publicized the position that deposit legislation in Vermont and other states ". . .costs consumers more." Although the claim was never publicly retracted, Andrew Staursky, U.S. Steel's director of public affairs, admitted upon questioning by the news media that the company "knows of no studies specifically on Vermont" which would bear out that contention.[16]

Under any objective analysis of price patterns in Vermont, two general conclusions are apparent:

1. In all cases where the distributor takes advantage of the economic incentive for actual refilling of beverage containers, the consumer who chooses to purchase beverages in those containers saves a substantial amount of money. This opportunity for saving is a direct result of the deposit law, as refillables were virtually unavailable in the state prior to enactment.

2. While economic logic would indicate that the mandatory deposit system would tend to raise prices of containers which are not refilled, in actual experience, this effect has been negligible. The handling and storage costs inherent in the deposit system are partially compensated for by the value of the materials for recycling. The difference is apparently a miniscule factor in the price a consumer pays for beverages--it is difficult to isolate this cost, but it amounts at the most to one or two cents in the price of a six pack of unrefilled containers of beer or soda. If a cost of that magnitude does exist, it is offset many times over, not only by savings on other containers, but also savings of tax dollars for litter pickup.

Based on available information, it is impossible to obtain a hard and fast figure indicating the consumer price impact of the deposit legislation. There are many factors which affect prices, including a vast array of production costs as well as supply and demand.

It is possible, however, to compare prices and price trends in Vermont with prices in other states which do not have deposit laws. The most logical state to choose for such a comparison is our sister state of New Hampshire, for a variety of reasons. The two states have a long and easily crossed common border; merchants in Vermont and New Hampshire compete directly with each other for business; and demographic characteristics, while hardly identical, are roughly similar.

Prior to passage of Vermont's deposit law, Vermonters paid an average of about 30 cents more for a six pack of beer than did their New Hampshire neighbors. For soda, the average price in Vermont was about 5 to 8 cents a quart higher in Vermont.[17]

There may have been many reasons for this price differential, and we shall not attempt a thorough economic analysis. There are, however, two factors which clearly contributed to the differential: beverage taxes, and state laws governing retailers.

Vermont's malt beverage tax, prior to the enactment of the deposit law, was assessed at a rate of 25 cents per gallon. By comparison, New Hampshire's tax rate was only 12 cents per gallon. This translates to a differential of about 8 cents per six pack of beer. (The differential has been narrowed slightly since that time: Vermont's beverage tax rate has remained unchanged, while New Hampshire raised its tax to 15 cents per gallon last year.)

Secondly, New Hampshire merchants were (and are) allowed to sell beer as a "loss leader", at reduced prices, to attract shoppers into their stores. This practice is prohibited by Vermont law. New Hampshire retailers located near the state border take particular advantage of this difference between the laws of the two states, marking down beer prices in an effort to attract customers from Vermont and other neighboring states.

Even though both of these factors still exist, the price differential for beer has been squeezed considerably since passage of Vermont's deposit law. Vermonters, who had been paying 30 cents more for a six pack of beer, now pay an average of only 6 cents more if they purchase their beer in refillable bottles. As for soda, the tables have turned completely: the average retail price of soda is now approximately 5 cents per quart <u>cheaper</u> in Vermont than in New Hampshire.[18]

Based on national average consumption figures, these statistics indicate that the typical Vermont family, rather than spending $100 dollars more per year for beverages as the industry has claimed, has the opportunity for substantial savings--the most conservative possible estimate being in the neighborhood of $60 per year [19], directly attributable to the deposit law. (In interpreting the price comparisons, it should be noted that refillables are still virtually unobtainable in New Hampshire.)

This estimate of savings is verified by the results of an extensive price survey conducted this year by the Vermont Public Interest Research Group (VPIRG). The organization tabulated retail prices of 13 beer brands and 11 soda brands, in 18 stores distributed geographically throughout Vermont. All prices were recorded on the same day, June 27, 1977.[20]

The extensively documented results of this survey demonstrated that beverages in "refillable bottles" sell for an average of 10 per cent, or three cents per container, less than beverages in cans or in "non-refillable bottles." (VPIRG defines "refillable" in the same way that the authors of this report refer to "true refillable." As we have pointed out, this definition is narrower than that of the state statute, which requires only that bottles be capable of being refilled five times. VPIRG only acknowledges as refillable the heavy glass and stubby bottles which are actually refilled. The group's survey does confirm that this is the most economical type of container under the state's deposit system.)

It is interesting to note that, again using national average consumption figures, the VPIRG survey suggests the average Vermont family can save $60 a year by purchasing beverages in "true" refillables. This is the same savings figure arrived at by the conservative estimates used in our earlier comparison of Vermont and New Hampshire price trends. Incidentally, we use the national consumption figures in a further effort to be conservative in our estimates of savings. Vermont's per capita consumption is higher, but may be distorted by tourist consumption. Also, in this report we are attempting to provide information which is useful for those in other states, so the national average consumption figures would seem to be most appropriate.

To summarize, the accumulation of evidence is that substantial savings, conservatively estimated at $60 a year, are available to consumers who purchase their beverages in "true" refillable bottles, while the deposit law has had virtually no effect on consumer prices of other containers.

While few would dispute this conclusion, some opponents of deposit legislation have argued that a law like Vermont's has an indirect impact on overall consumer prices. Under this theory, grocers may sacrifice some of their profit on beverages for competitive reasons, and compensate by raising their prices for other goods. In other words, opponents claim the higher handling and storage costs associated with a deposit system may be passed along to the consumer not when he buys beverages, but when he buys tuna fish or toilet paper.

As a test of that theory, we have compared wholesale prices of beer in Vermont with wholesale prices in all of the neighboring state: New Hampshire, Massachusetts, and upstate New York.[21] The comparison uses June, 1977 figures, the most recent month for which wholesale prices could be obtained for all of the states. In order to make the comparison meaningful, we subtracted the state beverage tax charged by each state, as the tax varies considerably from state to state.

In each instance, beer available in "true" refillable bottles in Vermont wholesaled at a lower price than the same brand in throwaway-type containers in the other states. The price of beer in cans was close to the average for neighboring states: generally a penny or two higher per six pack than in New Hampshire and Massachusetts, and slightly less than the wholesale price (minus the tax) in upstate New York.

Carling Black Label may serve as a valid illustration, as the only glass containers used for that brand in Vermont are bar-type refillable bottles, while it is distributed in throwaway-type bottles in neighboring states. The wholesale price in Vermont for bottles of Black Label was $4.13 per case, compared to $4.62 in New Hampshire and $4.81 in Massachusetts. By contrast, the wholesale price for cans was $4.88 in Vermont, slightly more than the New Hampshire price of $4.77 per case. (The New York prices, and the Massachusetts price for cans, were not immediately available for Black Label.)

Pabst Blue Ribbon, which is available in bar-type bottles in parts of Vermont, wholesales for $4.63 a case, compared to $4.72 in New Hampshire, $4.85 in upstate New York, and $4.81 in Massachusetts. The wholesale price for cans in Vermont is $4.93, compared to $4.87 in New Hampshire, $4.85 in upstate New York, and $5.06 in Massachusetts.

The two largest selling beers, Budweiser and Schlitz, are still virtually unobtainable in Vermont in "true" refillables. The wholesale prices for bottles and cans of both brands are identical: $5.53 in Vermont, compared to $5.47 in New Hampshire, $5.75 in upstate New York, and $5.26 to $5.41 in Massachusetts.

Interestingly, both of these major brands <u>can</u> be obtained in "true" refillables in the three other states, a fact which seems to add strong circumstantial support to the contentions of consumer groups that the big brewers are actively resisting the intent of Vermont's law. The returnables available in other states wholesale at lower prices--$4.97 in New Hampshire, $5.40 in upstate New York, and $5.01 in Massachusetts.

It may be argued, with supreme irony, that the biggest brewers are keeping "true" refillables out of Vermont because of their displeasure with the state legislation. But if that is true, it is clearly a political decision by the brewers, rather than a result of the deposit law's economic incentives.

Because of the resistance of some major brewers, an argument may be made that the consumer who has a strong preference for one beer brand, such as Budweiser or Schlitz, may not be able to take full advantage of the $60 per year average savings made possible by the deposit law. But since "true" refillables are almost universally available for soda, and obtainable for several popular brands of beer, most consumers are able to save money.

It is important to note that the requirement that all bottles be refillable is relatively new, having gone into effect just this year. Most Vermonters assume that "true" refillables will become increasingly available in the future, either through industry economics or through legislative action.

But even if a person's favorite beer brand is not available in the most economical containers, or if he simply prefers to purchase beverages in cans (as many people apparently do), the wholesale price comparisons show that the deposit system has had very little effect on the price of unrefilled containers. The wholesale price of Budweiserin cans is a penny or two higher in Vermont, per six pack, than in New Hampshire, not including state taxes. If somebody wants to attribute that differential to Vermont's deposit law, we have no evidence to the contrary. We have no specific documentation as to whether the extra pennies are absorbed by retailers, added to the consumer price of beverages, or passed on to consumers of other products.

However, even using the worst assumptions regarding the price impact for consumers who purchase only canned beverages, the price is small compared to the benefits of the legislation: the consumer savings made possible by introduction of "true" refillables; the esthetic and economic benefits of clean roadsides; the taxpayer savings for litter pickup; the uncomputed but real savings in landfill disposal costs; and the satisfaction of taking a meaningful, concrete step for conservation of energy and other resources.

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JOBS AND THE ECONOMY

Claims by industry that deposit legislation would have a negative impact on employment, the economy, and beverage consumption have not been borne out in Vermont. To the contrary, the law has created new jobs for Vermonters, and beverage sales have risen to record levels in the state.

Opponents often point to the fact that in fiscal 1974, the first year the law was in effect, Vermont's beverage sales slumped--as evidenced by a 9 per cent decline in malt beverage tax revenues. If this were attributable to the deposit legislation, a strong argument could be made that the legislation resulted in a reduction in state revenues and a negative effect on the state's economy.

We concur with opponents that the beverage tax figures are well worth examining. The tax is a reliable indicator of beer sales in Vermont, as it is assessed according to volume rather than price. There is no similarly accurate gauge of statewide soft drink sales.

There are, however, many factors which influence beverage sales. In fiscal 1974, Vermont beer sales were affected by at least two sets of circumstances which are totally unrelated to the deposit legislation, and which could more than account for a 9 per cent drop in Vermont beer consumption.

During that year, the tourist industry, which accounts for a large part of Vermont's beverage sales, suffered one of its most disastrous years on record. Nationally, tourism was crippled by a combination of a gasoline shortage and severe inflation. In Vermont, the problem was compounded by the weather: the ski industry suffered from an unusual shortage of snow, and the state was hit by a major flood during the height of the summer tourist season. While beverage taxes were down 9 per cent during the fiscal year, all other tourist related taxes were down 10.8 per cent.[22] This overall decline in revenues could not, by any stretch of the imagination, be attributed to the deposit law.

Another key factor was that during fiscal 1974, New Hampshire lowered its legal drinking age from 21 to 18. Vermont had taken this step two years earlier, so beer sales had been bolstered--not only among young Vermonters, but also among New Hampshire youths who had been crossing the state border to purchase beer. This market, of course, dried up with enactment of the New Hampshire legislation.

As with beverage prices, Vermont's beverage sales can be most reliably gauged by comparison with sales in neighboring New Hampshire. The comparison for fiscal 1974 is distorted by the change in New Hampshire's legal drinking age: for the record, New Hampshire sales of beer did increase by 3.36 per cent in fiscal 1974. But to put the statistic in perspective, it is useful to note that in fiscal 1972, the year Vermont lowered its legal drinking age, beer sales shot up by 13.52 per cent.

Since fiscal 1974, beer sales in Vermont, as measured by the malt beverage tax receipts, have increased at a much faster pace than have New Hampshire sales. The price trends are shown in the following table:[23]

	VERMONT SALES	NEW HAMPSHIRE SALES
FISCAL 1975	UP 6.17 per cent	UP 2.85 per cent
FISCAL 1976	UP 5.77 per cent	DOWN .71 per cent
FISCAL 1977	UP 5.9 per cent	UP 3 per cent

We have no evidence to suggest that the deposit system is responsible for increased sales in Vermont. But the figures do clearly demonstrate that the law has not led to a decline in sales or loss of business in Vermont.

The law's impact on jobs has been strictly positive. While the number of new jobs may not seem impressive to those accustomed to statistics relating to large population areas, it is not insignificant in a state as small as Vermont.

Distributors, and some retailers, have hired additional persons to handle and sort containers, and to drive beverage trucks. Many of these positions are part-time, but in terms of man-hours, they add up to the equivalent of some 150 full time jobs in Vermont.

In addition, since the law was passed, about 100 redemption centers for beverage containers have opened in Vermont. Most of these centers also serve as beverage retailers. It is safe to estimate that these new businesses account for 200 to 300 additional full time jobs in the state.

To our knowledge, the deposit law has not brought about <u>any</u> job losses or economic dislocations. The job impact, therefore, has been entirely on the plus side of the ledger.

Opponents will be quick to point out that Vermont has no steel, aluminum, or container manufacturing industries. Such industries would be affected if there were a massive shift away from cans, to the use of refillable bottles. But consumption patterns in Vermont suggest there is little reason to fear that a larger scale deposit system would lead to that type of massive shift.

Prior to passage of the deposit law, cans constituted approximately 37 per cent of the beer market and 40 per cent of the soft drink market in Vermont. There is no question that the can share declined immediately after the effective date of the law, particularly for soft drinks. But because this resulted from the decisions of a relatively small number of distributors, a similar trend would not necessarily occur elsewhere: Vermont distributors simply do not make up a large enough sample to project that similar experiences would result in another state or nationwide.

What is significant for those who are concerned about the future of cans is that there is still very substantial consumer demand for them. As a direct result of that demand, the share of the beverage market for cans is rebounding. Cans now account for approximately 12 to 15 per cent of the soft drink market, and those close to the industry feel the share will increase steadily as cans become more widely available.[26]

The can share of the beer market has remained at 34 per cent, approximately the pre-law level.[27] There are indications that the use of cans is continuing to increase for beer as well: for example, cans are now seen in some bars which formerly used only bottles.

These trends indicate that the initial drop in can use resulted in a miscalculation by distributors as to the consumer patterns which would develop under the deposit law. At that time, the only available model upon which to make that judgement was the Oregon law, which was structured differently, and did discriminate against cans. Presumably, if Vermont-type legislation prevails in other states or nationally, distributors will look upon our experience as evidence of continued strong consumer demand for cans.

Why would so many Vermonters prefer cans if refillable bottles are cheaper? There may be any number of reasons, but some residents have commented that the advantages of cans are even more readily apparent under a deposit system than if they are discarded. Cans are lightweight and unbreakable, therefore easier to handle for the consumer, the grocer, and the distributor. In addition, they may be returned in damaged condition.

We should also emphasize that the continued use of cans does not defeat the purposes of a deposit law. Returning of cans for recycling not only reduces litter; it also conserves energy and material resources, as we will discuss in the next section of this report.

We dwell on this issue only because opponents have raised the spectre of economic displacement if deposit legislation were to result in a massive reduction in the can share of the market. It should be emphasized that regardless of whether such a shift were to occur, a deposit system creates a substantial increase in both jobs and labor income.

For example, in its lengthy 1976 report, the Federal Energy Administration estimates that a national deposit system would lead to a net gain of about 118,000 jobs and about $879 million in labor income.[28] The reason is that the manufacture of throwaways is capital and energy intensive, while refilling and recycling are labor intensive. Therefore, any concern which exists about labor impact is directed not toward the overall economic effect of deposits, but to potential displacements which could occur if there were a massive shift from one type of beverage container to another.

In analyzing whether such a shift would occur, it would be folly to attach undue significance to the Vermont experience. Consumer patterns in Vermont, relative to beverage containers, were dissimiliar to nationwide patterns before the deposit law went into effect, and there is no particular reason to believe that other parts of the country enacting similar legislation would have similar experiences in this regard. An expert analysis of this issue is contained in a report by Franklin Associates for the federal Environmental Protection Agency's Office of Solid Waste.

At this writing, the Franklin Associates study is still in draft form, but its general conclusions have been made public. The draft study indicates that if a Vermont-type deposit bill were enacted nationwide, cans would capture 50 per cent of the soft drink market by 1982--the same figure that would prevail without a deposit system.

For beer, the study says the proposed national legislation would result in a market share for cans of between 55 per cent and 76 per cent, compared to 71 per cent without mandatory deposits.[29]

The Vermont experience demonstrates that consumer demand for cans does not disappear with enactment of a deposit system, but the Franklin Associates study, when it is finalized, will be a far better source of insight on this issue.

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SAVINGS OF ENERGY AND MATERIAL RESOURCES

Regardless of any other implications of the Vermont soft drink industry's shift toward refillable containers, the move was consistent with the deposit legislation's conservation goals. There was initial resistance to these goals in the beer industry, and there still is to some extent, but substantial progress was made in late 1975 when most beer distributors began recycling all aluminum and glass.

The pervasive recycling of aluminum, and of any glass which is not refilled, continues in 1977. Some, but not all, steel cans are also shredded and recycled.

The aluminum industry seeks to take advantage of the ability to redeem large numbers of containers. Vermont distributors are reimbursed for aluminum at rates ranging from 17 cents to 28 cents per pound, depending on quantities, and on whether it is returned in shredded form.[30] Since there are 24 aluminum cans per pound, it is thus possible for a distributor to recover the full amount that he pays retailers for handling of aluminum cans.

Because of the high value of aluminum for recycling, the aluminum industry, once an ardent opponent of deposit legislation, has softened its attitude considerably. Alcoa, for example, has run a series of newspaper advertisements in Vermont based on the theme: "Where do aluminum cans go after you return them? Back to work." The advertisements note that aluminum cans "are 100 per cent recyclable. And by recycling them, we save 95 per cent of the energy that would otherwise be used to make molten metal from ore."[31]

While the industry has stopped short of active support of deposit legislation, Alcoa at least has discontinued any active effort to oppose "nondiscriminatory" laws such as we have in Vermont, zeroing in instead against Oregon-type bills which tend to discourage cans. A statement of Alcoa's position makes it clear that the savings of energy and material resources made possible by the Vermont law are economically attractive to the company.

We feel Alcoa's statement is highly significant for those interested in deposit legislation. It is one of the first departures from the solid block of industry opposition. It acknowledges that the conservation benefits are desirable from a business standpoint as well as an altruistic environmental standpoint. And, perhaps most significantly, it concedes that the alternatives which have been trumpeted by the industry for so many years are simply not as effective as deposit legislation.

The company says in its statement that Alcoa has been actively pursuing voluntary recycling programs over the years, with the result that "Today, about one in four aluminum cans are being returned for recycling, thus saving major quantities of materials and energy. Where the aluminum can is used widely, returns currently approach one in two. But we have trouble seeing the national figure going beyond 50 per cent through voluntary recycling. Making all containers returnable through uniform deposits, on the other hand, will dramatically increase the percentage of returns."[32]

In other words, after years of experience with voluntary recycling efforts, Alcoa projects that even under the best possible circumstances, it will never be able to get back more than half its cans in that manner--compared to the return rate of better than 95 per cent under the Vermont law.

Recycling of steel is less attractive economically, although it does conserve energy and material resources. Vermont distributors who are willing to shred their redeemed steel cans receive $5 to $10 a ton for recycling value. Some distributors find this to be financially worthwhile, although others continue to bury their steel cans in landfills.

A brochure distributed by U.S. Steel Corp. describes the virtues of recycling steel, saying, among other things, ". . .it takes a lot less energy to produce new steel using recycled steel than to produce new steel from scratch." But, as with other publicity materials from the steel industry, the brochure says the solution lies not in deposit legislation, but in installation of sophisticated resource recovery technology.[33]

Without digressing into an extensive discussion of resource recovery systems, we would point out that deposit legislation and recovery technology are not mutually exclusive. And, as the U.S. Steel brochure points out, "Most systems will be too complex and expensive to 'pay as you go' from current revenue, so your community will have to decide on which type of bond issue is most feasible."

The industry's promotion of resource recovery as an alternative to deposit legislation is not new. When Vermont legislators initially debated the issue, they received an extensive education on the virtues of resource recovery from beverage industry lobbyists. They made an informed judgement that as attractive as the technology may be, it is not a substitute for deposits. As the U.S. Steel brochure acknowledges, the technology is expensive, and in practice it is economically not feasible for the vast majority of small towns and cities which dot the Vermont landscape. By contrast, the deposit law provides a means to recover large quantities of materials and energy resources statewide, without any economic hardship or strains on the local or state tax base.

The authors do not wish in any way to downgrade the importance or the attraction of recovery technology: it recovers much more than just beverage containers. If it were possible to foresee a day when this sophisticated technology would be installed in most of the landfills throughout the country, it would be, as the industry claims, a more complete solution to the problem than is deposit legislation. But that day cannot be foreseen, so the argument is an illusion.

The energy savings made possible by Vermont's deposit legislation are substantial. Using the Federal Energy Administration's formula for computing energy impact[34] and Vermont figures on return rate and market share of various types of containers, we have computed these energy savings at 708 billion BTU's of energy each year.[35]

This is the energy equivalent of over 5 million gallons of Number Two fuel oil, or enough to provide for the home heating needs of 15,000 Vermonters--more than the population of the state's third largest city.

The assumptions used in this computation are generally on the conservative side: for example, we assumed the average refillable bottle is refilled 10 times, even though trippage has been higher than that in actual experience--Burlington Coca Cola estimates its bottles are refilled an average of 12 or 13 times. We must hedge on the estimate somewhat, however, because it includes an assumption that refillable bottles are actually refilled. While this may distort the energy savings which have actually been experienced to date, the general expectation in Vermont is that the widespread crushing and recycling of technically refillable containers will be no more than a temporary phenomenon.

The conservation benefits, of course, would be far greater in a larger state or region. The FEA study projects a nationwide system would save the energy equivalent of between 70,000 and 81,000 barrels of oil <u>per day</u>.[36] The Environmental Protection Agency estimates even <u>greater</u> energy savings, as well as yearly savings of 530,000 tons of aluminum, 1.5 million tons of steel, and 5.2 million tons of glass.[37]

Both the FEA and EPA studies assume return rates of 80 to 90 per cent of all beverage containers sold. Since Vermont's return rate is over 95 per cent, our experience indicates that the projections of conservation benefits by the two federal agencies are very conservative.

Another resource being conserved, with direct benefit to the state and its municipalities, is space in sanitary landfills. However, because the shift to pervasive recycling and refilling is a relatively recent event, this benefit is difficult to quantify at present.

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ADMINISTRATIVE COSTS

The Vermont deposit law, unlike most pieces of legislation, costs next to nothing to administer and enforce. It sets up a legal framework, and the rest is carried out by the free enterprise system.

Administration is the responsibility of a single state official--the co-author of this report, who has numerous other responsibilities and whose position existed before the deposit law went into effect.

In the five years since passage of the bill, total state administration costs have come to between $1,000 and $1,500. Most of this expense has been for duplicating costs for people who have requested copies of the law, and advertising requirements to notify the public of proposed regulations.

Because of the law's widespread support, it is virtually self enforcing. There is strong pressure upon the business community to comply with the legislation, and Vermonters have shown no reluctance to complaining if a violation is perceived.

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CONSUMER CHOICE

When the bill was initially debated in the legislature, some opponents maintained that if the deposit law were passed, a number of beverage brands--particularly minor beer brands--would no longer be available in Vermont.

In practice, immediately following implementation, a few minor beer brands were withdrawn from the market, in apparent protest against the legislation. Since that time, however, they have all been returned to the shelves. In addition, approximately 20 beer brands which had not been available prior to passage are now sold in Vermont.[38] These are mostly imported and western beers. While there is no logical reason to believe that the deposit law brought about the increase in consumer choice, it is clear that the initial fears were unfounded.

As we have already noted, there has been some shift in the array of containers available to consumers. There was an initial reduction in availability of soda cans, but they are returning because of consumer demand. Flip top cans have been replaced by equally convenient push top cans. Plastic rings for six-packs are now photobiodegradable, but the difference is imperceptible to consumers. And, "true" refillable bottles are increasingly available.

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FUND RAISING FOR WORTHY CAUSES

In Bennington, Vermont, an alternative education program for "problem" youths is partially funded by a beverage container redemption center operated by the students. Last year--the first year of operation--the center cleared $13,000 for the special education program, after start-up costs and all operating expenses.

Ralph Wright, director of the program, predicts the redemption center will net $20,000 this year, and that within two years, it will be possible to raise the full $40,000 annual cost of the educational program through this means.

The bulk of the receipts come through the handling fee of one cent per container paid by the beverage distributors, although the operation has now been expanded to include soda sales, and recycling of non-deposit bottles and cans and newspapers. Wright is enthusiastic about the project, pointing out that it provides a productive work experience for the youngsters as well as raising badly needed funds. The success of the center's recycling operation is also an example of the spin-off benefits of the deposit legislation. The students are now netting about $200 a month from recycling of newspapers and other materials--not enough for a self sustaining operation alone, but a profitable addition to the container redemption activity.

Many other nonprofit organizations have staged successful "bottle drives" to raise money, asking for donations of bottles and cans and using the refunds to finance youth sports and scouting activities, school band tours, and the like.

It would be difficult to justify implementation of a deposit system solely on the grounds that it provides fund raising opportunities for worthwhile causes, but many Vermonters have found that it is a nice side benefit.

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OTHER REPORTS

After the first year of implementation of Vermont's deposit law, two reports emerged, both of which painted the law in an extremely unfavorable light. The first, entitled "Report of the Vermont Beverage Deposit Law, Review and Analysis of its First Year of Operation," was prepared by the Vermont Retail Grocers Association, a group which at that time was adamantly opposed to the legislation. The second, called "Some Economic Consequences of the Vermont Beverage Container Deposit Law," was written by Milton J. Nadworny, a professor of economics at the University of Vermont, with financial backing from a group of opponents calling themselves the "Vermont Consumer and Industry Council."

It is no reflection upon the authors of these two reports to say that neither was an attempt to objectively analyze the effects of the deposit law. Now, both are so outdated that they are no longer useful as expressions of opposition to the legislation. They did serve a valid purpose: both reports extensively searched out all possible negative aspects and implications of the deposit legislation. By so doing, they alerted state policymakers of any problems which may have existed, and undoubtedly played a role in the improvements which have been made since that time.

Both reports maintained that the early indications are that the law was leading to higher prices for consumers, hurting the state's economy and revenue base, causing severe problems for grocers, and bringing on an array of other problems. With the benefit of three additional years of experience and hindsight, we have discussed all of these issues in this report, and a point by point rebuttal would be redundant.

Our only reason for mentioning these reports now is that they keep reappearing. The Retail Grocers' report, in particular, continues to surface wherever legislation for beverage container deposits is proposed, and continues to be cited as gospel truth by opponents.

In compiling their report, the authors of the Retail Grocers' report relied heavily upon an exercise scenario prepared by the Vermont Planning Office and the Development Department. This in-house scenario was prepared in April of 1973, and because of its erroneous assumptions and the possibilities of misuse, was repudiated by its authors on June 24, 1973, one week before the deposit system became law. The fact that this report continues to be used by deposit system opponents outside of Vermont confirms the worst fears of the state officials who had formulated the in-house scenario.

It should be emphasized that most of the adversities cited in the Retail Grocers' report were not even based on the state's one year of experience which had elapsed at that time, but rather were a rehashing of claims of adverse effects which had been made prior to the effective date of the legislation. Although these claimed effects never came to pass, we now find that they are cited as actual occurences by deposit system opponents elsewhere in the country.

The 1974 report of the Vermont Retail Grocers Association in no way reflects the current position of the organization, and it is extremely unfortunate that the report has been used, and continues to be used, by those who are anxious to spread misinformation about the Vermont experience.

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CONCLUSIONS AND SUMMARY

Through first hand experience and compilation of the best available information as described in this report, we believe the following is a fair summary of the benefits which have come to Vermont during the four years' duration of the state's beverage container deposit law:

***Virtual elimination of roadside litter, with a 56.5 per cent reduction in state effort for litter pickup.

***Substantial savings to consumers who purchase beverages in refillable containers, which have been made available as a result of the deposit law. These savings may be conservatively estimated at $60 per year for the typical family using refillables. The savings are not offset by raised prices for nonrefillables.

***Substantial conservation of energy, material resources, and space in sanitary landfills. The energy savings potential can be conservatively estimated as the equivalent of the home heating needs of Vermont's third largest city.

***The opportunity to re-direct voluntary beautification efforts to tree planting and other projects with long term benefit, rather than the Sisyphean task of litter pickup.

***Sizeable increases in beverage sales, with positive impact on state revenue and the economy. While the increases may not be directly attributable to the deposit law, the figures clearly show that the law has not had a negative impact.

***Spinoff benefits including raised environmental consciousness resulting from pervasive citizen participation, as well as fund raising opportunities for worthwhile causes through "bottle drives" and operation of container redemption centers.

***Greater consumer choice; approximately 20 more brands of beer are available in Vermont now than before the law. As with the figures on increased sales, this may not be directly attributable to the legislation, but serves as proof that the law has not discouraged the distribution of minor brands.

Against the benefits, we must weigh any drawbacks. There appear to be no quantifiable problems associated with the law: no economic displacements, no measurable price increases for any type of beverage container, no health or sanitation problems, no reduction of consumer choice. But less tangible burdens and inconveniences, if they exist, must be considered.

Presumably, if there were substantial burdens and inconveniences, they would be reflected in the views of those who are burdened. By all measures, the law enjoys extraordinary popularity. Support for the law has been expressed in a variety of ways, including:

***Consistently high, and growing, levels of approval for the legislation expressed in every public opinion survey taken on the issue; with the latest survey showing that 93 per cent of Vermonters like the law well enough to believe it should be implemented nationally.

***A complete turnaround in the positions of most retail grocers. Initially unified in strong opposition, the vast majority of Vermont grocers now support the legislation. Among others whose livelihoods are affected by the law: soda distributors have made it clear they are not unhappy with the legislation; while beer distributors constitute the major remaining open opponents. It should be emphasized that there is no evidence that the legislation has economically damaged the beer distributors, but that they tend to reflect the positions of the national brewers with whom they are affiliated.

***Rapidly rising beverage sales in Vermont, with no indication that Vermonters are crossing easily accessible state borders to purchase beer or soda in neighboring jurisdictions.

***A return rate of better than 95 per cent of all beverage containers sold in Vermont; an extremely high percentage considering that Vermont has a substantial tourist industry, thus many short term visitors.

As Vermonters, and because of the positions we hold, the authors have been exposed to a wide range of views on the subject of deposit legislation. We have heard numerous claims and arguments from both proponents and opponents.

In this report, we have attempted to evaluate all claims and arguments which have been brought to our attention, putting them in the perspective of actual experience in Vermont. We have rejected misleading claims by proponents, and have attempted to give fair treatment to claims by opponents. But we do not disguise our own opinion that after a thorough and objective evaluation, the facts come down clearly on the side of the deposit legislation. Most of the initial fears and concerns, legitimately raised when the legislation was new and untested, have been proven unfounded. We are disturbed that these discredited claims continue to be raised anew in discussions of deposit legislation in other states and at the national level.

There is no question that Vermont's deposit law is here to stay, regardless of whether or not the rest of the nation follows suit. Passage of time may bring further refinements and improvements in the deposit legislation and its implementation, but even the most ardent opponents have abandoned any realistic hope of repeal.

At the same time, we know that some of the greatest benefits of a deposit system, including conservation of energy and material resources, can only be fully realized on a larger scale.

It is our hope that this report will be useful to those who are interested in deposit system proposals elsewhere in the country. While the Vermont experience may not be fully transferrable to other jurisdictions, it should provide some clues as to potential impacts.

Since many misleading claims have been made regarding the Vermont experience, we are anxious, in any event, to do what we can to set the record straight.

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FOOTNOTES

1. Act No. 33, Vermont General Assembly, 1953 Session.

2. Report of the Vermont Litter Commission, established by Act No. 133 of the 1955 Session of the Vermont General Assembly.

3. Anchor Hocking Glass Corp. Vs. F.L. Barber, 118 Vt. 206, 105 Atlantic 2nd. Opinion filed May 4, 1954.

4. See footnote 2.

5. Litter Levy - T.10 Section 1521, Ch. 53.

6. Source: telephone conversation with Congressman Jeffords' staff, May 18, 1977.

7. Source: Vermont State Agency of Environmental Conservation.

8. Source: Dr. William Watson, Vermont State Department of Health.

9. Letter to the Editor, Rutland Daily Herald, Aug. 8, 1977.

10. See Appendix A, Litter Survey.

11. Source: Vermont State Agency of Environmental Conservation.

12. Source: Vermont Department of Highways.

13. Letter from R.W. Fraser, assistant maintenance management engineer, Vermont Department of Highways, to Professor Richard C. Porter, University of Michigan, May 3, 1977, with copy to Donald W. Webster.

The White River Valley News, May 9, 1977.

15. See Appendix B, pamphlet distributed by Massachusetts Committee to Protect Jobs and the Use of Convenience Containers.

16. Newspaper article, Gannett News Service, printed in The Burlington Free Press, July 15, 1977.

17. Source: Vermont State Agency of Environmental Conservation.

18. Ibid.

19. See Appendix C, computation of potential price savings.

20. Survey results copyright 1977 by Vermont Public Research Interest Group.

21. See Appendix D, wholesale beer prices for Vermont, New Hampshire, Massachusetts and upstate New York, minus malt beverage taxes.

22. Source: Vermont Department of Taxes.

23. See Appendix E., chart and tables depicting beer consumption in Vermont and other jurisdictions.

24. Source: Vermont State Agency of Environmental Conservation.

25 . Ibid.

26. Source: Vermont Soft Drink Association and conversations with soft drink bottlers and distributors.

27. Source: Telephone survey of beer distributors by Jeffords staff, January, 1977.

28. Final Report: Energy and Economic Impacts of Mandatory Deposits, Federal Energy Administration, September, 1976.

29. Franklin Associates, Draft Report for Environmental Protection Agency.

30. Source: Aluminum Company of America.

31. See Appendix F, reproduction of advertisement which appeared in several Vermont newspapers.

32. See Appendix G, Alcoa statement of position on deposit legislation, Aug. 26, 1977.

33. U.S. Steel publication, "Turning Trash Into Cash", May, 1977.

34. See Footnote 28.

35. See Appendix H, computation of energy savings.

36. See footnote 28.

37. U.S. Environmental Protection Agency, Fourth Report to Congress on Resource Recovery and Waste Reduction, August, 1977.

38. Source: Vermont State Agency of Environmental Conservation.

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APPENDIX A

STATE OF VERMONT

SPECIAL HIGHWAY LITTER EVALUATION PROJECT

SUMMARY

		BEER CANS				BEER BOTTLES				SODA CANS				SODA BOTTLES				OTHER LITTER (BARRELS)				TOTAL "BARRELS"			
		4 LANE	SS	SA	TH	4 LANE	SS	SA	TH	4 LANE	SS	SA	TH	4 LANE	SS	SA	TH	4 LANE	SS	SA	TH	4 LANE	SS	SA	TH
JUNE	1973	1553	1776	3979	2274	902	1185	2299	1869	755	628	806	420	209	277	447	295	24.6	17.6	20.6	11.9	35.0	31.2	45.5	23.[illegible]
	1974	1134	853	899	901	947	1016	534	666	395	447	209	202	233	237	195	120	43.5	26.1	30.8	20.6	52.9	35.1	37.2	25.7
PERCENT INCREASE OR DECREASE		-27.4	-51.7	-77.4	-61.4	+18.1	-14.3	-76.9	-64.4	-47.7	-36.0	-74.2	-51.9	+12.0	-14.4	-56.6	-59.3	+76.8	+48.3	+49.5	+73.1	+46.[illegible]	+12.5	-20.2	-5.[illegible]
		-59.7				-48.6				-53.3				-35.1				+62.0				+7.0			
JULY	1973	799	979	1135	390	364	549	574	977	500	594	294	248	159	255	253	165	16.7	11.2	9.4	7.7	22.9	18.7	17.2	15.[illegible]
	1974	392	252	161	93	132	150	60	71	199	107	27	21	35	33	18	19	14.7	13.2	7.3	6.5	16.9	15.1	9.1	7.[illegible]
AUG	1973	773	1194	1347	850	351	696	964	912	593	697	467	268	177	222	253	178	15.3	9.2	7.3	7.4	23.0	18.7	17.[illegible]	14.[illegible]
	1974	325	263	154	124	131	255	120	134	178	134	40	19	67	97	24	40	13.4	11.3	9.1	3.8	15.[illegible]	14.0	9.4	10.[illegible]
SEPT	1973	535	645	792	811	314	348	557	765	245	360	272	150	155	165	194	165	19.7	11.1	12.2	6.6	24.[illegible]	16.[illegible]	13.1	12.4
	1974	435	298	261	65	195	194	225	75	202	99	51	17	80	56	45	16	17.4	12.2	9.7	5.4	20.5	14.4	10.[illegible]	6.[illegible]
TOTAL	1973	2259	2703	3465	2541	1237	1593	2097	2454	1349	1641	1033	696	490	642	690	509	51.7	31.5	28.9	21.7	67.9	53.7	54.2	42.[illegible]
	1974	1064	903	556	272	458	599	414	280	578	340	127	57	182	195	87	74	45.5	36.7	24.3	20.7	53.3	53.5	28.4	23.3

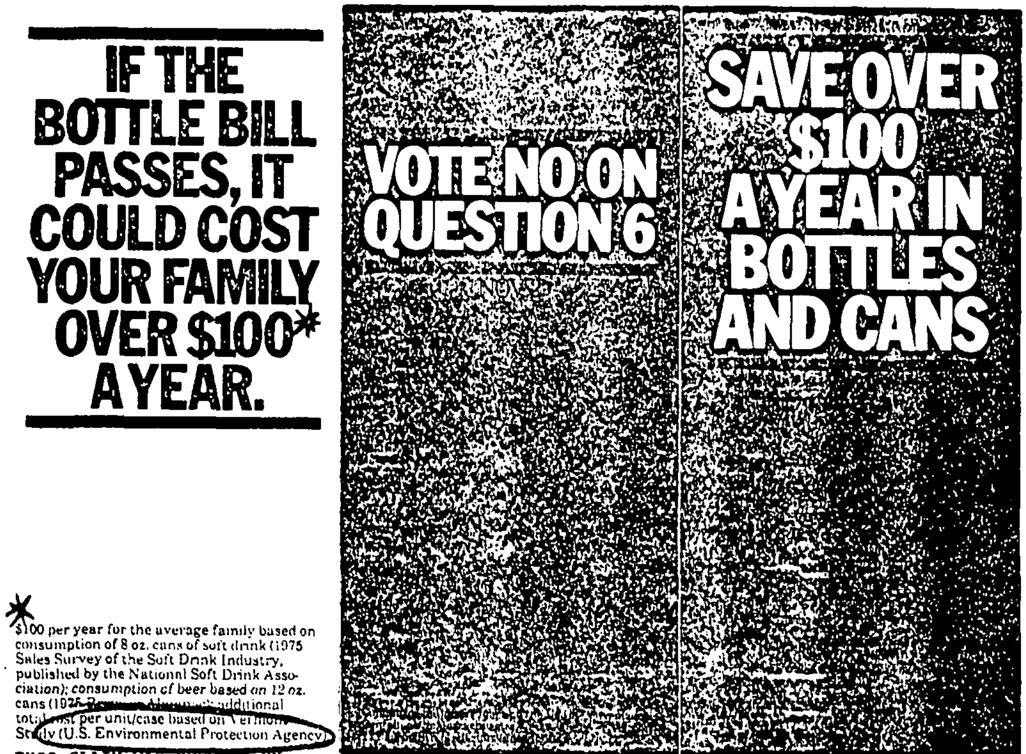
	TOTAL CANS	TOTAL BOTTLES	TOTAL CONTAINERS	OTHER LITTER (BARRELS)	*TOTAL BARRELS
1973	15,579	9,713	25,403	133.8	221.2
1974	3,802	2,280	6,082	127.2	143.4
PERCENT REDUCTION	75.8	76.5	76.1	4.9	32.7

* 1 Barrel = 260 BOTTLES
310 CANS

451

APPENDIX B

(Example of misleading propaganda distributed by deposit bill opponents.)



THIS CLAIM WAS REFUTED BY EPA IN AN UPUBLISHED REPORT DATED OCT. 4, 1976.

APPENDIX B (CONT'D)

(Misleading propaganda distributed by deposit bill opponents.)

THE CASE AGAINST THE BOTTLE BILL

On November 2, *the people of Massachusetts* will vote on Question 6.

The Bottle Bill.

On the surface, it sounds like a good idea. But when you pop it open, it's a *Pandora's* bottle of problems.

How the Bottle Bill could break you.

For openers, you'll have to pay a deposit of at least 5¢ on every can or bottle of soft drink, beer, or non-natural fruit drink you buy. And the price goes up to 10¢ for cans *and bottles* that are 32 oz. or more.

It's going to be tough to swallow.

If you don't bring clean cans and bottles back to the store, you'll lose that deposit.

And even if you carry through on your end of the deal, the Bottle Bill isn't a money-back *guarantee*. Because somebody will have to pay more for the handling, storing, and *processing of empties*. And who do you think that will be?

You.

Now if you have to pay more, you'll buy less. But in order to *survive, stores may* have to raise their prices further.

The vicious cycle will *drive even more* businesses out of Massachusetts, taking with them jobs and paychecks. And *leaving behind* the promise of higher taxes.

Now if somebody asked if your family would care to pour out an extra $100 a year on beverages in bottles and cans, or see possibly thousands of jobs lost in this state, what would you say?

No.

The Bottle Bill will get you coming and going.

If *you have to return your* beverage containers to get your deposit back, it's going to *amount to a pain in the can*.

And there'll be many unhappy returns *for storekeepers, who'll be caught in the* middle with storage and handling problems – and probably health *code problems, too*.

If somebody asked if you'd care to carry back bags and *bags of empty cans and bottles* of all sizes – all the way up to 64-oz. soda bottles – then stand in line till some guy with problems of his own gave you your deposit back, what would you say?

No.

Dispose of the Bottle Bill properly.

Surveys have shown that *you* can't catch litterbugs with a Bottle Bill.

In fact, the Bottle Bill hasn't been a smashing success in the two states where it *was adopted*.

In one state, roadside litter of beverage-*related material* was *up* two years after the bill was enacted. In another, much of the *population sees no change* in the litter situation, and even more want the bill repealed or modified.

It would be more efficient to enforce litter laws and fines we *already have*.

Because if $50 won't stop them, a 5¢ or 10¢ deposit certainly won't.

Finally, those empties you bring back may very well be carted away to a *central* dumping place.

Because Question 6 doesn't stipulate recycling.

If you're concerned about the environment, you're better off taking your trash to recycling centers. Just as people have been doing *without* compulsory legislation.

So, if somebody asked you, a person who doesn't litter, to pick up a $100 a year tab for people who do, what would you say?

No.

Don't wait till you have to pay the Bottle Bill.

The sad truth is, you'll pay through the mouth if Question 6 passes.

You'll pay for the litter of others.

You'll pay with additional inconvenience.

And most of all, you'll pay *more at the cash* register for beverage bottles and cans.

This is one time you know what a wrong vote could cost your family before you even vote on it. Over $100 a year.

If somebody asked if you'd care to stop the whole mess before it's even opened, what would you say?

NOV. 2 **VOTE NO ON QUESTION 6** NOV. 2

APPENDIX C

POTENTIAL PRICE SAVINGS

Annual consumption per capita - national average*

Beer - 230.4 (12-ounce containers)
Soda - 335 " " "

Average annual consumption per Vermont family

Beer - 230.4 x 3.6 (average Vt. family unit)= 829 (12-ounce containers, or 138.16 six-packs)

Soda - 335 x 3.6 = 1206 (12-ounce containers, or 402 quarts)

Approximate potential annual savings per Vermont family

Beer - 24¢ x 138.16 six-packs =	$33.15
Soda - 6¢ x 402 quarts =	24.12
Total	$57.27

Explanation: Prior to passage of the deposit law the average six-pack of beer in Vermont cost 30¢ more than in neighboring New Hampshire. Since implementation of the law that difference has been reduced to 6¢, thus a savings of 24¢ per six-pack has been realized. Before the law, the average quart of soda cost 5 to 8 cents more in Vermont than New Hampshire. Now, the average retail price of soda is approximately 5¢ per quart cheaper. We have used a 6¢ per quart savings figure simply to be conservative in our estimate.

*Source: United States Brewers Association

APPENDIX D

WHOLESALE BEER PRICES IN VERMONT AS OF JUNE, 1977
(All prices are for a case of six-packs, and adjusted for the 56.25¢ per case state tax)*

BRAND	Bottles	Cans
Black Label	4.13	4.88
Budweiser	5.53	5.53
Schaefer	4.52	4.93
Pabst	4.78	4.93
Schlitz	5.53	5.53
Miller	5.68	5.68

*Prices do not include mandatory deposit

WHOLESALE BEER PRICES IN NEW HAMPSHIRE AS OF JUNE, 1977
(All prices are for a case of six-packs, and adjusted for the 33.75¢ per case state tax)

BRAND	Bottles	Cans
Black Label	4.62	4.77
Budweiser	5.07	5.47
Schaefer	4.52	4.87
Pabst	4.72	4.87
Schlitz	5.07	5.47
Miller	5.07	5.47

APPENDIX D (CONT'D)

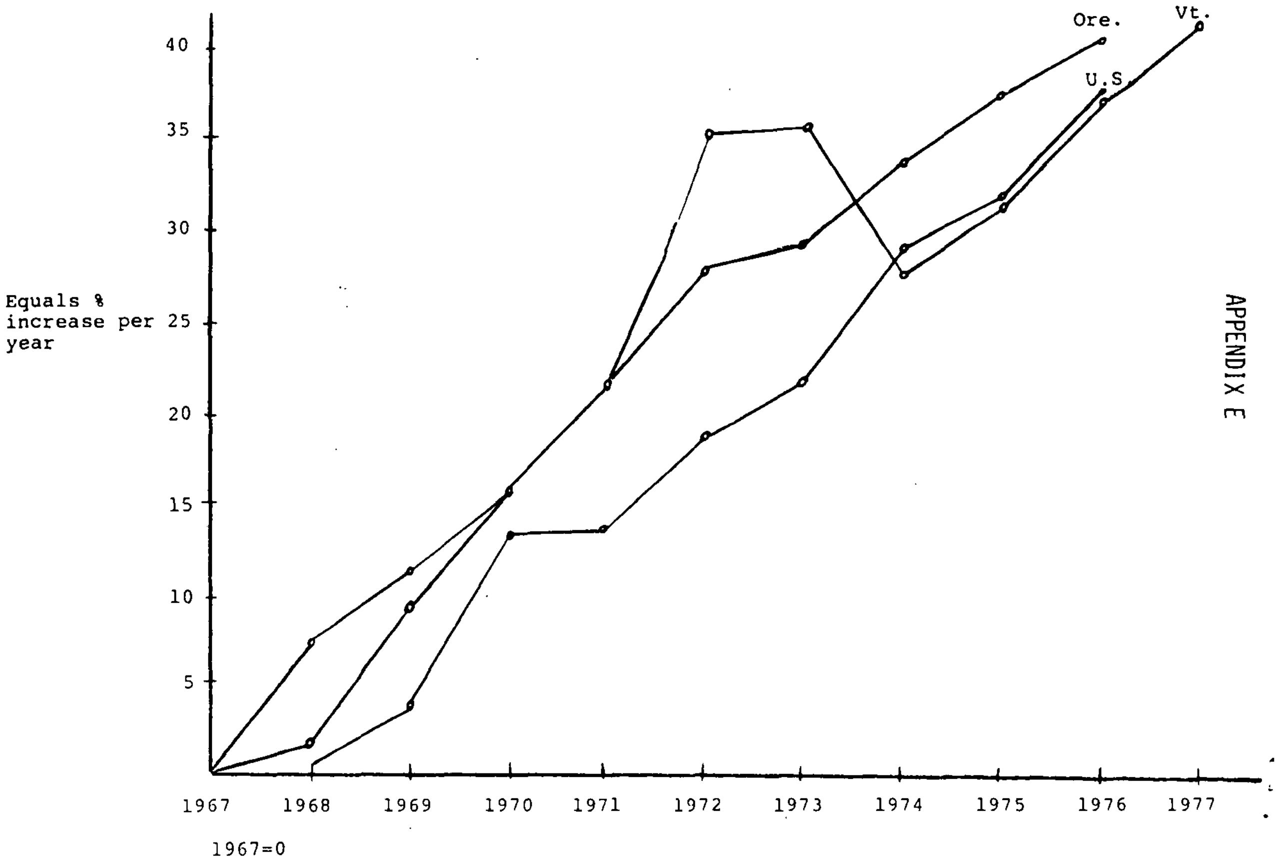
WHOLESALE BEER PRICES IN MASSACHUSETTS AS OF JUNE, 1977
(All prices are for a case of six-packs, and adjusted for the 24¢ per case state tax)

BRAND	Bottles	Cans
Black Label	4.81	N/A
Schaefer	4.81	5.06
Pabst	4.81	5.06
Budweiser	5.26	5.26
Schlitz	5.41	5.41
Miller	5.41	5.41

WHOLESALE BEER PRICES IN THE ALBANY, NEW YORK AREA FOR JUNE, 1977 (All prices are for a case of six-packs, and adjusted for the 10¢ per case state tax)

BRAND	Bottles	Cans
Schaefer	4.76	5.15
Pabst	4.85	4.85
Budweiser	5.75	5.75
Miller	5.75	5.75

APPENDIX E


Equals % increase per year
40
35
30
25
20
15
10
5
1967
1968
1969
1970
1971
1972
1973
1974
1975
1976
1977
1967=0
Ore.
Vt.
U.S.

APPENDIX E (CONT'D)

VERMONT BEER CONSUMPTION

(From Vermont Department of Taxes)

Converted to Barrels

YEAR*	SALES	+SALES	%INCREASE
1967	262,406	--	--
1968	281,198	18,992	+7.2%
1969	293,691	12,493	+4.4%
1970	305,524	11,833	+4.0%
1971	322,548	17,024	+5.6%
1972	367,711	45,163	+14%
1973	369,547	1836	+.5%
1974	334,531	-35,016	-9.4%
1975	350,826	16,295	+4.9%
1976	367,995	17,169	+4.9%
1977	389,678	21,683	+5.9%

* For fiscal year ending 6/30

APPENDIX E (CONT'D)

OREGON BEER CONSUMPTION

(From Oregon Liquor Control Commission)

Reported in Barrels

YEAR	SALES	+SALES	%INCREASE
1967	1,133,479	--	--
1968	1,151,273	17,794	+1.6%
1969	1,228,480	77,207	+6.7%
1970	1,314,602	86,122	+7.0%
1971	1,395,839	81,237	+6.2%
1972	1,469,595	73,756	+5.3%
1973	1,489,816	20,221	+1.4%
1974	1,574,252	84,436	+5.7%
1975	1,633,866	59,614	+3.8%
1976	1,694,974	61,108	+3.7%

APPENDIX E (CONT'D)

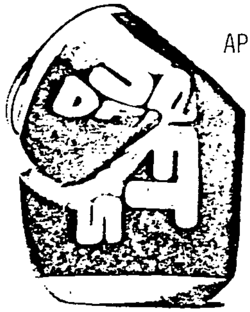
NATIONAL BEER CONSUMPTION

(From U.S.B.A. , Brewers Almanac - 1976)

Reported in Barrels

YEAR	SALES	+SALES	%INCREASE
1965	100,306,727	--	--
1966	101,510,307	1,203,580	+1.2%
1967	107,301,357	5,791,050	+5.7%
1968	107,470,430	169,073	+.16%
1969	111,866,595	4,396,165	+4%
1970	122,550,191	10,683,596	+9.5%
1971	123,850,399	1,300,208	+1%
1972	130,140,585	6,290,186	+5.1%
1973	133,960,457	3,819,872	+2.9%
1974	142,311,977	8,351,520	+6.2%
1975	146,853,088	4,541,111	+3.2%
1976	150,864,308	7,965,741	+5.4%

APPENDIX F



Where do aluminum cans go after you return them?

At Alcoa, they reappear again and again because aluminum cans are 100 percent recyclable.

And by recycling them we save 95 percent of the energy that would otherwise be used to make molten metal from ore.

Aluminum recycling also contributes to keeping the environment clean. Because every can that's returned is one less can you have to worry about.

So pick up a good thing. Stock up on beverages in the convenient returnable. Aluminum cans.

They're easy to store, light to carry, quick to chill and unbreakable.

And most importantly, they're 100 percent recyclable.

Pick up a good thing. Aluminum cans.

Back to work.

The convenient returnable.

ALCOA

Vermont News Guide - August 2, 1977. Page 15

APPENDIX G

ALCOA'S CURRENT POSITION ON DEPOSIT LEGISLATION

We have for several years been very active in opposing deposits at local and national levels. Our greatest concern has been those proposals that discriminate against the aluminum can and prevent it from competing in the marketplace. In addition to opposing such proposals with all our energy, we also have worked against uniform deposit proposals.

However, we have become convinced that uniform deposits are quite different from the discriminatory deposits that we still oppose. While Alcoa will not actively support uniform deposit regulations now, we can see a number of reasons why we should not object to a uniform deposit law. As a result, we have modified our position to focus on discriminatory deposit proposals.

Public opinion data indicate that between two-thirds and three-quarters of the U.S. public now support mandatory deposits on beverage containers. Evidence of this has also become evident at the ballot box. The public in Michigan and Maine was strongly favorable to deposit proposals on the ballot in those states last year. The citizens of Oregon are strongly behind the state's "bottle bill," the nation's oldest deposit law, even though it is discriminatory.

The public favors deposits as a means of litter control. While Alcoa feels this is at best only a partial measure and does not think this is the most productive means of getting at the litter problem, there is no question that littering of beverage containers does decline after deposits are imposed.

Another prime motive offered for supporting deposits is the public's growing interest in conserving materials and energy. Alcoa has been actively pursuing that course for some time through voluntary reclamation of aluminum cans. Today, about one in four aluminum cans are being returned for recycling, thus saving major quantities of materials and energy. Where the aluminum can is used widely, returns currently approach one in two. But we have trouble seeing the national figure going beyond 50 percent through voluntary recycling. Making all containers returnable through uniform deposits, on the other hand, will dramatically increase the percentage of returns.

1977-08-26

APPENDIX H

Potential Energy Savings in Vermont through the Reuse and Recycling of Beverage Containers

Vermont

Population: 470,000
Annual Beer Consumption: 19.2 gallons per capita
Annual Soft Drink Consumption: 36 gallons per capita

TABLE 1*

Energy Consumed Before Imposition of Deposit Law/annual

BEER	Ounces Consumed (x 1,000,000)	Energy Used/Containers (x 1,000,000 BTU)
Ref. Glass	76	12,844
NonRef. Glass	686	230,496
Steel	171	55,575
Aluminum	268	123,012
Sub-Total	1,201	421,927
SOFT DRINKS		
Ref. Glass	-0-	-0-
NonRef. Glass	1,300	461,500
Steel	433	140,725
Aluminum	433	199,180
Sub-Total	2,166	801,405
TOTAL ENERGY		1,223,332 (x 10^6 BTU)

* Formula for computation derived from FEA study (Final Report: Energy and Economic Impacts of Mandatory Deposits, Sept. 1976) In calculating these figures, each refillable bottle was conservatively assumed to make ten trips, and cans were assumed to be recycled in line with their 95% return rate.

APPENDIX H (CONT'D)

TABLE 2

Energy Consumed After Deposit Law

BEER	Ounces Consumed (x 1,000,000)	Energy Used In Containers and Refilling (x 1,000,000)
Ref. Glass	762	128,016
NonRef. Glass	-0-	-0-
Steel	153	49,725
Aluminum	240	44,160
Sub-Total	1,155	222,045

SOFT DRINKS		
Ref. Glass	1,842	209,874
NonRef. Glass	-0-	-0-
Steel	162	52,650
Aluminum	162	29,808
Sub-Total	2,166	292,332
TOTAL ENERGY		514,377 (x 10^6 BTU)
ENERGY SAVINGS (Table 1 - Table 2)		708,955 (x 10^6 BTU)

Addendum

It should be noted that this is a preliminary report prepared for initial publication in 1977. Since that date, there have been subsequent studies on this entire subject, as well as enactment of laws by several other states and localities. It is our intention to,at some point in the future, revise this report with data accumulated from these new legislative experiences and studies, for eventual publication.

APPENDIX 3

ADDITIONAL QUESTIONS

Subsequent to the hearings on H.R. 3567, the subcommittee submitted additional questions to several of the witnesses seeking further detailed information which was not fully explored during the hearings because of time constraints.

The section that follows contains the questions posed by the subcommittee and the replies furnished by the witnesses.

1. Would you please define for us the terms used in the soft dr bottling bills?

   a. The first term is "products of the same general class." What products are in products of the same general class? Does this term include: water, Perrier water, fruit juices, fruit drinks, tea, instant iced tea mix with lemon (Nestea), Kool-Aid, soft drinks, carbonated soft drinks, milk, coffee and beer.

   b. What does the term "substantial and effective competition" mean? If there is a strong consumer preference for a product and this allows one firm to raise its price above a competitive level, would this be sufficient to show there is a lack of "substantial and effective" competition between this product and other products?

2. Proponents of this legislation insist that it is designed to help small business. What is your opinion of an amendment to H.R. 3567 excluding from the provisions of this bill corporations with more than $50 million in assets and $100 million in sales? Would you oppose excluding from this legislation the protection of territories owned by major syrup manufacturers?

3. What are your views of an amendment to H.R. 3567 prohibiting further vertical integration in the soft drink industry by syrup manufacturers?

4. What is your view of an amendment providing that any licensee could sell in another licensee's territory if the bottler sold less than a certain percentage of soft drinks in returnable

containers or did not sell any returnable packages?

5. Since one of the declared purposes of H.R. 3573 is the conservation of our energy resources through the use of returnable containers, would you oppose an amendment requiring all soft drinks to be sold in returnable containers?

6. Does this bill immunize any <u>per se</u> violations of the antitrust laws? Would you oppose an amendment to the bill providing that this bill shall not be construed to authorize <u>per se</u> violations of the antitrust laws?

7. Would you oppose an amendment providing that this bill shall not be deemed to authorize horizontal market division or customer allocation?

Questions For Soft Drink Bottler Witnesses

From Congressman Peter W. Rodino, Jr.
Chairman, Committee on the Judiciary
House of Representatives

Answers To Those Questions

From Sidney P. Mudd
President, Joyce Beverages Inc
New Rochelle, New York

Question 1.

Would you please define for us the terms used in the soft drink bottling bills?

a. The first term is "products of the same general class." What products are in products of the same general class? Does this term include: water, Perrier water, fruit juices, fruit drinks, tea, instant iced tea mix with lemon (Nestea), Kool-Aid, soft drinks, carbonated soft drinks, milk, coffee and beer?

Answer 1.a.

Perhaps the simplest and best answer is "all drinks offered for sale in the beverage aisle of the average supermarket, excluding beer and malt liquors." Historically, this has meant bottled drinks and drinks in single-service size cans, carbonated and non-carbonated, and flavored, with the exception of sparkling water or soda.

In recent years the universal popularity of soft drinks has prompted market entry by innumerable fruit juices, fruit drinks, powders, dry mixes, tea, coffee, chocolate and milk flavored beverages, as well as foreign and domestic spring waters and mineral waters. To the degree that these new entries, through retailer approval and consumer support, achieve "shelf position" in the beverage aisle, to that degree they become close competitors of traditional soft drinks.

While the term, "products of the same general class", is best interpreted by the court, I believe its meaning to be those non-alcoholic beverages which retailer and consumer identify as directly competing drinks by placing and comparing them in the beverage aisle.

Note: I am not overlooking the fact that in every market there are some minor brands whose consumer demand is so low that they fail to merit supermarket approval. To the degree that these brands achieve a retail presence in other outlets, they fall into that "same general class" category.

b. What does the term "substantial and effective competition" mean? If there is a strong consumer preference for a product and this allows one firm to raise its price above a competitive level, would this be sufficient to show there is a lack of "substantial and effective" competition between this product and other products?

Answer 1.b.

Again I believe that this question is best decided by the courts, guided by the Committee Reports of the Congress accompanying the passage of H.R. 3567 into law. As a layman, the phrase means to me that competition among all the brands mentioned above in Answer 1.a., is of such substance or magnitude that no single brand can be said to "control" soft drink pricing or packaging. Competition that "substantial", which makes soft drink pricing and packaging essential considerations for all brands located in or aspiring to the beverage aisle, is, in my opinion, "effective" in the meaning of H.R. 3567.

Question 2.

Proponents of this legislation insist that it is designed to help small business. What is your opinion of an amendment to H.R. 3567 excluding from the provisions of this bill corporations with more than $50 million in assets and $100 million in sales? Would you oppose excluding from this legislation the protection of territories owned by major syrup manufacturers?

Answer 2.

I respectfully disagree with the premise of this two-fold question. This legislation was not "designed to help small business"; neither do any proponents of the legislation, known to me, "insist that it is designed" to accomplish that.

H.R. 3567 was designed with one objective in mind: to bring Congressional verification to the unique franchise system of manufacturing and marketing employed in the soft drink industry for nearly eighty years. Parties to that franchise contract are franchise companies and independent bottlers. Among the two thousand or more of the latter, the vast majority, by far, are small bottlers. Since these small bottlers would likely be the first to succumb were their contracts to be voided, their class would be the most numerous of those helped by the legislation. That is merely a function of numbers, not of intent.

So-called "big bottlers" are in similar jeopardy under the FTC threat to the franchise system. As one of them, I have testified many times to the likelihood of the takeover of our business by larger and wealthier entities, from within or without the soft drink industry, capturing by sheer weight of dollars what we have built over four generations, while moving the marketing of soft drinks rapidly toward a "monopolistic" mode.

Thus I am opposed to amendments to H.R. 3567 which exclude from its provisions corporations with arbitrary levels of assets and sales, as well as territories owned by major syrup manufacturers.

The legislation seeks the assurance of legality equally for all parties to the contract. It seeks to avoid favoritism of any class of franchise or franchisor. If members of the Committee fear large bottler or franchisor-bottler abuse of the marketing process to the harm of the consumer, there is ample room for legal remedy under the "substantial and effective competition" provisions of H.R. 3567.

Question 3.

What are your views of an amendment to H.R. 3567 prohibiting further vertical integration in the soft drink industry by syrup manufacturers?

Answer 3.

There is no doubt that a syrup manufacturer's ownership and operation of a franchise for its own and other soft drink products presents a magnified marketing challenge to competing bottlers. But that is no reason to deny that option to trade-mark owners in the broad marketing of their brands, as long as there is no violation of the franchise contract. In every instance, without exception, the fact of or possibility of franchisor ownership of franchises for the same or competitive brands was clearly understood and accepted by both parties to the franchise contract before ownership and investment occurred.

Under the present system, if franchisees or franchisors seek more territory, they must find a willing seller and pay a fair purchase price for the additional area and assets acquired. In my opinion that is a basic right of commerce for both buyer and seller which should not be frustrated.

Question 4.

What is your view of an amendment providing that any licensee could sell in another licensee's territory if the bottler sold less than a certain percentage of soft drinks in returnable containers or did not sell any returnable packages?

Answer 4.

Replying honestly and meaning no offense to anyone, I must reply that such an amendment would be an absurdity. If we want to go further down the road of capricious and misguided regulation, which fails to understand what makes our economic system work, this is the type of arbitrary control to do so.

What logical, practical or legal consideration makes type of packaging a condition to a franchise contract? Packaging is a response to consumer preference among present or past options provided by manufacturer and retailer. That consumer control and the manufacturer's response to it must not be artifically abridged by imposing penalties on manufacturers who so respond. Such an amendment would do just that.

Question 5.

Since one of the declared purposes of H.R. 3573 is the conservation of our energy resources through the use of returnable containers, would you oppose an amendment requiring all soft drinks to be sold in returnable containers?

Answer 5.

H.R. 3573 is not the bill which the soft drink industry supports for reasons stated above in response to Question 4. For the information of the Committee, let me add here that the question of energy differential between returnable and non-returnable packaging is unproven and therefore moot.

Question 6.

Does this bill immunize any per se violations of the antitrust laws? Would you oppose an amendment to the bill providing that this bill shall not be construed to authorize per se violations of the antitrust laws?

Answer 6.

This bill is in no way intended to immunize any such per se violations. I would not be opposed to an amendment to assure that per se violations are not authorized by the bill.

Question 7.

Would you oppose an amendment providing that this bill shall not be deemed to authorize horizontal market division or customer allocation?

Answer 7.

I would not oppose such an amendment.

ANSWERS TO QUESTIONS SUBMITTED
TO CHARLES B. RUTTENBERG
BY THE HONORABLE PETER RODINO
BY LETTER OF JANUARY 15, 1980

1(a):

The term "products of the same general class" is designed to give the courts flexibility to determine the range of products with which soft drinks compete in particular geographic markets. This concept fully comports with applicable antitrust practice under the Sherman and Clayton Acts whereby courts determine the relevant product market and the relevant geographic market to be analyzed in antitrust cases. I do not know which of the items listed in your question would be determined by a court to be products of the same general class in a particular case and do not think it would be desirable for the Congress to attempt to make such a determination. We can be certain, however, that the competitive marketplace is constantly changing, that some products which may have competed in the past no longer compete and that new products are being developed which may prove to be competitive. Moreover, consumer preferences vary in different parts of the country. Consequently, products that may be competitive in one part of the nation may not be competitive in another part. The genius of the present system of permitting individual judges and juries to determine the bounds of the relevant product market is that they can take these local conditions into account rather than be bound by an arbitrary and perhaps outdated list of products.

1(b):

The existence of substantial and effective competition is not susceptible to a simple formula but must be determined on a case-by-case basis, just as the courts determine whether restraints are reasonable or whether a practice "substantially lessens competition." Price is certainly one of the indicia to be considered by the courts in determining whether such competition exists. I believe that the best description of how the existence of substantial and effective competition is to be determined can be found in the report of the Senate Judiciary Committee on S. 3421 in the 94th Congress where the Committee listed what it considered to be appropriate factors to be considered in making such a determination:

> "Whether or not there is substantial and effective competition within a licensee's defined geographic area from other brands

> and vendors 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 profit; 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."

2 and 3:

The primary purpose of H.R. 3567 is to clarify the legal standard by which territorial arrangements in the soft drink industry are to be tested. It is fair to say, however, if substantial and effective competition is found to exist, an important result will be the preservation of many hundreds of small bottlers. An amendment to the Bill, however, which would authorize territorial arrangements only on the basis of size would be anti-competitive rather than pro-competitive. The bottler without territorial protection would soon cease contributing further capital to his enterprise once outside bottlers began to "free-ride" upon the local bottler's promotions and aimed their sales efforts at selected customers in the invaded territory. As a result, the local bottler would lose his incentive to promote aggressively and to distribute to all retail accounts. The purpose of the legislation is to require an examination of the state of interbrand competition in the territory when making a determination as to whether territorial protection should be permitted. If vigorous interbrand competition exists, it is irrelevant that one or more of the competing bottlers in the territory may be large or owned by a large entity.

Similarly, there is no indication that, in the soft drink industry, vertical integration is leading to anticompetitive effects. We know of no evidence that bottlers owned by syrup companies have any special advantages or have created any particular competitive problems in the markets in which they operate. Furthermore, the antitrust laws have never adopted the presumption that vertical integration is competitively objectionable, but rather there has been a requirement that the competitive consequences of such integration must be shown on a case-by-case basis. (It should be noted that, in the current litigation, the Federal Trade Commission specifically refused to order divestiture or other relief against the ownership of bottling plants by the syrup companies.) I believe that the existence of substantial and effective competition in the territory is sufficient protection for the consumer and that the mere fact of ownership of a bottling company is an irrelevant consideration.

Furthermore, it is our belief that if territories fall, the dangers from vertical integration in this industry markedly increase. The power of the vertically integrated companies would be significant enough to drive out many of the smaller companies without necessarily resorting to methods that might be illegal under the antitrust laws.

4 and 5:

There is no doubt that the territorial system fosters the survival of returnable containers and it is generally agreed that if territories are eliminated, returnable containers would disappear from many, if not most, markets. It should be noted, however, that the opportunity for the returnable container to survive if territories are continued is not the justification for territorial arrangements. The amendments suggested in these questions are not germane to the issue of whether or not the legislation should be enacted. The focus of H.R. 3567 is upon competition. Were the Congress ever to consider the desirability of requiring the use of returnable containers in the soft drink and other industries, that is a matter that should appropriate be considered in another legislative context on its own merits. The enactment of H.R. 3567 should not be contingent upon the question of whether national policy to conserve energy and improve the environment necessitates the mandatory use of returnable containers.

6 and 7:

The Bill is not intended to immunize any *per se* violations of the antitrust laws. I am aware of testimony presented to the Subcommittee which alleged that Section 2 of H.R. 3567 would legalize such enforcement methods as price fixing, horizontal agreements and group boycotts. I can categorically state that nothing in the Bill is intended to protect agreements among bottlers or syrup companies with regard to pricing, with regard to the allocation of territories or with respect to joint refusals to deal. Thus, appropriate amendatory language to make this intention clear would be acceptable. Such language should make it clear, however, that the vertical territorial arrangements used in this industry shall not be considered *per se* violations of the antitrust laws.

ANSWERS TO QUESTIONS SUBMITTED TO LEE E. PRESTON, STATE UNIVERSITY OF NEW YORK AT BUFFALO BY HON. PETER W. RODINO, JR., CHAIRMAN OF THE JUDICIARY COMMITTEE BY LETTER OF JANUARY 15, 1980

1. a. The general meaning of the phrase "products of the same general class" seems to be clear enough on its face. Its detailed application would depend upon the specific market situation, and would certainly lead to different results in different places and in different times. Criteria for determining whether or not products are in the "same general class" include demand characteristics (consumer preference and use), supply characteristics (physical and cost, methods of distribution, type and identity of firms involved), and associated differences and similarities in their prices.

   b. By "substantial and effective competition" I would mean that a sufficient range of choice of products, packages and prices (and these from a number of different supply sources) is actually available to buyers that the resulting consumer decisions can be reasonably taken to reflect underlying tastes and preferences, based on adequate information. Differences in the margins between prices and costs among firms and products do not, without any further information, necessarily indicate an absence of "competition" in the marketplace. If consumers, given a wide range of price-product choice in the market, choose to pay more for some products than for others (either in absolute terms or in relation to cost), that fact in itself cannot be termed an "uncompetitive" result.

2. I do believe that the bill is designed to, and will in fact, "help small business" in the sense that it will provide legal protection for economic interests, many of which are in fact "small", that have been built up on

the basis of business arrangements that have long been--and in my opinion still should be--considered both socially and legally acceptable. The protection provided by the bill will not, however, "freeze" the structure of the industry in any specific configuration, and I think it highly desirable that this should be the case. I cannot help but think that limitation of this legislation with respect to either the size or the organizational structure of the firms involved would prove hopelessly unweildy and perhaps ultimately unacceptable to the courts as well.

3. In general, I tend to think that any rigid limitation on the flexibility and adaptability of the economy is undesirable. Hence, I think that the prohibition of "vertical integration" by "syrup manufacturers"--in addition to presenting difficult definitional and enforcement problems--would be objectionable. What would be the implications of such a provision for the appearance of another firm on the Shasta model?

4. Again, I think that detailed provisions with respect to the form of container present problems of definition, measurement, and application--and also some ambiguity as to purpose--and hence should be avoided.

5. The energy (and other cost) implications of various forms of packaging, returning-refilling, and recycling have been much debated. Without knowing more about them than I do at present--and being unsure that anyone can substantiate a comprehensive analysis--I would not be prepared to endorse any specific requirement or prohibition. In addition, I would find it difficult to justify the application of any such policy to soft drinks alone, and not to other products with similar packaging and distribution alternatives.

6. Although I am not an attorney, it is certainly my understanding that H.R. 3573 does not "immunize any *per se* violations of the antitrust laws." If additional language is required to clarify that point, then insertion of such language would seem appropriate.

7. Both the meaning and the purpose of such an amendment would be entirely unclear to me; hence, I am unable to respond to this question in any way.

CENTRAL INVESTMENT CORPORATION

4050 EXECUTIVE PARK DRIVE • CINCINNATI, OHIO 45241 • PHONE (513) 563-4700

March 24, 1980

Honorable Peter W. Rodino, Jr.
Chairman, House Judiciary Committee
2137 Rayburn Building
Washington, D.C. 20515

RE: Soft Drink Bottling Franchise Legislation

Dear Mr. Chairman:

We are submitting herewith for the record our response to the questions you posed to me following my appearance before the Subcommittee on Monopolies and Commercial Law in support of H.R. 3567 and H.R. 3673.

Question No. 1

Would you please define for us the terms used in the soft drink bottling bills?

a. The first term is "products of the same general class." What products are in products of the same general class? Does this term include: water, Perrier water, fruit juices, fruit drinks, tea, instant iced tea mix with lemon (Nestea), Kool-Aid, soft drinks, carbonated soft drinks, milk, coffee and beer.

b. What does the term "substantial and effective competition" mean?" If there is a strong consumer preference for a product and this allows one firm to raise its price above a competitive level, would this be sufficient to show there is a lack of "substantial and effective" competition between this product and other products?

Answer

a. Products of the Same General Class: My understanding is the term "products of the same general class" has legal significance which courts are called upon to interpret on a case by case basis. We consider our company products to be in competition with a wide variety of other kinds of products. These include carbonated soft drinks, instant iced tea and various forms of processed fruit drinks. However, we would not say our produts are in competition with milk, coffee and beer.

b. Again, it is my understanding the term "substantial and effective competition" is a legal term which courts from time to time interpret and give meaning to on a case by case basis. As a businessman engaged in manufacturing and processing soft drinks and carbonated beverages, I know our company confronts substantial and effective competition every day. As a consequence, for example, our firm must frequently engage in advertising promotions in order to maintain, or ever hope to increase, our share of the market. It is our awareness of the high degree of price sensitivity in the soft drink market, and the effect on market share of price movement, that causes me to believe there presently exists in our industry substantial and effective competition. In response to the last part of Question 1(b), I do not know of any situation in our industry where consumer preference for one product or brand is or would be so strong vis a vis the many other competing products in the marketplace that it would be possible for a bottler to raise the price of his product above a competitive level.

Question No. 2

Proponents of this legislation insist that it is designed to help small business. What is your opinion of an amendment to H.R. 3567 excluding from the provisions of this bill corporations with more than $50 million in assets and $100 million in sales? Would you oppose excluding from this legislation the protection of territories owned by major syrup manufacturers?

Answer

While it is undoubtedly true that implementation of the FTC decision would drastically affect the substantial investments of many small businessmen, this has not been the basis of our company's support for this legislation. We have supported this legislation primarily on the grounds that the FTC's decision, restructuring an entire $15 billion industry by the *fiat* of two persons, (a) would cause the rapid and total disappearance of the returnable bottle, with serious adverse consequences for the consumer, the environment and our energy conservation goals, and (b) would not only fail to promote more vigorous competition in the industry, but would have serious anti-competitive consequences in the form of drastically increased concentration (indeed, the overnight creation of a giant oligopoly) and the instant erection of high barriers to the entry of new products, against which territorial franchises have until now protected us.

Neither of our principal reasons for supporting the legislation is affected in any way by the size of a bottler's assets. The need for recapture of the returnable bottle "float" demands small, contiguous, exclusive territories, regardless of the amount of assets possessed by the bottler operating in the franchise. Likewise, there is no rationale for distinguishing between large and small corporations owning bottling facilities where the concern is to avoid creation of a syrup-manufacturer dominated oligopoly with high barriers to entry of new products. Indeed, drawing any such distinction would merely create a crazy patchwork quilt of exclusive territories and "open" areas based solely on the historical accident of the size of the company holding a particular franchise at an arbitrary moment in time. In all likelihood under such a regime, most major metropolitan areas would fall outside the remaining pockets of exclusivity, thus making entry of new products every bit as difficult as if the territories had been eliminated entirely.

In short, the proposed distinction between large and small companies is, in our judgment, no better than the FTC's "split delivery" system, preserving exclusivity only for the returnable portion of a bottler's business. Both proposals are well-intended efforts at compromise between exclusivity and total elimination of territories. Both, however, would lead to the worst of both worlds.

Question No. 3

What are your views of an amendment to H.R. 3567 prohibiting further vertical integration in the soft drink industry by syrup manufacturers?

Answer

I was asked this question during my testimony on October 24, 1979 by Mr. Kearn. My response was that it certainly should be considered.

The syrup manufacturers' forward integration into the bottling business affords them a dual profit structure which we feel tends to lead to less competitive feature price ad activity, the decline of use of the returnable container and higher prices to the consumer because of emphasis on non-returnable packaging.

As we have steadfastly pointed out the three huge conglomerate syrup manufacturers have taken strong positions in vertically integrating into the bottling business. Pepsico owns and operates bottling plants which serve more than 24% of the total population of the United States. Coca-Cola Company does likewise for more than 14% of the total population. Both of these giants have made significant purchases of former independent bottling franchises since the FTC filed the complaint against them in 1971. Indeed, during 1979 the Coca-Cola Company purchased independent bottling franchises in Atlanta, Georgia and Taft, California, and just recently, it bought the largest single block of stock in the largest independent Coca-Cola bottler in the United States - New York Coca-Cola.

Pepsico made the largest single purchase of Pepsi-Cola independent bottlers subsequent to the filing of the complaint against them by FTC when they purchased Rheingold Brewing Co., giving them company-owned bottling operations in Los Angeles, Mexico City, Puerto Rico, St. Louis and Orlando. They have continued to purchase independent bottlers including Daytona, Florida, Ft. Worth, Texas and Shreveport, Louisiana.

Philip Morris, which purchased Seven-Up, the syrup manufacturer, only one month after the FTC overruled its own Administrative Law Judge 2 to 1 in April 1978, striking down franchise territorial boundaries, has indicated its desire to expand its company-owned bottling operations.

There are areas in the United States where the franchise is owned by the syrup manufacturer who operates its company-owned bottling plants. For instance, Pepsico owns and operates many franchises along the east coast, including Boston, New York, Philadelphia and almost all of New Jersey. Likewise, Coca-Cola Company owns and operates Boston and a good portion of New England. The results here are as follows:

1. Feature price ad activity is less by these two dominant firms in the respective franchises than it is for the rest of the United States where the independent bottler operates.

2. The returnable bottle is almost non-existent, denying the consumer the benefit of the least expensive cost per ounce of product, the most environmentally safe package and the most energy efficient package.

3. Dominance of non-returnable packaging forces the consumer to pay higher prices because he must pay for the package each time he consumes the contents.

Another major factor militating against further vertical integration in the soft drink industry has never been explored by the FTC and Congress. For some 59 years, the contracts between the Coca-Cola Company and its independent bottlers provided that the concentrate (syrup) price to the bottlers could only be increased as the price of sugar increased in a selected number of markets on a quarterly basis. Because Coca-Cola has always been the leading firm in the soft drink industry, these contracts really limited price increases and tended to hold concentrate prices down in the entire industry. As Arthur Kirsch, a beverage analyst with F. Eberstadt & Co., New York, states, "the industry as a whole has been restrained by Coke's fixed price clause."

In early 1978, the Coca-Cola Company proposed an amendment to their contract with their independent bottlers which would give them pricing flexibility by allowing them to raise the base element price of syrup and to make future changes based on the Consumer Price Index. Coca-Cola Company has been successful in getting about two-thirds of its independent bottlers to accept the new contract which has totally changed the concentrate pricing structure in the industry. As Gerald J. Fisher, Pepsico's Vice President stated - "We stand to gain (from the new Coke Contract) by having a better competitive freedom to move up in price than we'd have if Coke continued to have their ceiling." "Whenever the leader is held down, that can be disadvantageous to the whole industry."

The scheme used by the Coca-Cola Company to cajole these bottlers into signing a new agreement with their franchisor was to suggest that if the territorial provisions with their bottlers were ultimately held to be unlawful and unenforceable in the appeal from the FTC decision, then the entire agreement between the Coca-Cola Company and its bottlers would be vitiated; however, if the bottler signed the new agreement allowing Coke pricing flexibility, the Coca-Cola Company would give the bottler the continuing right to bottle Coca-Cola pursuant to the remaining provisions of the contract. (See copy of Consolidated Coca-Cola proxy statement, paragraph 2, section E which states, and we quote) "The Coca-Cola Company has consistently taken the position that the territorial exclusivity provisions of their contracts with bottlers were not a violation of the law; however, The Coca-Cola Company has also suggested that if the provision is ultimately held to be unlawful and unenforceable, then the entire agreement between The Coca-Cola Company and its bottlers would be vitiated because the territorial exclusivity provision is an essential part of the agreement. If The Coca-Cola Company is ultimately succesful in this position, the Company would be without any agreement with The Coca-Cola Company, and it would be forced to seek a new agreement with The Coca-Cola Company in order to continue its operations. Under the proposed Amendment to their contract, The Coca-Cola Company has agreed that should the territorial exclusivity provisions of the contract be held to be unenforceable the Company would continue to have the right to bottle Coca-Cola pursuant to the remaining provisions of the contract." Also, see new Coca-Cola Bottler Contract Agreement attached.

As Independent Bottlers have invested millions of dollars in their businesses one can see how such a threat -- which is nothing more or less than a threat of total forward integration -- could force an Independent Bottler into signing the new agreement. Once Coke had signed the majority of its Independent Bottlers it touched off a round of unprecedented concentrate price increases from other franchisors to their bottlers.

In a similar vein, the Pepsi-Cola Company has now taken the position that its current bottling and canning contracts may not actually grant exclusive territories -- as, in our judgment, they plainly do and as all parties have for years interpreted them to do. This not very thinly veiled threat of forward integration by the syrup manufacturer was made at a time when the Pepsi-Cola Company was seeking bottler cooperation on two sensitive matters -- "commissary delivery" of fountain syrup to national fast-food franchise operations and a huge price increase in syrup. In return for bottler cooperation on the "commisary delivery" issue, Pepsi offered to issue a "clarification" of its contracts to make it absolutely clear that territories were exclusive, but only if the FTC decision was first overturned by the courts on the Congress.

As vertical integration by the syrup manufacturers increases, the ability of the decreasing number of Independent Bottlers to influence packaging and pricing decisions diminishes. As the syrup companies integrate into bottling operations in the major markets, be it The Coca-Cola Company or Pepsico, they are able to control packaging decisions, pricing decisions and media advertising, thereby further hindering the ability of the independent bottler to remain viable, even though it is definitely a benefit to the public welfare and in the consumers' best interest for the independent bottler to remain so.

Question No. 4

What is your view of an amendment providing that any licensee could sell in another licensee's territory if the bottler sold less than a certain percentage of soft drinks in returnable containers or did not sell any returnable packages?

Question No. 5

Since one of the declared purposes of H.R. 3573 is the conservation of our energy resources through the use of returnable containers, would you oppose an amendment requiring all soft drinks to be sold in returnable containers?

Answer to Nos. 4 and 5

Questions 4 and 5 deal with whether the legislation should be amended to provide that exclusive territories would, in effect, disappear unless all soft drinks were sold in returnable bottles (5) or that each bottler must, in order to maintain his exclusive territory, maintain a certain percentage level of sales in returnable package form (4), a figure that would be presumably written into the statute.

Although our company has strongly urged enactment of legislation in order to permit continued high level usage of the returnable bottle package form, with the many benefits derived therefrom, we believe it would be a mistake to amend the legislation now before the Committee as suggested by either Question 4 or 5. The economics of the industry are such that a profitable operation in which there is substantial usage of the returnable bottle requires also the use of other nonreturnable package forms. Moreover, either of the suggested amendments would greatly increase the difficulty of introducing new products into the marketplace, because new products are almost invariably introduced in nonreturnable packages. If the product gains market acceptance, then packaging in the returnable bottle becomes possible. Moreover, we support the idea of allowing some consumer choice in the matter. Depending upon circumstances, consumers may wish to obtain the product in a nonreturnable form. At other times, the consumer is more interested in purchasing the product in the far less expensive returnable bottle. Also, in rural and sparsely settled areas of the country, where the territories cover large areas, it is sometimes difficult to use the returnable bottle package form.

We believe that the best way to sustain the viability of the returnable bottle is to preserve territorial exclusivity throughout the industry, rather than creating a patchwork of exclusive and "open" territories, depending upon the level of returnable sales -- a scheme which would, incidentally, be a nightmare to administer in light of fluctuations in package price.

Question No. 6

Does this bill immunize any *per se* violations of the antitrust laws? Would you oppose an amendment to the bill providing that this bill shall not be construed to authorize *per se* violations of the antitrust laws?

Question No. 7

Would you oppose an amendment providing that this bill shall not be deemed to authorize horizontal market division or customer allocation?

Answer to Nos. 6 and 7

Our lawyers tell us the bill does not authorize any *per se* violations of the anti-trust laws. Perhaps the best way for us to answer these two questions is to quote the testimony of Professor Gellhorn on the identical bill S. 598, given before the Senate Antitrust Subcommittee last year:

> "Nor is S. 598 written so broadly that it will confer protection on any collusive or exclusionary practices. That is, where territorial or other nonprice restrictions are being used for such pernicious purposes -- and this can be demonstrated by other evidence -- S. 598 provides no immunity. Price fixing by competing firms or market divisions by producers of competing soft drink products, for example, would continue to be fully subject to antitrust scrutiny and legal prohibition; and if used in conjunction with vertical territorial or customer restrictions, these actions would not be insulated in any way by S. 598. The purpose, aim and effect of S. 598 is solely to guarantee that distributors of trademarked soft drink products are free to select the most efficient means of distribution available and to assure consumers the benefits of substantial and effective competition."

Sincerely yours,

Richard W. Caudill

Richard W. Caudill
Executive Vice President

Enclosure

Answers to Questions Addressed to Dwight C. Reed of The National Soft Drink Association by the Honorable Peter W. Rodino, Jr.

By letter of January 22, 1980

Question 1.

Please provide us with a definition of soft drinks.

Answer 1.

The derivation of the term "soft drink" was to distinguish early flavored refreshments from hard liquors in the early stages of development of such refreshments in the late 1800's and early 1900's. As the variety of drinks has increased through research and additions of new and different ingredients, no universal definition has been adopted by either the industry and/or the numerous governmental agencies involved in regulation of the industry and its products. For the purposes of this legislation, the NSDA would suggest the following:

The term "soft drink" means a nonfermented beverage, carbonated or not, intended for human consumption, manufactured from any safe and suitable ingredient but excluding: (a) whole fruit juice or vegetable juice, sweetened or unsweetened, whether concentrated, frozen, or not; (b) fluid milk and dairy products including skim milk, yogurt, and milk powders; and (c) drinks based wholly on pure tea, coffee, cocoa, maté, sassafras, bark, buds, leaves, and similar plant material.

Question 2.a.

What was the total number of soft drink bottlers in 1960, 1965, 1970, 1975, and today?

Answer 2.a.

NSDA estimate of total number of soft drink bottlers for the years specified is as follows:

1960	4,519
1965	3,868
1970	3,054
1975	2,376
1979	1,960

These figures reveal plant sales and mergers wherein bottlers have been compensated for years of financial investment and development and established contract rights have been recognized.

Question 2.b.

What are your projections for the number of soft drink bottlers in 1985 and 1990?

Answer 2.b.

The Association does not make official projections of future numbers of soft drink manufacturers. In 1972, the Association hired the consulting firm of Cresap, McCormick and Paget, Inc., to analyze the industry and forecast the impact of a successful FTC complaint. A copy of that report is attached. It is our conviction, based upon member estimation of the impact of the termination of franchise territories and consequent industry restructuring, that the industry would lose between 600 and 1,000 manufacturing entities within three to five years. Existing investments in these facilities would be lost.

Question 3.

How many soft drink bottlers are owned by major corporations with assets over $50 million?

Answer 3.

We are unable to provide an estimate of plants by asset value because most plants in this industry are privately owned enterprises which are not required to file such disclosure. We have no access to such information.

Question 4.a.

What is the total annual volume of sales of soft drinks?

Answer 4.a.

The total 1978 (latest) estimated volume of soft drink industry production is 3.49 billion standardized units of 288 ounces (24 12-ounce unit cases.)

Question 4.b.

What percentage of total sales is by the syrup manufacturers or bottler they control?

Answer 4.b.

The Association does not collect market share data. Based upon generalized knowledge of franchise company ownership of manufacturing plants, we would estimate sales by bottling companies owned by franchise companies amount to less than 15 percent of total sales.

Several major trademark owners in this industry sell syrup directly to wholesalers for sales to retailers (fountain sales) in competition with their franchise bottlers/canners. This intra-brand competition share is not included in the above.

Question 4.c.

What percentage of total sales is by bottlers controlled by major corporations?

Answer 4.c.

The Association does not have data which would provide sufficient information to answer this question.

Question 4.d.

What percentage of total sales is by multi-plant bottling companies?

Answer 4.d.

The Association does not have data which would provide sufficient information to answer this question.

Question 5.a.

What percentage of your member firms have multi-plant operations?

Answer 5.a.

7.4 percent of NSDA' membership firms are multi-plant operators.

Question 5.b.

What percentage of your member firms have multi-territory operations?

Answer 5.b.

Information available to NSDA does not include the number of territories existing in the industry.

Question 5.c.

What percentage of your member firms distribute more than one trademarke soft drink brand?

Answer 5.c.

Our membership records indicate that 73 percent of our members manufacture and distribute more than one trademarked soft drink brand which is not to convey that all such brands are franchised.

Question 5.d.

What percentage of your member firms distribute more than three trademarked soft drink brands?

Answer 5.d.

Approximately 37 percent (36.8 percent) of NSDA's member firms manufacture more than three trademarked soft drink brands.

Question 6.

Please provide us with a breakdown of your member firms by sales volume and by market share.

Answer 6.

NSDA does not collect individual membership data concerning sales and/or market share. Attached is a breakdown of industry plants by state, showing single plant firms, multi-plant firms domestic vs. out-of-state ownership and firms by size (number of employees).

In the process of assessing membership dues, firms are asked to voluntarily categorize themselves within categories of sales volume. For 1979 a breakdown of such member firms reveals that:

32.5 percent (362) assess themselves dues based onfalling within a sales range of $1 to $800,000;

41.7 percent (458) assess themselves dues based on falling within a sales range of $800,001 to $3,000,000;

15.9 percent (175) assess themselves dues based on falling within a sales range of $3,000,001 to $7,500,000;

3.6 percent (41) assess themselves dues based on falling within a sales range of $7,500,001 to $12,500,000;

1.9 percent (21) assess themselves dues based on falling within a sales range of $12,500,001 to $21,000,000;

1.2 percent (15) assess themselves dues based on falling within a sales range of $21,000,001 to $50,000,000;

2.2. percent (25) assess themselves dues based on falling within a sales range of $50,000,001 and up.

Statistics compiled by the U.S. Department of Commerce, Bureau of Census, in the most recently published census of manufacturers, demonstrate that the soft drink industry is the least concentrated of the 35 largest food industries in this country. This lack of concentration is largely attributable to the trademark licensing agreements between trademark owners and soft drink manufacturers. The 1972 census published by the Department of Commerce showed the percentage of concentration in the soft drink industry as follows:

Four largest companies - 14 percent

Eight largest companies - 20 percent

Twenty largest companies - 32 percent

Fifty largest companies - 45 percent

A copy of the survey of the 35 food industries is attached.

Question 7.

Is it a common term in a soft drink bottler's licensing agreement for bottlers to have the right of first refusal for additional products introduced by their syrup manufacturers? With what frequency is the practice followed?

Answer 7.

We understand that "first refusal" is not a term common to typical bottler licensing agreements in the industry. However, this practice appears to be common in the industry.

Question 8.

What is the average rate of return on equity in the soft drink bottling industry?

Answer 8.

Because of the high degree of private (family) ownership in the industry (answer to question number 3) the Association has no knowledge of typical or average rate of return on equity. However, during the extensive hearings before the Federal Trade Commission in the matter of The Coca-Cola Company, a corporation, et. al., various witnesses testified regarding the profit levels obtained by bottlers.

The Proposed Findings of Fact submitted by the Respondents and Intervenors, summarized such testimony as follows:

"The effectiveness of the interbrand competition among flavored carbonated soft drinks is demonstrated by the reasonableness of the profit levels obtained by bottlers of Coca-Cola and other national brands. J. Lucian Smith, President of The Coca-Cola Company, testified that the return on investment obtained by bottlers of Coca-Cola is not "abnormal" compared with other industries.

The bottler of Coca-Cola in Annapolis, Maryland, obtained a 3.7 percent return on investment after taxes in 1974 which return was greater than that obtained in 1973. The Coatesville Coca-Cola Bottling Works, Inc., has been profitable since its inception in 1917, but did not pay a dividend until 1935, and still pays "meager" dividends today. The Filoromo family, which owns Coatesville Bottling Works, works on small salaries and makes a return on invested capital of 2 1/2 percent-3 percent after taxes. The James E. Crass Coca-Cola Bottling Plants, Inc., with plants in Washington, D.C.; Richmond, Virginia; Frederick, Maryland; and elsewhere, pays dividends of 2-3 percent on book value, which percentage would be much lower if based on market value of the investments. The bottler of Coca-Cola in Hartwell, Georgia, made an after-tax profit of $46,000 and its two owners receive monthly salaries of $1,000 and $1,200 respectively. The bottler of Coca-Cola in Spirit Lake, Iowa, made a profit during 14 of the last 17 years, which profit level has never been in excess of 4 percent of sales. The Spirit Lake bottler was profitable last year, obtaining a 3 percent return on sales, barely profitable the year before, and unprofitable two years ago. The bottler of Coca-Cola in Newport News has been profitable since 1914 and obtains a return on investment below 5 percent. The Coca-Cola Bottling Company of New York, Inc., a large publicly held bottler, has a current return on equity of 6.4 percent. The bottler of Coca-Cola in Belmont, California (Coca-Cola Bottling Company of the Peninsula) stated that his return on investment was "meager"; he made a before tax profit of 14 cents per case on a case of Coca-Cola in cans. The bottler of Coca-Cola in Ada, Oklahoma, has obtained a 3-4 percent return on book value for the last few years and achieves a 10 cent per case profit before taxes. The bottler of Coca-Cola in Jamestown, North Dakota, receives a 7-8 percent return after taxes on the replacement value of his investments.

Effective interbrand competition has also kept the profits of bottlers of other national brands at a reasonable level. The Pepsi-Cola bottler in Albany, New York, obtains a 4 1/2 percent return on the market value of his investments. The Dr

Pepper bottler in Galveston, Texas, makes a profit of $40,000 on sales of $1,600,000, obtains a 5 percent return on the market value of his investments, makes a profit of 15 to 20 cents per case before taxes, and has not paid any dividends in the last decade." (Proposed Findings of Fact before the Federal Trade Commission in the Matter of Coca-Cola Company, pages 121-213).

Question 9.

Are you aware of any studies that discuss size requirement to operate efficiently in the soft drink bottling industry? If so, provide us with copies of the studies or their citations.

Answer 9.

NSDA is unaware of any published studies discussing size requirements in relationship to efficiency in the soft drink bottling industry. During the extensive hearings before the Federal Trade Commission in the matter of Coca-Cola Company, a Corporation, et.al., various witnesses testified regarding the efficiency of small bottlers.

The Proposed Findings of Fact submitted by the Respondents and Intervenors, summarized such testimony as follows:

> "Small bottlers can be efficient in the manufacture, distribution and sale of Coca-Cola and other flavored carbonated soft drinks. Efficiency is not altogether a function of the size of a bottling plant. According to the former president of Shasta, William Meyers, there is no general rule that all large plants are more efficient than all small plants and both large and small plants can be efficient. The differences in production efficiency between large and samll plants average only 3 to 5 cents per case. Economies of production are "not a very big factor in the soft drink business." Efficiency is also a function of management competence and small bottlers with good management can be efficient. Besides production efficiency, there is also efficiency in distribution, which is measured by whether or not a consumer is provided with the necessary amount of product so he will not be out of stock.
>
> A small bottler can be efficient by being actively involved in the community in which he lives and by giving personal attention to the operation of his business and to his sales efforts, which a larger operation cannot provide. The greater local representation of Coca-Cola in small towns in Georgia, which has about twice the number of bottling plants as Alabam, a state with similar demographics, has added greatly to the volume of sales of Coca-Cola in Georgia. The Pepsi-Cola bottler in Tonawanda, New York, which is a small bottler "strongly entrenched in the fabric of the local communities" was able to out compete the largest bottler in the country, The Coca-Cola Bottling Company of New York, Inc. The bottler of Coca-Cola in Hartwell, Georgia, one of the

smallest plants in the country serving a population of 35,000, having 15 employees, and generating an annual sales volume of 240,000 cases, provided such strong competition that the San Antonio bottler of Coca-Cola spun off its bottling plant in Uvalde into a separate corporation with local ownership to better compete.

Small bottlers also can be efficient by virtue of the greater employee dedication, lower labor and land costs, lower taxes, and reduced distribution costs resulting from the absence of traffic congestion in small communities and rural areas. Small bottlers also can make very efficient use of manpower. For example, the bottler of Coca-Cola in Montross, Virginia, uses his production employees during slow periods in the winter to do maintenance work. The recent construction of a plant by the bottler of Coca-Cola in Coatesville, Pennsylvania, also demonstrates the savings which can be obtained by the personal dedication of a small bottler. Mr. Filoromo, the Coatesville bottler, purchased used bottling equipment for 25 cents on the dollar from a bottler who had gone out of business, personally took a tractor trailer 300 miles across the State of Pennsylvania, dismantled the equipment he purchased, brought it back, and installed it in a new plant which he constructed himself. By doing welding work on Saturdays and Sundays, Mr. Filoromo personally constructed water treatment equipment for $2,000 that would have cost $20,000 if it were purchased. He obtained the building and production equipment at a combined cost of $18 per square foot, the same sum which an outside contractor quoted on an initial bid for constructing the building alone.

The size of small bottlers has not prevented the introduction of new, larger size packages. For example, the bottler of Coca-Cola in Montross, Virginia, with a territory covering 39,000 people, was the first bottler in the State of Virginia to bottle the 32-ounce returnable bottle and, in fact, supplies 32-ounce returnable bottles under an agency agreement to the much larger bottler of Coca-Cola in Richmond, Virginia. Similarly, the Dr Pepper bottler in Dyersburg, Tennessee was, in February, 1972, the first Dr Pepper bottler in the United States to introduce the 32-ounce returnable-resealable bottle. The Dyersburg Dr Pepper bottler, who serves a territory of 137,000 people and sells approximately 463,000 cases annually invested $100,000 to introduce the 32-ounce returnable. For a period of ten months, the Dyersburg Dr Pepper bottler bottled this product on an agency basis for larger Dr Pepper bottlers, including the RKO bottler in Memphis. Many other small bottlers have invested their money to manufacture large packages such as the 32-ounce returnable/resealable bottle, including Hartwell, Georgia; Spirit Lake, Iowa; and Ada, Oklahoma.

Small bottlers of Coca-Cola have been able to take advantage of improvements in vehicles used for store-door delivery. Small bottlers such as Spirit Lake, Iowa, have implemented advance selling and tell-sell, where the selling is done in advance of delivery by a salesman in a vehicle or over the telephone. Other small bottlers, such as the bottler of Coca-Cola in Washington, Pennsylvania, have implemented the Omega delivery system for delivery to high volume outlets in prepackaged carts, a system which is just being developed in the industry.

One of the accepted measurements of the efficiency of a bottling plant is per capita consumption, which is the average number of drinks of a given brand consumed per person in a territory over the period of a year. Per capita consumption is an indicator of sales consumption in a territory and normally correlates with profitability. Of the top 10 or 15 per capita bottling plants of Coca-Cola in the United States, all are small plants. Two of the top per capita plants are West Point, Georgia, and LaGrange, each of which has an annual sales volume between 500,000 and 750,000 cases. Other efficient small operations with high per capitas include Elberton, Georgia; Hartwell, Georgia; Denmark, South Carolina; and Ada, Oklahoma. The highest Dr Pepper per capita bottler in the State of Tennessee and the fifth highest per capita Dr Pepper plant east of the Mississippi is the small Dyersburg, Tennessee, Dr Pepper bottler.

Small bottling plants have not been inhibited in their growth by exclusive teritories. The bottler of Coca-Cola in Hartwell, Georgia, increased per capita consumption of soft drinks in his area from between 50 and 100 in 1938 to over 250 today. The Dr Pepper bottler in Galveston, Texas, increased per capita consumption from three bottles in 1946 to 100 today and in the process increased his share of the market from .1 of 1 percent in 1946 to 9-10 percent currently. The bottler of Coca-Cola in Stockton, California, increased his sales volume from 250,000 cases in 1959 to 700,000 in 1974; the bottler of Coca-Cola in LaCrosse, Wisconsin, increased sales from 225,000-250,000 in 1963 to 675,000 equivalent cases in 1974; and the bottler of Coca-Cola in Jamestown, North Dakota, increased his sales in the Devil's Lake territory, encompassing 35,000 people from 44,000 cases the year before he acquired it in 1970 to 140,000 cases in 1974." (Proposed Findings of Fact before the Federal Trade Commission in the Matter of Coca-Cola Company, pages 131-134.)

Question 10.

What percentages of the market do the top four major syrup manufacturers control? What percentages of the market do the top eight syrup manufacturers control?